

DOES THE STATE CREATE THE MARKET — AND SHOULD IT PURSUE EFFICIENCY?

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INTRODUCTION

The economic turmoil that began in late 2008 has led many pundits to trumpet the death of free markets and welcome the final proof that allowing individuals to make economic choices without government oversight will lead to injustice and poverty. It is therefore time not merely to examine the specific policies proposed to deal with present economic problems, but to address the broader context in which we interpret those problems and the deeper premises on which contemporary policy proposals rely. Whether it be the push for nationalized health care, for economic “stimulus” through government spending, for government takeovers of lending institutions, or for a host of other interventions, many of today’s proposals for expanding government’s role in private life have at their core a deeply flawed conception of the nature and function of markets. Only by reexamining these premises can we hope to make sense of the specific proposals advanced today.

The basic error is the common notion—shared by both left and right—that governments create markets, and must manage and control individual economic choices to ensure that those choices serve collective goals. President Bush famously confessed to having “abandoned” his “free-market principles” in order to “save the free-market system” and “ensure that the economy doesn’t collapse.”¹ In his book *The Audacity of Hope*,

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1. Interview by Candy Crowley with President George W. Bush, on CNN (Dec. 16, 2008), available at <http://www.reason.com/blog/show/130606.html>.

President Obama complains about what he sees as a “tendency to take our free-market system as a given, to assume that it flows naturally from the laws of supply and demand and Adam Smith’s invisible hand.” President Obama believes that markets instead “depend[] on government action” to “open up opportunity, encourage competition, and make the market work better.”² Many of President Obama’s intellectual allies are even more explicit on this point. Former Clinton Administration Labor Secretary Robert Reich has written that “[g]overnment creates the market by defining the terms and boundaries for business activity, guided by public perceptions of governmental responsibility for the overall health of the economy.”³ Professor Cass Sunstein, recently appointed to a prominent office in the Obama Administration, agrees, and, quoting President Franklin Roosevelt’s statement that economic laws are “not made by nature” but “by human beings,” he contends that people “created economic markets and existing distributions. Laws underlay markets and made them possible. If they had good reasons for doing so, people might change those markets and existing distributions.”⁴ A popular book on economics for the layman asserts that government “does not just fix the rough edges of capitalism; it makes markets possible in the first place.”⁵ Another commenter holds that the “great fallacy of *laissez-faire*” is that “markets come first and social intervention thereafter,” whereas “[t]he reality” is that “the state creates markets and sustains them: the important point being that it should do so in such a way that the individual energies released lead to socially desirable results.”⁶

In short, government supposedly creates the market by defining and enforcing property and contract rights; consequently, there is nothing particularly wrong with the government radically altering those rights, or the other terms on which individuals engage in economic transactions. Such alterations are not infringements on existing freedoms, but merely shifts in the distribution of rights that the state created in the first place.

2. BARACK OBAMA, *THE AUDACITY OF HOPE* 150 (2006).

3. ROBERT B. REICH, *THE NEXT AMERICAN FRONTIER* 5 (1983).

4. CASS R. SUNSTEIN, *DEMOCRACY AND THE PROBLEM OF FREE SPEECH* 30 (1993).

5. CHARLES WHEELAN, *NAKED ECONOMICS: UNDRRESSING THE DISMAL SCIENCE* 51 (2002).

6. TESSA BLACKSTONE ET AL., *NEXT LEFT: AN AGENDA FOR THE 1990S*, at 6 (1992).

I want to challenge this premise and defend the classical liberal proposition that markets do, in fact, come first—although I consider all such terminology misleading. The state is neither historically nor ontologically prior to the market. Nor is it prior to other types of free human interactions. It can therefore assert no “ownership” claim over the market as a justification for controlling individual economic choices. After addressing these issues, I conclude with some observations expressing reservation about the related argument that government policy should be organized to increase economic efficiency.

I. TANSTATM (“THERE AIN’T NO SUCH THING AS ‘THE MARKET’”)⁷

The initial error in the claim that the state creates the market is that there is no such thing as “the market” in the first place. The term “market” is terribly misleading. When we speak of “the market” we are using shorthand for a whole spectrum of exchanges that take place between individuals.⁸ There is nothing unitary about these exchanges except in the abstract. To reify them, and to speak of “the market” as an existing entity, or as a corporate agent with an identity in itself, creates confusion, as expressed in the phrase “the market will do such and such.” Of course, markets do not *do* anything at all; only individual actors do. Economists observing transactions might group these individual actions into categories and observe certain trends within those categories, but “the market” is simply not the sort of thing that acts the way a living being does. When defenders of economic freedom say “the market will provide” a good or service in the absence of government interference, they are doing themselves a disservice. What they mean is that individuals are likely to pursue their self-interest by providing that good or service if they are free to do so.

It would be nice if the term “market” could be abolished entirely and replaced with another. The Framers preferred “commerce,” which has the advantage that it cannot take on that

7. With apologies to Robert A. Heinlein, who used the acronym TANSTAAFL to stand for the axiom “There Ain’t No Such Thing As A Free Lunch.” See ROBERT A. HEINLEIN, *THE MOON IS A HARSH MISTRESS* 244–45 (1966).

8. See 2 FRIEDRICH A. HAYEK, *LAW, LEGISLATION AND LIBERTY: THE MIRAGE OF SOCIAL JUSTICE* 107–08 (1976).

misleading definite article “the.” Even better would be “commercial intercourse,” or simply “intercourse.” This term would be preferable because it would emphasize that markets are interactions among people—just as sexual intercourse is intercourse between people. Nobody would speak of “the sexual intercourse” doing something, because such a phrase is incoherent; “sexual intercourse” is simply shorthand for a certain kind of interaction between people, which takes place in a variety of different contexts. Likewise, commercial or economic intercourse is a shorthand phrase, not a unitary entity that can do any particular action or act in any particular way.

The primary error of the assertion that the state creates the market lies in envisioning the market as a unitary institution that could be “created” in the sense that a car or a sculpture or Paley’s watch is created. The “market” is not such a thing—it is not a *thing* at all; it is a term for the multitude of economic interactions between individuals, each choosing for himself or herself which transactions are worthwhile. This mistake is by no means limited to those who advocate greater government control over economic choices; even so emphatic a defender of laissez-faire systems as Ayn Rand sometimes spoke of capitalism as having been “created.”⁹ Capitalism and free markets were never “created”; these words describe a category of intercourse that evolved along with other human behaviors. The market has characteristics and a nature, but no unitary purpose or design.

II. ECONOMIC INTERCOURSE IS NOT CREATED BY POLITICS BUT IS A RATIONAL RESPONSE TO INHERENT BUDGET AND TIME CONSTRAINTS

Economic exchange—what we sometimes call “the market”—arises from the intersection of limited resources and unlimited desires. Human beings are finite creatures, limited at the very least by their mortality. Every action therefore imposes an opportunity cost, and that means that, even in a state of nature, there would be limits on what human beings could accomplish in their efforts to survive and thrive. That they seek to thrive is the basic element of human ethical life. That they

9. See, e.g., AYN RAND, *Faith and Force: The Destroyers of the Modern World*, in PHILOSOPHY: WHO NEEDS IT 70, 80 (1982).

have limited time and unequal capacities for thriving is simply an objective fact. Specialization and exchange is the rational solution to this problem. Economic intercourse is the logical response to comparative advantage, which is an inescapable consequence of differential opportunity costs. Exchange is implied by the need of living creatures to maintain their existence within the inescapable constraints of reality. The state need not enter into the picture at all.¹⁰

Does the state create the exchanged resources? No, the resources exchanged are products of the earth, transformed into wealth by human effort. Does the state create demand? No, demand arises from the desire to thrive and the need for certain material elements—at the least, food and water. Does the state create the idea of mutual exchange? Unlikely; mutual exchange is a universal human trait. Adam Smith famously noted that nobody saw dogs deliberately and fairly exchange bones,¹¹ but more recent research suggests that apes will make exchanges according to what appear to be norms.¹² Indeed, most animals make “exchanges” of some sort, possibly even according to rudimentary social rules.¹³ Interactions between human beings of widely different cultures—for example, between American Indians and Western explorers in the fifteenth century and after—show that exchange (not to mention resentment at being cheated!) is a cross-cultural, universal human capacity. There was much wisdom in John Locke’s observation:

The promises and bargains for truck, etc. between . . . two men in [a] desert island . . . or between a Swiss and an Indian, in the woods of America, are binding to them, though they are perfectly in a state of nature in reference to one another. For truth and keeping of faith belong to men as men, and not as members of society.”¹⁴

10. See TARA SMITH, *MORAL RIGHTS AND POLITICAL FREEDOM* 31–59 (1995). This is a “state of nature” argument, but not vulnerable to the common criticism levied against state of nature arguments—that they depend on fictions.

11. 1 ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 13 (Edwin Cannan ed., Modern Library 1976) (1776).

12. FRANS DE WAAL, *CHIMPANZEE POLITICS: POWER AND SEX AMONG APES* 202 (2007).

13. See Gerald S. Wilkinson, *Reciprocal Altruism in Bats and Other Mammals*, 9 *ETHOLOGY AND SOCIOBIOLOGY* 85 (1988).

14. JOHN LOCKE, *TWO TREATISES OF GOVERNMENT* 276–77 (Peter Laslett ed., Cambridge Univ. Press 1988) (1690).

III. STATES ARE NEITHER HISTORICALLY NOR ONTOLOGICALLY PRIOR TO MARKETS

A. *History Strongly Suggests that Trade Precedes the State*

It is impossible to trace the historical origins of the state separately from the origins of economic intercourse. Most likely, the state evolved from tribal groups that cohered through different types of exchange and found it necessary also to exchange with other tribes.¹⁵ We can be certain that early man, like the higher apes, traded according to certain norms that were not the result of a deliberative political process, although they were certainly expanded and facilitated by such processes.¹⁶ Very likely, political institutions originated through a barter ritual such as Roger Masters describes: “[G]oods being offered by one group are placed next to an encampment without face-to-face contact; the resident group then inspects the offer and sets out a counteroffer if interested; finally, the group initiating the exchange either consummates the bargain or takes back its own goods and leaves.”¹⁷ But because intertribal trading, especially over long distances, can be managed more effectively under a single individual or small group, political leadership may have originated to facilitate such trading¹⁸—a tradition carried on into historical times in the form of ambassadors who simultaneously represent a nation’s commercial and political interests.

Many fundamental cultural institutions, including institutions central to the definition of a state, originated to serve the needs of trading and obtained their clearly political character only later. American Indian tribes, including the Cherokee, evolved pidgin “trade languages” to communicate when visiting other tribes on their trade routes. These languages predated European contact and clearly predated the formal legal institution of the Cherokee state.¹⁹ Even our own alphabet is inherited from Phoenician trad-

15. See ELMAN R. SERVICE, *ORIGINS OF THE STATE AND CIVILIZATION* 60–61 (1975).

16. See ROGER D. MASTERS, *THE NATURE OF POLITICS* 101–04 (1989).

17. *Id.* at 101–02.

18. SERVICE, *supra* note 15, at 292–93.

19. JAMES MOONEY, *HISTORY, MYTHS, AND SACRED FORMULAS OF THE CHEROKEES* 187–88 (George Ellison ed., 1992). Indeed, formal legal institutions were adopted by (or were forced upon) the Cherokee largely in response to the needs of trade, or in response to the political consequences of trade. RENNARD STRICKLAND, *FIRE AND THE SPIRITS: CHEROKEE LAW FROM CLAN TO COURT* 40–72 (1975).

ers who likely invented it to catalogue their wares.²⁰ Countless other market institutions, including many types of contracts and trading instruments—even, probably, money itself—were invented not by states as such but by groups of traders.²¹ And there are many examples of political or legal devices being fashioned by traders to suit the needs of trade.²² The most famous example is the *lex mercatoria* or Law Merchant, a legal system that had an ambiguous relationship with the state²³ and was perhaps entirely created by private actors who needed enforceable mores of trade.²⁴ Similarly, the eleventh-century Maghribi traders devised a privately enforced system of trading norms based on reputation.²⁵ In many countries, ethnically oriented codes substitute for formal institutions of contract law.²⁶ Even seventeenth- and eighteenth-century pirates—about as far from state actors as one could imagine—privately devised mores of trade to solve collective action problems that hampered the success of their enterprises.²⁷ Formal institutions that guide behavior and are backed by coercion or other penalties are a logical response to such collective action problems, which are endemic to any organization. It is therefore not surprising to find evidence that many of the formal legal institutions that we recognize, including norms of trade and the boundaries of property rights, evolved through the private

20. STEVEN ROGER FISCHER, *A HISTORY OF WRITING* 90 (2001).

21. JAMES BUCHAN, *FROZEN DESIRE: THE MEANING OF MONEY* 22–35 (1997); see also NIALL FERGUSON, *THE ASCENT OF MONEY* 34–39 (2008).

22. The clearest example of political institutions arising out of existing economic institutions is probably the formation of the legal and political institutions of Iceland in the Medieval period, which “gives us a well-recorded picture of the workings of particularly pure forms of private enforcement and creation of law, and of the interaction between the two.” David Friedman, *Private Creation and Enforcement of Law: A Historical Case*, 8 J. LEGAL STUD. 399, 401 (1979).

23. Ralf Michaels, *The True Lex Mercatoria: Law Beyond the State*, 14 IND. J. GLOBAL LEGAL STUD. 447, 453–54 (2007).

24. BRUCE L. BENSON, *THE ENTERPRISE OF LAW: JUSTICE WITHOUT THE STATE* 30–35 (1990). Historians dispute the degree to which the *lex mercatoria* was truly a private system of ordering. See, e.g., Stephen E. Sachs, *From St. Ives to Cyberspace: The Modern Distortion of the Medieval “Law Merchant,”* 21 AM. U. INT’L L. REV. 685 (2006). But however that dispute may be resolved, it is clear that the *lex mercatoria* was not a centralized ordering system by which the state “created” the “market.”

25. AVNER GREIF, *INSTITUTIONS AND THE PATH TO THE MODERN ECONOMY: LESSONS FROM MEDIEVAL TRADE* 58–90 (2006).

26. See Philip M. Nichols, *A Legal Theory of Emerging Economies*, 39 VA. J. INT’L L. 229, 273 (1999).

27. See PETER T. LEESON, *THE INVISIBLE HOOK: THE HIDDEN ECONOMICS OF PIRATES* (2009).

decisions of economic actors rather than being given to economic actors by a state apparatus.²⁸

It is not that the market necessarily created the state: Economic intercourse and political intercourse grew up together in human history.²⁹ Just as it was one of the great accomplishments of Enlightenment thinkers to formulate the distinction between government and society,³⁰ so it was one of their great accomplishments to formulate the distinction between state and market. Locke, Milton, Defoe, Smith, Jefferson, and their contemporaries discovered that the state does not create individual liberty, but can help defend it. Likewise, the state does not create property or contract rights, but can facilitate them by publishing and enforcing norms of trade and respect. There is no obvious reason private institutions cannot perform this service,³¹ and such private institutions are in fact ubiquitous even today. For example, eBay employs a feedback mechanism as well as a private dispute resolution system to police the conduct of traders.³² And it may be that these

28. It might be thought that slavery was a market created by state intervention, and that property "rights" in human beings was an institution of positive law. In fact, however, slavery in the United States was not an institution created by law. See THOMAS R.R. COBB, AN INQUIRY INTO THE LAW OF NEGRO SLAVERY IN THE UNITED STATES 82 (Philadelphia, T & J.W. Johnson 1858) ("[W]ith the exception of Georgia (where it was at first prohibited), no law is found on our statute books authorizing [slavery's] introduction.").

29. Robert Stevenson, after studying the formation of tribal states in Africa, concluded that "in far the majority of cases the process involved at least a threeway nexus between developing trade and trade routes, developing political and economic organization, and higher population densities, all reciprocally interacting and feeding back upon each other." SERVICE, *supra* note 15, at 280.

30. See THOMAS PAINE, COMMON SENSE, in COLLECTED WRITINGS 5, 6 (Eric Foner ed., 1995) (1776) ("Some writers have so confounded society with government, as to leave little or no distinction between them; whereas they are not only different, but have different origins."). The central element of "social justice" movements is to break down this distinction and thereby allow the state to control any relationship that political leaders deem worthy of outside control. This is the source, among other disputes, of attacks on the "state action" doctrine in Fourteenth Amendment jurisprudence. See Erwin Chemerinsky, *The Supreme Court and the Fourteenth Amendment: The Unfulfilled Promise*, 25 LOY. L.A. L. REV. 1143, 1147-48 (1992).

31. See Stephen Davies, *The Private Provision of Police During The Eighteenth And Nineteenth Centuries*, in THE VOLUNTARY CITY 151, 151-81 (David T. Beito et al. eds., 2002). The collective action problem of funding such activities, which is handled through coercive taxation, is one serious problem, but there are theoretical solutions to this and other collective action problems. See Ayn Rand, *Government Financing in A Free Society*, in THE VIRTUE OF SELFISHNESS 157, 157-63 (1964).

32. These policies are described in brief on eBay's website. eBay, How Feedback Works, <http://pages.ebay.com/help/feedback/howitworks.html> (last visited Feb.

private alternatives are more cost-effective and suit the needs of buyers and sellers better than a state institution. Economist Peter Leeson has observed that although government contract enforcement does enhance certain kinds of trade, it does not do so to an impressive degree, and may actually hamper trade by crowding out more cost-effective private enforcement mechanisms.³³

Fundamentally, the state does not create the things that are exchanged, the concept of or desire for exchange, or many of the formal institutions of exchange. It can help to enforce the norms of trade, thereby transferring the transaction costs in part from the contracting parties to taxpayers, but the effectiveness of such mechanisms is open to question. Either way, the proposition that political institutions *create* the market appears to be untenable on historical grounds. In addition, there are some profound philosophical problems with that proposition.

B. States Do Not Create Freedom

It might be said that I am putting up a straw man; the assertion that states create markets is not intended as an historical assertion but as a theoretical model to show that political institutions are ontologically prior to economic exchange. But here, too, the argument falls short. Professors Laurence Tribe and Cass Sunstein, to name only two, start from this premise when criticizing *Lochner v. New York*³⁴ and other cases that struck down laws limiting the individual's freedom of economic choice. According to Professor Tribe, the problem with *Lochner* is that the Court compared the challenged restriction to a hypothetical "liberty" that did not really exist: "[T]he law is inevitably embroiled in the dialectical process whereby society is constantly recreating itself."³⁵ In this process there is no such thing as a "neutral, 'natural' order of things," and it is therefore impossible to compare a law to any such baseline.³⁶ Rather, we must realize that "legal 'freedom' of contract and property" are

22, 2010); eBay Resolution Center, <http://resolutioncenter.ebay.com/> (last visited Feb. 22, 2010).

33. Peter T. Leeson, *How Important is State Enforcement for Trade?*, 10 AM. L. & ECON. REV. 61, 83 (2008).

34. 198 U.S. 45 (1905).

35. Laurence H. Tribe, *The Curvature of Constitutional Space: What Lawyers Can Learn from Modern Physics*, 103 HARV. L. REV. 1, 8 (1989).

36. *Id.* at 7.

“an illusion,”³⁷ and that there is no such thing as natural freedom to which political or legal institutions can be compared. Rather, there is only a fluctuating set of rules and rights created by the state, a set that changes with social circumstances (in other words, the “dialectical process”). Professor Sunstein shares this view when he writes that the

private or voluntary sphere . . . [is] actually itself a creation of law, and hardly purely voluntary. When the law of trespass enable[s] an employer to exclude an employee from “his” property unless the employee [meets] certain conditions, the law [is] crucially involved. Without the law of trespass, and accompanying legal rules of contract and tort, the relationship between employers and employees would not be what it now is; indeed, it would be extremely difficult to figure out what that relationship might be, if it would exist in recognizable form at all.³⁸

These arguments run directly counter to the “leading principle” of American constitutionalism, which is that each of us is equally born free.³⁹ This principle holds that each of us is presumed free to act and that those who would limit our freedom bear the burden of justifying such limits. This is the “presumption of liberty” that Professor Randy Barnett has rightly observed is implicit in the Constitution.⁴⁰ It is explicit in the Declaration of Independence, which speaks of each person’s equal right to freedom as a fundamental principle and explains that governments are instituted only to protect that freedom.⁴¹ The presumption of liberty is not merely a rhetorical device or an arbitrary preference for a convenient starting point in philosophical argument. It inheres in the structure of logic itself—just as one cannot be expected to prove a negative, so one cannot be expected to prove that he ought to be free.⁴²

Using freedom from coercion as a natural baseline for policy analysis—the starting point for evaluating a legal regime—allows us to evaluate states in terms of universal human rights,

37. LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 578 (2d ed. 1988).

38. SUNSTEIN, *supra* note 4, at 30.

39. 1 ABRAHAM LINCOLN, *Speech on the Kansas-Nebraska Act at Peoria, Illinois* (Oct. 16, 1854), in *SPEECHES AND WRITINGS, 1832–1858*, at 307, 328 (Don E. Fehrenbacher ed., 1989).

40. See RANDY E. BARNETT, *RESTORING THE LOST CONSTITUTION: THE PRESUMPTION OF LIBERTY* (2004).

41. THE DECLARATION OF INDEPENDENCE para. 2 (U.S. 1776).

42. See ANTHONY DE JASAY, *JUSTICE AND ITS SURROUNDINGS* 150 (2002).

as opposed to historically contingent dialectics.⁴³ That we are born with a right to life means that we cannot justly be deprived of our lives without some good reason (for example, that we have committed a capital offense). Recognizing an individual's right to life means that the burden of proof rests on the party who would restrict or eliminate that right—as opposed to a presumption in favor of death, which would require the living person to justify his existence. If we presume that individuals are born free and that coercion against them requires some justification, then we must also recognize that the freedom to engage in commercial intercourse is a logical starting point and that deviations from that starting point must be justified. This makes the ontological order clear, as it is in the Declaration of Independence. We are born with liberty, including the liberty to pursue happiness by commercial intercourse, and government is instituted to protect or to foster that freedom. That freedom may be limited only for good cause.

By contrast, the position advanced by Sunstein, Tribe, and others presumes that individuals have no rights unless they can propose and successfully defend their claims.⁴⁴ If individuals can meet that burden,⁴⁵ then the rights they receive are simply realms of individual action that government chooses to protect or subsidize—that is to say, privileges. Professor Sunstein is quite explicit: “[R]espect for private rights, the private sphere, and limited government should themselves be justified by publicly articulable reasons In the United States, any particular conception of the private sphere must be defended by substantive argument.”⁴⁶

43. Cf. RICHARD A. EPSTEIN, *BARGAINING WITH THE STATE* 25 (1993) (“Baselines offer the initial positions against which the propriety of subsequent individual or government action can be judged. The selection of these baselines is the first part of any inquiry into bargaining with the state . . .”).

44. As John Locke put it when attacking a very similar argument, “His System lies in a little compass, ‘tis no more but this, *That all Government is absolute Monarchy*. And the Ground he builds on, is this, *That no Man is Born free*.” LOCKE, *supra* note 14, at 142.

45. What exactly would such a burden entail? As de Jasay observes, it appears that such a burden would be literally infinite, because the person would be required to disprove an infinite series of potential justifications for limiting rights. DE JASAY, *supra* note 42, at 150. It is conceivable, of course, that the state could set some lower standard as sufficient for a proposed rights claim, but such a lower standard would then be arbitrary. One can hardly imagine a weaker foundation for a right than a privilege that is given by the state to citizens on the basis of literally arbitrary criteria.

46. SUNSTEIN, *supra* note 4, at 247.

This model is replete with serious problems. First, it reduces all rights to potentially conflicting assertions with no guiding principle for resolving conflicts that do arise.⁴⁷ If the state chooses to create one right for me and a different, contradictory right for my neighbor, how is this conflict to be settled? Do we have any right to be treated equally? Not if the state fails to grant us that right. And yet the whole purpose of rights, and of law, is to limit the power of the state, at least pursuant to *some* comprehensible standard that treats like cases alike.

The Tribe-Sunstein model would, in fact, give the lawmakers a degree of freedom withheld from ordinary citizens. Presumably, the lawmakers must deliberate over whether to grant people privileges, and that deliberation requires the lawmakers to have freedom to deliberate. Where do *they* derive this freedom? Evidently they gave it to themselves, or enjoy it by some inherent principle of superiority—something like “divine right.” This contradicts the American conception of a government of the people, by the people—the principle underlying the legitimacy of our Constitution. Despite their appeals to principles of democracy, Tribe and Sunstein actually deny the principle of equal freedom on which democracy necessarily rests. Without a guiding principle of political rule, the lawmakers grant and withhold privileges on the basis of mere will, and their will trumps that of the citizens because they are of a different caste. This rule is not democratic.

Second, as Tom G. Palmer has observed, the Sunstein-Tribe model collapses into an infinite regress. According to their view:

I cannot have a right not to be tortured by the police unless the police have an obligation not to torture me, and the police can only have an obligation not to torture me if there are some taxpayer-funded persons (monitors) above the police who can punish them. . . . But to have a right not to be tortured I would have to have a right that the monitors exercise their power to punish the police for torturing me. Do I have that right . . . ? I would have such a right only if the monitors had a duty to punish the police, and the monitors would have a duty to punish the police only if there were some taxpayer-funded persons above the monitors who could (and would) punish the monitors for failing to punish the police, and so on, ad infinitum. For there ever to be a right of any sort . . . there would have to be an infinite hierarchy of people

47. See TOM G. PALMER, REALIZING FREEDOM 47–53 (2009).

threatening to punish those lower in the hierarchy. Since there is no infinite hierarchy, we are forced to conclude that [this is] actually . . . an impossibility theorem of rights in the logical form of *modus tollens*: If there are rights, then there must be an infinite hierarchy of power; there is not an infinite hierarchy of power; therefore there are no rights.⁴⁸

In addition, under Tribe and Sunstein's view, the State cannot have any *rightful* authority to grant rights or privileges to individuals. If there is no prepolitical ground for individual rights, how can there be any prepolitical ground for political legitimacy? According to the social compact tradition articulated in the Declaration of Independence and the Constitution, government is legitimate because the people consent to it. But we can consent only because we have a prepolitical right to choose whether to consent or withhold that consent. By denying the existence of such prepolitical rights, Tribe and Sunstein reject—as did their Progressive-era progenitors, following Hegel⁴⁹—the possibility of any principle by which the state might be justified or legitimized. Instead, the state is simply a historical inevitability (Professor Tribe's "dialectical process") in the face of which all talk of prepolitical standards is incoherent.⁵⁰ There can be no "principle" by which lawmakers may "rightly" create or withhold privileges from the people when forming a Constitution—they simply do what they want, because politics is at bottom an act of will, not of reason. This way of seeing things, of course, makes it impossible to distinguish free states from tyrannies, just rulers from unjust rulers, or

48. Tom G. Palmer, *Book Review*, 19 CATO J. 331, 333–34 (1999).

49. Harry V. Jaffa, in discussing the political philosophy of John C. Calhoun, makes an insightful comment on the subtle distinction between Hobbes and Hegel. Although Hobbes, like Hegel, advanced an intellectual framework for totalitarianism by denying the existence of prepolitical limits on the state, he started with the proposition that there is a state of nature in which all men are equal—a proposition Hegel rejects. For Hobbes, this equality and the capacity for reason in the state of nature leads man to make the rational agreement to create the state. But Hegel (like Sunstein and Tribe) denies the possibility of a state of nature, holding instead that man has no capacity for reason outside of the forces of history and is not equal in any prepolitical sense. See HARRY V. JAFFA, *A NEW BIRTH OF FREEDOM* 448–50 (2000) ("The equal right of all men to life and liberty is a foundation stone of Hobbes' political teaching, and this is anathema to Calhoun."). It is also anathema to Tribe and Sunstein.

50. Or, in Oliver Wendell Holmes's famous phrase, it is like "churning the void in the hope of making cheese." Letter to Alice Stopford Green (Aug. 20, 1909), in *THE ESSENTIAL HOLMES* 116 (Richard Posner ed., 1997).

healthy regimes from abusive regimes. In practice, it means that whatever political group happens to take power, by arms or by propaganda, is, *ipso facto*, legitimate. When it comes to political legitimacy, the citizen's is not to reason why; his is but to do or die. If there are no such things as prepolitical standards of justice, then there is no such thing as a prepolitical legitimizing principle for any state.⁵¹ And this fact means that there is no difference between the arbitrary dictatorship of a military strongman and a polity governed by just laws; whatever the political authorities choose to call just is, by definition, just.

It cannot be too strongly emphasized how contrary this picture is to the principles underlying the American Constitution. The Framers believed the Constitution would help "decide the important question, whether societies of men are really capable or not of establishing good government from reflection and choice, or whether they are forever destined to depend for their political constitutions on accident and force."⁵² Tribe, Sunstein, and their allies have rendered their answer strongly in favor of accident and force.⁵³ But America's founders knew, better than do the stars of today's legal community, that if political leaders can choose which rights to give citizens, then they must constitute a caste enjoying by divine right greater freedom than the citizens whose rights they can grant or withhold at will. Such a scheme is at war with the principle of equality on which our democratic

51. Consider Aristotle's distinction between true forms of government and perverted forms of government. This distinction is based on the principle that "governments which have a regard to the common interest are constituted in accordance with strict principles of justice, and are therefore true forms; but those which regard only the interest of the rulers are all defective and perverted forms, for they are despotic, whereas a state is a community of freemen." ARISTOTLE, *POLITICS* BK. III CH. 6, in *THE BASIC WORKS OF ARISTOTLE* 1185 (Richard McKeon ed., 1941). These strict principles of justice are prepolitical even though Aristotle lacks a modern conception of individual rights.

52. *THE FEDERALIST* NO. 1, at 33 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

53. In fact, this is merely a confession of their theory's inadequacy. If one rejects all of the principles of an intellectual discipline that make the object of study comprehensible, then that object will seem arbitrary. The fact that their view of justice renders them unable even to distinguish just from unjust regimes, or to understand politics as anything other than an endless series of arbitrary claims to rule backed by mere coercion, is evidence enough that Tribe and Sunstein offer us not spectacles but a blindfold. See generally Leo Strauss, *Restatement on Xenophon's Hiero*, in *WHAT IS POLITICAL PHILOSOPHY?* 95 (Univ. of Chicago Press 1988) (1959) ("A social science that cannot speak of tyranny with the same confidence with which medicine speaks, for example, of cancer, cannot understand social phenomena as what they are.").

political institutions are based—an equality that, again, is not an arbitrary cultural preference, but a fact of reality, aptly described by Jefferson: “[T]he mass of mankind has not been born with saddles on their backs, nor a favored few booted and spurred, ready to ride them legitimately, by the grace of God.”⁵⁴

At bottom, the position advanced by Tribe and Sunstein is that all rights are actually privileges—benefits given to us by the grace of the state. But the fundamental difference between rights and privileges is that a right is not held at the mercy of another, or of the state. We *deserve* rights and are not answerable to our neighbors or the state when we exercise these rights. We cannot be made to pay for them. Privileges, on the other hand, are accorded to us by one in a superior position, who retains authority to restrict or eliminate those privileges; you do not *deserve* a privilege, and you can be required to pay for it. To say that the state “creates” our rights is to transform rights into privileges.

Let me reiterate that this difference between rights and privileges was seen by the Framers as the distinguishing grace of the American regime when contrasted with those that preceded it. Under the British monarchy, all rights were simply privileges accorded by Parliament or the crown, but revocable at any time.⁵⁵ The American constitutions were written to ensure that rights would *not* be held at the sufferance of any government. “In Europe, charters of liberty have been granted by power,” wrote James Madison. “America has set the example . . . of charters of power granted by liberty. This revolution in the practice of the world, may, with an honest praise, be pronounced the most triumphant epoch of its history”⁵⁶

C. *What Would It Mean If the State Did Create Freedom?*

In addition to the historical and philosophical flaws in the argument that states create economic or other kinds of freedom, the argument also implies several problematic consequences. The first is obvious if we return to my earlier analogy between commercial and sexual intercourse. The confusion between the state’s protection of rights and the state’s creation of rights becomes clear when

54. Letter from Thomas Jefferson to Roger C. Weightman (June 24, 1826), in THOMAS JEFFERSON: WRITINGS 1517 (Merrill D. Peterson ed., 1984).

55. See 1 WILLIAM BLACKSTONE, COMMENTARIES *49 (arguing that the sovereign is “supreme, irresistible, absolute, [and] uncontrolled”).

56. JAMES MADISON, *Charters*, in WRITINGS 502, 502 (Jack N. Rakove ed., 1999).

we ask whether the state also creates, say, a woman's right not to be raped.⁵⁷ Following the argument advanced by Sunstein and Tribe, a woman has no inherent human right not to be raped; after all, her so-called private or voluntary sphere is a creation of law and hardly voluntary. Without the criminal laws against rape—and accompanying legal rules regarding marriage, divorce, and child-rearing, and the regulation of contraceptives, maternity care, or abortion—the relationship between men and women would not be what it now is. Indeed, it would be extremely difficult to figure out what that relationship might be, if it would exist in recognizable form at all.⁵⁸ If a woman has a right not to be raped, then the burden would be on her to advance and justify that right in the public forum. The state might give her that right by promulgating and enforcing rules against rape, and it may do so because the lawmakers stand in a superior position to her—not in a position of equality—and are free to decide who does, and who does not, deserve this right.⁵⁹

This analogy⁶⁰ makes clear that the notion that rights are created by the state—whether they be so-called economic rights or any other kind of right—can have horrifying consequences.

57. Although I use the analogy of rape here, one could choose many others. John Locke used cannibalism, pointing out in his *First Treatise* that if rights are merely permissions given to us by absolute governments, then “Princes might eat their Subjects, too.” LOCKE, *supra* note 14, at 160. Mark Twain, probably inadvertently, used this same example to comic effect in his story *Cannibalism in The Cars* (1868), reprinted in MARK TWAIN: COLLECTED TALES, SKETCHES, SPEECHES & ESSAYS 1852–1890, at 269–77 (Louis J. Budd ed., Library of America 1992). The humor in Twain's story comes precisely from the elected officials, who in the story are stranded on a train in the snow, arguing with great care and precision over the procedural details of a proposal to kill and eat one of their fellow passengers. The story would not be humorous at all to one who truly believed that individual rights are permissions extended to us by elected representatives.

58. Cf. SUNSTEIN, *supra* note 4, at 30 (“Without the law of trespass, and accompanying legal rules of contract and tort, the relationship between employers and employees would not be what it now is; indeed, it would be extremely difficult to figure out what that relationship might be, if it would exist in recognizable form at all.”).

59. It is no answer simply to assert that this right is qualitatively more precious than the right to make free economic choices because if such a distinction exists, then *it*, and not the rest of their theory of rights, is doing the real work in Tribe and Sunstein's formulation.

60. I had thought this analogy somewhat fanciful until the Seventh Circuit Court of Appeals held that there is no constitutional barrier to the state eliminating the right to use deadly force in self-defense. See *Nat'l Rifle Ass'n of Am., Inc. v. City of Chicago*, 567 F.3d 856, 859–60 (7th Cir. 2009), cert. granted *sub nom.* *McDonald v. Chicago*, 130 S. Ct. 48 (2009).

Specifically, it empties the concept “right” of any real content, and replaces it with a “privilege” extended by a superior (the state) to the inferior individual, for the state’s own purposes. Turn this argument whichever way one will, it is always the same old serpent,⁶¹ and one might say that every laudable effort in the history of American law has been aimed at exploding it in various forms. Few would suggest that the state creates the freedom of sexual intercourse⁶²—and nobody should argue that the state creates the freedom of economic intercourse.

There are two other (comparatively minor) problematic consequences implied by the notion that the state creates markets. First, if the state really is responsible for the existence of markets, it is not clear how black markets are possible. America’s tragic thirteen-year experience with the prohibition of alcohol should have proved how difficult it is for government to eliminate commercial exchanges. But for decades now, federal, state, and local governments in the United States—armed with hundreds of billions of dollars, the highest quality weaponry and surveillance equipment available, and the dedicated service of thousands of brave and ingenious law enforcement officers, and aided by foreign governments and everyone from teachers to television writers—have hopelessly failed to eliminate the illegal drug trade. Black markets flourished even in the U.S.S.R. and North Korea—two of the most intense police states in human history. If governments do create markets, how can they be so inept at shutting markets down?

In a related vein, it is hard to explain the existence of inflation on the premise that economic exchange is the creature of the state. Inflation, simply put, occurs because consumers

61. Cf. ABRAHAM LINCOLN, Speech at Chicago, Ill. (June 10, 1858), in SPEECHES AND WRITINGS, *supra* note 39, at 1032–58 (“[T]he arguments in favor of kingcraft were of this class; they always bestrode the necks of the people, not that they wanted to do it, but because the people were better off for being ridden. That is their argument, and this argument . . . is the same old serpent that says you work and I eat, you toil and I will enjoy the fruits of it. Turn in whatever way you will—whether it come from the mouth of a King, an excuse for enslaving the people of his country, or from the mouth of men of one race as a reason for enslaving the men of another race, it is all the same old serpent . . .”). That Tribe and Sunstein add no racial character to their argument for inequality and the superiority of the rulers to the ruled changes nothing.

62. As Justice Blackmun wrote, “We protect those rights not because they contribute, in some direct and material way, to the general public welfare, but because they form so central a part of an individual’s life. ‘[T]he concept of privacy embodies the moral fact that a person belongs to himself and not others nor to society as a whole.’” *Bowers v. Hardwick*, 478 U.S. 186, 204 (1986) (Blackmun, J., dissenting) (citations omitted).

know that a dollar bill is not actually worth a dollar—or in Zimbabwe’s case, that a fifty billion dollar bill is not actually worth fifty billion dollars.⁶³ But how is this possible, if the state creates the market by formulating the conditions of exchange, and if, as Roosevelt and Sunstein assert, economic laws are not made by nature but by human beings? Evidently there are universal limits on the degree to which economic behavior can be controlled by the state’s mere fiat. Where do these limits come from? They come from the interchange of supply and demand—that is, economic laws antecedent to the state’s authority. The state does not create markets; it *steps into* markets—into the swarm of transactions that make up “the market”—and in doing so, the state is subject to principles of exchange over which it cannot assert absolute control.⁶⁴

63. In December 2008, *Forbes* reported that Robert Mugabe’s Zimbabwe had reached a level of inflation that it described as “6.5 quidecillion novemdecillion percent,” in which prices double every 24.7 hours. Steve H. Hanke, *The Printing Press*, *FORBES*, Dec. 22, 2008, at 106.

64. There are some situations in which the state can more realistically be said to create markets, or rather, pseudo-markets. In these cases, the traded commodities are state-created privileges that would not exist in a state of nature—for example, transferable development rights (TDRs) or pollution credits (today called “cap and trade”), as well as copyrights and patents. These commodities are promised by the government to employ its coercive power (that is, monopolies), or refrain from employing coercion in certain ways. Government may permit consumers to trade these privileges, and trade in them will allow participants to rank priorities and allocate these privileges to more efficient uses. Such trade therefore resembles a market. But there are crucial differences between these pseudo-markets and genuine markets that reinforce my broader point that states do not create markets.

First, pseudo-markets exist purely at the discretion of a single entity—the state—and are therefore more like an auction within a single firm than like an open market of competing sellers. The state does not set the rules of trade (for example, the “cap”) in response to actual consumer demand, but to its own political incentives. See Jerome W. Milliman, *Can Water Pollution Policy Be Efficient?*, 2 *CATO J.* 165, 185 (1982) (“[T]he market here is not a true market in that the number of permits would be fixed in relation to some predetermined environmental target There is no feedback from the users about water quality achieved and their willingness to pay on the supply of rights”). David M. Driesen argues that “mimicking free market features that do not coincide with *desired policy outcomes* proves counterproductive.” David M. Driesen, *Is Emissions Trading an Economic Incentive Program?: Replacing the Command and Control/Economic Incentive Dichotomy*, 55 *WASH. & LEE L. REV.* 289, 337 (1998) (emphasis added). Desired by whom? Under conditions of voluntary exchange, economic incentives are created by consumer demand; any other sense of the phrase “desired policy outcome” is meaningless. Only a pseudo-market is organized around a “desired policy outcome”—desired by the state, that is.

Second, the items sold are created entirely by government fiat; they are not created, as is economic wealth, by the interaction of humans with nature. The state’s

D. *States Must Respect, Not Create, Our Rights*

On an episode of *Meet the Press*, then-Senator Barack Obama summed up his view of the relationship between the state and the market: “If the market solution works, let’s go with the market solution. If a solution requires government intervention, let’s do that.”⁶⁵ But the moral equivalency suggested by this answer is actually shocking. A “market solution” is the result of uncoerced choices by individuals pursuing their interests with the knowledge and resources available to them. Government intervention, on the other hand, is an act of coercion, backed by state force, which deprives someone of the freedom to make choices and set priorities based on his knowledge and resources. Although intervention may benefit some, it simultaneously deprives others of their freedom and of their resources. Respecting the right of individuals to make free economic choices—just like respecting the rights to speak, worship, or love—is not just one among other morally equivalent options. It is a fundamental aspect of the freedom to which all people are naturally entitled, and depriving innocent persons of that freedom is an injustice. To regard these alternates as morally equivalent requires one to assume that the right to make economic choices for oneself is only a grace or privilege granted, however temporarily, by the state.

Yet states do not create—though they may foster or protect—the freedom of economic intercourse. Government is, among other things, a protective agency that can help individuals preserve rights that already belong to them. They could legitimately act to protect these rights themselves if they so chose. But because doing so is costly, time consuming, and potentially dan-

moral authority to create such goods is dubious. See RICHARD A. EPSTEIN, *TAKINGS* 189 (1985) (“How, it must be asked, is the city in a position to grant these rights . . . ? To do this, the city must first own the rights, which it acquired not by purchase . . . but by zoning [or other legislation] . . . It is as though A uses money stolen from B to pay B for property purchased from him thereafter.”); see also James L. Johnson, *Pollution Trading in LA LA Land*, 3 *REGULATION* 44, 48 (1994). In addition, substitute goods are rarely possible, and there is no competition by producers who can lower prices.

Third, it is impossible for there to be a black pseudo-market. There can be a true black market in government privileges, but by definition there cannot be an unauthorized pseudo-market because the pseudo-market is by definition created by the government authorization. Pseudo-markets are therefore distinct from true markets in ways that support my thesis here.

65. BARACK OBAMA: *IN HIS OWN WORDS* 139 (Lisa Rogak ed., 2007).

gerous, the state acts as their deputy, doing so on their behalf and by their authority. That service could also be provided by other entities, and often is—by private security firms, for example. It would, of course, be unjust for a person to hire the services of a protective agency with money stolen from his neighbor, which is why legitimate government must be based on consent: It is a kind of contract of mutual protection, in which individuals purchase protective services with tax dollars.⁶⁶ Here again we see why the freedom of economic exchange must precede the state and serve as one of the sources of its legitimacy.

IV. A COMMENT ON EFFICIENCY

I have thus far argued against the proposition that the state creates markets and thereby acquires authority to regulate markets to serve state ends. My point is obviously not to deny the importance of legal institutions in the working of economic intercourse. Rather, it is to challenge the premise upon which a number of policy arguments are based, particularly the view that “the market” is a thing that the state creates and that it might shape to achieve certain political goals. But this same error of considering “the market” as a unitary thing is also related to a different kind of policy argument.

Policy arguments on the left generally contend that legal institutions should organize “the market” to accomplish social justice goals,⁶⁷ an argument that has been sufficiently refuted elsewhere, principally on the grounds that the term “social justice” is meaningless.⁶⁸ But such an approach has at least the virtue that its normative house is in order: It explicitly aims to coerce economic choices in service of certain guiding principles. In this, it is unlike the typical claim on the right,⁶⁹ which is that institutional ar-

66. See, e.g., MASS. CONST. of 1780 pmbl. (“The body politic is formed by a voluntary association of individuals: it is a social compact, by which the whole people covenants with each citizen, and each citizen with the whole people, that all shall be governed by certain laws for the common good. It is the duty of the people, therefore, in framing a constitution of government, to provide for an equitable mode of making laws, as well as for an impartial interpretation, and a faithful execution of them; that every man may, at all times, find his security in them.”).

67. See, e.g., ALAN WOLFE, *THE FUTURE OF LIBERALISM* 82–84 (2009).

68. See DE JASAY, *supra* note 42, at 127–69. See generally HAYEK, *supra* note 8.

69. The terms “left” and “right” are imprecise, particularly as there are people identified with the political left who nevertheless argue in favor of efficiency-maximization as a goal to be pursued in institutional arrangements. For example, President Obama

rangements should be oriented to produce *economic efficiency*. A great deal of ink has been wasted explaining how various legal rules produce economically efficient results, or arguing that certain reforms would produce more efficient results. The problem is that the concept of efficiency is not a helpful guidepost for organizing economic or legal institutions, and in fact it smuggles in normative propositions that ought to be examined more openly.⁷⁰

“Efficient” is an adjective that describes the fitness of a means to a given end. A means is efficient if it accomplishes an end with the least amount of waste—where “waste” is defined, somewhat circularly, as the unfitness of the means to the given end. Obviously what qualifies as efficient will differ depending on what ends one is pursuing. If a person wants to drive quickly from Los Angeles to Sacramento, it is efficient to travel north on Interstate 5, as opposed to, say, Highway 99. On the other hand, if the person wants to stop along the way to shop in various towns, it would be more efficient to take Highway 99 and arrive later. Efficiency measures the effectiveness of a trade-off: which actions will accomplish the desired end with the least amount of ineffective energy expenditure. The efficiency of the driver’s trade-off—time versus shopping detours—depends on the driver’s priorities. No transaction is entirely waste-free, but some trades are more effective than others.

What this discussion means is that there is no such thing as efficiency *per se*—there are only efficient means to particular ends. But ends are agent-specific;⁷¹ that is, different people pursue different ends.⁷² Which ends are rational for me to pursue may not be—indeed, are rarely—rational for another person to pursue. Thus, the means that are efficient for one person’s ends are not necessarily efficient for another person’s. There can be

argues that government must intervene in economic decisions to “deal[] with market failures—those recurring snags in any capitalist system that either inhibit the efficient workings of the market or result in harm to the public.” OBAMA, *supra* note 2, at 153.

70. For an outstanding elaboration of this point, see Louis De Alessi, *Efficiency Criteria for Optimal Laws: Objective Standards or Value Judgments?*, 3 CONST. POL. ECON. 321 (1992).

71. I am purposely avoiding the term “subjective,” used by Austrian economists when discussing this point. See, e.g., LUDWIG VON MISES, HUMAN ACTION 332 (3d ed. 1963). I think that word is misleading because the economic proposition here does not necessarily entail moral subjectivism. See generally Tara Smith, *The Importance of the Subject in Objective Morality: Distinguishing Objective from Intrinsic Value*, 25 SOC. PHIL. & POL’Y 126 (2008).

72. And with good reasons, chief among which is comparative advantage.

no such thing as “social efficiency”⁷³ or “collective efficiency” because societies and collectives do not pursue ends—only individuals do.⁷⁴ Moreover, there is no way to determine what means are most efficient for a rational agent other than to observe the transactions that a person makes.⁷⁵ As James M. Buchanan puts it, “voluntary exchanges among persons, within a competitive constraints structure, generate efficient resource usage, *which is determined only as the exchanges are made.*”⁷⁶ Given our limited knowledge of another person’s spectrum of needs and desires, it is impossible for any one person to say with confidence what is and is not efficient for another person.⁷⁷

73. See ISRAEL H. KIRZNER, MARKET THEORY AND THE PRICE SYSTEM 35 (1963) (“Society has no single mind where the goals of different individuals can be ranked on a single scale We are not invoking the notion of a society having *its* goals in any sense apart from the goals of the individuals making up the society. Efficiency for a social system means the efficiency with which it permits its individual members to achieve their several goals.”); FRANK HYNEMAN KNIGHT, THE ETHICS OF COMPETITION 34–35 (1997) (“It is impossible to form any concept of ‘social efficiency’ in the absence of some general measure of value [O]nly within rather narrow limits can human conduct be interpreted as the creation of values of such definiteness and stability that they can serve as scientific data, [because] life is fundamentally an exploration in the field of values itself and not a mere matter of producing given values. When this is clearly seen, it will be apparent why so much discussion of social efficiency has been so futile.”).

74. See De Alessi, *supra* note 70, at 335–36.

75. See Donald J. Boudreaux et al., *Talk is Cheap: The Existence Value Fallacy*, 29 ENVTL. L. 765, 785 (1999) (“In market transactions, we can assume that all individual trades increase individual utility, because the occurrence of the trade itself suggests that the individual values the good received more highly than the good surrendered.”).

76. James M. Buchanan, *Rights, Efficiency, And Exchange: The Irrelevance of Transactions Cost* (1984), reprinted in THE LOGICAL FOUNDATIONS OF CONSTITUTIONAL LIBERTY 260, 273–74 (1999) (emphasis added).

77. As Hayek said in his Nobel lecture,

Into the determination of . . . prices and wages there will enter the effects of particular information possessed by every one of the participants in the market process—a sum of facts which in their totality cannot be known to the scientific observer, or to any other single brain. It is indeed the source of the superiority of the market order, and the reason why, when it is not suppressed by the powers of government, it regularly displaces other types of order, that in the resulting allocation of resources more of the knowledge of particular facts will be utilized which exists only dispersed among uncounted persons, than any one person can possess. But because we, the observing scientists, can thus never know all the determinants of such an order, and in consequence also cannot know at which particular structure of prices and wages demand would everywhere equal supply, we also cannot measure the deviations from that order; nor can we statistically test our theory that it is the deviations from that “equilibrium” system of prices and wages which make it impossible to sell some of the products and services at the prices at which they are offered.

Consider Richard Pryor's character in the movie *Brewster's Millions*,⁷⁸ who must get rid of as much money as he can as quickly as possible, but is repeatedly frustrated that his purchases end up accidentally making him richer instead. The comedic value of the movie arises because, although these purchases would be brilliant investments for most people, they are economically inefficient for Brewster. For him, they are not wise. They are not means that fit his ends; they are inefficient.

The same is true of all coercive policies. If I want to spend money on X, and government makes me buy Y instead, that is not an efficient or wise investment for me, because I did not want Y. I wanted X. Even if Y is something that most people prefer, it is not one of my ends. (If it were, coercion would be unnecessary.) Even apparently universal goods—literacy, or a college education—are not actually universally good; there are circumstances in which it would be economically unwise for a person to undertake the costs of obtaining them. An illiterate man on his deathbed with only hours to live would probably prefer to spend that time with his grandchildren rather than learning to read. A single mother raising three children on her own would not find it economically efficient to quit her job and enroll in college. Economic choices are trade-offs, and although we all may make mistakes, the person with the best access to the knowledge necessary for determining which trade-offs are efficient is that person himself.

In short, ends are inherently personal, which means that economic efficiency is inherently personal. A transaction thus can be efficient only if it is voluntary.⁷⁹ An involuntary transaction is one that the actors did not consider worthwhile—that is to say, it was not efficient in light of the transaction costs or other considerations.⁸⁰ At the very least, a coercive transaction

FRIEDRICH A. HAYEK, *The Pretence of Knowledge* (1974), reprinted in *NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS* 23, 27 (1978).

78. BREWSTER'S MILLIONS, Universal Pictures 1985.

79. Viktor J. Vanberg, *Individual Choice and Institutional Constraints: The Normative Element in Classical and Contractarian Liberalism*, in *RULES AND CHOICE IN ECONOMICS* 208, 210 (1994) ("In saying that market outcomes are efficient, one claims, in effect, that the processes by which they are generated are 'good,' in the sense that through their market choices the constituent individuals reveal what they consider 'good' in their own judgment. . . . There is no reference to any standard that would allow one to judge the outcome independently of the transaction itself.").

80. Nor, incidentally, can it be considered a moral good because choice is a necessary element in any moral good. See TARA SMITH, *VARIABLE VALUES: A STUDY OF LIFE AS THE ROOT AND REWARD OF MORALITY* 99 (2000). Note also that an individual need not

deprives a person of free choice, and for any compensation to truly make him whole—that is, to make the transaction efficient—the compensation would have to make up both for his economic and his psychological harm.

Economists have sought various substitutes for an agent-centered conception of efficiency in an attempt to rationalize coercive transactions under the efficiency criterion, but none of them have succeeded. For example, some define efficiency as an increase in social wealth; legal institutions ought therefore to aim for increasing the amount of wealth in society as a whole.⁸¹ But not all persons seek an increase in social wealth; a monk who has taken a vow of poverty certainly does not seek an increase in social wealth. To impose coercive policies on such a citizen in the pursuit of social wealth is to deprive him of utility. Moreover, if “wealth” is (mis)defined by reference to market prices, we risk overlooking that monetary prices do not accurately reflect *utility*;⁸² a transaction that appears efficient based only on the bottom line figures could easily result in a loss of total utility. Psychological factors not measurable in monetary terms must factor in.⁸³ To implement—coercively or otherwise—a transaction that results in more cash value but reduces overall utility would be inefficient.⁸⁴ And to impose a coercive transaction that deprives a

have perfect knowledge for his actions to qualify as efficient, as Murray Rothbard contended. See MURRAY N. ROTHBARD, *The Myth of Efficiency* (1979), reprinted in THE LOGIC OF ACTION I: METHOD, MONEY, AND THE AUSTRIAN SCHOOL 266, 266 (1997). Rather, the individual need merely act on the basis of transaction costs. The transaction cost of obtaining information may outweigh the value of a possible transaction. In such a case, the non-occurrence of a mutually advantageous exchange because of ignorance would still be efficient, because in light of the transaction costs, the exchange would not actually be mutually advantageous.

81. See, e.g., Richard A. Posner, *The Ethical And Political Basis of The Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487 (1980). Posner contends that “[o]ne objection to using autonomy directly as an ethical norm . . . is that it requires an arbitrary initial assignment of rights.” *Id.* at 496. But as we have seen, rights are not assigned, nor are they arbitrary. See DOUGLAS B. RASMUSSEN & DOUGLAS J. DEN UYL, NORMS OF LIBERTY: A PERFECTIONIST BASIS FOR NON-PERFECTIONIST POLITICS 299 (2005).

82. See De Alessi, *supra* note 70, at 330 (“At best, private (subjective or personal-use) values approach market (objective or observable) prices only at the margin.”).

83. Anyone who has done a crossword puzzle without checking Google knows that the value of “doing it myself” differs from the value of completing the puzzle.

84. See De Alessi, *supra* note 70, at 334 (“The maximization of aggregate wealth implies that sources of utility not reflected in the aggregate do not matter and that changes in the wealth of individuals that do not result in a reduction of aggregate wealth also do not matter.”).

party of utility and provides insufficient monetary compensation for that injury is simply to extract wealth from him to benefit others.⁸⁵ That transaction is not efficient, at least for him, because efficiency to him means the accomplishment of his ends with the least amount of what he considers waste.

It is not that Pareto efficiency is a senseless concept,⁸⁶ but it must subsume the agent-centered definition of efficiency: An outcome is Pareto efficient if it leaves nobody “worse off.” But “worse off” can be defined only by each agent pursuant to that agent’s own utility function—which means that if Pareto efficiency is to be meaningful, it must rely on individual value assessments. Substituting the pursuit of any other kind of ends (for example, maximization of society’s monetary wealth) to decide whether people are made better or worse off is simply to smuggle in an outsider’s own values under the counterfeit of objective assessment, and to impose them on the parties.⁸⁷ The same is true of Kaldor-Hicks efficiency, which is achieved if an outcome makes some people better off and if those who are made worse off could in theory be compensated for their loss. Given the personal nature of utility, such an outcome can only be truly efficient if, in fact, people accept that transaction voluntarily.

This point is not disproven even by a case in which an otherwise Pareto efficient transaction fails to occur because of the parties’ lack of knowledge. It is true that parties may forego ex-

85. *See id.* at 336 (“The opinion that rules which lower transaction costs enhance efficiency is not value-free and may not be correct even within its own frame of reference.”).

86. There are many problems with the notion. As De Alessi observes, Pareto efficiency requires an unattainable degree of knowledge if taken literally: Because all economic transactions have an endless chain of economic consequences, it is impossible to determine whether any transaction will make all persons better off. Cutting off the chain of consequences to say that only the parties to the transaction must be made better off is to smuggle in the normative premise that only the actual parties to that transaction have interests that ought to matter in the calculus. *See id.* at 338. Whatever criterion one uses to draw the line for cutting off the measurement of utility will then become the criterion with regard to which a given institution’s “efficiency” will then be measured; the individuals’ ends and valuations are no longer being consulted.

87. Note for instance that Posner defends the use of wealth maximization as a goal for social policy in part on the ground that, because it weighs the value of individual autonomy “less heavily” than does the classical liberal deontological principle of rights-protection, this approach fosters “the human impulse, apparently genetically based, to share wealth with people who are less effective in producing it.” Posner, *supra* note 81, at 496. In fact, this is a euphemistic and disingenuous defense of forcible wealth redistribution; it means that the state is really doing us a favor when it coerces us to give our wealth away to others.

changes that would benefit them because they are unaware of the profitability of the transaction, or because one side is holding out above his reserve price. But the parties' ex ante ignorance must be seen as a transaction cost that outweighs the foreseen benefits of the transaction. For the government to coerce the parties into such a transaction means that the taxpayers must assume those transaction costs instead, which requires its own set of justifications because each taxpayer now becomes a third (or fourth) party to the transaction.⁸⁸ Moreover, those who would advocate that the state coerce the parties into the transaction bear the burden of proof to show that the state has better access to the information the parties lack. States rarely have superior information, even if we disregard the ways that rent seeking distorts the state's decision of whether or not to force such transactions.⁸⁹ Finally, there is the fact—particularly keen in the context of eminent domain—that a great deal of the utility that a prop-

88. In at least the vast majority of such cases, the result will be inefficient because the taxpayer's costs are rarely exceeded by whatever attenuated benefits they might enjoy as a consequence of such subsidies. See RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* 200 (1985).

89. See Bruce L. Benson, *The Mythology of Holdout as a Justification for Eminent Domain and Public Provision of Roads*, 10 INDEP. REV. 165, 186 (2005) ("Clearly, such transfers are not efficient in a Pareto sense, and we have no way to know whether they are efficient in a Kaldor-Hicks sense."); Nicole Stelle Garnett, *The Neglected Political Economy of Eminent Domain*, 105 MICH. L. REV. 101, 139 (2006) ("Determining the 'efficiency' (whether Pareto or Kaldor-Hicks) of any project enabled by eminent domain is difficult at best, given the multiplicity of a project's possible costs and benefits, the length of the relevant time horizons, and so on."); Daniel B. Kelly, *The "Public Use" Requirement in Eminent Domain Law: A Rationale Based on Secret Purchases and Private Influence*, 92 CORNELL L. REV. 1, 6-7 (2006) ("Because courts have no mechanism for determining how much existing owners actually (*i.e.*, subjectively) value their property, courts routinely ignore actual value and instead rely on a property's 'fair market value' However, because market value neither calculates nor compensates for a taking's full costs (*i.e.*, the actual value to the existing owners), a socially undesirable transfer may occur whenever the existing owners' actual value deviates from the court-determined objective value. As a result, eminent domain may force a transfer where the existing owners value the land more than the private assembler."). Thomas W. Merrill acknowledges that requiring the state to actually compensate a property owner for the full measure of his loss "would pose difficult valuation problems, for subjective value is inherently difficult to measure" and that "[i]f these difficulties suggest that full indemnification is unrealistic, then we can no longer be confident that every exercise of eminent domain authorized by the basic model is in fact efficient." *The Economics of Public Use*, 72 CORNELL L. REV. 61, 84 (1986). He proceeds, however, to justify such takings by abandoning the principle of full compensation. For a discussion of the rent-seeking effects of redevelopment condemnations, see Donald J. Kochan, *"Public Use" and the Independent Judiciary: Condemnation in an Interest-Group Perspective*, 3 TEX. REV. L. & POL. 49 (1998).

erty owner derives from his land is precisely his ability to determine the uses to which it may be put. The Supreme Court thus has observed that the right to exclude others is “one of the most essential sticks in the bundle of rights that are commonly characterized as property”⁹⁰ In most cases, compensating a property owner even at fair market value will not make up for the injury done to this essential autonomy value.⁹¹

The theory of eminent domain advanced by some proponents of redevelopment is thus problematic.⁹² Susette Kelo’s house might have a monetary value of X , but that is not an adequate measure of her utility, which must include the value of her freedom of choice regarding the disposal of the property.⁹³ If there existed a price that would compensate her for these things, she would willingly sell her home for that amount. It is true that she might “hold out” above her real reserve price, but there is no reason to believe that the state can accurately determine this fact, and every reason to suspect that its assertions on such matters are motivated more by rent seeking than by an actual access to greater stores of information. In any case, for the outcome to be truly Pareto efficient, the compensation would have to be enough to pay for her loss of free choice, something that is exceedingly unlikely. The far more likely outcome is that at least one party will end up worse off than if the exchange had not taken place. Pareto criteria are therefore more confusing than helpful when analyzing takings. The use of Kaldor-Hicks criteria—that the parties *could in theory* be compensated, but are not actually—is even worse, as it unapologetically incorporates the forcible elimination of one person’s just deserts for the benefit of others.⁹⁴

As Louis De Alessi concludes, the use of economic efficiency as a guideline for the organization of legal and political institutions “suffer[s] from the use of implicit social welfare functions and the presumption that values can be measured by outside

90. *Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979).

91. I am indebted to my colleague R.S. Radford for these observations.

92. See, e.g., Frank I. Michelman, *Property, Utility, and Fairness: Comments on The Ethical Foundations of “Just Compensation” Law*, 80 HARV. L. REV. 1165, 1174–75 (1967).

93. See *Kelo v. New London*, 545 U.S. 469 (2005).

94. See De Alessi, *supra* note 70, at 337 (“Supporting a move on Pareto grounds *without compensation* implies the value judgment that the welfare gains of the gainers outweigh the welfare losses of the losers.”).

observers.”⁹⁵ The use of “increase in social wealth” or other poor substitutes for actual efficiency as goals for legal institutions is merely an attempt to substitute allegedly more scientific criteria for the old-fashioned standard of justice.⁹⁶ Justice, after all, is now widely considered an outdated term, burdened with normative baggage. And yet, as we have seen, the various criteria for “efficiency” used by law and economics scholars are also burdened with normative baggage: They presume that legal institutions *ought* to aim at an increase in wealth because an increase in wealth is *good*. I submit that, given the problems inherent in abusing words like “efficiency” and its failure to avoid the normative connotations it is supposed to avoid, it would be best for lawyers to return to their more comfortable homeland and to unembarrassed arguments about justice.

CONCLUSION

Recent efforts to increase government control over the economy are largely premised on the view that government is the source of our economic freedom and that it therefore has a responsibility to use its coercive powers to ensure that private decisions are made in accordance with the collective’s priorities (as articulated by political leaders). But this premise is untenable. Economic freedom is not a creature of the state any more than our other freedoms are. The state may facilitate our freedom, but it only does so subject to moral and economic principles that precede politics. These principles cannot be escaped through the allegedly more “scientific” route of pursuing policies devoted to economic efficiency. The state ought to respect the preexisting rights of individuals; only that approach is truly efficient—or truly just.

95. *Id.* at 340.

96. *Cf.* Letter from James Madison to James Monroe (Oct. 5, 1786), in *SELECTED WRITINGS OF JAMES MADISON* 28–29 (Ralph Ketcham ed., 2006) (“I shall never be convinced that it is expedient, because I cannot conceive it to be just. There is no maxim in my opinion which is more liable to be misapplied, and which therefore more needs elucidation than the current one that the interest of the majority is the political standard of right and wrong. Taking the word ‘interest’ as synonymous with ‘Ultimate happiness,’ in which sense it is qualified with every necessary moral ingredient, the proposition is no doubt true. But taking it in the popular sense, as referring to immediate augmentation of property and wealth, nothing can be more false. In the latter sense it would be in the interest of the majority in every community to despoil and enslave the minority of individuals In fact, it is only reestablishing under another name and, a more spec[ic]ious form, force as the measure of right . . .”).