

Contract Law and Distributive Justice*

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Within broad limits, our legal system leaves individuals free to dispose of their property as they wish, either by giving it away or by transferring it in exchange for the property of others. The freedom individuals enjoy in this regard includes the power to make contracts, legally binding agreements that provide for the exchange of property on terms fixed by the parties. Among contract scholars, there is nearly universal agreement that the law of contracts, the tangled mass of legal rules that regulate the process of private exchange, has three legitimate functions: first, to specify which agreements are legally binding and which are not;¹ second, to define the rights and duties created by enforceable but otherwise ambiguous agreements;² and finally, to indicate the consequences of an unexcused breach.³ Beyond this, however, it has sometimes been suggested that the law of contracts should also be used as an instrument of distributive justice and that those responsible for choosing or designing rules of contract law—courts and legislatures—should do so with an eye to their distributional effects in a self-conscious effort to achieve a fair division of wealth among the members of society.⁴

* An earlier version of this Article was presented as part of the Wilson Day Program at the University of Rochester on October 10, 1979. I am grateful to Bruce Ackerman, Owen Fiss, Arthur Leff, and Jerry Mashaw for their helpful comments on a prior draft.

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1. See 1 A. CORBIN, *CONTRACTS* 2 (1963); cf. U.C.C. § 1-201(11) (1972) (“‘Contract’ means the total legal obligation which results from the parties’ agreement”)

2. See, e.g., G. TULLOCK, *THE LOGIC OF THE LAW* 47 (1971) (one function of contract law is to save parties inconvenience of drafting very long agreements by providing rules of interpretation); Farnsworth, *Disputes Over Omission in Contracts*, 68 *COLUM. L. REV.* 860, 860 n.2 (1968) (court, having determined a contract exists, cannot refuse to apply it even in case for which parties did not expressly provide); cf. U.C.C. §§ 2-310, 2-511(1) (1972) (prescribing certain conditions to be considered part of all contracts “unless otherwise agreed” by parties).

3. See, e.g., O. HOLMES, *THE COMMON LAW* 227 (M. Howe ed. 1963); Farnsworth, *Legal Remedies for Breach of Contract*, 70 *COLUM. L. REV.* 1145, 1147 (1970). In recent years, a number of writers have advocated an economic approach to the problem of defining the appropriate remedies for breach. See, e.g., Barton, *The Economic Basis of Damages for Breach of Contract*, 1 *J. LEGAL STUD.* 277 (1972); Priest, *Breach and Remedy for the Tender of Nonconforming Goods Under the Uniform Commercial Code: An Economic Approach*, 91 *HARV. L. REV.* 960 (1978).

4. See, e.g., Ackerman, *Regulating Slum Housing Markets on Behalf of the Poor: Of Housing Codes, Housing Subsidies and Income Redistribution Policy*, 80 *YALE L.J.* 1093, 1098 (1973) (housing codes, if properly enforced, can play important role in “war on

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There are, in fact, many rules of contract law that are deliberately intended to promote a distributional end of some sort. Obvious examples include: usury laws limiting the interest that can be charged on loans;⁵ implied, but nevertheless nondisclaimable, warranties of quality or habitability;⁶ and minimum wage laws.⁷ The object of each of these rules is to shift wealth from one group—lenders, sellers, landlords, employers—to another—borrowers, buyers, tenants, workers—presumably in accordance with some principle of distributive justice, by altering the terms on which individuals are allowed to contract. Can legal rules of this sort be defended? More generally, is it ever appropriate to use the law of contracts—understood in the broad sense in which I have been using the term—as an instrument of redistribution, or should the legal rules that govern the process of private exchange be fashioned without regard to their impact on the distribution of wealth in society?

Libertarians, who deny that the state is ever justified in forcibly redistributing wealth from one individual or group to another, answer this question in the negative.⁸ Surprisingly, many liberals, who believe that at least some compulsory redistribution of wealth is morally acceptable, even required, give the same answer.⁹ The libertarian's opposition to the use of contract law as a mechanism for redistribution

poverty"); Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1778 (1976) (contract law an "ideal context" for judicial task of creating "altruistic order"); Michelman, *Norms and Normativity in the Economic Theory of Law*, 62 MINN. L. REV. 1015, 1016-37 (1978) (housing-code regulation of rental contracts justifiable as redistributive measure even if not demonstrably "efficient" in economic sense).

5. See, e.g., CONN. GEN. STAT. § 37-4 (1979); N.Y. BANKING LAW § 173-1 (McKinney 1971).

6. *Javins v. First Nat'l Realty Corp.*, 428 F.2d 1071, 1079-82 (D.C. Cir.), cert. denied, 400 U.S. 925 (1970) (housing lease includes implied warranty of habitability).

7. See, e.g., 29 U.S.C. § 206(a)(1) (1976).

8. See F. HAYEK, *THE CONSTITUTION OF LIBERTY* 93-102, 133-61 (1961) (redistribution of wealth restricts liberty and inappropriately attempts to align compensation with moral worth); R. NOZICK, *ANARCHY, STATE AND UTOPIA* 149-53, 167-74 (1974) (property rights, established by principles of acquisition and transfer, should be inviolate); Buchanan, *Political Equality and Private Property: The Distributional Paradox*, in *MARKETS AND MORALS* 69-84 (G. Dworkin, G. Bennett, & P. Brown eds. 1977) (individual freedom inconsistent with forced economic equality); Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293, 293-94 (1975) (contract law provides individuals with a "sphere of influence" in which they are not required to justify their activity to the state).

9. See C. FRIED, *RIGHT AND WRONG* 143-50 (1978); J. RAWLS, *A THEORY OF JUSTICE* 87-88, 274-79 (1971); Grey, *Property and Need: The Welfare State and Theories of Distributive Justice*, 28 STAN. L. REV. 877, 890 n.38 (1976); Rawls, *The Basic Structure as Subject*, in *VALUES AND MORALS* 47, 54-55 (A. Golman & J. Kim eds. 1978) [hereinafter cited as *Basic Structure*]; C. DeMuth, *Regulatory Costs and the "Regulatory Budget"* 9 (Dec. 1979) (Discussion Paper, Faculty Project on Regulation, John F. Kennedy School of Government, Harvard University). *But cf.* Dworkin, *Liberalism*, in *PUBLIC AND PRIVATE MORALITY* 133 (S. Hampshire ed. 1978) (preference for redistribution by taxation rather than regulation not essential to liberalism).

derives from his general belief that the compulsory transfer of wealth is theft, regardless of how it is accomplished.¹⁰ By contrast, liberals who oppose the use of contract law as a redistributive device do so because they believe that distributional objectives (whose basic legitimacy they accept) are always better achieved through the tax system than through the detailed regulation of individual transactions.¹¹

Thus, despite their fundamentally different views regarding the moral legitimacy of forced redistribution, liberals and libertarians often find themselves defending a similar conception of contract law. While lawyers and philosophers in both camps approvingly describe the role that contract law plays in reducing the cost of the exchange process itself and emphasize the importance of protecting those engaged in the process against threats of physical violence and other unacceptable forms of coercion,¹² there also appears to be widespread agreement, on both sides, that the legal rules regulating voluntary exchanges between individuals should not be selected or designed with an eye to their distributional consequences. It is tempting to conclude that this conception of contract law, which I shall call the non-distributive conception, must be correct if those with such sharply divergent views on the most basic questions of distributive justice agree on its soundness.

In this Article, I argue that the non-distributive conception of contract law cannot be supported on either liberal or libertarian grounds, and defend the view that rules of contract law should be used to implement distributional goals whenever alternative ways of doing so are likely to be more costly or intrusive. The Article is divided into two parts. In the first part I examine the libertarian theory of contractual exchange and argue, against the standard libertarian view, that considerations of distributive justice not only *ought* to be taken into account in designing rules for exchange, but *must* be taken into account if the law of contracts is to have even minimum moral acceptability. My aim here is to show that the idea of voluntary agreement—an idea central to the libertarian theory of justice in exchange—cannot be understood except as a distributional concept, and to demonstrate that the notion of individual liberty, taken by itself, offers no guidance in determining which of the many forms of advantage-taking possible in exchange relations render an agreement involuntary and therefore unenforceable on libertarian grounds. Having established this general point, I propose a simple test, similar in form to Rawls's difference

10. See, e.g., R. Nozick, *supra* note 8, at 172.

11. See, e.g., *Basic Structure*, *supra* note 9, at 55, 65.

12. Compare *id.* at 54-55 (fraud example) with R. Nozick, *supra* note 8, at 150 (same).

principle,¹³ for deciding which kinds of advantage-taking should be permitted and which should not, and argue that this test is the one libertarians ought to accept as being most compatible with the moral premises of libertarianism itself.

In the second part of the Article, I challenge the standard liberal preference for taxation as a method of redistribution. The choice of a redistributive method involves moral issues as well as questions of expediency. In my view, however, a blanket preference for taxation is not justified by considerations of either sort. There is no reason to think that taxation is always the most neutral and least intrusive way of redistributing wealth, nor is there reason to think it is always the most efficient means of achieving a given distributive goal. Which method of redistribution has these desirable properties will depend, in any particular case, on circumstantial factors; neither method is inherently superior to the other. And while any redistributive scheme is bound to involve a conflict between distributive justice and individual liberty, the existence of this conflict, although it raises serious difficulties for liberal theory in general, does not provide a reason for adopting a non-distributive conception of contract law.

There are important, but different lessons to be learned from both the liberal and libertarian opposition to using the law of contracts for distributive purposes, and I shall attempt to clarify these in the course of my argument. However, while both views contribute to our understanding of the difficulties involved in treating the law of contracts as a mechanism for redistributing wealth, neither view justifies the claim, implicit in the writings of liberals and libertarians alike, that there is something *morally* wrong with using contract law in this way.¹⁴

I. Distributive Justice and the Libertarian Theory of Exchange

A. *Voluntary Exchange*

The libertarian theory of contract law is premised upon the belief that individuals have a moral right to make whatever voluntary agreements they wish for the exchange of their own property, so long as the rights of third parties are not violated as a result. For a libertarian, there are only two grounds on which an agreement to exchange property may be impeached: first, that it infringes the rights of someone

13. See, e.g., Epstein, *supra* note 8, at 293-95; *Basic Structure*, *supra* note 9, at 65.

14. See J. RAWLS, *supra* note 9, at 60, 83, 302-03 (difference principle states that inequalities should be "arranged so that they are both to the greatest benefit of the least advantaged . . . and attached to offices and positions open to all").

not a party to the agreement itself, and second, that one of the individuals agreeing to the exchange was coerced into doing so, and thus did not give his agreement voluntarily. Imagine a judge charged with responsibility for enforcing contracts between the members of a particular community. So long as the judge acts in a way consistent with libertarian principles, he need ask himself only two questions whenever a contract dispute arises: Did the party now said to be in breach voluntarily agree to do what the other party wants him to do? Will performance of the agreement violate the rights of third parties? If the answers are "yes" and "no," respectively, the contract must be enforced, regardless of its consequences for the welfare of the individuals involved. If the judge refuses to enforce a particular contract merely because it has certain distributional consequences, or if he adopts a general rule invalidating an entire class of contracts for similar reasons, his actions are indefensible on libertarian grounds. Taking distributional effects into account in this way is inconsistent with the libertarian conception of individual freedom and violates the basic entitlement on which that conception rests.

The question of when an agreement violates the rights of third parties—as opposed to merely diminishing their welfare—is a difficult and interesting one, but I shall say nothing about it here.¹⁵ I want, instead, to focus on the second libertarian requirement for the enforcement of agreements—the requirement of voluntariness. Putting aside its effect on third party rights, the only thing about an agreement that matters, from a libertarian point of view, is the process by which it is reached. This is sometimes expressed by saying that the libertarian conception of contractual exchange is backward-looking or historical,¹⁶ concerned with how agreements are made but not with their distributive consequences. There is, however, an ambiguity in this way of characterizing the libertarian theory of exchange. Imagine, for example, a legal system in which there is only one way of creating an enforceable contract—by pronouncing a sacred oath and then reciting the terms of the agreement. A judge in such a legal system might be instructed to base his decisions in disputed cases solely on whether the specified procedure had been complied with, and to ignore entirely the distributive consequences of his judgments. Whatever one thinks of its merits, this is a perfectly intelligible method of adjudication which can be described by saying that so far as the judge is concerned, it is only the

15. The distinction between actions that violate a person's rights and those that merely reduce his welfare is developed in R. Nozick, *supra* note 8, at 57-84.

16. *See id.* at 153-55.

process leading up to an agreement, and not its distributive effects, that matters. However, this method—which might be called pure proceduralism—ought not to be confused with libertarianism. It is not enough, for a libertarian, that the procedure for creating contracts (whatever it might be) has been complied with; it is necessary, in addition, that it has been complied with in a particular way, voluntarily rather than involuntarily. If someone has spoken the sacred oath with a gun at his head there is no justification, from a libertarian point of view, for enforcing his agreement even though every formality has been meticulously observed. Libertarians and pure proceduralists share a common unconcern with the distributive consequences of the private arrangements individuals make for exchanging their property: what distinguishes these two positions is that the libertarian cares about something which the pure proceduralist is in theory free to ignore, namely, the voluntariness of agreement itself.

More importantly, the distinction between these two views must be maintained so long as libertarianism purports to be a theory of *justice* in exchange. The mere fact that someone has observed a particular procedure in agreeing to do something does not explain why he should be required to abide by the terms of his agreement; to explain why he should, an appeal must be made to something other than the procedure itself.¹⁷ Pure proceduralism is not a moral theory at all, although it may be part of one. By contrast, libertarianism is, or at least claims to be, a moral theory meant to vindicate the idea of individual freedom. A libertarian conception of contract law must therefore take the voluntariness of agreements, rather than their procedural correctness, as the ultimate touchstone of liability and disregard the latter where the two diverge.

But when is an agreement voluntary? For a libertarian, committed to the notion that all voluntary agreements must be enforced, the widest view of voluntariness is almost surely unacceptable. Suppose that I sign a contract to sell my house for \$5,000 after being physically threatened by the buyer. It is possible to characterize my agreement as voluntary in one sense: after considering the alternatives, I have concluded that my self-interest is best served by signing and have deliberately implemented a perfectly rational decision by doing precisely that. Described in this general way, my agreement to sell appears in

17. Thus, an advocate of pure proceduralism may attempt to defend his position on the ground that compliance with his favored procedure is the *best evidence* of voluntary consent, at which point his position becomes simply a more complicated version of libertarianism.

the same light that it would if, for example, I had not been threatened but signed the contract because I thought \$5,000 a good price for the house. Under this description, however, my act of signing will be involuntary only if it is not motivated by a decision of any sort at all on my part. Such would be the case, for example, if the purchaser forcibly grabbed my hand and guided it over the document himself, or commanded me to sign the contract while I was in an hypnotic state.

There is, of course, nothing logically absurd about drawing the line between voluntary and involuntary agreements at this point, but I doubt most libertarians would wish to do so. Among other things, defining voluntariness in this way conflicts with deeply entrenched notions of moral responsibility. In assessing the voluntariness of an agreement, it is not enough merely to determine that the agreement was motivated by a deliberate decision of some sort; we also want to know something about the circumstances under which it was given. But if this is true, the problem of drawing a line between agreements that are voluntary and agreements that are not—a problem the libertarian must confront if the idea of voluntary exchange is to have any meaning at all—can be understood as the problem of specifying the conditions that must be present before we will consider an agreement to have been voluntarily concluded. Put differently, unless the libertarian is prepared to accept a very broad concept of voluntariness, which equates voluntary agreement with rational choice, he must specify the various circumstances under which even a deliberately given, rational agreement will be held to have been coerced.¹⁸

B. *Advantage-Taking*

Whenever a promisor complains that his agreement was coerced and therefore ought not to be enforced, he should be understood as claiming that the agreement was given under circumstances that rendered it involuntary. In making an argument of this sort, a promisor may point to many different circumstances or conditions: he may say, for example, that his agreement was involuntary because he lacked the mental and emotional capacities required to appreciate its consequences;¹⁹ or a promisor may claim that he was threatened or deceived by the other party,²⁰ or that his agreement was given at a time he was hard-pressed

18. See generally Nozick, *Coercion*, in *PHILOSOPHY, SCIENCE, AND METHOD, ESSAYS IN HONOR OF ERNEST NAGEL* (1969).

19. See, e.g., *Faber v. Sweet Style Mfg. Corp.*, 242 N.Y.S.2d 763, 40 Misc. 2d 212 (1963) (plaintiff claimed to suffer from manic-depressive psychosis).

20. See, e.g., *Schupp v. Davey Tree Expert Co.*, 235 Mich. 268, 209 N.W. 85 (1926) (plaintiff signed contract after being assured he would not be bound by its terms).

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for cash and therefore had no choice but to accept the terms proposed by the promisee;²¹ or a promisor may assert that his agreement was involuntary because he, unlike the other party, was ignorant of certain facts which, if known at the time of contracting, would have led him to make a different agreement or no agreement at all;²² or he may say that the other party had a monopoly of some scarce resource—the only water hole or the best cow or the strongest shoulders in town—a monopoly which enabled him to dictate terms of sale to the promisor, making their agreement what is sometimes called a “contract of adhesion.”²³

In some of these cases, the circumstances allegedly making the promisor's agreement involuntary is an incapacity of the promisor himself—his insanity, youth, ignorance or impecuniousness. In others, the involuntariness of the promisor's agreement is attributable to an act by the other party—a fraudulent deception or threat of physical harm. Finally, in some cases, it is the other party's monopolization of a scarce resource and the market power he enjoys as a result which (it is claimed) renders the promisor's agreement involuntary. In each case, however, the promisor is asserting that his agreement, although deliberately given, lacked voluntariness because of the circumstances under which it was made—circumstances that in one way or another restricted his range of alternatives to a point where the promisor's choice could be said to be free in name only.²⁴

The problem, of course, is to determine when the circumstances

21. See, e.g., *Hackley v. Headley*, 45 Mich. 569, 8 N.W. 511 (1881) (plaintiff, unable to afford to sue for amount due him under contract, accepted note for lesser amount and gave receipt for full balance due).

22. See, e.g., *Sherwood v. Walker*, 66 Mich. 568, 33 N.W. 919 (1887) (sale of cow rescinded where the animal, assumed by both parties to be barren, later proved otherwise); *Obde v. Schlemeyer*, 56 Wash. 2d 449, 353 P.2d 672 (1960) (seller of home under duty to disclose termite infestation). For a theoretical discussion of the scope of the seller's duty to disclose, see Kronman, *Mistake, Disclosing Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1 (1978).

23. Contracts of adhesion are standardized contracts characteristically used by large firms in every transaction for products or services of a certain kind. The use of such contracts can have profound implications for ordinary notions of freedom of contract:

The weaker party, in need of the goods or services, is frequently not in a position to shop around for better terms, either because the author of the contract has a monopoly (natural or artificial) or because all competitors use the same clauses. His contractual intention is but a subjection more or less voluntary to terms dictated by the stronger party, terms whose consequences are often understood only in a vague way, if at all. Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 632 (1943). For a more recent discussion of adhesion contracts, see Leff, *Unconscionability and the Code—the Emperor's New Clause*, 115 U. PA. L. REV. 485, 504-08 (1967).

24. Cf. Scanlon, *Nozick on Rights, Liberty, and Property*, 6 PHIL. & PUB. AFFAIRS 3, 17 (1976) (idea of consent implies that choice occurs against some background of alternatives).

under which an agreement is given deprive it of its voluntariness in this sense. In my view, this problem is equivalent to another—the problem of determining which of the many forms of advantage-taking possible in exchange relationships are compatible with the libertarian conception of individual freedom. The latter way of stating the problem may appear to raise new and distinct issues but in fact it does not. In each of the hypothetical cases considered above, the promisee enjoys an advantage of some sort which he has attempted to exploit for his own benefit. The advantage may consist in his superior information, intellect, or judgment, in the monopoly he enjoys with regard to a particular resource, or in his possession of a powerful instrument of violence or a gift for deception. In each of these cases, the fundamental question is whether the promisee should be permitted to exploit his advantage to the detriment of the other party, or whether permitting him to do so will deprive the other party of the freedom that is necessary, from a libertarian point of view, to make his promise truly voluntary and therefore binding.²⁵

The term “advantage-taking” is often used in a pejorative fashion, to refer to conduct we find morally objectionable or think the law should disallow. I mean the term to be understood in a broader sense, however, as including even those methods of gain the law allows and morality accepts (or perhaps even approves). In this broad sense, there is advantage-taking in every contractual exchange. Indeed, in mutually advantageous exchanges, there is advantage-taking by both parties. Suppose I have a cow you want, and you have a horse I want, and we agree to exchange our animals. The fact that you want my cow gives me an advantage I can exploit by insisting that you give me your horse in return. Your ownership of the horse gives you a symmetrical advantage over me. Each of us exploits the advantage we possess and—in this transaction at least—are both made better off as a result. This might seem to make my broad conception of advantage-taking empty or trivial. There is, however, an important reason for using the term in the unconventionally broad way that I do. By using the term to refer to *all* types of advantage-taking—those we tolerate as well as those we do not—attention is focused more sharply on the need to explain why the illicit methods of gain for which we normally reserve the term are thought to be objectionable.

In order to give meaningful content to the idea of voluntary exchange, a libertarian theory of contract law must provide an explana-

25. Cf. *id.* at 19 (adequate conceptions of “consent” and “freedom” would not legitimate loss of control over one’s life resulting from unequal bargaining power).

tion of precisely this sort. However, although some principle or rule is needed as a basis for deciding which forms of advantage-taking should be allowed and which should not be, it is unclear what this principle or rule might be. Suppose, for example, that my neighbor threatens to shoot me unless I agree to buy his house. If there is one thing which must be treated as a condition for voluntary exchange, it is the absence of direct physical compulsion of the sort involved in this first case. But suppose that instead of threatening me with physical harm, the seller merely lies to me about the house—he tells me, for example, that water pipes inaccessibly buried beneath the basement are copper when in fact he knows them to be made of iron, an inferior material. Ought such advantage-taking be allowed?²⁶ While it is possible to justify advantage-taking of this sort on the grounds that only physical coercion should be disallowed, there is no good reason for making *this* distinction the decisive one. Moreover, even if one fastens on the physical nature of the advantage-taking act, explicit misrepresentation can be characterized in a way that gives it a physical character as well, for example by saying that the misrepresentation is communicated by soundwaves which stimulate an auditory response in the listener which in turn provokes a neural change that causes him to sign the contract. This may be fanciful, but it suggests that with enough imagination any form of advantage-taking can be characterized as a physical intrusion,²⁷ and the question of when such a characterization is appropriate cannot be answered by simply repeating that it is the physical nature of the act which makes it objectionable.

At this point, many will be tempted to acknowledge explicit misrepresentation as an illegitimate form of advantage-taking, but insist

26. This kind of advantage-taking does not differ significantly from deception that does not involve a spoken lie. Suppose that my neighbor makes no threats and tells no lies but merely covers over evidence of an existing termite infestation so completely that even an expert will now be unable to discover their presence in the house. See *DeJoseph v. Zambelli*, 392 Pa. 24, 139 A.2d 644 (1958). If I agree to buy the house after having had it inspected by an exterminator, should I be released from my agreement when the termites later make themselves known? It is difficult to see what reason there could be for not disallowing this form of advantage-taking if explicit misrepresentation is forbidden, other than the fact that here the deception is accomplished without a spoken lie. But this reason is hardly a good one since the seller has done things which are, in any meaningful sense, fully the equivalent of a deliberately uttered falsehood. So either it was a mistake to disallow one form of advantage-taking, or it is a mistake to permit the other: they ought to stand or fall together.

27. For an ingenious effort to assimilate verbal influence to physical action, see Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151, 172-74 (1973). According to Professor Epstein, defendants whose words frighten someone may thereby commit the tort of assault. If the frightened person suffers injury attributable to fright, or injures someone else in an attempt to flee, his reactions are not "volitional" on Professor Epstein's view, and should therefore be regarded as the physical acts of the defendant.

that the line be drawn there—limiting the conditions necessary for voluntary exchange to two (absence of physical coercion and fraud). Suppose, however, that the seller makes no threats and tells no lies, but does say things that, although true, are meant to encourage me to draw a false conclusion about the condition of the house and to inspect the premises less carefully than I might otherwise. (The seller tells me, for example, that the house has been inspected by an exterminator from the Acme Termite Company every six months for the last ten years, which is true, but neglects to inform me that during his last visit the exterminator discovered a termite infestation which the seller has failed to cure.) By telling me only certain things about the house, and not others, the seller intends to throw me off the track and thereby take advantage of my ignorance and naiveté. The same is true if he tells me nothing at all, but simply fails to reveal a defect he knows I am unaware of—a case of pure nondisclosure.²⁸

Should this last form of advantage-taking be allowed? At this point, undoubtedly, many will be inclined to say I have only myself to blame for drawing an incorrect inference from the seller's truthful representations and for failing to take precautionary measures such as having the house inspected by an expert. But why is this a good reason for holding me to my bargain here, but not in the previous cases as well? I can, for example, protect myself against the risk that I will be forced to sign a contract at gunpoint by hiring a bodyguard to accompany me wherever I go; and I can protect myself against the danger of explicit misrepresentation by requiring the other party to take a lie detector test or, more simply, by insisting that he warrant the house to be free of pests or any other possible defect that happens to concern me. Why isn't my failure to protect myself in these cases a good reason for enforcing the agreement I have made?

In attempting to sort out these various forms of advantage-taking, a number of distinctions suggest themselves—for example, the distinction between physical and non-physical advantage-taking, or between those forms of advantage-taking that can be prevented by the victim and those that cannot. None, however, provides a principled basis for determining which forms of advantage-taking ought to be allowed. Each can be interpreted in different ways, yielding different results, and the distinctions themselves provide no guidance in deciding which of

28. In many jurisdictions, a seller is now required by law to disclose the presence of termites in a dwelling, despite the buyer's failure to make inquiries. *See, e.g.*, *Williams v. Benson*, 3 Mich. App. 9, 141 N.W.2d 650 (1966); *Cohen v. Blessing*, 259 S.C. 400, 192 S.E.2d 204 (1972); *Obde v. Schlemeyer*, 56 Wash. 2d 449, 353 P.2d 672 (1960).

the competing interpretations is the right one. An independent principle of some sort is required to determine the scope and relevance of these distinctions, and consequently it is that principle, whatever it might be, rather than the distinctions themselves that explains why we ought to allow some forms of advantage-taking but not others.

C. *The Principle of Paretianism*

While there are many principles that might conceivably perform this function, the libertarian may be inclined to think that only one is morally acceptable. This principle, which I shall call the liberty principle, states that advantage-taking by one party to an agreement should be allowed unless it infringes the rights or liberty of the other party. The liberty principle has an appealing directness and simplicity. It does not, however, provide a satisfactory test for discriminating between acceptable and unacceptable forms of advantage-taking in the exchange process, but rather begs the question it is meant to answer.

For the liberty principle to be of any help at all, we must already know when an individual is entitled to complain that his liberty has been violated and to know this, we must know what rights he has. For example, we cannot say whether the liberty principle is violated if one person takes advantage of another by concealing valuable information in the course of an exchange, unless we have already decided that it is part of the first person's liberty that he be allowed to exploit the information he possesses in this way and not a part of the other person's liberty that he be free from such exploitation. The liberty principle does not purport to tell us what rights people actually have but assumes that we possess such knowledge independently of the principle itself.

How can we acquire the independent knowledge of rights needed to give the liberty principle meaning? Someone might claim that we can acquire such knowledge simply by looking to see what rights people have either by nature or convention. But rights cannot be ascertained in this way. Every claim concerning rights is necessarily embedded in a controversial theory: the only way to justify the claim that a person has a certain right is to argue that he does, and this means deploying a contestable theory²⁹ that cannot itself be verified or disproven by simply

29. My argument here is that individual liberty is an "essentially contested concept," as that term is defined by W.B. Gallie. See Gallie, *Essentially Contested Concepts*, 56 *PROC. ARISTOTELIAN SOC'Y* 167, 167-68 (1956). According to Gallie's formulation, a concept should be considered "essentially contestable" when it is evaluative as well as descriptive and has such diverse criteria of applicability that analysis of ordinary usage yields no single, preferred definition. The question which is the "best" definition is thus open to argument. The libertarian's failure to provide such an argument for his definition of

looking to see what is the case. In order to apply the liberty principle, we must already have a theory of rights. Because it does not itself supply such a theory, the liberty principle, standing alone, provides no guidance in deciding which forms of advantage-taking ought to be allowed.

If a direct appeal to the liberty principle is unhelpful, the libertarian is confronted with the problem of finding an alternative basis for distinguishing between acceptable and unacceptable forms of advantage-taking in the exchange process. A number of different principles suggest themselves, but three seem to me especially significant and I shall limit myself to these.

First, a libertarian might adopt the view that some people are simply better than others—more intelligent, beautiful, or noble—and argue that being a better person gives an individual the right to exploit his inferiors in certain ways.³⁰ A full elaboration of this view, which rests upon what may be called the doctrine of natural superiority, would require the following: a specification of the respects in which people differ as to their worth; a defense of the claim that worthiness is a legitimate ground for the assignment of rights and duties; and an account of the types of exploitation that can be justified by an appeal to the superiority of the exploiting party.

Second, a libertarian might attempt to justify certain forms of advantage-taking by arguing that they increase the total amount of some desired good such as happiness. Classical utilitarianism is the most familiar example of such a view; for convenience, I shall refer to the view itself as utilitarianism.³¹

Finally, a libertarian might attempt to distinguish between different forms of transactional advantage-taking by invoking the interest of the disadvantaged party himself. In some cases, it is reasonable to think that a person who has been taken advantage of in a particular way will be better off in the long run if the kind of advantage-taking in question is allowed than he would be were it prohibited. Whenever this is true, a libertarian might argue the advantage-taking should be permitted and in all other cases forbidden. I shall call this third view paretianism

individual liberty is criticized in Scanlon, *supra* note 24, at 3. For useful discussions of the disputable meaning of abstract concepts, see R. DWORKIN, *TAKING RIGHTS SERIOUSLY* 134-35 (1977) (distinguishing concepts from "conceptions" offered as elucidations of them); S. HAMPSHIRE, *THOUGHT AND ACTION* 230-31 (1959) (disputes about boundaries necessarily involve disputes about host of connected notions).

30. See F. NIETZSCHE, *THE WILL TO POWER* §§ 901-902, 926 (Vintage ed. 1968).

31. For an energetic defense and an equally spirited critique of utilitarianism, see J. SMART & B. WILLIAMS, *UTILITARIANISM: FOR AND AGAINST* (1973).

because of its close connection with the idea of Pareto efficiency.³²

Each of these three principles provides an intelligible criterion for discriminating between acceptable and unacceptable forms of advantage-taking in the exchange process. Each leads to different results. All three rely upon something other than the bare idea of individual liberty and are therefore immune from the special criticisms to which the liberty principle is subject. Only the last of these three principles, however, is consistent with the basic ethical commitments of libertarianism; if a libertarian were required to choose among the three, the only one that he could choose without abandoning his most fundamental moral beliefs would be the third.³³

In the first place, libertarianism is a strongly egalitarian theory. According to the libertarian, all individuals are equal in what, from a moral perspective, is the most important respect—in their basic right to freedom from the interference of others. This feature of libertarianism rules out the doctrine of natural superiority as a basis for discriminating between acceptable and unacceptable forms of advantage-taking. The doctrine of natural superiority not only leads to non-egalitarian results, as may libertarianism itself, but also rests upon a notion of differential worthiness wholly incompatible with the libertarian conception of individual equality. There is no way of incorporating the doctrine of natural superiority within the framework of a libertarian theory of rights.

In addition to being strongly egalitarian, libertarianism is also an individualistic theory in the sense that it assigns a unique value to the

32. Principles similar to paretianism have been discussed in connection with a range of legal problems. See, e.g., C. FRIED, *AN ANATOMY OF VALUES* 187-91 (1970) ("risk pool" concept in tort law); Epstein, *Nuisance Law: Corrective Justice and its Utilitarian Constraints*, 8 J. LEGAL STUD. 49, 77-78 (1979) (implicit in-kind compensation in nuisance law); Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1194-96, 1222-24 (1967) (distribution of longrun benefits and losses in eminent domain law); Polinsky, *Probabilistic Compensation Criteria*, 86 Q.J. ECON. 407, 420-21 (1972) (paretian criterion defined in terms of longrun probabilities); Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication* (forthcoming in 8 HOFSTRA L. REV. (1980)) (*ex ante* compensation). For a discussion of the ethical implications of the Pareto principle, see Coleman, *Efficiency, Exchange and Auction: Philosophic Aspects of the Economic Approach to Law* (forthcoming in 68 CALIF. L. REV. (1980)).

33. Libertarians therefore face the following choice: show that the liberty principle does in fact yield a determinate solution to the problem of specifying which forms of advantage-taking are legitimate; acknowledge the vacuousness of the liberty principle but argue that some other principle, different from the three I have considered, is the best one; or, finally, accept paretianism as the appropriate standard by which to assess the legitimacy of the various kinds of advantage-taking possible in exchange transactions. Even from a libertarian point of view, the last alternative seems to me the most attractive of the three and in what follows I shall assume that this is in fact the choice most libertarians would make.

autonomy of the individual person. Any principle, such as utilitarianism, that purports to evaluate states of affairs solely on the basis of the total amount of some good they happen to contain is capable of taking the idea of autonomy into account only indirectly; utilitarianism can give weight to the independence of individuals only insofar as their independence contributes to something else which is taken to be good in itself.³⁴ Given the peculiar strength of his commitment to individual autonomy—to the idea that individuals have moral “boundaries” which must be respected even if more happiness or welfare could be produced by disregarding them³⁵—the libertarian must also reject utilitarianism as a basis for distinguishing between acceptable and unacceptable forms of advantage-taking. This leaves only paretianism, which states that a particular form of advantage-taking should be allowed if it works to the longrun benefit of those disadvantaged by it, but not otherwise—a principle that is neither anti-individualistic, since it does not make the sum or total of any impersonal good the touchstone of evaluation, nor anti-egalitarian.³⁶

An important ambiguity in the principle of paretianism may seem to cast doubt on this claim, however. Suppose that Jim sells Fred a watch and lies to him about its condition. Should Jim be permitted to exploit Fred by deliberately defrauding him? On the assumption that paretianism is a strongly individualistic principle, one might conclude that it requires us to answer this question by considering the longrun effect of Jim's deceit on Fred's individual welfare. There are good reasons, however, for not interpreting the principle in this way. To begin with, it would probably be impossible for courts to make such highly individualized assessments, except in rare cases, and in any

34. This is true even of utilitarian theories that treat individual autonomy as an intrinsic good to be maximized, perhaps along with other intrinsic goods. If autonomy is made a maximand in this sense, then any limitations can be placed on a person's freedom so long as they yield a greater total amount of freedom overall. But this is to deny that persons have autonomy in the sense in which I am using the term. Respect for the autonomy of persons means that individuals cannot be restricted in their freedom solely for the purpose of increasing the overall amount of some desired good, including freedom itself.

35. Libertarian theorists often express the concept of individual autonomy in terms of the related notion of personal “boundaries.” See R. Nozick, *supra* note 8, at 57-87; Epstein, *supra* note 32, at 50-54. The notion of boundaries suggests that each moral agent possesses a natural right to be free from violations of his body, and, more problematically, a similar right to be free from imposition of constraints on choice that are incompatible with moral personhood. His commitment to the idea of personal boundaries requires the libertarian to reject any theory, such as utilitarianism, that permits the violation of boundaries whenever the sum of some impersonal good can be advanced by doing so.

36. The latter point is developed more fully in a later section. See pp. 491-93 *infra*.

event, an approach of this sort would create uncertainty and deprive legal rules of their predictability. Moreover, unlike a court, a legislature must evaluate the effects of proposed rules on classes of persons rather than on particular, identifiable individuals. For these reasons, a strictly individualistic interpretation of paretianism is likely to make the principle unworkable in all but a few cases.

How should the principle be interpreted, then? Although the matter is by no means free from difficulty, one reasonable approach is to interpret paretianism as requiring only that the welfare of *most people* who are taken advantage of in a particular way be increased by the kind of advantage-taking in question.³⁷ If one adopts this view, in order to resolve the dispute between Jim and Fred, it is only necessary to decide whether most victims of fraud will be better off in the longrun, all things considered, if conduct such as Jim's is legally tolerated.

This interpretation of the principle of paretianism makes the principle easier to apply. At the same time, however, it appears to diminish the difference between paretianism and utilitarianism by substituting the overall welfare of a group for the welfare of a particular individual. But despite this appearance of similarity,³⁸ there are two related respects in which these principles remain distinguishable from one another. In the first place, paretianism and utilitarianism may lead to different results where the group of persons harmed by a particular form of advantage-taking represents a permanently distinct subset of society as a whole, since in cases of this sort, it is always possible that total welfare will increase while the welfare of the disadvantaged group declines. Assume, for example, that most people with low IQs are disadvantaged in their transactions with brighter people. Whether this kind of advantage-taking should be allowed depends entirely, for the utilitarian, on the total amount of welfare that it yields. If one adopts the principle of paretianism, on the other hand, advantage-taking by those with superior intellectual endowments can be justified only if it increases the longrun welfare of those with low IQs.

This points to a second and more fundamental difference between

37. The practical necessity of evaluating rules by reference to their effects on classes rather than on particular individuals has been recognized previously. See J. RAWLS, *supra* note 9, at 98. Rawls keys his difference principle to the welfare of the least advantaged class rather than the least advantaged person, and argues that a theory intended to protect individuals can employ general classifications with complete internal consistency when such classifications afford fuller protection to individuals than any other "practicable" scheme. See *id.*

38. For a fuller discussion of the differences between paretianism and utilitarianism as ethical theories, see Kronman, *Wealth Maximization As a Normative Principle* (forthcoming in 9 J. LEGAL STUD. (1980)).

the two principles. The principle of paretianism ultimately rests on the notion that one person should be permitted to make himself better off at another's expense only if it is to the benefit of both that he be allowed to do so. By contrast, utilitarianism—as I use the term—is premised on the belief that more welfare is always better than less, regardless of how it is distributed. For a utilitarian, an increase in the total quantum of welfare is ethically significant in its own right; from the standpoint of paretianism, an increase of this sort has no meaning by itself. To be sure, a utilitarian may be driven to adopt paretianism as the best available method for measuring increases in total welfare,³⁹ but the principle of paretianism can never have independent ethical significance for the true utilitarian. Likewise, someone committed to paretianism may conclude that a simple summing of utilities is the only practical way of implementing *his* favored principle, but nevertheless reject the utilitarian notion that greater total welfare is a moral good in its own right, regardless of how it happens to be distributed among individuals. Thus, even where utilitarianism and paretianism converge to the same practical result, they do so for different reasons, arriving at a common conclusion from fundamentally different starting-points.

In comparing moral principles, it is important to consider the reasons they provide for acting in certain ways, as well as the actions they require and forbid.⁴⁰ Utilitarianism and paretianism offer strikingly different justifications for permitting certain forms of advantage-taking in the exchange process. Paretianism permits only those forms of advantage-taking that work to the benefit of all concerned, a requirement rooted in the conviction that every person has an equal right not to have his own welfare reduced for the sole purpose of increasing someone else's.⁴¹ This constraint expresses, in a powerful way, respect for the integrity of individuals, and distinguishes paretianism from every ethical theory—including utilitarianism—that treats the maximization of some impersonal good as an end in itself. Since he is committed to the idea of individual integrity, the libertarian has good reason to prefer the principle of paretianism over utilitarianism and to adopt the former principle as a basis for discriminating between acceptable and unacceptable forms of advantage-taking in exchange transactions.

39. See, e.g., Coleman, *supra* note 32; Posner, *supra* note 32.

40. See KANT'S CRITIQUE OF PRACTICAL REASON AND OTHER WORKS ON THE THEORY OF ETHICS 4-5 (6th ed. T. Abbott trans. 1909).

41. This conviction is an element of Rawls's theory as well. See J. RAWLS, *supra* note 9, at 3-4, 22-27.

D. *Paretianism Applied*

I want now to indicate, in a more concrete way, how the principle of paretianism can be used to give meaningful content to the idea of voluntary exchange by helping us decide which kinds of advantage-taking should be permitted and which should not. Let me begin with a relatively easy case.⁴² Suppose that *A* owns a piece of property that, unbeknownst to *A*, contains a rich mineral deposit of some sort. *B*, a trained geologist, inspects the property (from the air, let us assume), discovers the deposit, and without disclosing what he knows, offers to buy the land from *A* at a price well below its true value. *A* agrees, and then later attempts to rescind the contract on the ground that *B*'s failure to reveal what he knew about the property amounted to fraud. The general question here is whether buyers who have deliberately acquired superior information should be permitted to exploit their advantage by making contracts without revealing what they know or believe to be true. Except in special cases,⁴³ the law does not require disclosure by well-informed buyers, at least where their information is the product of a deliberate search. This rule can be defended in the following way. If *B* has made a deliberate investment in acquiring the information that gives him an advantage in his transaction with *A*, imposing a duty of disclosure will prevent him from reaping the fruits of his investment and thereby discourage others from making similar investments in the future. But this means that a smaller amount of useful geological information will be produced. As a result, the efficient allocation of land, the allocation of individual parcels to their best use, will be impaired. It is plausible to argue that this will hurt those at an informational disadvantage in particular exchanges more than they would be helped by imposing a duty of full disclosure in sale transactions such as the one involved here. For example, although imposing a duty of this sort will enable *A* to back out of a disadvantageous transaction with *B*, it will also increase the price *A* has to pay for oil and aluminum because the incentive to make the investment necessary to determine which pieces of land contain these resources in the first place will have been weakened as a result. Thus, a legal rule permitting *B* to buy *A*'s property without disclosing its true worth arguably works to *A*'s own benefit, since it provides a stimulus for the production of

42. For a fuller discussion of this and similar cases, see Kronman, *supra* note 22, at 9-18.

43. An example of such a case is a situation in which there is a prior fiduciary relationship between the parties.

efficiency-enhancing information. This is, in any event, the kind of argument required by the principle of paretianism.

Although paretianism justifies certain types of advantage-taking,⁴⁴ it clearly rules out others. Suppose, for example, that *B* forces *A* to sell his property by threatening *A* with physical harm. If *B*'s behavior does not bar enforcement of the contract, *A* himself may on other occasions be able to benefit from such a rule by coercing others to make agreements against their will. In the longrun, however, it is unlikely that *A* will be better off if physical coercion is permitted in the exchange process; as long as the means of violence are distributed in a relatively even fashion, there is no reason to think that *A*'s gains from such a rule will exceed his losses. More importantly, a rule of this sort would give people an incentive to shift scarce resources from productive uses—uses that increase everyone's level of material well-being—to non-productive ones (the development of more powerful weapons and better bulletproof vests) that improve no one's position but merely maintain the status quo. A legal rule permitting physical coercion in the exchange process would therefore have exactly the opposite effect of a rule permitting well-informed buyers to exploit deliberately acquired information.

The same is true of fraud (the deliberate production of misinformation).⁴⁵ If *B* agrees to purchase *A*'s automobile after *A* has lied to him about its mechanical condition, enforcing *B*'s agreement despite *A*'s fraud will hurt *B* and benefit *A*. The next time, however, *A* may be the victim and *B* the successful defrauder. Once again, there is no reason to think that most people will benefit from a rule permitting fraud; indeed, this is impossible, since total gains from such a rule will exactly equal total losses. Moreover, adopting a rule of this sort would give everyone an incentive to invest in the detection of fraudulent representations. Such investments yield information, but only of a non-productive kind. It is to everyone's advantage that resources be devoted to other uses; a rule prohibiting fraud in exchange transactions encourages precisely that result.

Of course, the principle of paretianism does not always yield so clear an answer as these cases might suggest. Suppose, for example, that *A* is aware of an important defect in his own property—a termite infestation, say—and merely fails to inform *B* of the defect's presence. *A* is surely exploiting his superior information at *B*'s expense; in this

44. Arguments similar to the one in text can be made to justify taking advantage of superior acumen or intelligence. See J. RAWLS, *supra* note 9, at 100-08.

45. See R. POSNER, *ECONOMIC ANALYSIS OF LAW* 80-84 (2d ed. 1977).

respect, *A*'s conduct is indistinguishable from *B*'s in the situation described earlier—when *B* offers to buy *A*'s property without revealing what he knows about its true value. Moreover, *A*'s information, like *B*'s, is productive in nature, because it reveals a fact that must be taken into account if the allocation of scarce resources is to be as efficient as possible. Unlike *B*'s information, however, *A*'s knowledge regarding the termites may be the product of casual observations made while living in the house, rather than the result of a deliberate and costly search. If so, a rule requiring *A* to disclose what he knows about the termites will have no, or only a small, effect on the production of such information. Moreover, a rule of this sort will reduce *B*'s own inspection costs—which are likely to be higher than *A*'s, given *B*'s unfamiliarity with the property.⁴⁶ Assuming that most people will be buyers about as often as they are sellers, one may perhaps tentatively conclude that their gains from a legal rule requiring sellers to disclose substantial, nonvisible defects will exceed the occasional losses they suffer as a result.

It does not follow, of course, that most people will be made better off if sellers of all sorts are required to disclose defects of every kind. Beyond a certain point, a rule requiring disclosure may have significant and undesirable incentive effects, and in some cases, the buyer's own search costs are likely to be so low as to trivialize the benefits he receives from disclosure. Even in this difficult area, however, the principle of paretianism provides guidance by indicating the kind of argument that must be made in order to justify any particular disclosure rule, whether it be a broad or narrow one.⁴⁷

E. *Paretianism and Equality*

The principle of paretianism requires us to evaluate different kinds of advantage-taking by asking whether they make the disadvantaged themselves better off in the long run. But what is the baseline against which we are to measure changes in the welfare of the disadvantaged? Clearly, the baseline is represented by the situation in which the advantage-taking in question is legally forbidden: advantage-taking is to

46. See Kronman, *supra* note 22, at 13-14.

47. Although the application of the principle of paretianism in difficult cases may require the resolution of factual questions that the professional economist is best equipped to answer, it would be a mistake to think that the principle states merely an economic test for assessing different forms of advantage-taking in exchange transactions. It would be more accurate to say that paretianism provides the morally inspired framework within which technical economic issues (for example, those regarding the incentive effects of a proposed disclosure rule) must be debated.

be allowed only if the disadvantaged are made better off than they would be were it prohibited. But the baseline situation, conceived in this way, is a situation of equality. Consequently, if a libertarian adopts paretianism as the basis for discriminating between acceptable and unacceptable forms of advantage-taking in the exchange process—and I have argued that he has good reasons for doing so—he will be endorsing a view that rests upon what, from a libertarian perspective, may seem to be a surprisingly strong egalitarian premise.

An example will help to clarify what I mean. Suppose that *A* possesses certain information but is forbidden to exploit it for his own benefit. If he wishes to make any use of the information in his transactions with others, *A* must reveal what he knows; a failure to do so, in any particular case, will render the other party's agreement unenforceable. When it is disclosed, *A*'s information becomes a public asset which everyone has an equal right to use as he pleases. If *A* cannot make an enforceable contract without disclosing what he knows, he will be unable to exploit his informational advantage except on terms that benefit others equally. The alternative, of course, is to give *A* a property right in his information and permit him to exploit it as he would any other privately owned asset. The principle of paretianism states, however, that a property right of this sort should be granted only if those to whom the information is not disclosed will be even better off than they would be were the information treated as a public asset belonging to no one in particular and thus available for the equal use of all. It is the latter situation that provides the baseline against which we are to measure changes in the welfare of the disadvantaged.

The egalitarian nature of this baseline situation is illustrated, in a different way, by the rule forbidding the use of physical force in exchange relationships. Suppose that *A* has greater physical strength than his neighbors. If we refuse to give *A* the right to exploit his superior strength by threatening his neighbors with harm unless they agree to do what he wishes, we once again place everyone involved (the person who possesses the advantage as well as those who do not) in a situation of equality. Here, of course, equality is achieved not by forcing *A* to share his advantage with others, but by denying everyone, including *A*, a right to make use of the advantage in question, at least in this particular way.

Paretianism justifies divergence from this situation of equality only when *A*'s weaker neighbors can be made better off if *A* is permitted to enforce agreements coerced by threats of physical force. The fact that *A* is not allowed to do so but is given the right to exploit his

superior strength in other ways—for example, by insisting upon a higher price for his labor—only shows that the principle yields different results where different forms of advantage-taking are involved. In every case, however, the principle forbids us to grant the possessor of an advantage the exclusive right to exploit it for his own benefit unless those excluded from its ownership are thereby made better off than they would be if no one were given a greater right to the advantage than anyone else. Stating the principle in this way emphasizes its strongly egalitarian character and underscores its similarity to Rawls's test⁴⁸ for assessing the fairness of inequalities in the distribution of material wealth.

F. *Possession and Ownership*

Another way of representing the egalitarian character of paretianism is to imagine that all advantageous assets, including strength, intelligence and information, belong to a common pool or fund in which no one—not even the person who possesses the advantage—has any prior claim.⁴⁹ With regard to any advantage in the common pool, three possibilities exist: 1) the person possessing the advantage may be granted a right to exploit it for his own benefit; 2) the possessor may be allowed to exploit the advantage, but only in ways that benefit others equally; or 3) he may be forbidden to exploit the advantage at all. Paretianism is then to be viewed as a principle for determining which of these three alternatives ought to be adopted in any particular case, and thus for deciding who should be assigned the rights to different kinds of advantages.

Of course, many libertarians reject this way of thinking about the assignment of rights, claiming that attributes and advantages come into the world already attached to particular individuals and not as part of some common pool or fund.⁵⁰ Libertarians claim that mere possession of an advantage gives the possessor a right to exploit his advantage in any way he wishes, so long as the rights of others are not violated in the process. On this view, the fact that an individual possesses a particular advantage is held to give him a *prima facie* right to exploit it

48. See note 14 *supra*.

49. This "common fund" notion is employed by Rawls. See J. RAWLS, *supra* note 9, at 101-02, 107, 179, 278 (no one deserves greater natural capacity nor merits more favorable starting place in society). For my views on the reasonableness and utility of treating all personal assets as if they belonged to a common fund, see Kronman, *Talent Pooling* (forthcoming in *NOMOS*).

50. See R. NOZICK, *supra* note 8, at 228-31.

for his own benefit; his right to do so, however, may be defeated or overridden by the legitimate claims of others.⁵¹

This view implies that possession itself provides a moral reason—although only a defeasible one—for assigning property rights in particular advantages to those who possess them. In my judgment, however, the fact of possession fails to provide even a limited justification for assigning property rights in one way rather than another. Suppose that *X* possesses two advantages that *Y* lacks—greater physical strength and superior intelligence. Should we allow *X* to exploit these advantages in his transactions with *Y*, in whatever way he wishes? Most libertarians would answer this question in the negative: *X* should not be allowed to exploit his physical strength by threatening *Y* with harm, and he should not be permitted to exploit his intelligence by persuading *Y* to accept a believable lie, although he may be free to take advantage of his gifts in other ways. Presumably, the reason a libertarian will give for disallowing certain forms of advantage-taking on *X*'s part is that they violate *Y*'s right not to be coerced in these ways. But which types of coercion violate *Y*'s right to non-interference? However one answers this question, the fact that *X* possesses the advantage he wants to exploit can never be an argument for defining the scope of *Y*'s right in a certain way; that proposition will always be true and therefore cannot make the position of either party stronger (or weaker) than it would otherwise be. Likewise, it can never be an argument either for limiting or expanding the scope of *Y*'s right to non-interference that *Y* himself possesses an interest that will be affected if others are allowed to take advantage of him, since this, too, is true in every case. The mere fact of possession—whether *X*'s or *Y*'s—provides no help whatsoever in deciding how *Y*'s right to non-interference should be defined, or whether *X* should be assigned an exclusive right to the advantages he possesses.

Thus, it is a mistake to think that the fact of possession has any moral significance in itself, even of the limited sort claimed by libertarians, so far as the assignment of entitlements is concerned. By viewing individual advantages as if they were part of a common fund or pool, one eliminates the fact of possession as a relevant consideration and thereby avoids this mistake. The great attraction of viewing advantages in this way is that it forces us to clarify the underlying argument that must always provide the true foundation for protecting one set of possessory interests rather than another.

51. See R. Epstein, *Possession as the Root of Title* (unpublished paper on file with *Yale Law Journal*).

G. *Advantage-taking and Differences in Wealth*

At this point, most libertarians would probably respond by claiming that I have shown the libertarian theory of contract law to be a theory of distributive justice in only a limited or perhaps even trivial respect. While conceding that the notion of voluntary exchange cannot be given meaning without specifying how rights to transactional advantages *in the exchange process itself* are to be distributed, a libertarian might argue that this can be done without attaching any importance whatsoever to the distributional *consequences* of those exchanges in which there has been no impermissible advantage-taking. So long as there has been no advantage-taking of this sort, he might argue, agreements should be enforced regardless of their impact on the distribution of wealth in society. On this view, contractual limitations of the sort mentioned at the beginning of the Article—restrictions on interest rates, minimum wage laws, and nondisclaimable warranties—would be wholly unjustified if one assumes their purpose is not to insure voluntariness in exchange transactions, but to alter the distribution of wealth that results from the free exchange of property itself. In this way, a libertarian might concede that a limited theory of distributive justice is needed to explicate the notion of voluntary exchange, yet still maintain that his view is meaningfully different from that of anyone who believes it appropriate to manipulate the private law of contracts in order to achieve a more desirable distribution of wealth in society.

This position can be interpreted in one of two different ways. First, the claim may be that differences in wealth created or maintained by contractual exchange need not be justified by invoking the same principle of distributive justice, whatever it might be, that we appeal to in justifying various forms of advantage-taking in exchange relationships. On this view, differences in wealth that result from the free exchange of property are not to be thought of as requiring any justification at all, unlike the assignment of rights to transactional advantages in the exchange process; while the latter poses a problem of distributive justice, the former does not. I shall call this interpretation of the position the strong interpretation.

A second, weaker interpretation is also possible. Someone defending the position in question can be understood as claiming either that disparities in wealth which result from the free exchange of property *are* justified, on the same basis that certain forms of transactional advantage-taking are, or that existing disparities in wealth are *not* justified but should be corrected in some other way than by manipulating the rules for private exchange. I call this second interpretation weak

because it accepts what the first interpretation questions—the claim that differences in wealth resulting from free exchange stand as much in need of justification as the exploitation of differential advantages in the exchange process itself.

In my view, the first of these two interpretations must be rejected since it rests upon an essentially arbitrary distinction between different kinds of wealth and the advantages associated with them, and fails to recognize that disparities in wealth resulting from one transaction become an advantage in the next. If we ask whether an individual should be permitted to exploit his superior information or intelligence in transactions with others, the answer—at least the answer the law gives⁵²—is “sometimes and under certain circumstances.” In order to explain why the possessor of these valuable resources should be allowed to exploit them in some ways but not others, appeal must be made to a principle of distributive justice. The same ought to be true if we ask whether someone with a substantial bank account should be allowed to take advantage of his superior wealth in transacting with other, less wealthy individuals. In the first place, if we define a person’s wealth as comprising the sum total of revenue-generating assets which the law permits him to exploit for his own benefit, his wealth will include things like information, intelligence and physical strength, as well as dollars in the bank. If we prohibit someone from exploiting potentially valuable information or skills (for example, the skill of deception) we thereby decrease his wealth just as surely as if we were to take some money from his bank account and burn it or transfer it into a common fund. Second, it is wrong to think of money—wealth in the narrow sense—as anything other than a transactional advantage, an advantage which gives its possessor a leg up in the exchange process. Money enables an individual to acquire other transactional advantages (for example, superior information), to withstand pressures that might otherwise force him to make agreements on less favorable terms, to outbid competitors, etc.; other things equal, the more money an individual has, the better he is likely to do in his transactions with other persons. In fact, money not only gives its possessor a transactional advantage: unlike intelligence or physical strength, it gives him nothing else. A sailor stranded alone on a desert island may benefit from his

52. Compare *Pratt Land & Improvement Co. v. McClain*, 135 Ala. 452, 456, 33 So. 185, 187 (1902) (“a purchaser [of real estate] though having superior judgment of values, does not commit fraud merely by purchasing without disclosing his knowledge of value”) with *Equitable Life Assurance Soc’y of United States v. McElroy*, 83 F. 631 (8th Cir. 1897) (insurance contract set aside due to nondisclosure of operation for appendicitis during period between signing of application and completion of contract).

physical and mental abilities; unless he has someone to transact with, however, the money in his pocket does him no good at all.

For these reasons, no one should be allowed to exploit his financial resources in transactions with others to any greater extent than he should be allowed to exploit his superior intelligence, strength or information. It is true that each of these represents wealth of a different kind and gives its possessor a distinct advantage in transacting with others. But it is unclear why any importance should be attached to differences of this sort. If one kind of advantage-taking—that based on superior information, for example—must be justified by showing that it is consistent with a particular conception of distributive justice, other kinds of advantage-taking, including those attributable to inequalities of a financial sort, should be justified in the same way. It is simply arbitrary to assert that some forms of advantage-taking must be justified but others need not be.

It does not follow, of course, that the rich should be forbidden to exploit their financial power in transacting with the poor. Whether and to what extent they should will depend upon the principle of distributive justice one adopts and factual details relevant to the principle's application. There is, however, no *a priori* reason for regarding a rule of contract law that is intended to reduce inequalities of wealth (in the narrow sense) as any more objectionable than rules prohibiting fraud or requiring the disclosure of certain kinds of information, which also redistribute wealth (in the broad sense) from one group of individuals to another. Although there may be a sound reason for opposing a rule of contract law whose purpose is to shift resources from the rich to the poor,⁵³ the reason cannot be that the special financial advantages enjoyed by the rich fall outside the scope of the principle of distributive justice that controls the assignment of rights to other kinds of transactional advantages. Therefore, the only sensible interpretation of the libertarian's position is the second or weak interpretation: when a libertarian asserts that contract law should not be used to redistribute wealth from the rich to the poor, he must be claiming either that existing inequalities of wealth *are* justified (for example, on utilitarian or paretianist grounds) or that contract law is an unsuitable instrument for correcting those inequalities which are unjustifiable. Stating the libertarian position in this way, however, eliminates the most fundamental difference between liberal and libertarian theories of contract law.

53. See Schwartz, *A Reexamination of Nonsubstantive Unconscionability*, 63 VA. L. REV. 1053, 1056-59 (1977).

II. Taxation and Contractual Regulation

A. *Two Methods of Redistribution*

A liberal theory of society, as I am using the term here, is one that approves forced redistributions of wealth, at least up to a point, as a means of achieving a fair division of material resources among the members of society. All theories of this sort are distinguishable from libertarianism, which regards compulsory transfers aimed at achieving distributive fairness as a kind of theft. For the purposes of this argument, a liberal theory of society may be defined as one that: 1) assumes there is some characteristic or attribute of individuals in virtue of which they may be said to deserve a share of society's wealth and purports to describe the pattern of holdings that would result if this principle of desert were the sole or at least the primary basis for the distribution of material resources; 2) treats this ideal pattern as an evaluative standard by which to assess the fairness of the distribution that actually obtains in any given society; and 3) assigns to the state the task of bringing the existing distribution of wealth into conformity with the ideal one.⁵⁴

There are, of course, many different theories that fit this general description, some of which may be regarded as illiberal by the proponents of others. Disagreements of this sort reflect the fact that two persons who both accept the legitimacy of forced redistribution may nevertheless endorse different principles of desert and therefore disagree as to which pattern of holdings would be an ideally just one. Such disagreements are often quite sharp and I do not mean to minimize their philosophical importance. In what follows, however, I shall ignore these differences and continue to use the term "liberal theory" in the broad sense defined above. There is significant agreement, among the proponents of otherwise distinguishable conceptions of distributive justice, regarding the appropriate *method* of achieving a fair division of wealth in society and it is this point of agreement that I am especially interested in challenging here.⁵⁵

It will be useful to begin by contrasting two different methods for redistributing wealth. One method is taxation. To illustrate how taxa-

54. This characterization of liberal theories follows the account of "patterned" conceptions of justice elaborated in R. Nozick, *supra* note 8, at 155-64.

55. The point of agreement is a preference for taxation as a method of redistributing wealth. This preference is shared by liberal theorists whose principles of distributive justice differ significantly in other respects. Compare *Basic Structure*, *supra* note 9, at 54-55 with J. MILL, *PRINCIPLES OF POLITICAL ECONOMY* 795-822, 966-69 (W. Ashley ed. 1923).

tion works, assume that every individual in society is given his fair share of society's resources, and then left free to transact with others on whatever terms he wishes. The initial assignment of shares will necessarily conform to a pattern of some sort, the pattern itself depending upon one's theory of distributive justice. Over time, however, the overall pattern of individual holdings is bound to diverge from the original and ideal one. As both critics and defenders of liberalism have pointed out,⁵⁶ this divergence is the unintended consequence of numerous private transactions between different individuals, all attempting to advance their self-interest in legitimate ways. However, when the resulting array of individual holdings is inconsistent with the principle of desert underlying the original distribution of wealth, it must be modified by a corrective redistribution. If taxation is adopted as a method of redistribution, those who now have more than they deserve will be required to make an appropriate payment to the state, and the funds collected in this fashion will be transferred to those whose holdings are unjustly small. In this way, the original pattern of holdings can be re-established, and distributive justice preserved.

A second method for achieving distributive justice involves a more direct regulation of the terms on which individuals are allowed to transact with one another. I shall call this method of redistribution contractual regulation. To illustrate, suppose once again that everyone is given his fair share of society's resources. This time, however, instead of leaving people free to transact as they please and imposing a periodic tax on their wealth, an attempt is made to preserve the fairness of the original distribution of resources by restricting the terms on which individuals are permitted to alter their holdings through voluntary exchange—by forbidding certain transactions and, perhaps, by requiring others. Minimum wage laws, for example, impose restrictions of this sort: such laws attempt to insure a fair distribution of wealth between workers and employers by specifying, in part, the terms on which workers may contract to sell their labor.

As between these two methods at redistribution—taxation and the direct contractual regulation of individual transactions—many liberal theorists appear to have a pronounced preference for the first. For example, both in his book and in subsequent articles, John Rawls insists on a distinction between what he terms the “basic structure” of society, on the one hand, and “rules applying directly to individuals and associations and to be followed by them in particular transactions” on

56. See e.g., R. Nozick, *supra* note 8, at 160-64; *Basic Structure*, *supra* note 9, at 64.

the other.⁵⁷ According to Rawls, the principles of distributive justice must be considered in designing the institutions that comprise the basic structure of society, including, in particular, the tax and transfer system. The function of the basic structure, on Rawls's view, is to establish and maintain a framework of entitlements that satisfies the principles of distributive justice, within which individuals remain free to pursue their own ends through voluntary transactions with others, "secure in the knowledge," as he puts it, "that elsewhere in the social system the necessary corrections to preserve background justice are being made."⁵⁸ Rawls of course recognizes that there must be rules governing private transactions between individuals, but he argues that these transactional rules should be "framed to leave individuals . . . free to act effectively in pursuit of their ends and without excessive constraints."⁵⁹ In Rawls's theory, rules of this sort are assigned only a facilitative role: their proper function is to keep the exchange process running smoothly by eliminating coercion and reducing the transaction costs associated with the process itself.⁶⁰ It is Rawls's view that rules governing private exchange between individuals, unlike the tax laws, should not be manipulated to help achieve a fair distribution of wealth among the members of society. More strongly, it seems to be Rawls's view that the law of contracts *cannot* be used in this way without illegitimately infringing the right of individuals to pursue their own conception of the good, free from excessive governmental interference. At several points, Rawls speaks of a "division of labor" between "the basic structure [of society] and the rules applying directly to particular transactions,"⁶¹ the implication being that the distinctive distributive function of one is no business of the other.

Rawls's preference for taxation as a method of preserving "background justice" and his reluctance to view the private law of contracts as an equally appropriate vehicle for redistributing wealth reflect an attitude shared by many liberal thinkers.⁶² Is it possible to justify this preference for taxation and the non-distributive conception of contract law that it entails?

One argument that is sometimes made by liberal theorists in support of a non-distributive conception of contract law may be dismissed at the outset. Suppose we have settled on a principle for evaluating the

57. *Basic Structure*, *supra* note 9, at 55.

58. *Id.*

59. *Id.*

60. *Id.* at 54-55.

61. *See, e.g., id.* at 66.

62. *See, e.g., C. FRIED, supra* note 9, at 143-50; Grey, *supra* note 9, at 890 n.38.

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fairness of different wealth distributions. The argument I have in mind states that it would be wrong to assess particular transactions and to resolve the disputes arising out of them by appealing directly to the distributional principle we have chosen.⁶³ There is no reason to think that judges or anyone else can correctly assess the distributional consequences of particular transactions; more importantly, if every transaction could be invalidated for its failure to conform to the principle in question, individual expectations would be frustrated and voluntary arrangements rendered insecure. Instead, the argument goes, transactional disputes should be decided by applying the relevant rules of law in a formalistic fashion, that is, without regard to the distributional consequences of the decision itself, and the redistribution of wealth should be left to the tax system instead.

This argument rests upon a confusion. Even if one agrees, for the reasons indicated, that in particular cases judges and others charged with responsibility for policing individual transactions should apply established legal rules regardless of their distributional consequences, it does not follow that distributional effects should also be ignored in the initial design of a system of transactional rules or in the choice of new rules to supplement or amend those that already exist. It is one thing to evaluate individual transactions from a distributive perspective; it is another to evaluate the rules governing transactions from the same point of view.⁶⁴ Naturally, if one adopts the latter approach, there may be individual cases in which the distributive purpose of a particular rule is frustrated rather than advanced by its application. But this is the inevitable consequence of having a system of adjudication based upon generally applicable norms rather than ad hoc determinations, and does not provide a reason for ignoring distributive considerations in the original choice or amendment of these transactional norms themselves. If we ought to design rules of contract law without regard to their distributive effect, it must be for some reason other than the one I have just stated.

B. *Redistribution, Neutrality and Individual Freedom*

Two further arguments, based on moral considerations, may be offered for preferring taxation to contractual regulation as a means of redistributing wealth, and it is these I now want to consider. First, it

63. See J. RAWLS, *supra* note 9, at 87-88; *Basic Structure*, *supra* note 9, at 54, 65.

64. Cf. Rawls, *Two Concepts of Rules*, 64 PHIL. REV. 3 (1955) (reasons used to justify choice of system of social rules may not properly be invoked to justify departures from those rules once the system is established).

can be argued that unlike taxation, contractual regulation discriminates between different pursuits by prohibiting some forms of exchange but not others, and is therefore inconsistent with the view, central to most liberal theories, that the state should remain neutral between the aims and activities of its citizens, so far as possible. Second, it can also be argued that taxation leaves more room for individual freedom than does a system of regulation that attempts to insure distributive justice by manipulating the rules of private exchange.

These two claims lie at the heart of the liberal preference for taxation. What do they purport to establish? On the one hand, each claim can be understood as asserting that taxation and regulation have invariant characteristics which necessarily make any tax scheme more neutral and less intrusive than a system of regulatory control designed to achieve the same end. If this were true, one would always be justified in choosing taxation as a method for redistributing wealth. On the other hand, these same two claims can be understood, in a more modest fashion, as asserting only that circumstantial factors, which vary from one situation to the next, often make taxation the better of the two methods. If one adopts the latter view, any preference for taxation will be contingent on contextual considerations which may (and I think do) sometimes warrant the pursuit of distributional goals through a regulatory scheme instead. In my judgment, it is the latter view which is the correct one: there is nothing about taxation that necessarily gives it greater neutrality or makes it less restrictive of individual liberty than contractual regulation, although in some cases a tax scheme may be preferable for both reasons.

Consider, first, the question of neutrality: is taxation, by its nature, a more neutral method of redistribution than contractual regulation? Suppose that a fair distribution of wealth could most easily be achieved by regulating or even prohibiting a particular class of transactions not thought to be objectionable in their own right—for example, those involving the sale of a few basic goods such as food and shelter. Even if it were the least costly way of reaching our distributional goal, a regulatory regime of this sort might be rejected on the ground that it unfairly discriminates against one particular group of citizens—those who would benefit, financially or otherwise, if the transactions in question were left unregulated—by imposing the full burden of the distributive scheme on them alone. More generally, in evaluating alternative methods for redistributing wealth, it is always necessary to consider how broadly the burdens of redistribution are spread: if a particular

method imposes these costs only on some of those who ought to bear them, this by itself counts against adopting the method in question.

This general consideration, however, applies to taxation and contractual regulation alike, and does not warrant a universal preference for the former method. Any workable scheme for redistributing wealth is bound to discriminate unfairly in favor of some individuals or activities. This is true even of the simplest income tax, which gives an unjustified advantage to those who have more than they deserve but are nevertheless able to accomplish their ends in ways that do not produce taxable income. A selective income tax (such as the one we actually have) that applies only to the income from certain types of transactions or a sales tax on specific items designed to finance a system of redistributive transfer payments are more obvious examples of discriminatory taxes. But just as taxes vary in their neutrality, so do contractual regulations: a law requiring bakers to sell their bread at a fixed price spreads the burdens of redistribution less widely than a law requiring all employers to pay their workers a minimum wage. Neutrality is a property that each method of redistribution may possess to varying degrees, and therefore even though we should always prefer less discriminatory arrangements to more discriminatory ones, this does not mean that we ought in every case to choose taxation as the appropriate means for redistributing wealth. In any particular instance, whether taxation is the least discriminatory way of achieving a given distributional end will depend upon the circumstances and the types of taxation and contractual regulation that are being compared. The relative neutrality of these two methods cannot be ascertained in advance since it is not a function of anything inherent in their nature.

Now consider the second moral argument for preferring taxation to contractual regulation as a method of redistribution—that taxation is less restrictive of individual liberty. To begin with, this may be understood as a claim about the frequency of intervention required by these alternative methods of redistribution. While taxation requires only a periodic interference in the lives of individuals, the direct regulation of transactions appears to necessitate continuous state involvement in individual affairs. Since it is sensible to prefer less frequent intrusions to more frequent ones, this might seem a good reason for preferring taxation as a method of redistribution.

This argument is unconvincing, however. In the first place, some taxes (sales taxes, for example) *do* apply continuously, to every individual transaction, and we do not think them objectionable for this reason alone. The argument is plausible only if we think of every

redistributive tax as being like a periodic tax on income. We are tempted to do this, of course, because the income tax (unlike most other taxes) has an explicit redistributive purpose. It would be a mistake, however, to think that non-income taxes cannot perform a similar redistributive function: a special sales tax on luxury items might be an example.

Second, even if a tax is only applied at periodic intervals, it represents a continuous interference in the lives of individuals in precisely the sense suggested above. Suppose, for example, that the state imposes a progressive income tax that must be paid annually and that treats all income in the same way, regardless of its source. Throughout the year, every income-generating transaction that an individual makes is subject to the tax in question; the tax casts a shadow, as it were, over the whole of his economic life. Just as a minimum wage law prevents workers and employers from making certain kinds of contracts, an annual income tax restricts the contractual freedom of those subject to it. The existence of such a tax makes it impossible for anyone to form a contract that does not have as one of its implied terms a requirement that both parties share their income from the contract with the state. In many transactions, this implied requirement is also likely to affect other aspects of the parties' relationship, limiting their choice of additional terms, and even dictating the very structure of the transaction.⁶⁵

All of this makes it wrong, in my view, to maintain that a periodic tax on income is a less frequently intrusive method of redistribution than the direct regulation of individual transactions. At this point, it might be objected that an income tax is in any case less *deeply* intrusive even if the restrictions it imposes apply continuously. Taxation appears to be less intrusive because it only takes money from people, leaving them free to arrange their affairs in the way that best realizes other, non-pecuniary ends. Regulation, by contrast, limits the sorts of transactions individuals may arrange for themselves and thus seems more restrictive of personal liberty.⁶⁶ Thus, one might argue, while regulation forbids people from doing certain sorts of things, a tax scheme merely requires those subject to the tax to share with the state the fruits of their voluntary transactions with other individuals.

This apparent difference in the restrictiveness of these two methods

65. For example, tax considerations are paramount in the planning of corporate mergers, liquidations, and reorganizations.

66. Rawls implicitly endorses this view of regulation. See *Basic Structure*, *supra* note 9, at 65.

of redistribution is illusory, however. In the first place, it is misleading to say that contractual regulation forbids people from doing things but a tax scheme does not. A tax on income, for example, forbids people to keep what they have earned in income-producing transactions without making an appropriate payment to the state. If an individual finds this prohibition too restrictive, he can always shift his resources, including his time and personal labor, to activities which do not produce income, or which produce income and other goods—such as leisure—in differing proportions. By the same token, if the law requires that a certain class of agreements be made on terms specified by the state, individuals making such agreements remain free to abandon them in favor of other, unregulated transactions. In either case, of course, those subject to the tax or regulatory limitation may remain free to avoid it only in a theoretical sense: in an exchange economy, most of us must earn income in order to survive, and an employer who wants to avoid the impact of a law fixing the minimum compensation he must pay his workers can do so only by going out of business. In my view, however, this underscores the similarity—not the difference—of taxation and contractual regulation as methods of redistribution, and casts doubt on the claim that one is more restrictive of individual liberty than the other.

The essential similarity of taxation and regulation is reflected in another way as well. To the extent that it leaves individuals free in other respects, a redistributive tax on income is unlikely to produce the ideal pattern of holdings it is meant to achieve. If individuals are able to shift the burden of the tax to others by arranging their transactions with them in a particular way, and if they are free to substitute non-taxable forms of wealth such as leisure for taxable income, the redistributive goals of the tax may be frustrated, perhaps to a significant degree. If so, to achieve a closer fit with the distributive ideal, it will be necessary to supplement the tax with a set of rules which regulate the content of individual transactions in greater detail. To achieve a perfect fit, it may be necessary to expand the notion of taxable income to include leisure itself, and once this has been done little difference remains between mere taxation and a restrictive system of contractual regulation. It is perfectly acceptable, of course, to stop short of this point and opt for an income tax which leaves individual transactions largely unregulated, but only if one is prepared to live with whatever discrepancies exist between the resulting pattern of holdings and the ideal one.

The same is true, of course, if one chooses to pursue a given distributive goal by simply altering the terms on which individuals can voluntarily exchange their property. Any incomplete regulation of a contractual relationship, that is, any regulation which stops short of imposing a compulsory contract on the parties, is unlikely to achieve its redistributive purpose. So long as the parties to a contract remain free to modify their arrangement in ways not already subject to governmental control, the distributive consequences of regulating one aspect of the contract can be partially frustrated or undone by altering its other features. To illustrate the point, suppose that poor people are frequently victimized by exorbitant interest rates (rates in excess of those justified by the special risks of transacting with the poor). To prevent exploitation of this sort, a law is passed forbidding merchants to charge interest greater than some fixed amount. The first effect of such a law may well be to diminish the supply of credit to the poor, or to particular groups among the poor, thus making them worse rather than better off. Even if the supply of credit is unchanged, merchants may respond to the law by changing the terms on which they sell goods to the poor—for example, by increasing price, eliminating warranties or requiring additional security—and thereby prevent any change in the *status quo*. If the regulation of interest rates is to have its intended effect, these other aspects of the contractual relationship may also have to be controlled by the state. In this way, partial regulation of the contractual relationship creates its own pressure to expand the scope of regulation, bringing the entire transaction more fully under the control of the state.

Consequently, whether one adopts taxation or contractual regulation as a method of redistribution, the incomplete control of individual conduct, control which leaves individuals free in other respects, is certain to result in some divergence from the distribution of resources that would be ideally just. In either case, any closer approximation to a perfectly fair distribution of wealth will require more extensive limitations on individual conduct and hence less freedom. Whichever method we choose, if we value individual liberty, we are bound to reach a point at which further restrictions on conduct cannot be justified by the additional increment of distributive fairness that they yield. Every theory of society that includes a desert-based principle of distributive justice must face the unpleasant fact that to some extent liberty and fairness inevitably conflict and must attempt to resolve the conflict between them in a non-arbitrary manner.

This conflict does not, however, provide a reason for abandoning

liberalism altogether since it is not a crushing objection to a theory of society that it values two different things which conflict even across a wide range of cases. More importantly, the inevitable conflict between liberty and fairness does not justify a blanket preference for taxation as a method of redistribution. A preference of this sort would be warranted only if a greater degree of distributive justice could always be achieved at a lesser cost in liberty by taxing the fruits of free exchange than by regulating the exchange process itself. The claim that taxation has this universal advantage is an *empirical* claim and can only be verified by a detailed, case-by-case comparison of these two methods in different settings. In my view, an inquiry of this sort is more likely to support the competing claim that contractual regulation is sometimes a less—or at least a no less—restrictive way of achieving particular distributional goals. Usury laws, minimum wage laws, rent control laws, and laws prohibiting racial discrimination in employment and the sale of real property all have, as one of their objectives, a redistribution of wealth in favor of traditionally disadvantaged groups. Each of these laws attempts to achieve its goal by imposing restrictions on the process of voluntary exchange. In each case, the same end could be achieved through an appropriate combination of taxes and subsidies. However, putting aside any question of the relative efficiency of these different methods of redistribution, it seems to me unreasonable to think that in every instance the restrictions on individual liberty required to achieve a given level of distributive fairness through the tax system will be less severe than the restrictions associated with its regulatory counterpart. If we hold the distributional goal constant in each case, and ignore all considerations of efficiency and administrative cost, a blanket preference for taxation, based upon the belief that it always leaves more room for individual freedom, is almost certainly unjustified.

C. *Efficiency and Administrative Cost*

Of course, it might be the case that taxation is invariably a more efficient and administratively simpler way of redistributing wealth, and should therefore be preferred to contractual regulation on this ground alone. This claim may be understood in two different ways. First, someone making the claim may be asserting that contractual regulation, unlike taxation, is almost always counterproductive in the sense that it leaves its intended beneficiaries worse off than they would otherwise be. This is an argument frequently made, for example, with

regard to minimum wage and rent control laws.⁶⁷ If a landlord can only charge his tenants some statutorily-fixed amount, the argument goes, he will have an incentive to reduce maintenance and take his property out of the rental market altogether, to the disadvantage of renters or at least poor renters. This may be true but it does not show the alleged superiority of taxation as a method of redistribution. If we impose a tax on rental income and do not restrict the terms on which landlords are allowed to rent, rents will rise accordingly, again to the disadvantage of the poor.⁶⁸

Naturally, it is irrational to adopt any redistributive scheme if it leaves its intended beneficiaries worse off than they would otherwise be. This is a general requirement, however, that applies to redistributive arrangements of all sorts. In my view, it does not support a blanket preference for taxation. Even if contractual regulation often hurts those it is meant to help, there is no reason to think that taxation is not frequently counterproductive as well. This question is an empirical one which must be resolved on a case-by-case basis, in the light of detailed information about the circumstances likely to influence the effectiveness of each method of redistribution.

The claim that taxation is more efficient than contractual regulation can also be understood as a claim about their comparative administrative costs. Even if taxation is on the whole equally restrictive of individual freedom, and has equally undesirable incentive effects, one can argue that tax schemes are by their nature easier to administer and therefore less costly than regulatory arrangements designed to achieve the same end. But this argument, too, is unconvincing. Suppose, for example, that a particular racial group has in the past been discriminated against in both the housing and employment markets, as a result of which the group currently has an undeservedly small share of society's wealth. One way of improving the group's material circumstances is to impose restrictions on the exchange process in both markets by

67. See, e.g., R. HEILBRONER, *THE ECONOMIC PROBLEM* 521 (3d ed. 1972) (minimum wage laws); R. POSNER, *supra* note 45, at 356-59 (housing codes imposing minimum standards of habitability on slum dwellings); Komesar, *Return to Slumville: A Critique of the Ackerman Analysis of Housing Code Enforcement and the Poor*, 82 *YALE L.J.* 1175, 1186-93 (1973) (same); Stigler, *Director's Law of Public Income Redistribution*, 13 *J. L. & ECON.* 1, 2-3 (1970) (minimum wage laws).

68. Of course, if some other group is taxed in order to generate the funds with which to subsidize low-income tenants, the behavior of landlords may be relatively unaffected. By the same token, however, it may be possible to improve the welfare of low-income renters by imposing contractual restrictions other than rent control, for example, a minimum wage law. But either of these alternative arrangements may itself have undesirable incentive effects that work to the disadvantage of poor people generally and hence to the disadvantage of poor renters.

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forbidding employers and those who sell or rent real property to discriminate on the basis of race. Alternatively, one might attempt to accomplish the same end without contractual regulation of any sort, through an appropriate set of taxes and subsidies. For example, employers who hire members of the group might be rewarded by a reduction in their taxes, and group members might themselves be given whatever additional funds they need to overcome the prejudice of landlords and sellers and bid scarce housing resources away from non-members.⁶⁹ In this case, however, reliance on the tax system as a means of redistributing wealth is likely to entail much higher costs of administration than its regulatory counterpart. It is plausible to think that at least up to a point, the group's material prospects can most easily be improved by imposing a few simple restrictions on the contractual rights of those whose past discrimination has created the present inequity.

More generally, contractual regulation always has at least *one* advantage over taxation from an administrative point of view. Under a redistributive tax scheme, wealth must first be collected by the state and then redistributed to the beneficiaries of the tax. Each of these two steps has administrative costs. By contrast, if a redistributive restriction on contractual freedom achieves its intended purpose, it causes a direct transfer of wealth from one group to another without any mediation by the state. Other things being equal, this means a reduction in administrative costs.

Of course, other things are *not* always equal. There are additional administrative costs associated with any redistributive scheme, including, in particular, the cost of enforcing it, and these costs will sometimes be sufficiently high under a regulatory arrangement to offset whatever administrative advantage such an arrangement might have.⁷⁰ It is unlikely that this will always be the case, however. Is there reason to think, for example, that a minimum wage law will be more expensive to enforce than a tax on income (designed to benefit the working poor) which relies on self-reporting by individuals subject to the tax? In either case, some of those burdened by the redistributive scheme will

69. For a discussion of individuals' "taste for discrimination," see G. BECKER, *THE ECONOMICS OF DISCRIMINATION* 16-17 (2d ed. 1971).

70. These include not only the direct costs of organizing, staffing, and maintaining a regulatory agency, but also the drain on the economy that results from the forced diversion of private sector resources away from their best economic uses. See, e.g., POSNER, *Taxation By Regulation*, 2 BELL J. ECON. & MANAGEMENT SCI. 22 (1971) (regulation should be considered branch of public finance); DeMuth, *supra* note 9, at 10-17 (discussing and criticizing proposal that federal agencies should be forced to estimate costs of policies before implementing them).

attempt to circumvent it by concealing the details of their transactions with others, and in both cases, preventive measures must be adopted which make concealment of this sort more difficult. There is, however, no *a priori* basis for believing that one scheme will be more costly to police than the other, at least if the provisions contained in both schemes are equally simple or complex. Considerations of administrative cost may justify efforts to simplify any redistributive method one adopts, but they do not warrant a blanket preference for taxation. Here, too, circumstantial factors will be decisive—dictating in some cases the choice of a tax system, in others the imposition of restrictions on exchange, and in many a mix of the two. Like predictions regarding incentive effects, considerations of administrative cost almost certainly favor the use of different redistributive methods in different situations.

Conclusion

If one believes it is morally acceptable for the state to forcibly redistribute wealth from one group to another, the only question that remains is how the redistribution should be accomplished. I have described two methods of redistributing wealth, taxation and the regulatory control of private transactions, and have argued that the choice between them ought to be made on the basis of contextual considerations that are likely to vary from one situation to the next.

Both methods may be more or less neutral in effect and both are costly to administer. Each necessarily imposes limitations on individual liberty and, on occasion, has incentive effects that make its adoption irrational. These are considerations we must always keep in view in choosing between the two methods, but they do not invariably dictate the same choice: instead, they are likely to suggest that sometimes one method, sometimes the other, most often, perhaps, a mix of the two, is the best way of achieving whatever distributional goal we have set for ourselves. I have attempted to show (admittedly, in a casual way) that a blanket preference for taxation is unwarranted, and that contractual regulation will on occasion be the least intrusive and most efficient way of redistributing wealth to those who have a legitimate claim to a larger share of society's resources. If I am right in thinking this is so, distributive considerations should be permitted to influence our choice of contract rules, as circumstances dictate, and should not be flatly excluded from the domain of private exchange for what are alleged to be principled reasons.

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I would like to conclude by returning briefly to the problem of liberty and fairness. I have argued that distributive fairness can only be achieved, by taxation or contractual regulation, at some sacrifice in individual liberty. This claim reflects what I believe is the core of truth in Nozick's assertion⁷¹ that the implementation of any patterned conception of justice is bound to require interference in people's lives. As I have suggested, however, the conflict between these values is not itself a reason for abandoning liberalism and embracing libertarianism, nor is it a reason for endorsing a non-distributive conception of contract law. But the conflict does present any liberal theory with a central and difficult challenge—the challenge of elaborating a reasoned basis for reconciling the claims of liberty and fairness, without abandoning either. The measure of success achieved by a liberal theory of society will depend, in large part, upon the extent to which it is able to avoid arbitrariness at just this point.

71. R. Nozick, *supra* note 8, at 163.

The Yale Law Journal

Volume 89, Number 3, January 1980

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Student Contributors to This Issue

Robert A. Katzmann, *Judicial Intervention and Organization Theory: Changing Bureaucratic Behavior and Policy*

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