

Economic Regulation and Social Regulation

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Abstract

“Health, safety, morals, and the general welfare” are the traditional subjects of the police power of the state. When we think of government regulation we usually think of economic regulation. This is generally efficient only for a narrow range of activities and is subject to abuse by private parties who can profit from it. Social regulation is another area of government regulation, however, and one where the presumptive efficiency of laissez faire disappears, because market imperfections are more common and capture by special interests is less profitable. This does not immediately imply that the government should engage in social engineering, because our current knowledge of social processes is primitive. It does imply that courts should be reluctant to strike down social regulation on the grounds that it is irrational. This is an article-length version of a book I am currently writing.

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I. INTRODUCTION

“What you say is very fine indeed, Cephalus,” I said. “But as to this very thing, justice, shall we so simply assert that it is the truth and giving back what a man has taken from another, or is to do these very things sometimes just and sometimes unjust? Take this case as an example of what I mean: everyone would surely say that if a man takes weapons from a friend when the latter is of sound mind, and the friend demands them back when he is mad, one shouldn’t give back such things, and the man who gave them back would not be just, and moreover, one should not be willing to tell someone in this state the whole truth.”

“What you say is right,” he said.

“Then this isn’t the definition of justice, speaking the truth and giving back what one takes.”²

Maintaining contracts and property rights— “speaking the truth and giving back what one takes”— is clearly an important function of government. It is appealing to modern Americans, as well as to ancient Greeks, that people should be free to do what they want with their property, so long as they respect other people’s property rights. There exists, at the same time, a strong feeling that the economy would work better if the government intervened in it to control the prices people charged when selling their property, or the kinds of property they are allowed to sell, but this feeling diminished sharply from the 1930’s to the 1990s. After experiencing deregulation of industries such as air travel, trucking, and telephone sales, both the educated and the uneducated public have come to realize that such regulation hurt consumers and helped only airlines, truckers, and telephone companies. The virtues of *laissez faire* have come to be part of the conventional wisdom not just for America, but worldwide, even though numerous economic regulations still exist, and new ones are created as old ones are killed.

Not all life is monetized, even in America, and governments traditionally have regulated social as well as economic behavior. The picture here is more mixed. In some areas, deregulation has been vigorous— state laws supporting segregation have been eliminated wherever possible, for example, and while restrictions on drug use, sexual behavior, and gambling, are often maintained as written laws, the probability of prosecution has diminished sharply. The government does, on the other hand, seek to promote social change by such things as laws favoring racial integration, restrictions on hate speech, and hindrances on smoking tobacco.

In both the economic and social spheres, deregulation has existed simultaneously with a certain amount of new regulation, but the trend seems to have been towards a lower level of regulation overall. The general picture is one of increased tolerance, with libertarianism on the rise in both the economic and social spheres. Its success has been paralleled by the success of the law-and-economics movement, many of whose adherents have a strong tendency towards libertarianism. The economic approach to law has been applied in great detail to economic regulation and deregulation, to the point where an acquaintance with economics is indispensable to anyone trying to do serious policy research in the area. It has been much less applied to social regulation, although by 1992 it seems clear that in comparison with other developed countries, the social problems of the United States are much more severe than the economic problems.

Is this simply because economics has nothing to say about nonmonetary problems? No. The two driving ideas of economics are that of the rational maximizing individual, who chooses actions

² Plato, *The Republic*, translated by Allan Bloom, Basic Books, (1968) at 331c.

depending on costs and benefits; and that of the competitive marketplace, which generates predictable collective consequences from the independent actions of many individuals. These ideas have been applied to many topics traditionally allocated to other disciplines such as political science, law, sociology, and biology.³ The economic approach seems to explain behavior in a variety of cultural and historical settings, and even the behavior of animals in laboratory experiments.⁴ Social interactions call for somewhat different tools of analysis than economic interactions, even starting from the base of maximization and markets, but the rise of game theory and information economics in the 1980's has vastly expanded the number of tools at our disposal, and we can expect continued progress.

In the traditional interactions studied by economics, individually rational behavior tends towards collectively optimal consequences. Smith's famed Invisible Hand guides property to be traded until no one can benefit from future voluntary trades. At that point, almost by definition, no intervention can make any one person better off without making someone else worse off. Economists therefore favor the libertarian view that government regulation is unnecessary and pernicious if society is to reach results that are optimal given the constraints of resources and technology. People are often surprised by economists' policy conclusions, because economists they thought were liberal turn out to oppose the minimum wage and rent control, and economists they thought were conservative turn out to favor legalization of marijuana and homosexuality. The explanation is that in each case, the economist supports legalization of voluntary interactions between consenting adults, which makes both parties to the transaction better off.

Government plays a role in recognizing and protecting property rights, but it decentralizes authority by allocating those property rights to individuals. A property right is effectively the right to take some action. If the horse, Dobbins, is allocated to *A*, *A* is allowed to take a number of actions with respect to Dobbins— to ride him, drown him, eat him, or sell him— but *B* cannot do any of those things without *A*'s permission. In the economic world of perfect competition, every action is under the control of someone; there are no actions which a person cannot undertake if he is willing to pay someone else enough to do so. In addition, the action is an *alienable* property right; *A* can either ride Dobbins himself or sell that right to *B*. A government regulation or a social custom that forbade the riding of Dobbins by anyone, or made the right inalienable by allowing only *A* to ride him would reduce welfare, because nobody would get the benefit of the ride, or the benefit would go to *A* rather than to someone else that valued it more.

Economists are like Cephalus in *The Republic*: they view the role of government as to define and protect property rights and to make people keep their promises. But Socrates dismisses Cephalus and the economist's definition of justice, only seven pages into the three hundred and three pages of *The Republic*. He does not scoff; this is the first definition of justice, and Cephalus is the paradigmatic solid citizen, the pillar of society. Yet something is missing. This article will try to determine whether given the assumptions of the economic approach the government does serve any purpose other than to set property rights and settle contract disputes.

³Gary Becker is the best known imperialist, e.g., Gary Becker(1974), "A Theory of Social Interactions," *Journal of Political Economy*, 82: 1063-1093 (November/December 1974); Gary Becker(1981), *A Treatise on the Family*, Harvard University Press, 1981. He has been joined by many other scholars using "rational choice" analysis in: Law, Richard Posner(1998) *Economic Analysis of Law*, 802 pp., 5th edition (1st edition, 1972), Aspen Law and Business, 1998; Sociology, James Coleman, *Foundations of Social Theory* (1990); Political science, Peter Ordeshook, *Game Theory and Political Theory: An Introduction* (1986); Biology, John Maynard-Smith(1982) *Evolution and the Theory of Games*, 224 pp., Cambridge University Press, 1982.

⁴Raymond Battalio, John Kagel, Howard Rachlin & Leonard Green (1981) "Commodity-Choice Behavior with Pigeons as Subjects," *Journal of Political Economy*, 89:67-91 (February 1981).

To these two functions, economists, and, I expect, Cephalus, would add the provision of public goods such as national defense. Since the provision of public goods is independent of regulation, in the sense that it imposes no constraints on individual behavior beyond requiring that someone pay taxes, I will not discuss it further, except to briefly distinguish taxation from regulation. Taxation is the use of government force to acquire funds with which to buy things. Regulation is the use of government force to change people's behavior. In both cases, government force is used, but the purposes differ. A pollution "tax" is really regulation, since its primary purpose is to change behavior and only incidentally does it raise revenue. A requirement that private employers provide health insurance is a tax since the end there is to buy things for people that the government could pay for itself. This distinction has even been recognized in law, as the celebrated *Nollan* case illustrates (*Nollan v. California Coastal Com.*, 483 U.S. 825 (1987)). The State of California would not let Mr. Nollan build a house unless he built a public path. The U.S. Supreme Court ruled that this was not regulation, since the path did not solve any problem created by building the house, but simply a tax, and a tax specific to the individual. This made California's requirement a taking without compensation. Since such takings are forbidden in the U.S. Constitution, California was required to allow Nollan to build or else compensate him for not building. In this paper, we will be concerned with regulation, not taxation.

I will argue that while the method of economics is useful for analyzing human interactions beyond the traditional economic markets, the default policy recommendation of laissez faire becomes dubious if one goes too far afield. The old recommendation does not match local circumstances in the newer provinces of economics' empire. The analyst can still usefully assume that the individual acts rationally, but he cannot deduce that this leads to efficiency in the absence of government regulation and social custom. The positive predictions of economics will still be valid, but not the usual normative conclusions. A presumption of the optimality of laissez faire is not a bad thing for economic regulation, but for social regulation a better presumption is that the status quo should be left untouched.⁵

This conclusion is important to the law because it implies that judges should not invalidate statutes merely because they do not make sense on purely economic grounds. Judges who pronounce on the "reasonableness" or "rational basis" of statutes and private covenants are too self-confident, and they should be more deferential to the status quo of customary law and practice. The burden should be on those opposing the rules to show that they have a bad purpose, not on those who support them to show that they have a good purpose.

The argument will not be based on making tradeoffs between standard economic goals and other values, as in discussions that trade off efficiency and equality. Here, efficiency— in the economist's sense— will be the only goal, so the conclusions will be based on the utilitarian premises standard in economics, not on religious or liberal premises. This requires some preliminary discussion to clarify society's objectives. The objective, value maximization, will be to maximize utility by making the appropriate tradeoffs. This is different from trying to reconcile absolute rules that conflict with each other or from trying to discover the will of God. My hope is that by starting from the generally accepted premise that it is better to make people happier, the analyst can come to useful conclusions about how the government should restrict behavior. If it turns out that the resulting government

⁵The reader may be annoyed that I have not defined what is social and what is economic. That is because, to use Edmund Burke's words, "A definition may be very exact, and yet go but a very little way towards informing us of the nature of the thing defined; but let the virtue of a definition be what it will, in the order of things, it seems rather to follow than to precede our inquiry, of which it ought to be considered as the result." Edmund Burke, *On the Sublime and the Beautiful*, p. 13. It is hard to define the boundary between the economic and the social, economics and sociology, but in everyday language we seem to see a difference. The economic sphere involves what is private to the individual or an organization that produces goods for sale; the social sphere is what is left.

regulation offends an ethical or religious principle of the analyst, the analysis is nonetheless useful, in showing that the principle cannot be imposed without reducing human happiness.

Even in a utilitarian framework, the individuals under analysis may have religious and ideological beliefs, and these will affect policy under value maximization. If some people believe that God forbids people to work on Sunday or others believe that Kant forbids people to ban pornography, the feelings of those people must be taken into account. The analysis will neither ignore such beliefs nor take them as final: rather, they are data on utility to be fed into the utilitarian calculus. If enough people are enough upset by Sunday work or pornography bans, those things will be restricted.⁶ In evaluating both economic and social regulation, the objective will be to examine taboos as means to increasing human happiness rather than as ends in themselves; the Sabbath will be for man, not man for the Sabbath.⁷

The thrust of this article will be that *laissez faire* is the presumptive best policy in the economic sphere, with, of course, many exceptions and special cases, but tradition is the presumptive best policy in the social sphere. This is a modernized version of the argument of the English jurist James Fitzjames Stephen.⁸ In *Liberty, Equality, Fraternity*, Stephen admires John Stuart Mill's *Principles of Political Economy*, with its careful explanations of the workings of the Invisible Hand in economic markets, but he attacks Mill's *On Liberty* as a confused muddling of utilitarian principles. Mill, Stephen says, is willing to create human unhappiness merely for the sake of abstract ideals (liberty, equality, and fraternity) that benefit no one and lack a rational basis.⁹ This was a dispute between two Liberals, each claiming to start from the same premises of maximization of human happiness as the goal of society. This article will start from the same premises, with the difference that it will update the discussion using twentieth century advances in economic theory, and links it to contemporary American law.

Sections II, III, and IV will be concerned with making policy, which usually means the writing of statutes by the legislature. Section II shows why *laissez faire* is good economic policy, and then sets out the usual special cases where economic regulation is helpful. Those readers familiar with economics may wish to skip it. Section III, the heart of the paper, discusses *laissez faire* and regulation in the social context. Even if markets fail, governments fail too, and Section IV looks at government failure in the context of social regulation. The argument in these three sections will be that: (i) *laissez faire* works well in economic interactions, with certain exceptions, and regulation is

⁶ In law and economics, this approach is best known from the work of Richard Posner. See Michael McConnell & Richard Posner (1989) "An Economic Approach to the Issues of Religious Freedom," *University of Chicago Law Review*, 56: 1-xxx, Posner, Richard (1992) *Sex and Reason*, 458 pp., Harvard University Press, 1992. I will not be addressing the concerns of those who object to "universal commodification" of relationships or "incommensurability" of values. See Joseph Cropsey (1955) "What is Welfare Economics," *Ethics*, 65: 116-125 (xxx 1955). Reprinted in *Political Philosophy and the Issues of Politics*, University of Chicago Press, 1977; or, for an overview, Matthew Adler, "Law and Incommensurability: Introduction," *University of Pennsylvania Law Review*, 146: 1169- xxx (xxx 1998). The utilitarian framework leaves considerable room for analysis and is less liable to the criticism of assuming its conclusions than many other approaches, as is evidenced by the differences between Posner's conclusions and my own.

⁷The intellectual ancestor of this approach is David Hume: "But there is this material difference between *superstition* and *justice*, that the former is frivolous, useless, and burdensome; the latter is absolutely requisite to the well-being of mankind and existence of society.... Were the interests of society nowise concerned, it is as unintelligible why another's articulating certain sounds, implying consent, should change the nature of my actions with respect to a particular object, as why the reciting of a liturgy by a priest, in a certain habit and posture, should dedicate a heap of brick and timber and render it thenceforth and forever sacred." David Hume (1751) *An Inquiry Concerning the Principles of Morals*, p. 29, Bobbs- Merrill Co. Inc. 1957.

⁸ James Stephen, *A History of the Criminal Law of England* (1883)

⁹ James Stephen, *Liberty, Equality, Fraternity*, 2nd edition (1874), page numbers from Chicago University Press edition, Richard Posner, ed.(1992).

apt to be misused by the government, (ii) in social interactions, the exceptions dominate, the case for laissez faire is much less compelling, and (iii) government officials face less temptation to use social regulation contrary to the public good, but since it is difficult to predict the effects of social innovation, the best strategy is to maintain the status quo. Section V is concerned with judicial intervention. Courts in the United States have often intervened to strike down formal regulation on the grounds that it lacks a rational basis or informal regulation on the grounds that it is irrationally discriminatory. This article will argue for a more modest role of the courts, to preserve tradition or to give the benefit of the doubt to legislative and social experimentation.

II. ECONOMIC REGULATION

Economics takes as given the tastes of individuals, their information, and the actions available to them, and then predicts how they will behave. Economics can also predict whether the interactions of these individual actions leads to desirable results, if “desirable” is carefully defined. As tastes, information, and the available actions change, the actions chosen will also change predictably. In the simplest paradigm, a person with given wealth faces given prices for two goods, X and Y, and must decide how much of each to buy. If the price of X rises, the person will ordinarily decide to buy less of X.¹⁰ If Smith is deciding how much whisky to buy, for example, his decision depends on his wealth, the price of whisky, the price of gin, the quality of whisky available, and his concern for his health. If Smith’s wealth declines, or the price of whisky rises, the usual prediction is that he will consume less whisky. The essence of the theory is that people make tradeoffs, and that they do what they think is best for themselves. They do not buy whisky randomly, or from instinct, or to satisfy arbitrary social customs: their choices are affected by price and quality. That is not to say that social custom, chance events, and biology do not affect the decision. People with differing tastes buy different amounts, even when incomes and prices are identical, and these tastes have biological and social origins. But income and price will also have an influence, and an influence that can be predicted.

If (a) property rights are well-defined, (b) all parties are well- informed, and (c) a competitive market exists, then the Invisible Hand leads individual’s decisions to produce socially optimal results. Thus, if *A* can produce whisky at a cost of \$5, and *B* values the bottle at \$8, we would expect trade to take place, at some price between \$5 and \$8. If *C* values whisky at \$6, but *A* can only produce one bottle, then *B* will still ultimately end up with the whisky, but at a price of at least \$6. This is efficient, because the whisky ends up, at whatever price, in the possession of *B*, who values it most. We will go through several numerical examples of this kind, and the numbers are summarized in Table 1.

Table 1: EXAMPLE OF THE GAINS FROM TRADE

<i>A</i> ’s production cost for whisky	\$5
<i>B</i> ’s valuation of whisky	\$8
<i>C</i> ’s valuation of whisky	\$6
<i>D</i> ’s cost from whisky littering	\$20
<i>E</i> ’s production cost for whisky	\$5

¹⁰. There are well- known exceptions under which a consumer buys more after a price rise: if the good is a large part of his budget (the Giffen good effect) or if price signals quality, for example. See Leibenstein, “Bandwagon, Snob and Veblen Effects in the Theory of Consumers’ Demand,” *Quarterly Journal of Economics* 64: 183-207 (1950).

The Invisible Hand relies on government to some extent, because it helps that property rights be well defined. If B has produced the whisky, but no government protects his ownership of it, A and B may come to blows rather than making a peaceful trade, and blows benefit nobody. Or, if A is clearly the weaker party, he will refrain from producing whisky, because he knows B would just steal it from him. Once property rights are defined, however, the whisky will end up with whoever values it most. Regulation will not increase efficiency. One might think that a regulation requiring that whisky be sold at a price not greater than \$2 would help the buyer, B , but this is not true. The regulation would reduce efficiency, utility, and the dollar value of output, because A would choose not to produce whisky, even though he would like to have \$8, and B would like to have the whisky.

The same sort of analysis can be carried out for other kinds of regulation. Banning the whisky trade altogether destroys the gains from trade; A does not spend the \$5 in production costs which will produce benefits of \$8 for B . Imposing a minimum price of \$9 has the same effect as banning trade, because B will refuse to buy at that price. Government regulation cannot increase efficiency.¹¹

II.A. Market Failure and Economic Regulation

There are a number of separate justifications for economic regulation, which will be considered one at a time.

II.A.1. Externalities

If someone takes action X which has an impact on someone else, but neither party can compel an exchange of money, then it is said that X has a negative or positive *externality*, depending on whether the impact is bad or good. Suppose that in the example of Table 1, B , after buying whisky from A for \$5 and drinking it, will throw the bottle onto the sidewalk in front of C 's house, where it will shatter and cost C \$20 to clean up. Unless B values the whisky at least at \$25 (which is the \$5 production cost to producer A plus the \$20 clean-up cost to C), it is inefficient for B to acquire the whisky. Government regulation banning whisky is therefore appropriate. Or, more cautiously, a \$20 whisky tax might be imposed.¹²

The shattered whisky bottle is an example of a *real externality*: a spillover in which one person's action affects the utility of someone else without any payment being made, and affects the utility directly rather than just through the action's impact on prices.¹³

¹¹Not everyone agrees that laissez faire is the best default policy even for economic regulation; Ian Ayres believes that both Posner and Rasmusen go too far in this respect; Ian Ayres, "Playing Games with the Law," *Stanford Law Review*, 42: 1291 (1990). I think it fair to say that most economists would fall back on laissez faire as a recommended policy if they are not told that a market has any unusual features. xxx To back up this footnote, find the surveys in that AER article of a few years back.

¹²The tax is safer, because if B in fact valued whisky consumption at \$30, his consumption is efficient even taking into account C 's costs, and the tax would just result in an increased price, not in an end to B 's consumption.

¹³If the spillover results from the prices, it is called a *pecuniary externality*. If, for example, A has been regularly selling whisky at \$8/bottle to B , making a profit of \$3 per bottle, and then E begins selling at a price of \$7/bottle, D has inflicted a negative pecuniary externality of \$3/bottle on A . This is only a pecuniary externality, however, because it arises through prices, not through changes in the amount of goods that are ultimately consumed. A has indeed lost \$3, but D has gained \$2 (if his production cost is the same as A 's, \$5) and B has gained \$1 from the price drop, so there is no net gain or loss. Pecuniary externalities have been used as a justification for regulation, but not because they reduce economic efficiency. In a well-functioning marketplace, pecuniary externalities are inevitable and desirable. But see Justice Brandeis's position in the text at note ?? *infra* for an example. On pecuniary externalities, see R. Tresch (1981) *Public Finance: A Normative Theory* p. 91; J. Viner, "Cost Curves and Supply Curves," 3 *Zeitschrift fur national-ökonomie* (1932), (reprinted in American Economic Association, *Readings in Price*

Pollution controls are an example of regulation based on externalities. When a tire factory manufactures tires, the fumes created in the process reduce the utility of its neighbors. As a result, the government commonly forbids factories to emit more than a certain amount of pollution.¹⁴

II.A.2. Monopoly

Ordinarily an exchange benefits both parties, resulting in both producer and consumer surplus. In the whisky example, if the price is \$6, the producer surplus is \$1, for *A*, and the consumer surplus is \$2, for *B*. If one side of the transaction has a monopoly, it can capture more of the surplus, but usually at the expense of diminishing the total surplus. Monopoly welfare losses arise from these inefficient attempts to capture surplus. The loss may arise either from the attempt to become a monopoly (as in the expense of lobbying the government for a monopoly), from the attempt to exploit the monopoly (as in the administrative costs of price discrimination or the familiar triangle losses discussed next).

Thus if *A* can produce whisky at \$5 per bottle and must charge a single price to all buyers, when *B* values whisky at \$8 and *E* at \$6, *A* would choose to sell the whisky at \$8 per bottle instead of \$6, even though this cuts off *E* as a customer. The high price maximizes *A*'s producer surplus, but it diminishes consumer surplus even more, because *E*, who would have bought at a price of \$6, will not buy at \$8. *A*'s monopoly has exactly the same defect as a government price floor; an attempt by either government or monopolist to manipulate the market reduces welfare by constricting trade.¹⁵

The most important kinds of regulation justified by monopoly are public utility regulation and anti-trust laws. The technology of electricity distribution is such that it is best that one firm provide the service, but important to prevent it from doing so at such a high price the people are discouraged from using electricity. In other industries, competition would naturally arise, but anti-trust policy is useful for preventing the competitors from making agreements not to compete.¹⁶

II.A.3. Imperfect Information

Theory, (1952) (the origin, so far as I know, of the term "pecuniary externality"); Allyn Young, "Pigou's Wealth and Welfare," *Quarterly Journal of Economics*, 27:672-686 (August 1913). English law early recognized that pecuniary externalities are not a social evil and do not create a cause of action. (The opening of a new private school reduces the tuition that an old school is able to charge, but that does not justify compensation, from a medieval case cited in *Keeble v. Hickeringill*, 103 Eng. Rep. 1127 (Queen's Bench, 1707).)

¹⁴ The perceptive reader will note that the externality justification for government regulation can be reduced to the justification of setting property rights. The Coase Theorem tells us that what matters most is that either the factory or the neighbors own the right to clean air, and that this right be alienable. Ronald Coase, "The Problem of Social Cost," *Journal of Law and Economics*, 3: 1 (1960). If the factory owns it, it will sell the right to the neighbors; if the neighbors own it, they will keep it. The difficulty is that bargaining costs and information imperfections make it difficult to carry out trades in pollution rights.

¹⁵ This efficiency justification is different from a distributional justification for monopoly regulation. From the point of view of efficiency, the social loss is not the wealth transfer from *B* to *A*; it is that *E*'s surplus is lost to everyone.

¹⁶ A quite different monopoly-based reason for regulation is to *create* monopoly profits. When producers compete with each other, they inflict negative pecuniary externalities on each other by reducing profits. What producers lose, and more, consumers gain, which is why monopoly is ordinarily thought to be bad. But if the government does not care about consumers, as might be the case if the producers were domestic and the consumers foreign, it might want to create monopolies. Thus, it makes sense for the Japanese government to encourage its automakers to organize voluntary export restraints, because that raises the prices of Japanese cars in the United States and increases Japanese profits at the expense of U.S. consumers.

Perfect competition assumes that everyone in the economy is well-informed about the value to everyone else of the goods being exchanged. Otherwise, inefficiencies result as the parties try to take advantage of their private information. The monopoly inefficiencies just described are one example; the inefficiency arises only because A cannot charge \$6 to E and \$8 to B , which might be because A does not know which consumer is the one willing to pay \$8 and both consumers have incentive to pretend that their valuation is \$6. Information about quality also matters. Government regulation of advertising and fraud are justified by information problems. If A claims he is selling whisky, and he is actually selling colored water, trade breaks down, because B refuses to buy the dubious product. This is limited to some extent by reputation, but reputations are costly to acquire.¹⁷ It is especially difficult to start a new business if reputation is the only basis for consumer trust. In the absence of government regulation of fraudulent new products, innovation is stifled. Or, it may be that the consumer does not know what he wants, exactly, and would like to delegate this task to the government. Thus, the government requires technical safety features on cars which it thinks almost all consumers would desire. The wide variety of problems arise from imperfect information have been the subject of a vast literature since 1975, including much of my own work.¹⁸ Most of these problems arise from the difficulty of enforcing contracts: the payer cannot costlessly force the performer to perform, whether that performance consists of product quality, work effort, or provision of human talent. Many of these problems cannot be remedied by government regulation, but some of them can, especially by regulations encouraging the truthful provision of useful information.¹⁹

II.A.4. Coordination Problems

When expectations matter, there may exist a number of stable configurations of behavior, each with its own set of expectations, and some of these equilibria may lead to better results than others. Such multiple equilibria have been studied chiefly in macroeconomics.²⁰ In the whisky example, A will not expend the \$5 to produce the whisky unless he expects B to buy it. But B will not waste time visiting A unless he thinks A has whisky to sell. In one equilibrium, the whisky is produced and traded; in a second equilibrium, with lower surplus, B stays home and no whisky is produced. This has been suggested as a cause of business cycles; nobody in the general economy will produce goods unless they expect other people to produce goods for which to exchange them. One equilibrium has low production and welfare; another has high production and welfare. Government jawboning might shift the economy from one equilibrium to the other.²¹ In another example, nobody wants to be the last depositor to withdraw their money in a bank run. In one equilibrium, nobody expects a bank run, so nobody bothers to withdraw their money. In a second equilibrium, everybody expects a bank run, so one occurs, and the banks fail. Government deposit insurance is intended to eliminate the bad equilibrium—although we have seen from the savings- and-loan mess that it introduces its

¹⁷ See Benjamin Klein & Keith Leffler (1981) “The Role of Market Forces in Assuring Contractual Performance,” *Journal of Political Economy*, 89: 615-41 (August 1981).

¹⁸ See Eric Rasmusen *Games and Information: An Introduction to Game Theory*, 3rd edition, (1st edition, 1989), Blackwell Publishers, Oxford (2001), <http://Php.indiana.edu/~erasmuse/GI/index.html> for references.

¹⁹This kind of regulation is strewn with potential pitfalls for regulation, however. If, for example, regulation requires extensive disclosure of unimportant information, as is perhaps the case with credit agreements, the resulting information overload can actually leave the consumer more confused and apt to buy from disreputable sellers than if the sellers had been allowed to disclose only useful information.

²⁰xxx A different kind of multiple equilibria is the possibility that more than one set of prices might equate supply and demand across the general equilibrium of the economy. This does not create any inefficiency. Also, microeconomists frequently find multiple equilibria in models of incomplete information such as signalling models, but it is then difficult to know whether to attribute the market failure to information or coordination problems. See Chapter 10 of Rasmusen (2001), and the references cited there.

²¹See, for example, Peter Diamond(1982) “Aggregate Demand Management in Search Equilibrium,” *Journal of Political Economy*, 90: 881-894 (October 1982).

own problems.²² In each of the two examples, the government helps by changing expectations. This may justify government macroeconomic intervention, and some forms of regulation such as banking law, but it ordinarily does not apply to what we think of as regulation.²³

In most economic transactions, market failure does not arise. Welfare losses are limited because of the monetary character of economic transactions, because where there is imperfection, there is profit. The making of the profit will ameliorate the imperfection, though at some real cost. It may not matter, for example, whether consumers can themselves test the quality of car bumpers, because either the competing sellers will themselves try to demonstrate quality, to obtain competitive advantage, or businesses such as the many car magazines one can buy at supermarkets will enter to provide information to consumers, at a small price. Similarly, the losses from externalities are limited by bargaining costs. The problems create costs, but these costs are limited by the cost of technological solutions.

II.B. Government Failure and Economic Regulation

Even when market failure is a problem, it does not follow that regulation is the proper response, because one must also consider government failure, which arises from the unwillingness or inability of the government to regulate efficiently. When the government exerts force to restrict behavior, it also redistributes wealth. This gives private parties an incentive to expend resources to induce the government to shift the wealth to them, an activity known as “rent-seeking.”²⁴ *Journal of Political Economy*, 83:807-27 (1975). Other parties, who want to prevent the redistribution, will also expend resources. The expenditure might be for bribing and counter-bribing government officials, or it might be for political campaigns. In either case, since wealth is just redistributed, not created, and people use resources to effect the redistribution, society’s total wealth diminishes.

Even if the government is motivated by the public interest rather than the pressures of rent-seekers, it is not necessarily intelligently motivated. Since the costs and benefits of government actions flow to third parties rather than the government decisionmakers, there is little incentive for the decisionmakers to expend effort to make good decisions. And to the extent that those who are hurt or helped have the ability to influence the government decisionmakers, the rentseeking problem is exacerbated. The government falls between the Scylla of interested rentseeking and the Charybdis of disinterested incompetence.²⁵

Thus, economic regulation is severely limited in its optimality for two reasons: the Invisible Hand leads most markets to optimality, and even in the rare cases when government regulation

²²Douglas Diamond & Philip Dybvig (1983) “Bank Runs, Deposit Insurance, and Liquidity,” *Journal of Political Economy*, 91: 401-419 (June 1983).

²³A somewhat different multiple- equilibrium problem is created by “network externalities”: the externality that if two companies produce a product according to the same standard, sales of both can increase because of the interchangeability. Thus, government may be helpful in setting a standard railway gauge or a standard technology for high- definition television. On standards, see Michael Katz & Carl Shapiro (1985) “Network Externalities, Competition, and Compatibility,” *American Economic Review*, 75: 424-40 (June 1985); Charles Kindleberger (1983) “Standards as Public, Collective and Private Goods,” *Kyklos* 36: 377-396 (xxx 1983).

²⁴ See Gordon Tullock, “The Welfare Costs of Tariffs, Monopolies, and Theft,” *Western Economic Journal*, 5:224-32 (1967); George Stigler “The Economic Theory of Regulation,” *Bell Journal of Economics*, 2 (1971); Richard Posner, “Taxation by Regulation,” 2 *Bell Journal of Economics*, 22-50 (1971); Richard Posner, “The Social Costs of Monopoly and Regulation,

²⁵On the pros and cons of reliance on interested providers of information, see Eric Rasmusen, “Lobbying When the Decisionmaker Can Acquire Independent Information,” *Public Choice*, 77: 899-913 (1993).

could help, the helpful regulation may not be what the government implements. We must now see whether this is as true for social regulation.

III. SOCIAL REGULATION

The rational-actor model is useful for studying social as well as economic interactions. Consider a typical social decision: how many children a woman decides to bear. She faces a variety of constraints, including her physical ability, the cost of raising children, and the preferences of her husband. She does not face explicit prices, but she does face implicit prices for children, and one can predict that if, for example, the cost of college tuition were higher, or her husband liked children less, she would bear fewer children. She will take the costs and benefits of the decision into account, behaving rationally in the economist's sense rather than behaving randomly or as an automatic result of social custom. She will have more children if the benefits are greater and the costs are less. Just an increase in the price of televisions reduces the number a person acquires, so with an increase in the price of children.

The difference between children and televisions is in not in whether behavior takes into account costs and benefits, but the market structure. The market for televisions is competitive, and explicitly priced. Children, on the other hand, are usually produced at home rather than in a market, and the constraints on their production are highly individualized. This makes a difference in the implications of economic analysis for government policy. The traditional motivations for economic regulation—externalities, monopoly, imperfect information, multiple equilibria, and paternalism—might still apply, but for social goods we might expect other problems to arise also.

Social interactions differ from economic interactions precisely in that in social interactions monetary exchange has failed to be useful, even if a market of sorts exists. The United States presently has what might be called a marriage market, in which those wishing to marry inspect potential spouses and seek to make the best match possible, but prices are not posted. This is not because it is illegal to pay a potential spouse; rather, it must not be a useful way to organize the transaction in the modern United States. In other cases, markets may exist but society tries to suppress transactions involving money. The sale by A of sexual services to B would seem to be a purely economic transaction, but people tend to view prostitution as a social problem rather than an economic problem. The difficulty is not perceived to be that the prostitute is overpaid or underpaid, but that sexual services should not be sold for money at all. We must ask why people think markets are bad in these circumstances, even though the parties involved both seem to benefit from the transaction.

We must also ask why laws exist regulating behavior when this seems unjustified by the simplest economic approach of asking whether the behavior has a physical impact on other people. If efficiency is the goal, can any argument be made for the following kinds of laws?

1. (Drugs) Making heroin illegal.
2. (Sex) Making pornography illegal.
3. (Disgust) Forbidding me to sell human livers for food.
4. (Race) Forbidding me to deny employment to blacks at my law firm.

5. (Hate crimes) Increasing the penalty for assault if it was motivated by dislike of Hispanics.
6. (Zoning) Forbidding me to use my residential property for a law office.
7. (Aesthetic controls) Forbidding me to put up a billboard on my property next to the highway.
8. (Crime) Heavier penalties for rape and robbery than for assault and larceny.
9. (Abortion) Making partial-birth abortion illegal.
10. (Animals) Forbidding the torture of cats.
11. (Education) Requiring that all children, whether in public or private schools, be taught U.S. history.
12. (Desecration) Forbidding the burning of U.S. flags.
13. (Children) Forbidding children to drink beer in taverns.
14. (Inalienability) Forbidding me to sell myself into slavery.
15. (Sympathy) Forbidding parents to kill their children.

The task of the next few sections is to try to show how social interactions differ from economic interactions. Because of the great variety of interactions of each type, the best one can hope for is to say that economic interactions have a tendency to certain kinds of problems and social interactions a tendency to different kinds of problems, but this is exactly what is needed if one wishes to generalize concerning whether social regulation is more likely to be justified than economic regulation. The libertarian economist's claim is that social regulation is no more justified than economic regulation; the claim here will be that it is more often justified, because (a) the standard market failures discussed in Section II are more likely to occur, (b) other kinds of market failure also occur, and (c) government failure is not such a problem (discussed in Section IV).

III.A. Social Regulation and Standard Market Failure

In social interactions, trades occur, but the use of money is either impractical, illegal, or illegitimate. As with economic interactions, the argument can be made that any voluntary exchange results in greater welfare. If A wants to sell his corpse to B , for example, then at first glance it seems that both parties must benefit, since both agree to the transaction. Consequently, the state should not interfere, nor should it lend any support to social norms that seek to block the trade, and one might even go so far as to ask the state to discourage such social norms. As with economic interactions, however, we must investigate the possibility of market failure. First, let us go through the same types of market failure that appeared in economic interactions in Section II: externalities, monopoly, imperfect information, and coordination problems.

Externalities are more of a problem in nonmonetary interactions. If A drinks large amounts of whisky, he is more likely to wish to engage in violence against B , who happens to be sitting in the same bar. This does not mean that A should necessarily stop drinking whisky altogether, since he derives pleasure from it himself, but he should drink less than if B were not also affected. This

externality does not argue against solitary drinking, but it does argue for restricting drinking in social situations.²⁶

Information is likely to be even more imperfect in social than economic interactions, because social goods are not mass-marketed, and the economies of scale from information provision are lost. A magazine can profitably print an article on “What men want from marriage,” but John Smith cannot afford to advertise his own particular desires in a form that attracts wide attention or whose accuracy can be guaranteed by his reputation in future marriages. Also, since the goods differ so much, any general claims are hard to prove true or false; even the truthfulness of the magazine article is harder to guarantee than the truthfulness of an article claiming that Ford bumpers stand up well to crashes, because what people consider spousal quality differs so much from person to person.

A number of other information problems are particularly severe in social relationships. One-time big decisions are important. Such decisions most justify government intervention, because systematic consumer errors are most likely there. A woman intends to buy toothpaste many times, and because of the experience she acquires she cannot be persistently fooled, but she only intends to get married once, and her inexperienced mistake is very expensive. This might explain why a woman is not allowed to give up the widow’s dower in agreeing to marriage.²⁷ Moreover, while information about economic decisions has been getting steadily better over the years as communication improves and markets expand to make information investments profitable, social information has become worse. We have left the small town where everyone knew everything about everyone else, but we have not reached the computer age where everyone can look up everything about everyone else.²⁸

The recent advances in the economic theory of information have shown how to model a number of problems that seem particularly applicable to social interactions. One example is *signalling*: the situation in which *A* undertakes some costly action solely to convey information about himself to *B* which is hard to verify otherwise.²⁹ A person’s reluctance to enter into a prenuptial agreement might be due to signalling. Such an agreement might be highly desirable, except that it would signal the attitude of whichever party proposed it—thus the saying that the longer the pre-nuptial agreement, the shorter the marriage. If all marriage required long standardized agreements, it would not follow that all marriage would be short. Rather, the desire to have a long agreement signals something about the particular marriage; the agreement would not signal anything if it were forced upon everyone. Proposing special terms in a marriage contract ordinarily signals venality, and thus non-venal people refrain from such proposals.³⁰ Similarly, Cass Sunstein suggests that

²⁶Implementation is a different issue. One way is to tax whisky. A second is to impose penalties for fighting in bars. A third is to allow bartenders to refuse service to people they think likely to start fights. All of these are used in practice.

²⁷The same argument might seem to apply in rare and important economic decisions such as buying a house. Homebuyers, however, have sources of protection that those entering into marriage do not. In economic settings with big decisions and bad information, information arises spontaneously, since it is profitable to sell it to the ignorant consumer. This is to some extent true of marriage as well, but, as discussed in the previous paragraph, it may be harder to mass-market advice. In addition, the person getting married, unlike the home-buyer, may not have the money to pay an expert for help, whereas enough money is at stake in buying a house that the mortgage lender, if no one else, will give advice. Finally, in marriage, even more than in homebuying, emotion is likely to cloud judgement.

²⁸xxx Lawrence Friedman on bigamy. Maybe cite Posner on privacy as a luxury good and suggest that we need replacements for privacy.

²⁹On the signalling literature, see Rasmusen (2001), Chapter 10.

³⁰A government requirement, or even a default agreement that the parties must explicitly override, could raise welfare. This is proposed in Jeffrey Stake, “Mandatory Planning for Divorce,” *Vanderbilt Law Review* 45: 397-454 (March 1992); and in Eric Rasmusen & Jeffrey Stake, “Lifting the Veil of Ignorance: Personalizing the Marriage Contract.” *Indiana Law Journal*, 73: 454-502 (Spring 1998) .

people might not wear seatbelts because they want to show how brave they are, but they would favor a government law requiring them to wear seatbelts.³¹ Alternatively, some people do not like to feel restrained, and other people do not mind it.

Because of imperfect information, private social institutions can be quite important— and important even to economic productivity. Max Weber observed that the churches were essential to business in the rapidly developing parts of the United States. “Admission to the congregation is recognized as an absolute guarantee of the moral qualities of a gentleman, especially of those qualities required in business matters... When a sect member moved to a different place, or if he was a travelling salesman, he carried the certificate of his congregation with him; and thereby he found not only easy contact with sect members, but, above all, he found credit everywhere.”³² Governments usually have higher costs than private organizations, so this suggests that often private social regulation will suffice, but it also suggests that the government should not discourage such organizations, and should in fact encourage them— as it does encourage churches by exempting them from taxation.

Continuing to the next source of market failure, multiple equilibria are a real possibility in social interactions, because convention is so important. It is unimportant whether people salute, shake hands or kiss when they meet, but it seems to matter that one convention or the other be established. The purpose may be to acknowledge that the two greeters are peers and can use further conventions in the assurance of being understood. Multiple equilibria similar to those in the boom/recession and banking models discussed in Section II may also exist. It might be, for example, that if more people are alcoholic, it makes more sense for any one person to become an alcoholic, because fewer people engage in sports, and that two equilibria would exist: one in which most people drink heavily, and one in which most people engage in sports, and that the equilibria can be ranked in their welfare levels.³³ ³⁴

Network externalities are also important. Much of the pleasure of conversation builds on the common knowledge of the conversors, for example. If more people watched basketball, I would be more likely to watch it, because to the pleasures of the spectator would be added those of the disputant. Similarly, if we all had classical training, I could tell my limerick about Marcus Aurelius and discuss whether Achilles is more admirable than Odysseus. Regulations encouraging cultural uniformity help encourage acquisition of any culture at all. It is an unusual feature of coordination games, however, that government intervention can increase welfare even if it just takes the form of “jawboning, ” without any penalties or rewards. Immigrants want to know whether the society uses kisses or handshakes in its greetings, and a simple statement by the government, without penal sanction, would be enough to avoid embarrassment and ensure uniformity.³⁵

Monopoly is the one area where failure might be thought less likely in social than in economic regulation. We typically think of monopoly as a problem with a *market*; there must be a priced good

³¹Cass Sunstein, “Legal Interference with Private Preferences,” *University of Chicago Law Review*, 53:1129, 1145 (1986) .

³² Max Weber, from *Max Weber: Essays in Sociology*, 305, H. Gerth and C. Wright Mills, trans. (1958) . What would Weber have thought about laws forbidding credit discrimination on the basis of religion?

³³“An individual getting regularly drunk on gin may be a private matter. Millions of workers and parents’ regularly getting drunk on gin is a social disaster— and was a reason for British licensing laws.” George Will, *supra* note 95 p. 84.

³⁴xxx Discuss opium in China too, and cite to JS Mill. See, too, Eric Rasmusen (1996) “Stigma and Self-Fulfilling Expectations of Criminality,” *Journal of Law and Economics*, 39: 519-544 (October 1996).

³⁵xxx Add a paragraph on how the Coase Theorem fails a lot because bargaining is difficult—strangers hurt me, or info makes bargaining costly as in marriage.

sold, for monopoly of the good to be possible. There are indeed frequently bilateral monopolies in social relations, however, especially in family relationships such as that between mother and son. One cannot shop around for the best mother in the market.³⁶ The problems in economic monopoly, however, arise chiefly because of the arms-length transactions between the monopolist and his customer. The monopolist does not know exactly how much a given customer values the good, and the efficiency loss arises from his mistakes. In the longterm relationship between mother and son, both are stuck with each other, and they know each other well, so even if relations are bad, they are less likely to be inefficient. Also, the two parties have ample threats against each other because of their numerous interactions, unless the point is reached where the relationship is about to be severed completely. Determining the threat point of the allocation of property and duties in case the relationship crumbles is the most important role of law.³⁷

Thus, except perhaps for monopoly, the same failures of the Invisible Hand that justify economic regulation justify social regulation. Furthermore, one would expect market failure to occur more frequently in social than in economic interactions. Which is perhaps why social interactions so often lack formal markets.

III.B. Special Reasons for Market Failure in Social Markets

In addition to the increased importance of the standard reasons for market failure, a number of other difficulties arise in social interactions, and I will spend more time on these, since they are less well-known. The most interesting are perhaps those that I will call “mental externalities,” a particular class of real externalities. Failures of economic rationality provide another reason for government intervention. Paternalism has been generally accepted as a reason for regulation of children by parents and government, but failures of judgement and self-control also are a reason for social regulation of adults. Finally, economics generally takes tastes as given, but certain tastes are useful to society and should be encouraged. These include the general taste for altruism—taking pleasure in the pleasure of other people—and a number of more specific tastes covered by the name “duties.”

III.B.1. Mental Externalities: Ideological, Sympathetic, Altruistic, and Aesthetic

A special type of real externality is what I will call the *mental externality*, a particular type of real externality. In general, a real externality arises when *A*'s action hurts *B*'s utility in some way other than via a change in prices or an agreement between them. I will call such an externality a mental externality if it arises without any physical link between *A* and *B*. If *A*'s air pollution hurts *B*'s lungs, or even if it offends his eyes, it will not be a mental externality; if its very existence offends him, it will. Mental externalities will be subdivided, in turn, into *ideological externalities*, *sympathetic externalities*, *altruistic externalities*, and *aesthetic externalities*.³⁸

³⁶Recall the Confucian advice that if a man tips over in a boat with his wife and his mother, he should rescue his mother first—she's the only mother he has, and he can always get another wife (xxxx Analects?).

³⁷xxx See Mnookin & Kornhauser (1979) “Bargaining in the Shadow of the Law: The Case of Divorce,” *Yale Law Journal*, 88: 950 (1979).

³⁸The possibility of mental externalities is well known in the law-and-economics literature, though they have not been discussed in depth. See Guido Calabresi & D. Melamed, “Property Rules, Liability Rules and Inalienability: One View of the Cathedral,” *Harvard Law Review* 85: 1089-1128 (1972), at xxx (where such externalities are called *moralisms*), and Kennedy “Cost-Benefit Analysis of Entitlement Problems: A Critique,” *Stanford Law Review*, 44: 87-445, 400 (1981), which notes their expansive possibilities for justifying regulation.

The first three mental externalities are based on A 's *actions*: they occur when knowledge of the action of A increases or decreases B 's utility, even if there is no direct impact of B 's action on A 's senses.³⁹ This may be because B does not like the idea of such actions taking place in his society (an “ideological externality”) or because B imagines the emotions of A , of himself taking A 's action, or of some third party directly affected by A 's action (a “sympathetic externality”). Something that is distinctive about all of these mental externalities is that if the action is taken, but B believes it was not, the action has no externality. What B doesn't know, doesn't hurt him.⁴⁰ These externalities may be either positive or negative. If A engages in sodomy and that bothers B , the externality is negative. If A gives money to charity and that pleases B , the externality is positive. The link in either case may be either sympathetic, ideological, or altruistic.⁴¹

An interesting feature of these externalities is that they tend to diminish with distance. Whether A disapproves of B 's drinking because A thinks drinking is (a) sinful, (b) disgusting, or (c) unhealthful, it seems a psychological rule that A cares less the further away in time and place is B . A will be very concerned if B lives in the same room, less concerned if he lives in Somalia. This gives some reason for why it may be efficient for customs to differ across times and places.⁴²

The fourth type of mental externality, the aesthetic externality, is a bit different. The first three types of externalities are emotions induced by the actions or feelings of other people. Aesthetic externalities are emotions induced by things other than people— especially, by the regulations themselves. If A passes a law banning Islam in North Dakota, that may offend B even if there are no Moslems in North Dakota and never would be even without the law.

III.B.1.a. Mental Externalities: Ideological

Let us start with a statute motivated by ideological externalities: the Texas statute struck down in the 1989 flagburning case, *Texas v. Johnson*, 491 U.S. 397 (1989):

- “§ 42.09. Desecration of Venerated Object
 (a) A person commits an offense if he intentionally or knowingly desecrates:
 (1) a public monument;
 (2) a place of worship or burial; or

³⁹As noted in footnote 14, the problem of externalities can be reduced to that of establishing property rights. One way of saying that A is forbidden to engage in sodomy in B 's presence is to say that the property right of “ A engaging in sodomy in B 's presence” has been allocated to B . Formally, regulations make this right inalienable, but in practice if A buys the right from B , B is likely not to complain to the authorities.

⁴⁰Gordon Tullock has said that “If, however, none of the people who are offended by the existence of the brothel discovers that it exists, it generates no negative externality. Nevertheless, our laws do not prohibit brothels whose existence is known to puritans, they prohibit all brothels.” Gordon Tullock (1970) *Private Wants, Public Means*, p. 150. He is wrong on the facts, for the law, in action, does permit inobtrusive brothels. People do not want evils brought to their attention, but they may not mind having them around in a suppressed form. Recall also a point Hans Linde has made: “Contrary to the instrumentalist canon, the ineffectiveness of a law to achieve its goal may be itself a policy, a policy shared by the act's opponents and some of its supporters, and may be the price for permitting the law to reach enactment.” Linde, *supra* note ?? at 233.

⁴¹How disapproval of an activity affects the optimal policy is not always clear; a number of subtleties arise. Suppose A is displeased when B gets drunk, and pleased when B resists getting drunk when all that is stopping him is his own better feelings. If the pleasure of seeing B resist temptation on his own is greater than the displeasure of seeing him succumb, and he succumbs half the time, then there should not be a law constraining drunkenness.

⁴²This phenomenon has been noted in the context of public aid for the poor. People seem much more willing to help the nearby poor than those who are far away. See Pauly (1973) “Income Distribution as a Local Public Good,” *Journal of Public Economics*, 2:35.

- (3) a state or national flag.
- (b) For purposes of this section, 'desecrate' means deface, damage, or otherwise physically mistreat in a way that the actor knows will seriously offend one or more persons likely to observe or discover his action.
- (c) An offense under this section is a Class A misdemeanor." (Tex.Penal Code Ann. (1989))

This statute is entirely driven by mental externalities. On its face, it seems that one may legally burn an American flag, if nobody cares, but one may not burn down one's own church, if that would seriously offend even someone who was not a member. The harm prohibited is the unhappiness of observers over the offensive behavior, not its effects on patriotism or morality. Whether this statute is justified on efficiency grounds therefore becomes a question of whether such desecration tends on average to increase the happiness of the desecrator more than it decreases the unhappiness of other citizens. The citizens in general are given a property right in desecration; the desecrator must obtain a release from them before he can engage in desecration.

Because of ideological externalities, observing someone else burn flags is a consumption good, but an unusual one in that everyone must consume the same good, even though tastes differ. It is, to use technical terms, "nonexcludable," and since it is also nonrivalrous, it is a "public good." There is an inevitable conflict, because some people like to burn flags, but other people derive disutility from it, yet these people must share a society, despite the efforts of federalism to carve out niches.⁴³ Whether the Texas statute is justified depends on the balance of those whose utility is increased and those whose utility declines. It raises interesting questions of federalism as to whether Texas should be allowed to have such a statute if those who gain from it live in Texas and those who lose by it live in other states who might be able to outvote Texas in Congress or the Supreme Court.

Ideological externalities abound. A more homely example is the issue of zoning restrictions on funeral parlors.⁴⁴ Funeral parlors have been held to be a nuisance in a residential area, even in the absence of a zoning ordinance:

"When constantly forced upon the attention of neighbors and the passers-by of the community, it is not unreasonable to conclude that these have a depressing influence on normal people and tend to make them uncomfortable, as well as to render near-by residences less desirable."⁴⁵

This is reasonable from the point of view of efficiency. For one reason or another, mortuaries depress most people, reducing property values near them. This depression is no more rational or irrational than a taste for clean air instead of pollution. Given that it exists, it is reasonable to restrict the placement of mortuaries, despite the fact that their only offense is their very existence near other people's homes.

A common ideological externality is the feelings of indignation at unfairness. This feeling is often desirable, but it can have highly pernicious consequences. An architect friend of mine says

⁴³xxx See Tiebout at note 71. Further complicating the picture is the aesthetic externality that some people derive utility from flagburning being permitted, and others from it being banned, regardless of whether anybody actually engages in it.

⁴⁴See "Note: Funeral Homes," *Syracuse Law Review*, 20: 45 (1968).

⁴⁵Bond v. Cooke, 237 App. Div. 229, 262 N.Y.S. 199 (3d Dep't 1932).

that it seems unfair to him that teenage boys pay much higher rates than girls for car insurance. His unhappiness is a genuine externality arising from the transaction between the insurers and the teenagers. But, as is typical with ideological externalities, there are two ways to eliminate the externality. The first is to impose regulations equalizing car insurance rates. The second one is education to change the ideology, so that even if rates differ, third-parties do not feel indignation, a method which might be called “consciousness-lowering.” Which method is optimal depends on which is cheaper— or, perhaps, the efficiency losses from equalizing the rates would outweigh the ideological externality anyway, and the status quo is fine. In the case of my friend, a short explanation of how equalized rates would result in even greater cross-subsidization of bad drivers by good drivers eased his mental distress. Since I actually enjoyed explaining the workings of insurance to my friend, there was no real cost to changing his ideology in this particular example. If half of the population felt similarly aggrieved about discriminatory rates, however, and if the cost of explaining the situation to them was high, it might be more efficient to simply regulate the market and reduce their unhappiness, even though this reduction comes at a high cost in terms of distortion in the insurance market. Whichever route is taken, anti-market ideologies like this one are pernicious: they either cause disutility directly, or they require markets to be regulated, which is inefficient in the standard economic sense.

The dominant force in insurance regulation is probably special interests, rather than ideological externalities, but one subject where ideology is highly important to the formation of government policy is the death penalty. I venture to guess that most opponents of the death penalty oppose it on the ideological grounds that it is wrong for the government to kill someone outside of war, and most supporters wish either to deter crime or to punish it, but do not care so much about the symbolic value of having a death penalty.⁴⁶ If this is true, then if crime is low, only the opponents of the death penalty will care very much about the issue, and the death penalty will be banned, but if crime is high, both sides will care, and it is not clear whether the death penalty should or will be banned. This corresponds to the current situations in Western Europe and the United States, respectively.^{47 4849}

Although from the economic point of view ideological externalities are hard to distinguish from other real externalities, modern Americans do have a feeling they are different. John Stuart Mill

⁴⁶ A poll asked people who supported the death penalty whether they would still support it if it were found not to affect the murder rate. 73 percent said yes. The same poll asked opponents whether they would still oppose it if they found that it really did lower the murder rate. Only 71 percent said yes. Thus, about the same numbers on each side think that deterrence is the issue. U.S. Department of Justice Statistics, *Sourcebook of Criminal Justice Statistics*, 1988, p. 228. But another poll found that 76 percent of supporters favored the death penalty mainly to “Protect society” or “Deter others.” (ibid at 230). Most likely, supporters think the death penalty good for a variety of reasons, but the simple principle that society should have a death penalty is not one of them.

⁴⁷xxx There is a subtle difference from the aesthetic externality at work here. Opponents of the death penalty oppose a rule, not an action, but it is not for aesthetic reasons. Think about this.

⁴⁸In the U.S. in 1988, 71 percent supported the death penalty, and 18 percent opposed. This was quite broad support; each of 32 subcategories of people polled had more people favor the death penalty than oppose it, the weakest support being the 46-44 among Black/other. I suppose the typical judge or law professor is male (77-18), white (76-18), college-educated (71- 23), professional/business (72-21), earns over \$15, 000 (74-20), is 50- years or older (70-22), Northeastern (66-26), Protestant (72-22), and a Democrat (62-32). See *Sourcebook, supra* note 46 at 227. As an indication of the uniformity of view, note that the percentage of people opposing the death penalty is identical to the percentage supporting a return of Prohibition (18 percent, ibid at 274, 1987 poll).

⁴⁹Alan Schwartz has noted a similar effect in the context of procedural unconscionability in contracts. If rich people are upset when poor people sign cheap contracts without warranties, then a law requiring warranties will increase the price in the contract, to the benefit of the rich people and the detriment of the poor, despite the rhetoric to the contrary. Alan Schwartz, “A Reexamination of Nonsubstantive Unconscionability,” *Virginia Law Review*, 63:1053, 1061 (1977).

was ahead of his time.⁵⁰ He expresses his feelings eloquently in *On Liberty*:

[T]he only purpose for which power can rightfully be exercised over any member of a civilised community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant. He cannot rightfully be compelled to do or forbear because it will be better for him to do so, because it will make him happier, because, in the opinions of others, to do so would be wise, or even right.⁵¹

Unfortunately, this is indeed feeling, or perhaps rhetoric, and says very little when analyzed for content. As Richard Epstein notes, it is like the nuisance maxim, “*non sic utere tuo ut alienum laedes*” (do not use your things to harm another person), because it begs the question of what is harm.⁵² These various examples show that efficiency and personal freedom may conflict, but the conflict is even deeper than it might seem. Amartya Sen has pointed out that a libertarian view of personal freedom, in which mental externalities are ignored, conflicts with the almost universally accepted criterion of Pareto optimality, the idea that any law which raises the utility of all members of society is good.⁵³ I am sure that some readers object to the utilitarian viewpoint of this paper, and it might be worth showing that my conclusions are somewhat robust even to the broader approach, which seems completely innocuous, that the government should undertake any policy that benefits everyone. Sen’s example involves two people, Prude and Lewd, and two actions for each person, reading or not reading a dirty book. Prude’s ranking of outcomes is that (a) it is best for neither party to read the book, (b) next best for just Prude to read it (to avoid the bad influence on the already- susceptible Lewd), (c) next best for just Lewd to read it, and (d) worst for both of them to read it. Lewd’s ranking of outcomes is that (a) it is best for all both people to read the book, (b) next best for just Prude to read it (Lewd being rather a jokester), (c) next best for just Lewd to read it, and (d) worst for neither person to read it. The laissez faire outcome, preferred by the libertarian, is that both people make their own choices, in which case Prude will not read the book but Lewd will. But both Prude and Lewd would prefer an outcome in which the government forces them to act against their will, forcing Prude to read the book and preventing Lewd from reading it. Thus, human happiness can require restriction of personal liberties even when our criterion for social welfare is the strong one of Pareto optimality— and *a fortiori* when we impose the more reasonable and weaker criterion of utility maximization.⁵⁴

It may be objected as a practical matter that ideological externalities should not enter into policy decisions because they are hard to measure. To the contrary, the premise and the conclusion in that sentence are unrelated; merely because an element in a cost- benefit analysis is imprecise does not mean it should be left out.⁵⁵ Many things of value are hard to measure, because they

⁵⁰I do not intend this as a compliment.

⁵¹John Stuart Mill, *On Liberty*, 95 (1859).

⁵²Richard Epstein, “The Utilitarian Foundations of Natural Law,” *Harvard Journal of Law and Public Policy*, 12: 713, 741 (1989).

⁵³Amartya Sen, “The Impossibility of a Paretian Liberal,” *Journal of Political Economy* 78: 152-57 (1970).

⁵⁴One might object and say that the laissez faire outcome would simply be for Prude and Lewd to make an agreement to switch their reading habits— an example of the Coase Theorem at work eliminating externalities. That is a good criticism of the example, and will be valid if Prude and Lewd are roommates, but the example is, of course, a simplification of a situation with a thousand Lewds and a thousand Prudes, who cannot easily bargain with each other or compel each other to keep to their promises. The government may be viewed as a grand go- between, establishing the results that private contracting would obtain were it costless.

⁵⁵Suppose, for example, that for ten dollars a sign could be posted next to a drinking fountain to say: OUT OF ORDER, POISON, and that this would save an expected two human lives per year. The value of a human life can only be imprecisely measured, but to leave it out of the calculations would be absurd.

depend on personal taste, but the law does not ignore them. Consider contract disputes over quality. If A is promised Chateau-Lafitte, and B delivers him Algerian red, should A really have a cause of action? One might say that red wine was indeed delivered, and it is A 's problem if he thinks it tastes worse than Chateau-Lafitte, and one might even accuse him of a racist view of African wines. A judge with a wooden palate might say that A has no cause of action.⁵⁶ Or, a judge who himself could taste the difference might say that there is nonetheless minimal damage; he will not penalize B for subjective tastes, even though he himself and most citizens happen to share them.⁵⁷

One might object that in the case of wine, a market exists. Indeed, the law does not try to measure A 's damage by measuring the strength of his exquisite taste, and only awards damages based on what other people are willing to pay for wine. This merely reinforces the point that it is the tastes of society, measured in a convenient way, that drive the law, not the tastes of the individual, who is simply unfortunate if he values good wine more than normal people do.⁵⁸

III.B.1.b. *Mental Externalities: Sympathetic*

Let us say that a sympathetic externality results when the action of A affects B 's happiness through his psychological identification with A . To the extent that one builds community, such identification is inevitable and desirable, but it does create externalities that make restrictions on individual freedom efficient.⁵⁹ I take the term from Adam Smith's less well-known book, *The Theory of Moral Sentiments*, which is largely about sympathy, explained near the book's start as follows:

As we have no immediate experience of what other men feel, we can form no idea of the manner in which they are affected, but by conceiving what we ourselves would feel in the like situation. Though our brother is on the rack, as long as we ourselves are at our ease, our senses will never inform us of what he suffers. They never did, and never can, carry us beyond our own person, and it is by the imagination only that we can form any conception of what are his sensations. Neither can that faculty help us to this any other way, than by representing to us what would be our own, if we were in his case. It is the impressions of our own senses only, not those of his, which our imaginations copy. By the imagination we place ourselves in his situation, we conceive ourselves enduring all the same torments, we enter as it were into his body, and become in some measure the same person with him, and thence form some idea of his sensations, and even feel something which, though weaker in degree, is not altogether unlike them.⁶⁰

For a sympathetic externality to arise, it is not necessary that A believe B shares his tastes. If A does not like cheese, he cringes as he observes B eat Velveeta, even though he can deduce that B must actually like the stuff. whether the analogy is correct or false. A would be willing

⁵⁶For an example of a judge with a tin ear, if not a wooden palate, see *Sandow* at note ?? *infra* .

⁵⁷For this attitude, see *O'Connor* and *Cleburne* at note *cleburne infra*.

⁵⁸xxxx The hypothetical becomes even more difficult if it is not wine, but a rare coin that is at stake. Suppose that A has been promised a Brasher Doubloon by B , but B actually delivers a fake. The police discover this, reveal the fake, and A brings a civil action against B for the purchase price. B might say that not he, but the police have inflicted harm upon A ; A was happy and enjoyed his coin until the police disillusioned him.

⁵⁹As James Stephen puts it, "Complete moral tolerance is possible only when men have become completely indifferent to each other— that is to say, when society is at an end." *supra*, note 9, at 149. Thus, California.

⁶⁰ Adam Smith, *The Theory of Moral Sentiments* (1759), p. 47. Reference to one's own tastes is, of course, the only basis for utilitarianism; it assumes that humans are roughly similar. This step is absolutely necessary— as necessary as, and no more justified, than the assumption that other people actually exist.

to pay *B* something to induce him to abandon his perverse pleasure— although he might not be willing to pay him much.⁶¹ Indeed, the idea of human dignity may have its origin in the principle of sympathy: *A* dislikes seeing *B* or any other human engage in debased behavior because he himself feels soiled as a result.

The idea of the sympathetic externality has a positive value in explaining criminal law. Why is rape a serious crime, even nowadays, when adultery and fornication are not? Mental externalities are an answer. Rape often inflicts physical harm, of course, and, like robbery, it creates fear of injury, but its high penalty cannot be justified on those grounds. These grounds are the same as those which justify the banning of pornography or homosexuality— subjective disgust. It is just that liberals, somehow, do not tolerate rape and do tolerate homosexuality. Some punishment for rape is certainly justified on the grounds of forcible violation of another person's rights, but not a severe punishment. The same goes for hate crimes such as cross-burning. Why not just punish them with ordinary statutes? (if no problem of needing to justify federal enforcement is needed).

III.B.1.c. Mental Externalities: Altruistic

A different sort of externality is when *A*'s behavior does not affect *B* directly, but *B* does care about what happens to *A* in some way. If *A* acts to reduce his own utility, *B* is hurt too, if *B* is an altruist. This may not be because *A*'s utility is lower, but because of some other kind of effect on *A*—his health declines, or he becomes more likely to be damned. *B* cares about *A*'s welfare, and is grieved when that welfare, defined by *B*'s definition, not *A*'s, declines.

This is close to the idea of the sympathetic externality. It differs because here *B*'s utility depends not on *A*'s actions (and consequent sympathetic feelings of *B*) but on *A*'s feelings. *A* may recognize that *B* cares only about the present, and so does not mind drinking himself to death, but *A* may care about *B*'s future well-being nonetheless. This is probably an offshoot of Smithian sympathy— *A* is more likely to care for *B* if *B* is related or has a similar appearance— but it is subtly different. Sympathy creates the bond, but is not needed to sustain it.

Malice is an appropriate term for negative altruism, and malice shows the difference between sympathy and altruism more cleanly. Sympathy would cause *A* to shudder at *B*'s pain; malice causes him to delight in it— perhaps even at the same time as he is involuntarily shuddering from sympathy.

Malice is a difficult form of utility for cost/benefit analysis. It seems repugnant, and we rebel at policies which encourage it. I suspect that this is because malice, while a good for the malicious person, is invariably accompanied by disutility for someone else, and we generally do think that the malicious person's utility exceeds the other person's disutility. It should be noted that public feeling does favor certain kinds of malice. When it was discovered that Alger Hiss was a Russian spy, for example, and left public life in disgrace, most Americans thought that it served him right. When Dean Acheson said that he felt sorry for him and "would not turn his back on Alger Hiss," the public response was outrage that Acheson would feel sorry for someone who had betrayed him. People seem to find malice (used in my sense) acceptable when inspired by the disutility of wrongdoers, even though they find it unacceptable when inspired by the disutility of someone

⁶¹As Smith notes, "We sometimes feel for another, a passion of which he himself seems to be altogether incapable; because, when we put ourselves in his case, that passion arises in our breast from his imagination, though it does not in his from the reality. We blush for the impudence and rudeness of another, though he himself appears to have no sense of the impropriety of his own behavior; because we cannot help feeling with what confusion we ourselves should be covered, had we behaved in so absurd a manner." Smith, *supra* note 60, at 51.

innocent. This implies that the feeling is not considered bad in itself— only when it would lead to bad actions such as the infliction of pain on the innocent.

III.B.1.d. Mental Externalities: Aesthetic

So far actions and people have been the subject of the mental externalities under discussion. Other mental externalities exist, which for lack of a better term I will call aesthetic. These frequently arise in environmental regulation. Conservationists like forests and deserts to be preserved in their ancient state and they are willing to override the preferences of other people and the maximization of material production to achieve this goal.⁶² There is something special about a 1,000-year-old tree, a feeling that is hard to justify, but very real in its effect upon utility. Whether that feeling is strong enough to justify sacrificing ten thousand dollars of high-quality wood to it is an empirical question.

Social customs or institutions can have the same dignity of age, the same aesthetic appeal. This is almost completely unrecognized currently. People who would shudder if a 100-year-old Manhattan warehouse is crushed by a wrecking ball or a 50-year-old desert tortoise by a jeep will cheer when a 1,000-year-old tradition bites the dust. Yet the appeal of all three is similar.⁶³ Indeed, from an aesthetic point of view,

It is delightful to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more delightful if the grounds upon which it was laid down have vanished long since, and the rule simply persists from blind imitation of the past.⁶⁴

Social conservation requires people, not animals, plants, or rocks to remain in a certain natural position, but we give people more options to move or object than we give to creatures lower on the evolutionary scale. Indeed, zoning requirements for architectural preservation or neighborhood “feel” already force people into cultural modes they would otherwise disfavor.⁶⁵ And social conservation is less likely to be tainted by rent-seeking, since social preservationists often must to live in the society they constrict, whereas lovers of forests need only visit them on weekends.⁶⁶⁶⁷ ⁶⁸

⁶² Please note that maximization of material production is not the same as “wealth maximization,” a term of art which takes into account the dollar value of non-material goods. See Richard Posner “Utilitarianism, Economics, and Social Theory,” pp. 48-87 of *The Economics of Justice*, Harvard University Press, 1983. “Wealth maximization” is an unfortunate term, since it is easy to confuse with the maximization of material production; a better term is “value maximization.”

⁶³xxx Till this century public policy was not kind to buffalo or redwoods either. In a hundred years, we may see wild-eyed conservationists desperately trying to save the pitiful remnants of American culture, just as they currently are trying to save the last of the old-growth forests.

⁶⁴ Others have different tastes; this quotation is, of course, a well-known passage from Oliver Wendell Holmes, corrected by replacing the word “revolting” with “delightful; “The Path of the Law,” *Harvard Law Review* 10: 457, 469 (1897) . See also the admiring cite to Holmes by Justice Blackmun in his dissent in *Bowers v. Hardwick*, 478 U.S. 186, 199 (1986) . But it is not only one’s affection or distaste for tradition that matters: elsewhere (xxx add cross-reference), this article argues that even those with neutral tastes should give the benefit of the doubt to ancient laws.

⁶⁵xxx Are there Chinatown ordinances, maintaining those neighborhoods?

⁶⁶ Aesthetics may be involved in both tradition and diversity, which are separate goals but similar in their elusiveness. On tradition, see also the text at note 64.

⁶⁷xxx Traditions are harder to restore than the environment, too. It only takes 250 years to grow an oak tree.

⁶⁸xxx Preserving culture is preserving a public good for future generations. So discounting enters here also. The future will be rich enough not to need more material goods, but they will want good institutions. They will say: “You have bequeathed us the snail darter, and we are grateful. But why couldn’t you bequeath us another of your precious belongings— the family?”

III.B.1.e. Private- Sector Responses to Mental Externalities

The simplest response to mental externalities is government regulation to discourage negative externalities and encourage positive ones. One must ask whether this is necessary, however, since the private sector may be capable of solving the problem on its own.

One result of mental externalities might be Coasean transactions, in which the disturbed party pays the disturber to cease his activity.⁶⁹ If *A* is bothered by *B*'s long hair, *A* can pay *B* to cut his hair. The difficulty is that this faces the standard list of reasons why the Coase Theorem fails to apply. *B* might start threatening to wear his hair long even though he secretly prefers it short himself. *C* and *A*, both disliking long hair, might disagree as to who pays *B* for a haircut. *A* and *B* might not come to an agreement because both are trying to be tough bargainers, and so forth.

Even if the Coase Theorem does not apply, the question the policymaker should ask is what the outcome would be in the absence of transactions costs, just as when the externality is a more standard one like air pollution. Judge Posner has said that laws regulating sex are “public- sentiment statutes,” not justifiable on utilitarian grounds, and that courts think “statutes forbidding abortions or denying teenagers access to contraceptives flunk an elementary Benthamite test.”⁷⁰ Whether the Benthamite test is flunked is indeed the big question, but Posner is too quick to suggest an answer. David Friedman, another Chicago libertarian, would allow societies to have puritanical laws if they compensated those who lost by them, but he is similarly skeptical that the winners would be willing to pay for morality. He says that “People who want to control other people’s lives are rarely eager to pay for the privilege; they usually expect to be paid for the ‘services’ they provide for their victims. And those on the receiving end— whether of laws against drugs, laws against pornography, or laws against sex— get a lot more pain out of the oppression than their oppressors get pleasure.”⁷¹ He suggests the interesting example of heroin use. Heroin users in the United States pay roughly 2 billion dollars a year for heroin, so it would cost the 250 million non-addicts a minimum of about 10 dollars per capita to keep heroin illegal, if compensation were required. Would they be willing? Maybe. But consider New York City, Friedman says. If eight million non-addicts bid against 100,000 addicts, raising the cost to over 100 dollars per non-addict per year, the efficiency of suppression comes into serious question. Friedman’s example is apt, but it supports my point too, by suggesting that heroin should be illegal everywhere except New York City. Since mental externalities diminish with distance, this is an argument for federalism.⁷²

Sometimes the Coase Theorem does apply, and we do see voluntary social controls. This is essentially the idea of zoning, real estate covenants, and condominium association rules, and it is not hard to imagine them being applied to behavior in general as well as to activities directly connected with land or buildings. As we will see below, courts often obstruct this private social regulation, and are more hostile to it even than to government regulation, despite its voluntary nature.⁷³ Economics-oriented libertarians generally find such private arrangements acceptable, however, since they clearly enhance efficiency. Once accepted, however, these arrangements are a slippery slope, because they differ very little from governments units that allow free immigration and emigration. If it is granted that neighbors should be allowed to voluntarily bind themselves to follow the rules of a neighborhood association, it is no great step to accept that they should be allowed to use the

⁶⁹See Ronald Coase, “The Problem of Social Cost,” 3 *Journal of Law and Economics*, 1 (1960) .

⁷⁰ Richard Posner *The Federal Courts: Crisis and Reform* (1985), p. 275.

⁷¹ David Friedman, *The Machinery of Freedom*, 2d Ed. (1989), p. 127.

⁷² On federalism and local public goods, see C. Tiebout, “A Pure Theory of Local Expenditure,” *Journal of Political Economy*, 64: 416-24 (1956).

⁷³xxxx I need to cite to that point in the paper.

city government as their association. The only question is whether government failure makes it inadvisable for them to trust the government with such powers, something that will be discussed in Section IV.

III.B.2. Paternalism

A quite different reason for regulation is paternalism: poor ability to make certain kinds of decisions. This is often difficult to distinguish from satisfactory decisionmaking ability but poor information, which has already been discussed. It does seem to be true, however, that some people make predictable mistakes in their decisions, which opens up the possibility of beneficial regulation. Children are the best example, and their behavior is heavily restricted, either directly by law or by delegation of the legal authority to their parents. Yet as James Stephen said, mocking John Stuart Mill's position, "Virtue up to twenty- one knows no compromise, but we must draw the line somewhere, and when the twenty-first birthday is passed liberty claims her prey, and I concede the demand. 'Fiat libertas ruat justitia.'" ⁷⁴

III.B.2.a. Paternalism: Poor Judgement

We restrict what children can do, and we say that some people lack the mental capacity for contracts. This is similar to imperfect information, in that we think the person whose behavior is restricted lacks the ability to fully appreciate the consequences of his actions. We prohibit children from buying whisky, for example, because we do not trust their judgement. We think that although a child might think he would like whisky, there is a good likelihood that he would refrain from it if he were better at predicting the consequences. This argument is also standardly applied to lunatics. It may now be regaining popularity, since the abandonment of paternalism with regard to mentally deficient adults has contributed to what is now called the homelessness problem. ⁷⁵

Paternalism is a very literal form of social regulation. Children are not allowed to satisfy their own tastes; they must obey their parents. In ordinary cases, the interests of parents and children are closely enough aligned that the parents can be trusted to make decisions for the children. In extreme cases, society will thwart the desire of both children and parents, as in the case of mandatory schooling.

Restrictions on heroin use are a particularly interesting example of paternalism, since those who claim to know that heroin use is bad generally have not tried it. This does not mean they are irrational; only that sufficient knowledge can be gained about an activity to rule it out without personal experimentation. ⁷⁶ This would be a problem in both economic and social interactions, except that the same two features of economic transactions that ameliorate the effects of perfect decisionmaking with imperfect information also ameliorate the effects of imperfect decisionmaking with perfect information; to wit, repeat transactions and the profitability of selling advice. Hence,

⁷⁴Stephen, *supra* note 9, at 178.

⁷⁵The idea is old; the epigraph from *The Republic* suggests that it is not good to return weapons to a lunatic.

⁷⁶xxx Psychologists have discovered that certain systematic mistakes are made in human decisionmaking. In particular contexts it has been discovered, for example, that people are consistently underoptimistic or overoptimistic. Amos Tversky is the psychologist that economists standardly cite, and ignore. The leading collection of articles on the interaction of psychology, economics, and decision theory is *Judgement under uncertainty: heuristics and biases*, ed. by D.L Kahneman, P. Slovic & Amos Tversky (1982). A recent example of this literature is Tversky & Kahneman, "Loss Aversion in Riskless Choice: A Reference- Dependent Model," *Quarterly Journal of Economics*, 1039-1061 (1991). Cite to newer rationality book here.

we would expect this kind of mistake to be most harmful in social situations, and especially when big decisions are to be made.

III.B.2.b. Paternalism: Self- Control

A person's judgement can be deficient in a different way: he may be able to predict that he will make decisions he will later regret, and seek to bind his hands to prevent this.⁷⁷ Members of Alcoholics Anonymous, for example, try to abstain completely from alcohol. They would presumably favor a society in which they would be denied the right to consume alcohol, and it would make their lives easier if nobody else were allowed to consume it either.⁷⁸⁷⁹ There is no contradiction in someone (a) engaging in an activity, and (b) wishing to ban it. There may be a negative externality, so that he likes to engage in it himself, but he would be willing to stop if others are also prevented, or it may be that he wishes to avoid temptation.⁸⁰⁸¹

III.B.3. Improving Tastes

According to Felix Frankfurter, "Law is concerned with external behavior and not with the inner life of man."⁸² George Will has expressed what seems a nearly opposite view: "The first question of government is : 'What kind of people do we want our citizens to be?' "⁸³ The two views can be reconciled, however if one grants to government the role of forming the inner tastes of its citizens to give them an incentive to make their external behavior cooperative rather than harmful. If this is the case, it may be efficient for the government to encourage the formation of such habits, and equally to discourage harmful ones. Just as the government subsidizes liberal education, it should subsidize moral education.⁸⁴⁸⁵

Moreover, there is a paternalistic case for the shaping of tastes, as well as a cooperative one. James Stephen said, "There is hardly a habit which men in general regard as good which is not

⁷⁷Sunstein *supra* note 30 at 1141 suggests foreclosing one's ability to use narcotics.

⁷⁸Quite possibly, they would favor a law denying themselves alcohol while allowing it to those who are for some reason, physical or otherwise, not prone to alcoholism. Laws restricting a minority are not necessarily oppressive. Such paradoxes of commitment are frequently encountered in game theory; see Thomas Schelling (1960) *The Strategy of Conflict*.

⁷⁹xxx Find the court decision invalidating a Wisconsin law banning drink to town drunk on wife's request.

⁸⁰An example of the first kind of rule is the much-supported, much-violated 55 mile per hour speed limit.(xxxx find cite on opinion polls). Clear examples of commitment are harder to find; people are reluctant to admit that they themselves are tempted by the vices they seek to ban, and that they mistrust their own willpower.

⁸¹xxx Perhaps cite Plato, Republic, on being unable to avert one's eyes from the rotting corpses. note 2 at xxx.

⁸²West Virginia v. Barnette, 319 US 624, 655 (1943).

⁸³Will, *supra* note 95 at 17.

⁸⁴Judges continue to dispute this, and often sees a perverse pride in judges encouraging private activities that are personally abhorrent to the judge and almost everyone else (oddly enough, judges seem less tolerant of public acts they dislike but almost everyone else accepts) . In regard to whether a state university must give official recognition and privileges to a student group advocating homosexuality, one opinion reads, "Thus, associations devoted to peaceful advocacy of decriminalization or social acceptance of sadism, euthanasia, masochism, murder, genocide, segregation, master-race theories, gambling, voodoo, and the abolishment of all higher education, to list a few, must be granted registration, upon proper application and indicated compliance with reasonable regulations, if VCU continues to 'register' associations." Judge Markey's concurrence, *Gay Alliance of Students v. Matthews*, 544 F.2d 162, 167-68 (1976) .

⁸⁵xxx Somewhere this is relevant: "... between paying a single shilling of public money to a single school in which any opinion is taught of which any single taxpayer disapproves, and the maintenance of the Spanish Inquisition, is a question of degree." Stephen, *supra* note 9, at 87.

acquired by a series of more or less painful and laborious acts.”⁸⁶ This is true, however, not only of “good” in the sense of “good for others,” but also in the sense of “good for yourself”. And this combines with the other paternalistic arguments, because a young person, child or adult, may not realize the usefulness of the habit *ex ante*, or have the self-control to acquire it even if he does recognize its usefulness. Even middle-aged professors sometimes find athletic trainers, marriage counsellors, and church pastors useful in these ways.

Good habits are useful for both production and consumption. It is not always clear which habits are the good ones— that is part of our problem here— but a list might include keeping regular hours, responding to phone messages and emails promptly, regular exercise, eating in moderation, regular prayer, and avoiding envy. I, myself, at age 41 am deficient in all these items, and, indeed, unsure of whether any or all of them are indeed worthwhile, but I am better able to judge than at age 12, and accumulated societal wisdom could do better still, if it were fostered.

Even more intriguing from an economic point of view is the shaping of tastes to increase utility. It has long been realized that people can invest in certain tastes so as to increase their long-run utility at the expense of the short run, learning to like classical music being the standard example. This is the other side of the coin from avoiding bad habits such as alcoholism, avoidance which likewise increases long-run utility at the expense of the short run. But the idea can be carried much further. There are two ways for someone dissatisfied with his current state to become happier: to change the state, or to change his tastes. If you are unhappy because you do not have a Porsche sports car, you can work to earn the money to buy a sports car, or you can try to change yourself so that you are happy with a cheaper car.

III.B.3.a. The Encouragement of Altruism

Gordon Tullock points out that giftgiving is superefficient, because it benefits both the giver and the receiver.⁸⁷ If *A* gives *B* a dollar, the gift has benefited *A* by at least a dollar (or he would not have given it), and benefits *B* by exactly a dollar (or perhaps less, if *B* has scruples about accepting charity).⁸⁸⁸⁹ This suggests that altruism is a desirable taste, since it allows a given amount of wealth to generate more utility than if people are completely selfish.

Similarly, the law should usually discourage *schadenfreude*— the deriving of utility from the suffering of others. This emotion may, like expensive prisons, be useful as a deterrent to bad behavior, but it is an evil in itself.⁹⁰ There may or may not be disagreement about what morals should be inculcated, but it is clear that some morals are more conducive to happiness than other. Stephen said of the British in India that “They have forced upon the people, utterly against the will of many of them, the principle that people of different religions are to live at peace with each other, that there is to be no fighting and no oppression as between Mahommedans and Hindoos, or between different sects of Mahommedans.”⁹¹ The British imposed the principle of tolerance as a

⁸⁶Stephen, *supra* note 9, at 59.

⁸⁷xxx find cite; it is in a book. Incoem Distribution book?

⁸⁸xxx Maybe cite Ellickson’s student on this— begging requires higher pay than dishwashing.

⁸⁹This explains why it is sometimes inefficient to give cash. The giver may not get as much happiness from cash, and so although the gift of one dollar is worth one dollar to the receiver, it is worth less to the giver. If the giver gives a book, on the other hand, he can imagine the receiver using the book, and gets more than a dollar of utility out of it himself, even though the receiver gets less than a dollar of utility.

⁹⁰xxx Add this joke: When an American worker see his boss drive by in a Cadillac, he says: Someday, I too will drive a Cadillac like him.” When an English worker see his boss drive by in a Rolls Royce, he says: Someday, he too will take the bus like me.” The American’s attitude is better for economic growth.

⁹¹Stephen, *supra* note 9, at 89.

check on external behavior, however, rather than making any serious attempt to change the inner man, and since Independence we have seen a resurgence of religious violence. In other cases, the desirability of certain tastes is less disputed, but human nature resists education.⁹²

III.B.3.b. *The Encouragement of Duty*

A person carries out an action from a sense of duty when he obeys a norm purely for the sake of obedience rather than personal gain. In the economic framework, this behavior is acknowledged but reclassified: the person carries out the action because the utility of doing his duty exceeds the disutility of that action. When one prefers death to dishonor, that is equivalent to saying that dishonor has lower utility than death. This is really just a matter of terminology, and the economist would agree that it is useful to have people in a society who have a strong taste for duty.⁹³ Thus, regulations which encourage such tastes would seem to be useful.⁹⁴⁹⁵ ⁹⁶

To summarize: the reasons for regulation of economic markets are often applicable to social interactions, where, in addition, a number of other reasons justify intervention. As with economic regulation, we must worry about government failure as well as market failure, but this is an important enough topic to deserve a section of its own, Section IV.

IV. GOVERNMENT FAILURE IN SOCIAL REGULATION

Even if social regulation is more often justified than economic regulation, it does not follow that a government can be trusted with providing it. Section II pointed out that not only was economic regulation rarely able to increase welfare over *laissez faire*, but even when it could, it often falls prey to the two implementation problems of (a) rent-seeking governments that act on behalf of special interests and (b) neutral governments that are nonetheless unable to implement regulations perfectly. Section III showed that social regulation would more often be able to increase welfare over *laissez faire*, in theory. The presumption for *laissez faire* might still remain, however, if social regulation falls prey to those same two implementation problems. Even if there exists some form

⁹²xxx We do not like malice—common law often discourages it. See the law of wills. Mencken: “Puritanism: The haunting fear that someone, somewhere, is having a good time.” *A Book of Burlesques*, (1920) (find page, thank Elwood). Add to this section. In particular, does malice add to punishment in tort and criminal cases? Perhaps high liquidated damages in contract breach too, when dissipative—the pound of flesh. Spite fences. Racial, etc., discrimination motivated by animus.

⁹³xxx George Mason proposed adding the power to enact sumptuary laws explicitly to the U.S. Constitution, because “No Government can be maintained unless the manners be made consonant to it.” His motion was defeated by a vote of three states to eight; James Madison, *Notes of Debates in the Federal Convention of 1787*, p. 488 (1840) W.W. Norton, 1987.

⁹⁴xxx Possibly mention flagburning regulations here. We perhaps must educate people to hate to see flags burned, and once those preferences exist, we should not cause those people disutility by allowing flags to be burned.

⁹⁵xxx Jefferson in notes on Virginia: “And can the liberties of a nation be thought secure when we have removed their only firm basis, a conviction in the minds of the people that these liberties are the gift of God? That they are not to be violated but with His wrath? ” *Notes on Virginia*, Query 18. But also: “... it does me no injury for my neighbor to say there are twenty gods or no God. It neither picks my pocket nor breaks my leg.” (query 17). Contradiction noted by George Will, *Statecraft as Soulcraft: What Government Does*, New York: Simon & Schuster, 1983, p. 71. See Washington’s farewell address, and cite up to Weber, note 32. George Akerlof, “Loyalty Filters,” *73 American Economic Review*, 54-63 (1983) .

⁹⁶Here we have another paradox of game theory: we all may be better off if each of us would suffer mental anguish from engaging in fraud— because if we would suffer such anguish, we will avoid fraud.

of social regulation that could raise welfare, if government failure is great enough, that theoretical existence is irrelevant to practical policy.

Before going into the details of government failure, however, it might be useful to clear away one form of government failure that I will not discuss in depth: the allocation of political power. I will be assuming that the regulations under discussion, economic or social, are adopted by a democratic government, and have no great impact on the distribution of political power. If part of the population is denied political power, then it is easy to see how inefficient regulations will be adopted, because their wishes will be ignored. If blacks were not allowed to vote, for example, then it would not be surprising to see inefficient regulations adopted excluding blacks from employment in certain jobs or from the use of public facilities. Social and economic regulations will often have political implications, and these require a very different analysis than I have been using here. An economic regulation forbidding the entry of new newspapers, or a social regulation forbidding women from appearing alone in public would shift political power, and might be undesirable for that reason, even if it was justified by the costs and benefits of its direct impact. The government failures to be discussed below are more innocuous: the capture by special interests and the loose administration to be found even in a secure democracy.

IV.A. Rent-Seeking in Social Regulation

Rent-seeking is the manipulation of regulation in order to create transfers of wealth. Real resources expended in the struggle to regulate or keep from being regulated are a cost of the policy. It may be better to have a constitution that completely forbids regulation than to allow it to consume resources in the political arena, and Section II showed that this is a serious danger for economic regulation.

Rent-seeking is certainly possible in social regulation. Suppose that members of group *A* dislike homosexuality, and would pay five million dollars to stop it, members of group *B* like homosexuality and would pay ten million to allow it, and the remaining citizens are indifferent. We would expect members of groups *A* and *B* to lobby the remaining citizens on this issue, expending some millions of dollars. Probably group *A* would lose and group *B* would win, but whatever happened, lobbying costs would be incurred. This cost could be avoided by constitutionally closing the question, either allowing or prohibiting homosexuality, but banning the use of resources to discuss the issue.

A different problem is that not only is rent seeking costly, but it can result in the wrong side winning. Suppose that there are five members of group *A*, who would each give one million dollars to ban homosexuality, and ten million members of group *B*, who would each give one dollar each to allow it. Group *A* will find it easy to lobby, but group *B* is subject to a severe collective-action problem. Each member of *B* would be tempted to free-ride on the efforts of the others and not contribute his one dollar to the group effort. Thus, the small numbers and intense feelings of group *A* would give them an advantage despite their collectively weaker feelings. The political process would give the inefficient result of banning homosexuality.

This is clearly a problem in economic regulation. A regulation can easily be tailored to benefit five companies at the expense of ten million customers. If the market is economic, it involves profits, and if there are profits, a clever entrepreneur can garner a large share of them. Consumers are at an organizational disadvantage, and most of the lobbying will be between various companies to decide who gains the profits.

In social regulation, rent-seeking is less of a problem. Social regulations do not directly involve

dollar transfers, so it is harder for a few individuals to reap large benefits from the regulation. The homosexuality example above is unrealistic, because it is unrealistic that the opponents of homosexuality are so few and so intense. Rather, there are many people on each side of the question. What is most important is that social regulation is usually a consumption good for its supporters, whereas economic regulation is a production good. If *A* desires an economic regulation such as entry barriers to the trucking industry, it is because he hopes to earn money from the regulation. He treats the lobbying decision as a production decision: is it worth spending ten thousand dollars on lobbying in exchange for the profits from his trucking business if the regulation passes. This means that if a regulation will be profitable, people will arise to push for it, even though it will hurt the public generally. If *A* desires a social regulation such as a ban on abortion, on the other hand, it is because he feels disutility from abortions occurring, and he wants to avert that disutility. He treats the lobbying decision as a consumption decision: is it worth spending ten thousand dollars on lobbying in exchange for the utility from abortions being banned. No such regulation will arise unless someone begins with a strong aversion to abortion, and the dollar value of his benefit from the regulation is limited to his initial wealth and bounded by his preferences. Thus, it is much less likely that small numbers of concentrated beneficiaries will lobby for social regulation than for economic regulation.

Where social regulation on behalf of a minority does occur, it is likely to be efficient. Thus, in Israel the religious parties have managed to strongly affect immigration laws, because they care very much about the definition of “Jew” and the majority has no opinion on the subject. The religious parties could have asked for monetary advantages instead, as their price for staying in coalitions, but they care more about immigration than money relative to their more secular fellow-citizens.

This is not to say that regulations always benefit a minority. If a regulation is efficient, that may give an advantage to the majority that is not undone by their free riding. Or, a political entrepreneur may collect a personally large fee in terms of money or honor for coordinating the efforts of the majority. In the economic sphere, airline deregulation is an example of this. For many years regulation persisted because it benefited the airlines, even though it hurt air travellers by more. By the 1970’s, however, air travel had increased enough that the inefficiency was massive, and the opportunity arose for politicians to score points with the electorate by proposing deregulation.⁹⁷

Often, however, social regulation will benefit large numbers and be efficient. In that case, it will go through. There is not a presumption against efficiency, as with economic regulation, where the very profitability of regulation is likely to indicate that someone will make a profit by creating an inefficient distortion in the economy.⁹⁸

Constitutional Restrictions and Regulation

It is worth digressing here to discuss the possible desirability of writing a constitution that forbids social regulation. Might citizens not want a set of rules that could not be changed by majority vote, so as to prevent the majority from working its will in an inefficient way?

Such a constitution is certainly desirable, but the reasons for its desirability do not apply to forbidding social regulation. Four reasons for constitutions come to mind.

- (1) A constitution prevents one group of citizens from eliminating the political power of another

⁹⁷xxx cite needed.

⁹⁸xxxx The Bush administration suggested as a campaign reform idea that we allow ideological PACS but not trade unions or corporations or trade associations. That makes sense from the point of view of rentseeking.

group. If the majority could take away the political rights of the minority, then inefficient regulation would be sure to follow- confiscation of the minority's property, to start. Moreover, a majority of the new ruling class would eliminate the power of a minority of it, and the situation would degenerate into tyranny. Thus, laws affecting political power- the ability to change policy- are a natural subject for a constitution.

(2) A constitution allows citizens to commit to policies. The majority wants to bind its hands to prevent dynamic inconsistency- a situation where they would take a short- run action that would hurt even the majority in the long run. Thus, the citizens want to be prevented from violating contracts, because otherwise nobody will make contracts with the government. It wants to be prevented from taking property without compensation, because otherwise nobody will invest in property. In both examples, the problem is that though there is a short-run gain to the majority from the policy, there is a long-run loss, not just to the minority, but to the majority.

(3) The Founders are intelligent people who do not trust a less intelligent majority to make sound decisions later.

(4) The Founders want to protect future generations against the actions of the current generation. A constitution might require a certain forest be set aside as a park, for fear that one generation might cut down the trees out of selfishness.

(5) To induce the minority to join the new state, a constitution ensuring they get their way on particular decisions later may be necessary. In this way, a constitution may be like a contract. Thus, in order to join the new federal government, the far Southern states required that the U.S. Constitution forbid laws banning the slave trade for twenty years, knowing they would otherwise be outvoted (which they were, exactly twenty years later).

None of these is a reason for a ban on social regulation, except perhaps (3) if one is willing to be paternalistic and one believes the intelligent view is that even apparently efficient social regulation usually turns out to be inefficient. Suppose the majority wants to prevent the minority from using heroin. That does not reduce the political power of the minority. Far from it, without their heroin those people will be more effective politically, not less. Nor will the majority regret the effects of its ban because of future effects. The minority will always object, but the majority will always be happy to have adopted the policy. Nor is it necessary to protect against foolish anti-heroin future generations, or protect a cultural heritage of heroin use, or to induce heroin users to join a new state.

But what of the argument that the current majority would rather be blocked from regulation, for fear that "my turn will come next"? That idea has appeal, but the appeal diminishes if we make it precise. Consider the following example.

CONSTITUTIONAL BAN EXAMPLE. There are 100 citizens. 40 are homosexuals, and 60 are not and want homosexuality banned. 15 of the homosexuals and 25 of the anti-homosexuals are smokers, and the other 60 citizens want to ban smoking. Each citizen has equal intensity of feeling, being willing to pay 1 dollar for his preference on an issue.

If social regulation is permitted, and there are separate votes, then both homosexuality and smoking will be banned. This will result in a majority of 65 people (40 homosexuals and 25 non-homosexual smokers) being constrained from the behavior they like best.

So wouldn't those 65 people prefer to have a constitution that bans social regulation? They would not, because a person's happiness doesn't depend just on being able to do what he wants.

The proper way to analyze the situation is to see the total social value in each possible situation.

Start with the situation of the constitution that forbids regulation. The 15 homosexual smokers each get values of 2 dollars, since they get both their preferred policies. The 25 homosexual nonsmokers and the 25 anti-homosexual smokers each get values of 1 dollar, since they get one of their preferred policies. The 35 anti-homosexual smokers each get 0, since they do not get their way on either policy. Thus, the total social value is 80.

What happens if both smoking and homosexuality are banned? Then the 15 homosexual smokers each get values of 0. The 25 homosexual nonsmokers and the 25 anti-homosexual smokers each get values of 1 dollar, since they get one of their preferred policies. The 35 anti-homosexual smokers each get 2 dollars. Thus, the total social value is 120. What has happened is that 50 people are indifferent between the two policies, 35 are much better off, and 15 are equally worse off.

Thus, it is not true that fear of being regulated when they were in the minority would induce citizens to favor a constitution that banned regulation.

The reason the idea of “my turn will come next” is appealing is that it is valid in two other contexts, contexts which are very common. The first is when the majority policy is to deprive the minority of political rights. Such deprivation will quickly be followed by the adoption of policies which hurt the minority more than they benefit the majority— complete confiscation of their assets, for example. Such deprivation also may suffer from dynamic inconsistency— the majority may later regret its temptation to take away all the minority’s assets, since after one grand haul the minority could no longer be taxed. But these are the reasons for constitutions that I have already discussed above, which do not apply to social regulation.

The second context is when the policy is directly inefficient. Suppose in the example above that the minority of smokers and the minority of homosexuals each value their activities at 2 dollars each, but that the voting does not allow intensities of preferences to be measured. Then, the outcomes will be inefficient. This would be true even if there were just one issue— just homosexuality, for example. When there are two issues, however, the homosexuals and the smokers could band together and form an alliance to prevent regulation. By forming a political party that opposed both forms of regulation. they would increase the value they received.

It is worth working out the numbers to check this. With no regulation of any kind, the 15 homosexual smokers each get values of 4 dollars, since they get both their preferred policies. The 25 homosexual nonsmokers and the 25 anti-homosexual smokers each get values of 2 dollar, since they get one of their preferred policies. The 35 anti-homosexual smokers each get 0, since they do not get their way on either policy. Thus, the total social value is 160.

If both smoking and homosexuality were banned, the 15 homosexual smokers would each get values of 0. The 25 homosexual nonsmokers and the 25 anti-homosexual smokers would each get values of 1 dollar, since they get one of their preferred policies. The 35 anti-homosexual smokers would each get 2 dollars. Thus, the total social value is 120, as in the first example, but now it is lower than if there were no regulation. Moreover, under regulation, a full 65 voters have lower utility than if there were no regulation. The 25 homosexual nonsmokers would like to abandon the coalition and ban smoking, but they know that if they did, the 25 anti-homosexual smokers would abandon them too, and both halves of the coalition would end up worse off than if they stuck together.

Thus, there do exist situations in which banning social regulation would maximize value. But

why do it by constitution? In the second example, political parties form spontaneously to eliminate the inefficiency. To be sure, if we complicated the model a bit by making it costly to form a political party, there would be a free rider problem. No one homosexual or smoker would want to bear the cost, since he could receive the benefit of the party anyway, if someone else formed it. But the real-world solution to this is the political entrepreneur: someone who bears the cost but who also receives a personal benefit. Most obviously, a politician would run for office on a platform of smoking and homosexuality, and his personal benefit would be the glory or salary of an elected official.

Notice, too, that social regulation is no different from any other government policy in the difficulty of reconciling majority rule with a minority having intense preferences. Instead of smoking and homosexuality, our two issues could be support for Israel and gun control. Just because it might happen that majorities consisting of Israel-supporters and gun controllers would have weaker preferences than the opposition does not mean that the U.S. Constitution should ban aid for foreign countries and state regulation of weaponry. We do not know, *ex ante*, which way the preferences will be more intense, and we can hope that logrolling and coalitions will result in the efficient political outcome even without constitutional restrictions.

IV.B. Government Mistakes in Social Regulation

The second disadvantage of government is poor choice and administration of regulations. Just as someone with pneumonia will prefer treatment by a medical doctor to *laissez faire*, but prefer *laissez faire* to treatment by a witch doctor, so it may be that society could be improved by an omniscient government, but not by the available government. This might be because governments are not as good as private organizations at providing services, or it might be that human knowledge is too limited for either the government or the private sector to know what regulation is appropriate.

Patrick Moynihan has said, “The central conservative truth is that it is culture, not politics, that determines the success of a society. The central liberal truth is that politics can change a culture and save it from itself.”⁹⁹ This suggests that Moynihan agrees with the first half of this article, and he concludes that the government should intervene by novelty in social regulation. But this is dangerous. We are probably not very good at social regulation.¹⁰⁰

We are quite ignorant of sociology, from a theoretical point of view.¹⁰¹ Social engineering may be an eventual goal, but we do not know enough sociology now to be safe in trying it. In economics, we can usually identify the opposing forces and theoretically explain their interaction, even if we do not know the magnitudes. But what is the effect of allowing flags to be burned? Of not having a flag at all? Of letting women keep their maiden names after marrying? Of allowing easy divorce? In social regulation, “an ounce of history is worth a pound of theory,” if I may steal a line from Justice Holmes.¹⁰²

Laissez faire is a very simple policy. The optimal intervention is complicated. It is analogous

⁹⁹As cited by Fallows in xxxx, p. 17, as cited by Mickey Kaus, *New Republic*, 7 July 1986 in his article “The Welfare State.”

¹⁰⁰xxx The Revolution was inspired by “the belief that what was wanted was to replace the complex of traditional customs governing the social order of the day by simple, elementary rules deriving from the exercise of the human reason and from natural law.” Alexis De Tocqueville, *The Old Regime*, 3-1 (find ref and exact quote; this is reported by Carr):

¹⁰¹xxxEven government lawyers are now coming to know economics, but nobody knows sociology yet.

¹⁰²Holmes said that “a page of history is worth a volume of logic,” in the question of defining an indirect tax. *New York Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921) .

to putting a pollution tax in place compared to having zero tariffs.

IV.B.1. Social Ecology

One cannot imagine the corporate counsel of a major automaker looking inside a car, and saying: “I don’t know what that gizmo does— take it out and we’ll save some money.”¹⁰³ The other attitude is: “It must be good for something.” And, especially, if there is a mechanic present who says the gizmo is important, the lawyer should defer to him, even if the mechanic cannot explain very well why the gizmo matters.

There is an analogy to ecology: intervention is dangerous because we do not know how things interconnect, and a small intervention might have a large and unanticipated effect. Also, of course, we may be at a local maximum rather than a global one, but that possibility warns against piecemeal changes in social rules. “Society is like a Calder mobile. Touch it here, it trembles over there. Beliefs, habits, mores, dispositions are connected to one another in subtle ways and are related to behavior in many ways. Many of the ways are not known— cannot be known— until a chain of changes has begun.”¹⁰⁴ This has been recognized in the sphere of economic regulation, where the Supreme Court has held that someone growing wheat for personal consumption is still subject to federal acreage restrictions under the Commerce Clause because his reduced purchases in the open market affect national commerce.¹⁰⁵

It has sometimes occurred that human intervention in ecological systems has produced results that are distasteful, and even contrary to the intended results. Two examples will suffice. In New Hampshire, state officials reduce the skunk population, hoping to encourage tourists, but found the fish population shrinking. It turned out that skunks control the snapping turtle population by eating their eggs, and without the skunks, the numerous turtles ate more fish eggs. In Montana, the state introduced mysis shrimp into the rivers as a food source for salmon. Unfortunately, the shrimp competed with the salmon for plankton, a mutual food source. The number of salmon spawning on one lake fell from 100,000 to 200, and the number of bald eagles counted over the lake (attracted by the fish) fell from 639 to 13.¹⁰⁶

The same danger may await social regulation. Economic regulation at least has the virtue that economic systems tend to be self-correcting: if the government introduces a distortion such as a price floor, economic forces tend to mitigate the distortion as far as possible. The system is self-equilibrating. We cannot be so sure that social systems are self-equilibrating. When there are multiple equilibria, in fact, social regulation can shift the equilibrium from a better situation to a worse, with very little chance of return.¹⁰⁷

Homosexuality is a good example. Without good knowledge, homosexuality was *de facto* legalized. That allowed the spread of various old venereal diseases, and one new one, AIDS, that has killed over xxxx people. The death penalty could not have suppressed sodomy more cruelly, and surely, *ex post*, everyone must agree that it was safer to be homosexual in the 1950s than in the 1980s. But before AIDS, arguing against homosexuality based on vague fears of disease would

¹⁰³At least, one cannot imagine the counsel of a Japanese automaker saying this.

¹⁰⁴Will, *supra* note 95 at 85.

¹⁰⁵Wickard v. Filburn, 317 U.S. 111 (1942).

¹⁰⁶Maccaro, “Regulating Mother Nature,” *Human Events*, 25 April 1992, p. 9/337. Other examples: the usefulness of fever and iron deficiency, from Randolph Nesse and George Williams *Why We Get Sick: The New Science of Darwinian Medicine*, Random House, 1995.

¹⁰⁷xxx See Eric Rasmusen “Stigma and Self-Fulfilling Expectations of Criminality,” *Journal of Law and Economics*, 39: 519-544 (October 1996).

have induced smiles from the sophisticated. Is a ban too harsh a remedy? Not compared to an AIDS epidemic surely, though some policy between a complete ban and complete freedom might have been better still. This may, in fact, have been the old rule: homosexuals were denied access to large numbers of partners in public settings, but there was little enforcement against discreet sexual encounters between people who knew each others' names.

Institutions take time to develop. We should therefore be very careful about destroying them. This is another ecological point. There is a research program to be undertaken on social regulation. Since the Invisible Hand does not always work, a theme of the earlier part of this paper, the status quo may well be a bad policy. But before changing the status quo, one should answer the question of how it came to be that way— is it accident, or is there a reason?¹⁰⁸

We should be cautious even about apparently good innovations. One argument is what I have called the regression argument for conservative bias.¹⁰⁹ Suppose that the status quo has a value of 100, and random innovation would most likely lead to a value of 90. Rather than innovate randomly, however, the policymaker carefully measures the value of a particular new policy, and finds it to be 101. If there is any measurement error, the policymaker should reject the innovation, because his measurement of 101, higher than the average of 90, might have been caused by measurement error as well as by the true value being high. Put a little differently, if the true value of the innovation is 95, and its value is independently measured 5 times, the measurements might turn out to be 89, 95, 96, 94, and 101. A policymaker who adopted every seemingly superior innovation would end up adopting the innovation after the fifth measurement. Thus, even if an innovation seems slightly superior to the status quo, it should be rejected unless it seems substantially superior.¹¹⁰

IV.C. The Usefulness of Tradition

What, then, can be done? We know enough sociology to know that some regulation is optimal, but which? *Laissez faire* is probably not best, but can the government be trusted to find a better policy?

We do have one guide to fall back upon. Despite our small progress in the science of sociology, we can fall back upon our predecessors. Just as Beethoven composed symphonies as good or better as can be produced today, so Blackstone recommends social regulations as good or better as can be produced today. Without science, we must resort to art, retreating from the idea that progress has occurred, based as it is on the scientific paradigm of step-by-step progress.

There are a number of reasons for trusting tradition, all of them second-best arguments, which do not militate against careful progress. First, social regulations whose purpose is not immediately apparent may in fact have purposes known in the past to the people who designed them. Second, social regulations whose purpose is not immediately apparent may have reasons unknown to even to their designers, but which have led those regulations to survive evolution and experimentation.

Both reasons justify the tone apparent in much of Blackstone's work, that the common law should be respected, and reformed only when clearly wrong, not only when it seems useless or elaborate. As Blackstone says,

¹⁰⁸xxx A similar research program is needed for political regulation— how important empirically are different instrumental liberties? Counterfactuals, a la Fogel and economic history.

¹⁰⁹See Rasmusen, *supra* note 130.

¹¹⁰xxx There is also a danger of eliminating something important by social engineering of which we are not really aware currently. That is the theme of *Brave New World*. In that book, this destruction is not accidental, however, but is considered a necessary cost. People are made happy, but high art is lost, and must be lost, in consequence.

Not that the particular reason of every rule in the law can at this distance in time be always precisely assigned; but it is sufficient that there be nothing in the rule flatly contradictory to reason, and then the law will presume it to be well founded. And it hath been an antient observation in the laws of England, that whenever a standing rule of law, of which the reason perhaps could not be remembered or discerned, hath been wantonly broke in upon by statutes or new resolutions, the wisdom of the rule hath in the end appeared from the inconveniences that have followed the innovation.¹¹¹

A third reason is that disallowing innovation, whether as the elimination of old regulations or the imposition of views, prevents rentseeking. Rentseeking is a danger only if it is possible to change the status quo.¹¹² And we certainly should not try to hamper private social regulation via customs and mores, without great care. “Autre temps, autre moeurs,” but not “Autre temps, pas de moeurs;” the morals of different times may differ, but no time has no morals.¹¹³

One thing about rational conservatism and about economics is that one should not have hard-and-fast rules like the supreme court imposes. Flexibility is important, as evidence accumulates. That is the economist’s contribution: always allow tradeoffs.¹¹⁴

When the status quo cannot be retained, because of a technical innovation, perhaps, social innovation is also needed, and government regulation may be quicker than social custom to respond. European culture has had long experience with the dangers of alcohol, and biological and social evolution has ameliorated, without eliminating, its harmful effects. This is not true of other drugs, such as marijuana or heroin.¹¹⁵ It is also not true that alcohol generally is less in need of regulation; it was and remains a scourge of American Indians, who are not permitted to have a different regulation than the dominant culture.¹¹⁶

Treating rights as property, one can apply the notion of *prior tempore, prior jure* here as well as in other property— if traditionally people have not had the right to play loud music, but rather it has been the common property of the neighborhood, then they must purchase it from their neighbors. This supports traditional social regulation, but forbids novel social regulation unless compensation is paid as for a taking. It raises interesting questions as to prescriptive rights— if

¹¹¹William Blackstone, *Commentaries....*, v. 1., para 3, p. 70

¹¹²xxx There is informal and formal social regulation. The informal regulation— manners, public opinion, mores, norms— should be allowed to evolve slowly, without degenerating. That is a tough goal. Remember that much of enforcement is private. We should not block that enforcement. Tacitus quote: *Quid Leges sine moribus?* Find source— tken from Ellickson article. See also the Goldsmieth quote from the Traveller that Frank Buckley recommends. “Manners are of more importance than laws. Upon them, in a great measure, the laws depend. The law touches us but here and there, and now and then. Manners are what vex or soothe, corrupt or purify, exalt or debase, barbarize or refine use, by a constant, steady uniform insensible operation, like that of the air we breathe in.” Edmund Burke (1789) *Letters on a Regicide Peace*, I.

¹¹³xxx “Of all the dispositions and habits which lead to political prosperity, religion and morality are indispensable supports... A volume could not trace all their connections with private and public felicity. Let is simply be asked, Where is the security for property, for reputation, for life, if the sense of religious obligation *desert* the oaths which are the instruments of investigation in courts of justice? Whatever may be conceded to the influence of refined education on minds of peculiar structure, reason and experience both forbid us to expect that national morality can prevail in exclusion of religious principle.” George Washington, “Washington’s Farewell Address,” (1796), in H. Commager & M. Cantor, *Documents of American History, vol. I, to 1898*, 173 (1988).

¹¹⁴xxx Federalism becomes very important. First, we do not know very well which society is best, though we have some ideas. Second, it is good to have laboratories. Third, different cultures have their own beauty.

¹¹⁵See E. Thomas Veal, “Booze and Pot: The Metaphysical Distinction,” *The American Spectator*, Feb. 1973, Reprinted as pp. 74-78 of *Orthodoxy: The American Spectator Anniversary Anthology*, ed. R. Emmett Tyrrell, 1987.

¹¹⁶xxx Find the court case outlawing a regulation against selling liquor just to Indians. the 43 gallons case? No.

there is a statute against homosexuality, but it has not been enforced for fifty years despite open and notorious homosexuality (adverse possession of the property right), then perhaps title to the property has passed to the individual. This is too large a question for discussion here.¹¹⁷

IV.D. Explaining Past Social and Economic Regulation

I have claimed that tradition is a good guide, laid out reasons why economic regulation is generally undesirable, and shown that these reasons do not apply to social regulation. Instead, I suggest reliance on tradition. A difficulty is that tradition often supported economic regulation as well as social regulation, and that much of the social regulation of the past seems pernicious. The question can be separated into two parts: (1) Why do uneducated people in the present (and almost everyone in past) generally support economic regulation which now seems clearly bad to people with an undergraduate training in economics? (2) Why do educated people in the present generally oppose much of social regulation?¹¹⁸

Table 2 shows categories.¹¹⁹

Table 2: POLITICAL DIVISIONS

		Social Regulation	
		FOR	AGAINST
Economic Regulation	FOR	European conservatives Marxists	American liberals
	AGAINST	American conservatives Classic liberals	Libertarians Neoconservatives

Why has economic regulation been attractive? Partly it is due to lack of understanding of economics; to the untutored, the idea of the invisible hand is as striking and incredible as the idea that the earth goes around the sun. A European conservative may believe that government subsidies to the steel industry increases national wealth, even though accepted economic theory reaches the

¹¹⁷One problem, for example, is whether property in rights can be acquired by adverse possession against the government. With regard to real property this is not the case (xxx find cite).

¹¹⁸This is a debatable statement, of course, since most educated people do support such social regulation as laws against racial discrimination, child pornography, and heroin sales. But except for regulation of drug and alcohol use and racial discrimination, the trend in elite circles has been against social regulation, and the attitudes of the courts is a reflection of this (see Section V).

¹¹⁹Table 2 generalizes, of course. American liberals, for example, favor social regulation when it comes to race and gender, and there has been a strong trend towards economic deregulation on the part of all the groups listed. “Neoconservatives” are perhaps defined by their attitude towards the Soviet Union and Israel more than anything else. Classic liberals might belong either with American conservatives or libertarians, since the Victorians favored free trade but not free love. John Stuart Mill is an exception; he opposes Sabbatarian legislation and prohibition of strong drink, bigamy, and opium; John Stuart Mill, *On Liberty*, 194, 196, 198, 203 (1859), in *Utilitarianism, Liberty, and Representative Government*, E.P. Dutton and Co., Inc., 1951. One would expect different views from Macaulay, Gladstone, and De Tocqueville.

opposite conclusion.¹²⁰ The puzzle is not that uneducated people misunderstand economics, but that it has taken so long for economic theory to develop and to penetrate into policy.¹²¹

One explanation is that rent-seeking is the source of much economic regulation. It is no mystery why optometrists were forbidden to advertise: this increased the profits of optometrists by making it harder for them to bid down prices. When rent-seeking is the motive, the very economic sophistication of the interest groups seeking regulation is the source of trouble. Thus, the economic regulation of the past may be the consequence of government failure— or perhaps of the necessary defects of past governments.

Another explanation is that in the pre-industrial age economic regulation may have been efficient. Economic regulation is generally inefficient in the modern world, but it is not so clear that it was generally inefficient in primitive societies, where market imperfections were more likely to arise.¹²² In the past, economic regulation was much more like social regulation, because economic interactions were on a very local level, and violence was prevalent enough that efficient outcomes were difficult to obtain in any case. Perhaps economics failed to catch on before Adam Smith because it did not apply to most situations; few interactions were market interactions, so the invisible hand failed to operate. The old feeling that regulation was necessary could have been correct for the kinds of interactions that then existed.

With regard to both kinds of regulation, some people are not utilitarians, or at least do not like to think of themselves as utilitarians. One modern academic view emphasizes the importance of “autonomy,” and of people being free to act as they wish. If this is the goal, rather than happiness, a quite different approach to regulation is needed. It may be that economic regulation is unnecessary for this goal or that social regulation is necessary, but that is a problem I leave to those more sympathetic with the goal of autonomy.¹²³ Or, American liberals may value not just happiness, but equality of achievement, in which case economic regulation is undoubtedly useful. Similarly, a European conservative may be religiously motivated and feel that the gross national product is a trivial goal compared with spiritual well-being, so that both economic and social regulation is helpful. Or, even accepting the utilitarian premise, the utilitarian who considers monetized output important may be fundamentally misled because social stability may be much more important to happiness, returning us to the policies of the European conservative.¹²⁴

¹²⁰The conservative may even be right: remember that not too many years ago it was accepted medical practice to remove children’s tonsils, and now it is not. This is not say that economics is less reliable than biology or engineering, but we cannot count on certainty in any discipline.

¹²¹xxx “In a simpler age of the world and in a smaller community such laws [sumptuary laws] may have been very useful. The same remarks apply to laws as to the distribution of property and to the regulation of trade.” Stephen, *supra* note 9, at 157.

¹²²xxx See Earl Thompson on guilds.

¹²³See Sunstein, note 30, and Cass Sunstein *After the Rights Revolution*, Harvard University Press, 1990, for example.

¹²⁴xxxx Maybe cite Hume in his little book here, on happiness being the goal. Maybe Augustine too. As an economist myself, the position of economists particularly interests me. We economists must beware of wearing blinders, like the tipsy partygoer who was looking for his car keys near the streetlamp. “Are you sure you dropped them here?” “No, but the place where I dropped them is too dark to look.” Economists like parties, we have a paradigm of intoxicating power, and we sometimes avoid the hard questions. The approach of value maximization is an example: once one decides that value maximization is the goal, questions of how to increase the utility people get from the same amount of resources once we have allocated them so as to maximize value vanishes. See *supra* note 62. This is like overstressing productive efficiency at the expense of innovation which could make the same resources yield more physical output. Robert Ellickson suggests that law-and- economics is ripe for a second generation of models, which would incorporate psychological elements (see Kahneman & Tversky, note 76), limited human ability to process information, culture, and the difficulty of self control; Robert Ellickson, “Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics,” *Chicago-Kent Law Review*, 65: 23-55 (1989).

Even on this slippery slope, however, the economic approach does give some purchase.¹²⁵ Economists are like Freudians: Nothing happens by accident.¹²⁶ If an institution exists, it exists for some reason, and one must always ask *cui bono*. More strongly, if the costs of changing the institution are low, the Coase Theorem tells us that it is reasonably efficient.¹²⁷ What, then, is the goal of social regulation? If it is granted that nothing exists without a reason, the policymaker will not abandon a custom with just a little evidence that it is useless or pernicious, as he would if Everything Happens By Accident. Economists have approached the common law in this spirit and shown that various of its rules are efficient.¹²⁸ They have not succeeded so well at explaining the common law with respect to social regulation—sodomy, the position of women, and so forth—but why should they conclude that the common law’s social regulation is inefficient?¹²⁹ Is it not equally possible that the economists just haven’t figured out the regulations’ point yet? One might better trust the collected social wisdom of the centuries than the negative research results of two decades.¹³⁰ Thus, another argument in favor of social regulation is that it has been so common. We do not expect big inefficiencies to persist.¹³¹

An unfortunate feature of social regulation is that it may need to employ an ideology with self-destructive tendencies.¹³² While it may be useful to shape people’s tastes shaped to make them happy and good citizens, the tastes useful for this purpose may not be tastes which support the system.¹³³ This should be an important point for libertarians who remember the *laissez faire* of the Victorian Age nostalgically: if the system worked so well, why could it not keep the allegiance of the elite class?¹³⁴ Laws by themselves may be insufficient without tradition and ideology. A tradeoff may be required between stability and happiness. I will do no more than hint at the problem here.

Thus, when confronted with the unknowns of sociology, economists tend to support the default of *laissez faire*.

¹²⁵xxx Fix up this metaphor.

¹²⁶Economists are also like Freudians in saying that the motives and preferences that men claim—and may even believe—are not always the true motives. Rent-seeking is a prime example. But economists do not say that people really want something besides what they actually buy—only that one cannot trust their explanations for what they buy, or their stated intentions about what they will buy in the future.

¹²⁷Coase, *supra* note 69.

¹²⁸For the debate on the efficiency of the common law, see William Landes & Richard Posner, “Adjudication as a Private Good,” *Journal of Legal Studies*, 8:235 (1979); George Priest, “The Common Law Process and the Selection of Efficient Rules,” *Journal of Legal Studies*, 6:65 (1977); Paul Rubin, “Why Is the Common Law Efficient?” *Journal of Legal Studies*, 6:51-63 (January 1977).

¹²⁹Posner admits and emphasizes that much social regulation makes sense in terms of efficiency—and, indeed, is skillful at noticing efficiency justifications—but he remains critical of it. See Richard Posner, *Sex and Reason*, Harvard University Press, 1992, pp. 213-219.

¹³⁰The thoughtful reader will turn my argument on its head and ask: “Why do American intellectuals oppose social regulation, if it is such a good idea?” Whenever clever people disagree, the truthseeker should be troubled. I point to one answer above: lack of training in history and economics. xxx An overdose of the ideology of freedom. Anti-Confucianism. Also, lack of understanding of the regression argument for conservatism. Rasmusen, “Managerial Conservatism and Rational Information Acquisition,” *Journal of Economics and Management Strategy*, 1: 175-202 (Spring 1992). Starting from a situation of heavy social regulation and light economic regulation, there is a theoretical reason why politicians and people might like bad innovation: the selection theory. Eric Rasmusen, “Observed Choice, Estimation, and Optimism About Policy Changes,” *Public Choice*, 97: 65-91 (October 1998).

¹³¹This is an important theme in Robert Ellickson’s work, laid out in “A Hypothesis of Wealth-Maximizing Norms,” Chapter 10 of Ellickson (1991).

¹³²Parfit, note ?? at 3-45, has an interesting discussion of *self-destroying theories*, in which individuals who follow the theory destroy the goal collectively, and *self-effacing theories*, which require that the individuals not believe the theory.

¹³³Schumpeter pointed out the weakness of the ideological underpinnings of capitalism: Joseph Schumpeter, *Capitalism, Socialism, and Democracy*, 3rd Edition (1950). He doubted that capitalism could survive, given its unromantic ideology, because the bourgeois had not the will to defend their own interests.

¹³⁴xxx I heard somewhere that former French president Giscard D’Estaing said that he did not want to go back to before 1968, the year of unrest in France, because then 1968 would happen again.

A good society may require three things (a) social regulations, (b) a belief that the laws are good, and (c) a belief that the laws have specific justifications rooted in morality, not in efficiency or tradition. This would be the case if the justifications I have advanced for social regulation are correct, but are not psychologically effective in inducing people to obey the laws. If this is the case, an ideology is needed— a set of beliefs that induces people to behave optimally but need not be logical, consistent, or correct.¹³⁵

V. CONCLUSIONS

There has been a marked decline in traditional social regulation in the United States since 1960, combined with a decline in some areas of economic regulation (brokerage commissions, airline fares) and an increase in others (product liability, firing workers), to the point where by now we regulate the car industry more than the pornography industry. John Kenneth Galbraith is known for the claim, some thirty years ago, that there are not enough public goods in a rich society, so we have “private wealth and public squalor”.¹³⁶ By 1992, it seems there are not enough social goods in a rich society.¹³⁷

Economics has become increasingly unimportant over the years, for both theoretical and empirical reasons. On the theoretical side, economics is well developed and has been intensively studied using the standard paradigm, to the point where theory has outstripped policy recommendations. Economic policy can still be reformed, but the important reforms are those justified by the simplest, most basic theory. An economist transported forward from 1890 to 1990 would find that his advice could still help governments, and would still be refused. The main lesson of economics is that *laissez faire* works very nicely. Having learned this lesson, there is not much in the way of positive policy implications. On the empirical side, the current economic policy of the United States works reasonably well, and the country is wealthy enough that it could afford much worse policies. America has solved the economic problem and is left with the social problem. Everybody has a flush toilet and a television, but everyone also has high crime and divorce rates in their neighborhood, if not always in their immediate families. Table 3 shows some of these conflicting trends. The net effect on happiness is unclear. Indeed, anyone saying that the government get out of our bedrooms should ask himself where it is that our problems begin.

TABLE 3: Trends in American Life¹³⁸

¹³⁵xxx “Why rake into those corners of nature which spread a nuisance all around? Why dig up the pestilence from the pit in which it is buried? The ingenuity of your researches may be admired, but your systems will be detested, and mankind will agree, if they cannot refute them, to sink them at least in eternal silence and oblivion. Truths which are *pernicious* to society, if any such there be, will yield to errors which are salutary and *advantageous*.” Hume, *supra* note 7 at 99. Note the word “nuisance”— an old word for a certain kind of negative externality. Also, think about Plato’s noble lie—see *The Republic*, note 2 at xxx.

¹³⁶xxx John Galbraith, *The Affluent Society*, Houghton Mifflin, 1958, p. xxx.

¹³⁷xxx Cite to Coleman on social capital.

¹³⁸Sources: 1950 per capita consumption, Lebergott, p. 152. 1990, p. 162. Toilets: Lebergott, p. 102. TV’s: Lebergott, p. 137. TV viewing, Bennett, Index of Leading Cultural Indicators, Vol. I, 1993 p. 21 (original source: Neilsen). Infant mortality: SA99-98 and HS 142. Death rates: 430 HS 187 and SA99-95. 1950 births:HS B1-4 , B28-35 142/3,632. 1996 births: SA-99, p. 80. 1950 marriage and divorce: 385/1,667 HS B1-4. 1995 marriage and divorce SA-99, p. 75. 973/1954. Married people: SA-99, p. 58, 1950 men: 6,540, married 5,321. Women: 6,633. Married: 4,310. People: 13, 173. Married: 9,631. 1998 men 10,673. Married: 8,559. Women: 11,582. Married: 7,847. People 22,255. Married: 16,406. Murder rate: SA99, p. 215. HS 972, p. 414. Suicide rate: HS-980, SA99, p. 99. Robbery rate: HS-956, SA99-p. 214. Prisoners: 1.1 per 1,000 equals 166/150697 HS-H1135, SA99, p. 8. 1183/264463, SA99, p. 232, 8. (1996 data). Books: SA99,p. 587. HS-R193, p. 808.

Variable	1950 or so	1990's (date variable)
Per capita personal consumption (1987 \$)	\$5,741	\$13,051
Households with inside flush toilets	71%	99+%
Households with televisions	9%	98%
Infant mortality (per 1,000 births)	29.2	7.3
Death rate for males aged 35-44 (per 100,000)	430	264
People aged 55-64 with a spouse	73%	74%
Household hours of TV viewing	5.06 (in 1960)	7:04
Suicide rate (per 100,000)	11.4	11.1
New books and editions published	11,022	64, 711
Ratio of illegitimate to all births	4%	32%
Ratio of divorces to marriages	.23	.50
Murder rate (per 100,000)	5.3	6.8
Robbery rate (per 100,000)	38 (in 1957)	186
People in prison or jail (per 100,000)	110	447

On the theoretical side, sociology is more important than economics because it contains more unsolved basic questions. We are at a loss as to what to do for social policy, relying more on intuition than theory. On the empirical side, as a state becomes richer, economic affairs matter less, and social affairs more. The poor people of the United States are rich by world standards, but they may well be unusually unhappy by those same standards. We can expect to get richer in spite of our economic policy, if not because of it. Economic markets are working better and better—information improves, transport costs fall, and markets carry the division of labor further and further. Moreover, technical innovation continues to advance even mismanaged economies— with enough good scientists, statesmen are superfluous— but social markets are not working better. Social pathologies seem to have increased in many ways.¹³⁹ Also, we cannot expect economic progress to bring social progress, for it seems unlikely that we can solve social problems by spending money, instinctual though increased spending is for politicians facing problems.¹⁴⁰ If the government throws money at a problem, there's generally somebody there to catch it. Social regulation is not prone to rentseeking, but social spending certainly is.¹⁴¹

I have tried to sketch out reasons why economic and social interactions are different enough that one cannot safely extrapolate from the general undesirability of economic regulation to conclude that social regulation is also undesirable. This is true not only because the exceptions which sometimes justify economic regulation are so much more common in social regulation, but also because social regulation is often based on other justifications which have no place in economic interactions— concerns with the formation of tastes and the interdependence of utility functions, for example. Also, social regulation is less prone to misimplementation than economic regulation, because it is

¹³⁹xxx Facts should go here. It is noteworthy that private law relies heavily on custom, and teh private economy has done well in the US; public law (criminal and constitutional) relies heavily on theory, and the social system has done badly.

¹⁴⁰In a recent television interview of attorney general William Barr, Sam Donaldson attacked programs that try to make it more difficult to have an illegitimate child and said “But you can’t have a social agenda without money.” Barr’s weak response was that the government was indeed spending a lot of money. Paul Gigot “Los Angeles Riot is also Verdict on Washington,” *Wall Street Journal*, Friday May 1, 1992, A14.

¹⁴¹xxx President Clinton would get more credit for reducing unemployment than the illegitimacy rate, though he may have more influence over the latter.

less prey to rent-seeking. At the same time, the very complexity of social interactions and our ignorance of how they work should give pause to anyone intending to innovate in social regulation.

I am afraid that this article's conclusions may be considered indecisive— and, in fact, may well be indecisive. It has come to the typical economist's position that there should be a balancing test: sometimes innovation in social regulation is justified, and sometimes it is not. The choice of when to favor social experimentation may be driven largely by temperament. Yet I hope that this article has shown two things. First, that apparently broad disagreements do not necessarily indicate difference in non-arguable values, but rather indicate differences in interpretations of facts. Whether drugs should be legalized depends not on whether drug use is evil or not, but on how much pleasure it creates for drug users and how much cost it imposes on the government to prohibit drug use. Second, this article has shown that traditional conservatism can be based on a modern utilitarian framework, and even someone who has an innovative temperament should consider carefully the conservative arguments of caution and modesty. Whether these arguments should stop judicial intervention or legislative action in a particular case may be a matter of temperament, but the utilitarian arguments for tradition and social regulation cannot be ignored.

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