Presenting a Critical Perspective on “Economic Efficiency” in Law and Economics Courses

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PRESENTING A CRITICAL PERSPECTIVE ON “ECONOMIC EFFICIENCY” IN LAW AND ECONOMICS COURSES

Gregory Crespi*

ABSTRACT

“Law and Economics” courses are sometimes criticized for inadequately explaining the normative criterion of “economic efficiency” and then applying this criterion throughout the course in a superficial and biased manner that pejoratively labels most governmental market interventions and wealth redistribution measures as inefficient. These criticisms have merit, and in this article I point out a number of conceptual problems, empirical difficulties, and normative shortcomings of the economic efficiency criterion that students need to understand in order to be able to effectively counter policy arguments that rest upon dubious efficiency assessments.

The eight specific shortcomings of the economic efficiency criterion that I address in this article are the pervasiveness of severe data limitations that render efficiency assessments unreliable; the indeterminacy regarding whether willingness to pay should be measured by offer prices or instead by asking prices; the difficulty of obtaining honest and accurate responses as to willingness to pay; the uncertainty as to the appropriate discount rate that should be used for discounting future policy consequences; the problem posed for efficiency analyses by endogenous preferences; the severe difficulties posed by the often-overlooked “problem of person-altering consequences;” the problematic nature of using willingness to pay as a measure of social value; and finally, the dubious nature of a normative criterion that does not give special primacy to rights.

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I. INTRODUCTION

JOE McKnight was a pillar of the SMU law faculty from 1955 until 2015, an incredible sixty-year career that spans most of the history of the law school. Joe was widely known to several generations of Texas lawyers as the leading expert on the influence of Spanish law upon the Texas legal system, as the leading authority on Texas family law and matrimonial property law, and as a principal drafter of the Texas Family Code. But Joe was not only a leading scholar and active participant in law reform; he was also an excellent teacher. As any of his students will tell you, Joe taught his classes in a rigorous and demanding manner, but his strict approach was always leavened with a wry sense of humor and recognition of the long history of human folly. He required his students to deeply question the conventional wisdom in the subjects that he covered. He insisted that they make efforts not only to learn the law and learn it well, but also to strive to better understand the interest group dynamics and social policy considerations that have shaped legislation and judicial rulings as well as influenced the general climate of intellectual opinion.

This article follows in Joe’s tradition of encouraging skeptical inquiry. Most Law and Economics courses are based upon relatively uncritical

3. I will refer generically to those widely-offered upper-level elective law school courses that apply basic microeconomic concepts to analyze the operation of various as-
application of the normative criterion of “economic efficiency” to various aspects of the law. If this fact had been called to Joe’s attention, he would not have liked it. He would have wanted the instructors of such courses to first impart to their students an understanding of the historical origins and hidden implicit assumptions underlying any evaluative criteria that they would later be encouraged to use to assess laws or to suggest the contours of appropriate legal reforms. It is in this spirit of critical reflection that I write this article and dedicate it to Joe’s memory.

Law and Economics courses are sometimes criticized for inadequately explaining and then summarily endorsing the use of the normative criterion of “economic efficiency” to evaluate policies and then applying this criterion in a superficial and biased manner to pejoratively label most governmental market interventions and wealth redistribution measures as inefficient. Those critics argue that the efficiency criterion is not well defined and allows for result-oriented manipulation by analysts, and that it is also often difficult or impossible to obtain sufficiently reliable data to meaningfully apply the criterion. In addition, they argue the criterion has a pronounced bias in favor of the interests of the wealthiest members of society and does not accord any respect to rights. They also argue that these severe shortcomings of the criterion are not made sufficiently clear to students to enable them in their later studies and careers to effectively counter policy recommendations that are based upon dubious efficiency assessments.

There is considerable merit to these criticisms, and as Joe McKnight surely would have noted, consideration of the history of the introduction of Law and Economics courses into law school curricula is helpful in understanding why the shortcomings of the efficiency criteria are often underemphasized in those courses. It is troubling to learn that much of the early advocacy and financial support provided in the 1970s and afterward for the introduction of Law and Economics courses into law school curricula of the legal system as “Law and Economics courses,” although such courses are sometimes offered under different though similar titles such as the “Economic Analysis of Law” (the course title used at the SMU Dedman School of Law where I teach), “Law and Economic Analysis,” etc.

4. When I use the terms “economic efficiency” or “efficiency” in this essay I am consistently referring to the Kaldor–Hicks efficiency criterion that is the evaluative criterion generally applied in practice and not to the Pareto-efficiency criterion, which because of its unanimity requirement has very little practical application. I will discuss the Kaldor–Hicks efficiency criterion in some detail infra Part II.

5. See, e.g., Markovits, supra note 1; see also McCluskey et al., supra note 1, at 298–99.

6. See, e.g., Eric M. Fink, Post-Realism, or the Jurisprudence Logic of Late Capitalism, 55 HASTINGS L. J. 931, 940 (2004); see also Anthony T. Kronman, Wealth Maximization as a Normative Principle, 9 J. LEGAL STUD. 227 (1980).

ricula, as well as for the broader use of the efficiency criterion in legislative, regulatory, and judicial decision-making often in the guise of “cost-benefit analysis,”8 has been shown to be directly or indirectly due to the efforts of certain wealthy individuals who embraced a right-wing libertarian political orientation and whose financial interests would be furthered by a more widespread embrace of the efficiency criterion.9 The fact that several ideologically-oriented foundations established by these individuals provided much of the financial support in the 1970s and afterward for many law schools’ Law and Economics courses, and for various judicial and regulatory workshops that promoted efficiency as an important social interest,10 suggests that the broad and uncritical embrace of the efficiency criterion that often characterizes these courses and workshops is not just a mere oversight but was instead actively encouraged by those persons promoting and sometimes later offering those courses and workshops.11

These criticisms call into some question conventional Law and Economics courses that rest heavily upon application of the efficiency criterion. However, in my opinion, these criticisms can be adequately addressed through relatively modest pedagogical changes and do not justify the more radical measure of eliminating these otherwise useful classes from law school curricula. My experience in teaching Law and Economics courses for over twenty-five years here at the SMU Dedman School of Law is that it is possible to provide law students with a succinct yet fairly comprehensive and critical introduction to the concept of economic efficiency that not only explains the criterion and apprises students of its current widespread application in policy analysis but also helps them to understand the numerous and severe conceptual, empirical, and normative shortcomings of that criterion.

It is important for teachers of Law and Economics courses to explain and critique the concept of economic efficiency in some detail at the outset so that the students will then understand why efficiency assessments of policies are often useless or even positively misleading. This coverage is necessary to prepare students to be able to respond effectively to the policy arguments that they will encounter in various contexts in their

8. The phrases “cost-benefit analysis” or “benefit-cost analysis” are simply synonymous phrases that describe assessing a policy measure by its economic efficiency as measured by the Kaldor–Hicks efficiency criterion that is discussed in detail infra Part II. The same wealthy and politically influential persons that promoted the introduction of efficiency-oriented Law and Economics courses into law school curricula in the 1970s also supported the promulgation by the Reagan administration in 1981 of Executive Order 12291, which required many proposed executive branch regulatory initiatives to be supported by a cost-benefit analysis showing them to be economically efficient. See generally JANE MAYER, DARK MONEY: THE HIDDEN HISTORY OF THE BILLIONAIRES BEHIND THE RISE OF THE RADICAL RIGHT 100, 102, 107–10 (2016); Exec. Order No. 12, 291, 3 C.F.R. § 127 (1981). Despite the shortcomings of the economic efficiency criterion that I discuss herein, cost-benefit analysis has since become deeply embedded in federal regulatory policy. See generally CASS SUNSTEIN, THE COST-BENEFIT STATE (2002).
10. Id.
11. Id. at 109.
other law school courses and during their later professional careers that are based on dubious efficiency assessments, whether couched in the jargon of cost-benefit analysis or otherwise. In this brief essay offered in tribute to the work of Joe McKnight I will attempt to highlight the major conceptual and empirical difficulties that one will face when attempting to assess the efficiency or inefficiency of a particular policy, and I will discuss what is normatively problematic about using this criterion as an evaluative standard even in those few instances where these conceptual and measurement difficulties can somehow be overcome.

II. THE ECONOMIC EFFICIENCY CRITERION DEFINED

"Efficiency" is a protean term that means different things in different contexts. In the physical sciences, the concept of technical efficiency—the idea of achieving the maximum possible amount of a desired output from given amounts of various inputs—is obviously an attractive normative criterion for evaluating machines and production processes. Where the goal of a process is a single, well-defined output, the efficiency with which costly inputs can be turned into that output rather than wasted is of central importance. Who could argue with, for example, evaluating an engine largely by the proportion of the fuel energy that it is able to convert to useful work rather than being lost in friction, vibration, or radiation of heat energy? The obvious advantages of turning particular inputs into useful outputs in a technically efficient manner has consequently given the generic term "efficiency" a positive connotation in the popular imagination.

The particular variation of the efficiency concept that is generally applied in assessing the economic consequences of policies is what economists call "Kaldor–Hicks efficiency." The Kaldor–Hicks efficiency criterion has a straightforward and intuitively appealing definition. If the aggregate benefits of a policy to those persons favorably impacted by it, as measured by their willingness to pay for those benefits if they were required to do so, exceed the aggregate costs of that policy imposed upon those persons unfavorably impacted by it, again as measured by their willingness to pay if required to do so to avoid those costs, the policy is then regarded as a "Kaldor–Hicks improvement" and is often more colloquially described as simply being economically efficient or as resulting in an increase in social wealth. Or, alternatively, the policy can be described as satisfying the "cost-benefit" test. There is no additional requirement that compensation be paid by the policy's beneficiaries to those persons burdened in order for that policy to be a Kaldor–Hicks improvement or justified by the cost-benefit criterion. It is sufficient if the

13. See id. at 17.
aggregate benefits so measured exceed the aggregate costs. If a resource allocation is reached where no further Kaldor–Hicks improvements are possible, then that allocation is described as being “Kaldor–Hicks efficient,” or, equivalently, as being “efficient” or “wealth maximizing” relative to any possible re-allocation of resources.15

The most straightforward application of this economic efficiency criterion, one that is usually presented early on in Law and Economics courses to illustrate the underlying concepts, is to conduct a geometric analysis of the efficiency of various forms of governmental intervention into a hypothetical free market that otherwise satisfies the behavioral and institutional assumptions for perfect competition. Using a simple supply-and-demand graph depicting such a market in competitive equilibrium,16 the aggregate benefits of the existence of such a market to the buyers of the good or service can be shown to be the size of the triangle17 under the demand curve and above the equilibrium price line. This area represents the aggregate willingness to pay of those persons who buy in this market over and above the market equilibrium price they are required to pay for the good or service. Each of these buyers will obtain a benefit from their purchase equal to the difference between their personal “reservation price” for the good or service18 and its equilibrium price. The aggregate benefit to all of these buyers is referred to as the “consumer surplus” generated by this market.19

In a similar fashion, the aggregate benefits of the existence of this market to the sellers can be shown by the size of the triangle20 above the marginal cost-based supply curve and below the equilibrium price line, with each of these sellers obtaining a benefit from their sale equal to the difference between their personal reservation price for the good or service21 and its equilibrium price. The aggregate benefit to all of these sellers is referred to as the “producer surplus” generated by this market.22

16. Id. at 11.
17. This area will not be precisely triangular unless the demand curve is a straight line, but this fact does not affect the usefulness of this framework for illustrating this basic point regarding the determination of the size of the consumer surplus. See id. fig. 1.2.
18. A buyer’s reservation price for a good or service represents the highest price that they would be willing to pay for that good or service rather than to have to do without it.
20. This area will not be precisely triangular unless the supply curve is a straight line, but this fact does not affect the usefulness of this framework for illustrating this basic point regarding the determination of the size of the producer surplus.
21. A seller’s reservation price for a good or service represents the lowest price that they would be willing to accept for that good or service rather than to retain it unsold.
22. See Posner, supra, note 12, at 358.
ance of collusion among buyers or sellers—will generally reduce the combined consumer and producer surplus that the market generates. Therefore, such governmental interventions into market processes are usually judged to be inefficient or described as failing the cost-benefit test.

It is also easily demonstrated that under this willingness to pay-based valuation framework any simple transfer of wealth from one group of persons to another through one of these market interventions will have an aggregate cost to those persons burdened that is exactly equal to its aggregate benefits to those persons benefitted. Since any transfer of wealth will, in practice, necessarily involve some transaction costs and inefficiencies in arranging and carrying out those wealth transfers, when those transaction costs and inefficiencies are taken into account the redistribution of wealth will be wealth-reducing and therefore inefficient.

I recognize that most teachers of Law and Economics courses, at about this point in the class, will then attempt to make clear to students that not all markets satisfy the perfectly competitive market assumptions that underlie these conclusions as to the general inefficiency of governmental interventions that alter market outcomes or redistribute wealth. Teachers can and usually do demonstrate through use of the same basic supply-and-demand framework that there can be market failures when there are positive or negative externalities of production or consumption that are not captured by the relevant supply or demand curves, or sellers or buyers significantly depart from rational actor assumptions. Under such circumstances markets may fail to reach efficient results, and appropriate governmental interventions may to some extent rectify these inefficiencies and increase overall social wealth. Another way that this insight is sometimes communicated to students is to explain that some governmental regulatory measures that first appear not to be cost-justified may actually satisfy the cost-benefit criterion if the impacts of those measures on external costs and benefits are also quantified and included in the overall assessment. But these important caveats as to the possible inefficiencies resulting from market failures, and their potential amelioration through appropriate governmental actions, are then often downplayed or overlooked entirely later in the course when various laws, and in particular various governmental market interventions, are examined for their efficiency or inefficiency. In addition, the points that I will discuss below regarding why the use of the efficiency criterion as an evaluative standard is problematic, even in those contexts where all of the restrictive assumptions of perfect competition are satisfied and when all costs and benefits are internalized, are generally covered inadequately if at all.

The economic efficiency criterion and its widely used cost-benefit analysis embodiment do have some appeal as a normative standard because of the association of this criterion in the popular mind with the relatively unproblematic concept of technical efficiency that is utilized in the physical sciences. But as Richard Posner has noted, this evaluative criterion
also has appeal because it is a criterion with a precisely defined algorithm for quantifying and aggregating disparate impacts. By utilizing the willingness to pay-based measure for valuing all policy impacts the efficiency criterion has the substantial operational advantage of avoiding the severe, if not insurmountable, measurement difficulties and highly subjective value judgments inherent in applying utilitarian happiness impact measures, valuing the abridgment of Kantian personal autonomy constraints, or harmonizing the different aspects of more complex multi-factor evaluative criteria. The willingness to pay-based algorithm of efficiency analysis certainly makes valuing policy impacts much simpler than it would be under these other criteria, to say the least. However, if its properties are not then developed in some detail so that the more subtle yet severe conceptual, empirical, and normative limitations of the criterion are made clear, this criterion which consistently demonstrates the inefficiency of governmental interventions into perfectly competitive markets and of governmental income or wealth redistribution measures will implicitly convey to students the broad and misleading message that a limited, laissez-faire government that provides a basic framework of law and order, but does not otherwise interfere with market processes or redistribute market-generated incomes, will better facilitate the general welfare than will a more interventionist government. This simplistic, pro-free-market orientation that the uncritical use of the efficiency criterion encourages often implicitly suffuses the remainder of the Law and Economics course as various legal doctrines in property law, contract law, tort law, corporate governance, etc., and various governmental regulatory efforts, are in turn examined for their efficiency or inefficiency. This repeated assessment of legal rules by the efficiency criterion when its conceptual and empirical shortcomings and problematic normative basis have not been first fully explained to students is what those persons who criticize these Law and Economics courses as superficial and biased in favor of the interests of the wealthiest members of society find most objectionable.

Law and Economics courses do not have to be taught this way. It is entirely possible for a teacher who is willing to devote a week or so of class coverage to the economic efficiency criterion to properly explain that concept and demonstrate its wide usage, yet do so in a critical manner that makes clear to students its numerous shortcomings. The students then, both in their studies and later professional careers, will hopefully have a greater capability to effectively refute arguments regarding a pol-

23. For discussion of the advantages of the Kaldor–Hicks efficiency criterion relative to either utilitarian or Kantian-type evaluative criteria, see generally Richard A. Posner, Utilitarianism, Economics, and Legal Theory, 8 J. LEGAL STUD. 103 (1979) [hereinafter Posner (1979)]. Posner does a much better job in that article demonstrating the weaknesses of utilitarian or Kantian evaluative criteria than in defending the Kaldor–Hicks efficiency criterion, and moreover, his defense essentially only addresses the major normative criticisms made of that criterion and not the several conceptual or empirical problems that I discuss infra Part III. See also Posner, supra note 12, at 15–20.

Let me briefly discuss the numerous serious problems that are inherent in the use of the efficiency criterion to evaluate policies. I will first address the substantial and arguably overwhelming conceptual and empirical difficulties that are involved in reaching a meaningful quantitative assessment of the efficiency or inefficiency of a policy. I will then address the problematic assumptions involved in using efficiency as a normative criterion for assessing the merits of a policy even if one is somehow able to meaningfully quantify the policy impacts.

III. CONCEPTUAL AND EMPIRICAL PROBLEMS INVOLVED IN MEASURING WILLINGNESS TO PAY

The most severe problems that are commonly encountered in quantifying the willingness to pay based impacts of a proposed policy measure are the following six difficulties:

A. The practical limitation that it is usually not possible to survey more than a modest-sized sample of the likely affected current population when measuring a proposed policy’s impacts, and that it is obviously impossible to survey those persons who will later be impacted by the policy but who are not yet born at the time of its implementation;

B. Resolving the question of whether to measure the willingness to pay of the persons surveyed through their offer prices or instead through their asking prices;

C. The difficulty of obtaining honest and accurate measures of willingness to pay from those persons surveyed;

D. The problem of determining the appropriate discount rate to apply to future policy impacts before aggregating them with current impacts;

E. The problem posed by the possibility that the preferences of some or all of the persons impacted by a policy may be endogenous with respect to that policy rather than stable and exogenously determined; and perhaps most intractably,

F. The problem that one of the long-term impacts of any policy whatsoever is that its implementation will eventually lead to a different genetic identity at the time of conception than would otherwise be created for all persons born thereafter through the end of eternity—i.e., the policy will eventually have universal “person-altering consequences” in that all of the persons who will later come into being after some relatively short period of time after the implementation of a policy will do so only because of the particular policy that was implemented, and these obviously momentous policy consequences of existence itself for those persons will somehow have to be taken into account in valuing those impacts.

Let me briefly address each of these several difficulties in turn.
A. SAMPLING LIMITATIONS

For the basic supply-and-demand market model commonly used to geometrically introduce the concept of economic efficiency in Law and Economics courses, the reservation prices of all of the potential buyers and sellers are assumed to be known and represented by the positions of the demand and supply curves, respectively. In that event, the problem of calculating the willingness to pay-based impacts of a governmental market intervention is reduced to a simple matter of addition and subtraction. For real-world attempts to assess the efficiency of policies, however, the willingness of the impacted persons to pay to experience (or to avoid) the consequences of the policies are not so given. The exact positions of the relevant supply and demand curves are generally not known, and the contours of those curves will have to be empirically determined.

In practice, unfortunately, whoever is directed to assess a policy’s efficiency or inefficiency is usually not provided with anywhere near the resources that would be necessary to survey even a substantial fraction of the living individuals who would be impacted to some extent by the policy, who may easily number in the millions or more for significant governmental policies, and of course the analyst will be unable to survey those persons who will eventually be impacted by the policy once they come into existence but who have not yet been born at the time that the policy’s impacts are being assessed. The analyst will typically be limited to surveying the responses of, at most, a relatively small sample of the current population and then will have to make projections based upon those findings in order to estimate the aggregate willingness to pay of the entire current population. Based also on those sample survey findings, the analyst will have to speculate as to how the affected members of future generations will regard the policy impacts and then offer willingness to pay-based estimates for those future persons accordingly. With all of this projection and speculation from an often very small survey database, even if relatively sophisticated stratified sampling techniques are utilized to enhance the representativeness of the selected sample, this will sharply limit the confidence that one can have in these estimates.

B. DETERMINING WHETHER TO USE OFFER PRICES OR INSTEAD ASKING PRICES TO MEASURE WILLINGNESS TO PAY

The use of the simple blanket phrase “willingness to pay” masks an important yet unresolved (and perhaps unresolvable) issue in efficiency analysis. When attempting to ascertain the willingness to pay of a person who is benefitted by a policy, is the proper question to pose how much the person would be willing to pay to receive those benefits—commonly referred to as their “offer price” for those benefits—or is the proper question instead how much that person would demand to give up those benefits once they had been conferred upon them—commonly referred to as their “asking price”? Similarly, and more importantly, when attempting to ascertain the willingness to pay of a person who would be
injured by a policy to avoid its costs, is the proper question to pose how much that person would be willing to pay to avoid the imposition of those costs—again their offer price—or instead how much that person would demand for their consent to have those costs imposed upon them—their asking price?

Unfortunately, the manner in which the willingness to pay question is posed may significantly affect the answers obtained. Depending on the framing of the question, these answers may differ dramatically in size, particularly when attempting to measure the impacts of a policy on those persons for which the policy is perceived as imposing substantial costs. The reason for this is that while a person’s offer price to avoid a policy’s costs is necessarily constrained by the amount of their wealth and by what other objectives they will want to use their wealth to satisfy their asking price is not so constrained and has no necessary upper limit. If a person is highly reluctant to consent to implementation of a particular policy as a matter of principle then that person’s asking price for their consent could be very large or even infinite in the sense that they might refuse to give their consent to the policy’s implementation for any amount of money.

An efficiency assessment of a policy will obviously not provide meaningful guidance to policymakers if there are one or more infinite costs included in the balance that will dominate all other valuations.

An analyst conducting an efficiency analysis will have to choose whether to use offer prices or instead asking prices for their measurements of willingness to pay or whether instead to use some combination of the two forms of measurement. The efficiency criterion would be more useful if there was a theoretically “correct” choice here as to the proper questions to pose so that analysts would not be able to covertly manipulate the questions used in order to reach a result that they favored for other reasons. But no one has yet offered a convincing and definitive resolution of this offer/asking price problem that can be incorporated into standard analytical practice given the inherent vagueness of the willingness to pay efficiency formulation.

One may, for example, choose to look to the operation of markets for some guidance as to how to measure willingness to pay, given that efficiency analysis is often regarded as an attempt to apply market-like assessment principles to evaluate governmental policies that primarily impact persons in non-market settings. Buyers in markets will pay no more than their offer prices for the benefits of having a good or service, and this suggests that offer prices are perhaps the most appropriate measures of willingness to pay, at least for policy beneficiaries. On the other hand, sellers in a market do not have to part with their goods or services

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25. Consider, for example, the very large asking prices that might be expressed by some persons sincerely opposed to abortion as a matter of principle with regard to a policy whereby the federal government facilitated and fully financed all abortions.

26. For further discussion of the conundrum posed by the choice between using offer prices or instead asking prices in efficiency analysis, see generally Crespi (2006), supra note 14.
unless their asking prices are met, suggesting that asking prices may be the proper measure to use for valuing the costs imposed by policies. So if efficiency analysis is to be done in a manner that most closely emulates the workings of markets, perhaps offer prices should be used to measure benefits and asking prices to measure costs.

In practice, however, almost all efficiency analyses use offer prices to measure both the benefits and costs of the policies being considered. But this approach seems to be based primarily upon the desire of analysts to avoid the possibility of having the assessment skewed heavily against the policy in question by very large or even infinite asking prices that perhaps only a very small minority of the adversely impacted persons would declare rather than upon some credible theoretical argument as to why the adversely impacted persons’ offer prices instead of their asking prices are the “correct” measure of a policy’s negative impacts. This lack of clear guidance as to how willingness to pay should be measured, and the possible sensitivity of the conclusions reached in an efficiency analysis as to how the willingness to pay questions are posed, greatly undercuts the usefulness of the efficiency criterion as an objective measure of the merits of policies.

C. Obtaining Honest and Accurate Responses

Even once an analyst has determined the sample of the impacted population to survey and has made their choice between using offer price or instead asking price measures of willingness to pay, there remains the question as to whether the responses obtained can be trusted to honestly and accurately reflect true willingness to pay. There are several reasons why this may not be the case.

First of all, the questions posed to respondents with regard to the impacts of a proposed policy are usually not the sort of questions that people are asked to answer on a regular basis and therefore have some experience to draw upon in responding. Being asked how much one would be willing to pay, for example, for more stringent limits on the emission of certain toxic chemicals, or for a worldwide treaty banning blue whale hunting, or for a better freeway connection in a neighboring city that one occasionally visits by automobile, is not like the normal routine shopping expenditure decisions that one makes every day. People may give answers to such unfamiliar hypothetical survey questions that are not very well considered with regard to all of their competing preferences, particularly since they are not subject to the discipline of actually having to pay the declared amounts for the benefits of the policy or having to accept the declared compensation for its costs. Economists generally favor on reliability grounds the use of “revealed preference” data that reflects actual spending behavior over merely hypothetical survey re-

27. Many of which are done by governmental agencies and styled as a “cost-benefit analysis,” a common and synonymous term for a Kaldor–Hicks efficiency assessment.
sponses, but an efficiency analyst will unfortunately usually only have such hypothetical survey responses with which to work.\textsuperscript{29}

A second problem here is that some of the persons surveyed may deliberately misstate their willingness to pay for strategic reasons. A person who would benefit from a policy has an incentive to overstate the size of this benefit in response to a survey question in an attempt to make the policy’s implementation more likely, particularly since they will not then be required to pay this stated sum. Similarly, a person who would be burdened by a policy has an incentive to overstate the size of this burden in an attempt to discourage the implementation of the policy. On the other hand, the persons surveyed might be concerned that their responses might somehow provide a basis for later public assessments against (or compensation payments made to) them, which would encourage the beneficiaries to now understate the benefits but would further encourage those persons burdened by the policy to further overstate those burdens.\textsuperscript{30} All of these strategic considerations that may be in play will undercut the confidence an analyst can have in the accuracy of their efficiency calculations.

D. \textbf{Determining the Appropriate Discount Rate}

Some of the impacts of a policy will occur immediately, but other impacts will not occur for some period of time. This raises the difficult question of how to aggregate the different benefit and cost impacts of a policy that occur during different time periods into a single bottom-line figure. The standard approach taken in efficiency analysis is to discount all future impacts to a smaller present value before their aggregation in a manner similar to what is done in conventional finance calculations of the present value of streams of future cash flows. Use of this procedure then presents the question as to what is the appropriate discount rate.

Ideally, the benefits or costs borne by each person impacted by a policy in each future time period would be discounted by the impacted person’s personal rate of time preference with regard to events occurring in that future period as compared to the current time period. Once again, sampling limitations will generally preclude such an individualized assessment and use of personal discount rates, and the usual convention in efficiency analysis is to use a single discount rate for discounting all future impacts of a policy on all affected persons to a commensurate present value. The chosen discount rate usually reflects either the analyst’s estimate of the average rate of time preference of the entire affected population over the relevant time period, or instead some bond market-based interest rate(s) paid in the market for long-run riskless investments over the relevant time period, such as the interest rate(s) on long-term U.S. Treasury bonds of the appropriate maturity, or instead some estimate of

\textsuperscript{30} Crespi (2006), \textit{supra} note 14, at 448.
the average annual rate of return on private invested capital over the relevant time period, or some combination of more than one of the above measures.\textsuperscript{31} In addition, there is controversy both regarding whether such finance theory-based discount rates are appropriate for valuing very long-term policy consequences that even if quite large in magnitude when they occur will be reduced to insignificance by even a relatively small discount rate, and there is controversy regarding what discount rate is appropriate when the future impacts being valued are of the nature of loss of human life rather than merely financial consequences.\textsuperscript{32}

The lack of clear agreement as to what discount rates should be used in efficiency analysis presents a significant problem because the assessment of policies that have substantial long-term impacts (which, as I will discuss below, includes \textit{all} policies whatsoever because of their inevitable and universal genetic person-altering consequences) is very sensitive to the discount rate applied to these long-term impacts before aggregating them with current impacts.\textsuperscript{33} The sensitivity of the results reached in many analyses involving long-term policy consequences to an analyst’s relatively unconstrained choice of a discount rate serves to undercut the objective significance of the conclusions.

E. \textbf{Valuing Policy Impacts When Preferences Are Endogenous}

A common assumption made in efficiency analysis is that people’s underlying preference structures are exogenous with regard to the impact of policies. In other words, it is assumed that people will value the impacts of a policy at the same amount whether they express their willingness to pay before or after they experience the policy’s impacts. But for a couple of reasons this may not actually be the case.

First of all, behavioral economists have established that in many instances people exhibit an “endowment effect” in their valuations where they will value a good or service that they own more than they would value that same good or service if they did not yet own it, even if their underlying preference structures with regard to the relative merits of that good or service otherwise remain essentially unchanged after they take ownership.\textsuperscript{34} In such instances, the aggregate willingness to pay for the

\begin{itemize}
  \item\textsuperscript{31} For discussion of the problem of choosing an appropriate discount rate for use in efficiency analysis, see \textit{generally} Gregory Scott Crespi, \textit{Cost-Benefit Analysis: Not a Suitable Approach for Evaluating Climate Regulation Policies}, 22 \textit{WASH. & LEE J. ENERGY, CLIMATE AND ENV’T} 227 (2011) [hereinafter Crespi (2011)].
  \item\textsuperscript{32} \textit{Id.}
  \item\textsuperscript{33} \textit{Id.} For example, a policy whose costs occur largely in the near-term and whose benefits are mostly long-term, such as many environmental protection policies, and whose benefits just barely exceed its costs using a 3% discount rate, will appear to be much more wealth-increasing if a 1% discount rate is used, but may appear to be highly inefficient under a 7% discount rate.
  \item\textsuperscript{34} Russell Kordokin, \textit{The Endowment Effect and Legal Analysis}, 97 \textit{NW. U.L. REV.} 1227, 1228 (2002).
\end{itemize}
benefits of a policy will vary depending on whether that willingness to pay is expressed before or after the policy consequences are experienced.

Secondly, and presenting more difficulties as a conceptual matter, it is possible that the implementation of a policy may significantly alter the preference structures of some of the people affected, perhaps dramatically so. Stated in a more technical manner, preferences may be endogenous to a significant extent with regard to the policy under consideration. If this is the case, then it presents the question of whether an analyst attempting to ascertain the efficiency or inefficiency of a policy should determine the impacted persons' willingness to pay on the basis of their pre-policy implementation preference structures or instead on the basis of their different post-policy implementation preference structures. In some instances, the use of pre-policy implementation preference structures as the valuation baseline would seem to be more appropriate, but in other instances, the use of their post-policy implementation preference structures would appear to be more appropriate. There is a lack of agreement as to the proper way to address the problem of potentially endogenous preferences, as a general matter, and this issue as to the appropriate set of preference structures upon which to base the policy valuations creates yet another opportunity for a result-oriented analyst to manipulate the results of the assessment.

F. Valuing Policy Impacts in Light of the Person-Altering Consequences of Policies

The noted and recently deceased British philosopher Derek Parfit has elaborated in some detail regarding what he refers to as the “non-identity problem.” This is a strikingly novel and greatly under-appreciated insight that is of major significance for policy assessment. I have relabeled this problem with what I regard as a more apt moniker as the “problem of person-altering consequences” in several articles that I have written in recent years for economists, lawyers, and other policy analysts rather than for the professional philosophers that were Parfit’s target audience.

35. Consider, as one extreme example, a policy that involved a forced brain lobotomy for one person who opposes that operation. It would appear more appropriate to most people to value the costs of that policy by that person’s willingness to pay to avoid that operation that results from the pre-lobotomy preference structure than to value the costs by willingness to pay based on their post-lobotomy preferences! For an extended discussion of the problems posed for efficiency analysis by the possibility of endogenous preferences, see generally Gregory Scott Crespi, The Endogeniety Problem in Cost-Benefit Analysis, 8 GEO. J. OF L. & PUB. POL’Y 91, 109–18 (2010) [hereinafter Crespi (2010)].

36. For example, policies that impose educational requirements on persons or that provide them with environmental amenities that they have not previously experienced have been shown to sometimes alter preference structures in a way that is more favorable to those policies. For an extended discussion of the problems posed for efficiency analysis by the possibility of endogenous preferences, see generally Crespi (2010), supra note 35.


38. See, e.g., Crespi (2010), supra note 35, at 118–44; Gregory Scott Crespi, The Fatal Flaw of Cost-Benefit Analysis, 38 ENVTL. L. REP. NEWS & ANALYSIS 10703 (2008) [hereinafter Crespi (2008)]; see generally Gregory Scott Crespi, What’s Wrong with Dumping Ra-
This interesting problem results from the fact that even a policy with very minor social impacts will surely have enough effect on some human behavior to at least slightly alter the details of at least one successful act of human reproduction so that the female’s egg is fertilized by a different male sperm, out of the hundreds of millions of sperm released in a typical male ejaculation, than the specific sperm that would have succeeded in fertilizing the egg had the precise timing or some other detail of the act of conception not been slightly altered by the policy. This different sperm-egg fertilization will then lead to a person being conceived with a different genetic identity than would otherwise have been the case. In other words, now a different person will eventually be born because of the policy that was undertaken. As this genetically different person matures and goes through life, they will surely affect other persons in ways that are different, perhaps radically so, than would have been the case had the policy not been implemented and had the other person been conceived and born instead through a different sperm-egg fusion.

The—change of events arising from a genetically different person going through their life will then also surely alter some later acts of conception by other pairs of parents in a similar fashion, leading over time to an exponentially growing cascade of genetic alterations of the persons later conceived, all stemming from the initial minor policy impact. After some period of time, one that is likely measured in mere decades rather than centuries, the entire human population conceived and born for the rest of eternity will all have different genetic identities than the alternative future population that would have been conceived and born had the initial policy in question not been implemented. The policy will therefore eventually have what I describe as universal person-altering consequences.

Another way to put this fascinating though somewhat disturbing insight articulated by Parfit is that one result of any policy whatsoever, even one with very minor initial impacts, will be to eventually create a future human population extending for all eternity thereafter for whom that policy was a necessary condition of their existence. In other words, none of the members of that future population would have been conceived and born had the policy at issue not been implemented. This inarguable fact creates a real dilemma for attempts to estimate the willingness to pay for the policy’s benefit and cost impacts of the many members of that eternal parade of future generations.

One would expect these future persons to each place a very high value on a policy whose effects were a necessary condition of their existence, certainly if asking price measures are utilized. The expressed value would likely be very high even if necessarily constrained offer prices are aggregated, and even if the policy in other ways had significant adverse effects.

These untold billions or perhaps even trillions of future persons would surely place in the aggregate an astronomically high value on the policy that resulted in their existence even if some of the other consequences of that policy were significantly adverse to their interests. Even if those future valuations are heavily discounted to a current present value, the aggregate benefits are still likely to be massive (although obviously impossible to precisely estimate), very likely large enough to greatly outweigh any negative policy impacts upon the members of the current generation.

In other words, any policy option whatsoever, including the null option of doing nothing and maintaining the status quo, will result in massive net benefits of uncertain magnitude because of the particular very large future population that the policy will bring into existence over time, regardless of any negative impacts upon the current population. This fact will render efficiency assessments rather useless for distinguishing among alternative policy options, and policymakers are of course likely to reject out of hand any evaluation method that essentially ignores negative policy impacts upon existing persons.

So what can be done here to salvage the usefulness of economic efficiency as an evaluative standard, given this seemingly insuperable difficulty? Analyses of the efficiency of policies that take into account future consequences for persons not yet conceived when the policy is first implemented are now invariably conducted on the basis of the demonstrably false assumption that the same future persons will come into being whether or not the policy under consideration is implemented. With this facilitating assumption, the policy impacts on the wealth of future persons can then be assessed against the hypothetical baseline alternative of those same future persons coming into existence but not experiencing the policy’s impacts, which could then lead to either positive or negative estimated valuations of the policy impacts for each of those many future persons depending on the nature of those individual impacts. Those impacts are then all discounted to present values for aggregation with the impacts upon current persons.

This approach is untenable. This facilitating assumption that the same future persons will come into existence whether or not the policy in question is implemented is not merely a typical simplifying assumption that has been chosen in order to make otherwise difficult calculations somewhat more mathematically tractable without changing their basic character. This is instead the far more dubious use of a hypothetical counterfactual baseline for assessing policy impacts that cannot possibly occur since it is beyond reasonable argument that any policy will have the dramatic person-altering consequences that I have described that will eventually create an entirely different future population. Assessing the impacts of a policy on future persons as compared to the future impacts

of maintaining the status quo is unavoidably an apples-to-oranges comparison involving two different groups of people, for each of which the policy alternative being evaluated is a necessary condition of their existence. It is indeed a big problem for willingness to pay-based policy evaluation when all policy options whatsoever will generate massive net benefits of indeterminate size, but this is a problem that simply must be faced. Those many efficiency analyses that simply assume away the problem of person-altering consequences by pretending that it does not exist are unfortunately not relevant to the real choices at hand between policy options, all of which do have these person-altering consequences.

I have given this question considerable thought, but I have not so far come up with any way to incorporate person-altering consequences into efficiency analysis without leading to the counterintuitive and unhelpful but seemingly unavoidable conclusion that massive but practically unquantifiable benefits will result for future generations that dwarf any impacts upon existing persons, no matter what policies we pursue. This is because those future persons that will eventually come into being after any policy has been implemented will be created as a result of that policy and would therefore likely deem the particular policy that is a necessary condition of their existence to be of overriding significance. Even if the numerous other conceptual and empirical problems of the efficiency criterion that I have discussed above can somehow be resolved, I believe that the problem posed for efficiency analysis by person-altering consequences is likely fatal to that approach.

Given this fundamental problem with a willingness to pay-based valuation approach it appears to be necessary to develop alternative evaluative criteria that do not require valuing policy impacts upon specific future persons. Trying to think outside of the box here, one possible approach would be to simply assume that the massive benefits of uncertain magnitude for the eternal parade of future persons that will result from any policy whatsoever because of its person-altering consequences will in effect “cancel out” when comparing alternative policies, including the null option of not implementing any policy and continuing the status quo, and therefore only the impacts upon current persons need to be considered and compared in policy assessment. This approach would make policy assessment far more tractable by obviating altogether the need to assess long-term consequences for future persons. However, this approach is unsatisfactory because it would unduly favor those policies that provide current benefits but impose large long-term costs for future persons,40 and it would unduly disfavor those policies that impose current costs but pro-

40. Consider the ocean radioactive waste dumping policies considered in Crespi (2007), supra note 38. Those seemingly short-sighted and highly irresponsible policies, despite their likely significant and adverse long-term environmental consequences, would surely receive massive approval from the many future persons for whom they would be necessary conditions of their existence.
vide large long-term benefits for future persons. Effectively ignoring policy consequences for future persons in this manner does not appear to be any more reasonable than the current practice of pretending that policies do not have person-altering consequences.

Another and more radical possible approach would be to develop evaluative criteria that focus on valuing future policy impacts not on the basis of their impacts upon specific individuals but instead on their impact upon the overall human race when it is viewed as a distinct entity that exists apart from the specific individuals that comprise it. It is unclear, however, what sorts of policy impacts upon this human race one would want to consider that are not simply aggregations of the willingness to pay-based impacts of the policy on individual persons, and it is unclear how those “human race” impacts would be quantified.

Another even more radical tact might be to abandon consequentialist approaches altogether and instead try to develop evaluative criteria that are based upon a non-consequentialist assessment of the merits of the goals being pursued by policy architects, rather than upon an assessment of the policy consequences for individual human beings. But should we really ignore the consequences for individuals in evaluating policies? Who else matters? Or could we perhaps embrace criteria that are more explicitly theological in character and that do not rest upon either the intentions of the actors or the policy impacts upon human welfare but only upon their congruence with God’s grand plan? But is there any chance that we would be able to reach even a rough consensus on which theological premises as to the nature of this grand plan are most accurate?

Determining how to take person-altering consequences into account in policy assessment is a very difficult question, and I concede that I do not have the answers at hand. But it is clearly not a viable approach to, as many analysts now do, simply ignore the problem these consequences pose for efficiency analyses by making a demonstrably false assumption as to the invariability of the genetic identity of future persons with regard to policy impacts.

This interesting and difficult conundrum for policy analysis created by person-altering consequences should be made clear to students as part of their immersion in efficiency analysis. I have found that students find the problem of person-altering consequences to be quite interesting, and with just one or two examples presented they are usually quickly able to grasp its great significance for undercutting the usefulness of conventional efficiency analysis.

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41. One example may be an environmental protection measure that conferred very large benefits upon the members of future generations but that imposed small net costs on current persons.
IV. NORMATIVE PROBLEMS WITH THE ECONOMIC EFFICIENCY CRITERION

Even if one is somehow able to overcome (or chooses to ignore) all of the above-discussed measurement and conceptual difficulties involved in trying to obtain a meaningful estimate of the aggregate willingness to pay-based impacts of a policy, there is still the fundamental question presented regarding whether economic efficiency is an appropriate normative criterion for assessing the merits of that policy. There are two major concerns here that deserve more discussion in a Law and Economics class than usually take place. These concerns are fortunately relatively easy to convey to students in a succinct manner.

First of all, a person’s willingness to pay to experience (or to avoid) the consequences of a policy are obviously not only a function of that person’s preferences but also a function of that person’s wealth. The efficiency criterion can be succinctly described as a “one-dollar, one-vote” aggregate decision criterion. It is definitely not the widely embraced and more democratic “one-person, one-vote” criterion, and the efficiency criterion systematically gives more weight to the preferences of more affluent persons in proportion to their relative wealth in policy assessment.

Now one can argue that the amount of an individual’s wealth is positively correlated with their productivity and with other socially desirable traits, at least to some substantial extent, and that this provides some social justification for giving greater weight in policy assessments to the preferences of more wealthy individuals.42 But the relatively modest degree of correlation between wealth and virtue obviously allows for many exceptions. Many individuals are wealthy through inheritance or accidental good fortune without necessarily being productive or otherwise virtuous (does anyone prominent come to mind here?), and some people are productive or otherwise virtuous yet poor, and so arguments can easily be made that would cut the other way against giving such overriding weight to relative wealth differentials in making social policy decisions. It is clearly a matter for ongoing and perhaps ultimately unresolvable debate as to whether a willingness to pay-based decision-making criterion is more appropriate, all things considered, than would be the more democratic alternative of giving equal weight to the preferences of each person, or than would be, as another example, the alternative of adopting a utilitarian-type criterion that focuses more directly upon the relative psychological impacts of a policy upon different persons without regard to their wealth.

There is a sophisticated and highly mathematical welfare economics literature that is not usually assigned in Law and Economics courses because relatively few law students have both a sufficient economics background and a strong enough mathematical ability to benefit from that

42. This point is the central argument made by Richard Posner in his 1979 defense of the economic efficiency criterion. See Posner (1979), supra note 23, at 123–125 (describing and defending the economic efficiency criterion as the “wealth-maximization principle”).
literature. That welfare economics scholarship is extensive and makes clear that there are an infinite number of alternative “social welfare functions” that could be used to measure and aggregate the impacts of a policy upon different persons in order to evaluate its merits, and this literature analyzes in great depth the interesting and often quite subtle properties of a number of different possible social welfare functions.43 The willingness to pay-based economic efficiency criterion is only one possible social welfare function, only one of the many possible valuation yardsticks, and moreover, it is a criterion with no special justification for its use other than the fact that when it is applied using certain combinations of offer prices and asking prices it closely parallels how the prices for goods or services are set in competitive markets. The basic point as to the arbitrariness of the choice of the economic efficiency criterion as an evaluative standard from among the plethora of alternative social welfare functions can be easily communicated to law students in a simple manner without the need to delve into the mysteries of the Bergson–Samuelson social welfare functions or the Arrow Impossibility Theorem or other logical and mathematical complexities of welfare economics theory.

Secondly, and perhaps even more importantly, there are no “rights” inherent in an efficiency calculation.46 If a person’s willingness to pay-based assessment of the costs that a policy imposes upon them is exceeded by the net aggregate benefits conferred on the other impacted persons, then the efficiency criterion will still endorse that policy no matter what the size or nature of the costs that are imposed upon that unfortunate person; there are no rights inherent in this criterion that would take precedence over these overall wealth effects. But the use of an evaluative criterion that does not recognize any rights except the right to vote up to the limit of one’s willingness and ability to pay obviously coexists uneasily with the fundamental values of our larger social and political system, a social framework that is based on a Constitution that embraces the idea of inalienable rights that are not to be infringed upon regardless of benefits thereby conferred upon other persons, especially if willingness


45. See KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES 51 (2nd ed. 1963).

46. It has been argued that there is in fact a distribution of “rights” inherent in the economic efficiency criterion and that this distribution is that the rights to goods and services should be assigned to those persons who could put them to the highest-valued uses so as to maximize overall social wealth. See, e.g., Posner, supra note 23, at 126–27. However, most people would regard themselves as having their rights grounded upon a more fundamental basis than merely as an instrumental means to maximize overall social wealth as measured in accordance with willingness to pay, and thus being properly defeasible if those rights no longer contribute to that particular social goal. In other words, individual rights are widely viewed by their holders as taking precedence over the wealth-seeking objectives of other persons, even if overall social wealth might thereby be increased by abridgment of those rights.
to pay is measured by necessarily constrained offer prices rather than by asking prices.

V. CONCLUSION

Serious policy analysis is difficult. Evaluation of any significant social policy presents monumental challenges both in identifying and then in quantifying all of the policy impacts upon the many persons affected into a single bottom-line assessment, particularly when the impacts upon future persons as well as current persons are also being taken into account. The economic efficiency criterion provides a beguilingly simple and straightforward framework for generating such an assessment; just add up the willingness to pay for (or to avoid) the policy impacts upon all of the affected persons. But as I have demonstrated, this framework of analysis is made relatively tractable only by ignoring a large number of problems that, taken together, drastically undercut that approach.

Some commentators have criticized Law and Economics courses as often being biased in favor of encouraging students to uncritically apply this evaluative criterion of economic efficiency in policy analysis, either directly or in its cost-benefit analysis incarnation, despite these severe conceptual and empirical shortcomings and despite the fact that the criterion clearly privileges the interests of the wealthy and inadequately addresses infringements upon rights. There is considerable merit to these criticisms, and Joe McKnight in particular would applaud the recognition that as a historical fact, the introduction of these courses into law school curricula in recent decades, as well as the broader incorporation of efficiency analysis and cost-benefit analysis over that period into legislative, judicial, and regulatory policymaking, has been significantly facilitated by substantial funding provided by a small coterie of very wealthy persons who hoped to further institutionalize the normative biases of this approach that work in their favor within the legal and political communities.

A response to these critics is called for. But I do not believe that we need to throw out the beautiful baby of Law and Economics courses, which surely help students understand the valuable analytical tools and perspectives developed by economists, in order to rid ourselves of the dirty bathwater of a poorly defined and ideologically biased evaluative criterion. It is entirely possible for teachers of Law and Economics courses to convey to their students not only the basic mechanics of efficiency assessment and a recognition of the wide embrace of this valuation methodology in many social contexts, but also instill an appreciation of the numerous and substantial conceptual and empirical difficulties involved in quantifying the efficiency consequences of a policy. In addition, it is easy to call to students’ attention the rather obvious normative concerns raised by the use of a one-dollar, one-vote evaluative criterion, one that moreover does not recognize any limitations on policies based upon infringement of rights.
If these crippling shortcomings of efficiency assessments and cost-benefit analysis are effectively communicated to students, then I believe that the bias of many Law and Economics courses in favor of the interests of the wealthy and against giving proper consideration to rights, a bias that is often decried by critics, will be largely eliminated. Students who are made aware of the significant limitations of the economic efficiency criterion that I have here described will hopefully be able to more effectively counter policy arguments that are based on dubious efficiency or cost-benefit assessments, and they will better understand the need to disregard or at least supplement these assessments of policies with the application of other evaluative standards.