Journal of Contextual Economics 142 (2022), 21 – 39
Duncker & Humblot, Berlin

# Opportunity, not Welfare: How Behavioral Insights Should Lead to a Reorientation of the Normative Foundation in Law and Economics

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**Abstract**

In *Fairness versus Welfare* (2003), Louis Kaplow and Steven Shavell provide a manifesto for normative law and economics. Therein, they spell out the foundations for contemporary law and economics based on a Paretian consequentialist welfarism and a preferentialist account of welfare. We argue in this paper that this normative program faces serious challenges from recent behavioral insights that push back against a core assumption of a preferentialist welfare analysis, i. e., that people hold context-independent, stable preferences across different legal arrangements. We suggest an alternative normative focus for law and economics that borrows from Robert Sugden's (2018) *opportunity criterion*, which holds that individuals have an intrinsic interest in expanding their choice sets. We make the case that opportunity, rather than welfare as preference satisfaction, is a more convincing normative standard for law and economics, as its contractarian justification takes people's broadly construed interests seriously. Moreover, it is methodologically better suited to deal with people's unstable, context-dependent preferences.

*JEL Codes: K40, D63, D91*

*Keywords: Behavioral Economics, Normative Law and Economics, Opportunity Criterion, Preferences, Robert Sugden, Welfare*

## 1. Introduction

Since Richard Posner's (1979; 1981) initial focus on wealth maximization as a normative standard for the economic analysis of law, the field has shifted toward a normative approach more analogous to that of theoretical welfare economics. The most spirited defense of this shift in recent years was made by Kaplow and Shavell in their book *Fairness versus Welfare* (2003). Their approach can be summarized as a Paretian consequentialist welfarism based on a preferentialist account of welfare. In a nutshell, this approach equates welfare with preference satisfaction and defines the goodness of legal rules as a function of aggregated indi-

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vidual welfare. Kaplow and Shavell make a bold claim: they say that such a "welfare-based normative approach should be exclusively employed in evaluating legal rules" (*ibid.*, 3).

We argue in this paper that recent insights from behavioral economics pose serious challenges to the feasibility of a preference-based welfarist approach to law and economics. Behavioral insights highlight the problems of conceptualizing real-world individuals as beings that "[maximize] their utility from a stable set of preferences and [accumulate] an optimal amount of information and other inputs in a variety of markets" (Becker 1968, 14). In reality, real-world individuals have trouble instantiating their preferences in choice (due to a host of interfering psychological biases) and, more importantly for the argument of this paper, often exhibit unstable preferences which seriously complicates traditional welfare analysis (Loewenstein and Angner 2003; Grüne-Yanoff and Hansson 2009; Delmotte and Dold 2021; Dold and Rizzo 2021b). The field of behavioral law and economics has developed in response to some of these concerns (Jolls *et al.* 1998; Jolls 2007), but many scholars continue to propose Paretian welfarism based on a preferentialist account of welfare as the normative benchmark for comparative legal analysis (Posner 1997; Mitchell 2002; Kaplow and Shavell 2003). In contrast, this paper sketches the contours of an alternate legal normative criterion that, as we hope to show, is more adept at dealing with the dynamic, context-dependent nature of preferences. While the paper is ambitious in its argumentative scope, we deliberately chose an explorative tone for this project. We invite our peers to evaluate and expand on our arguments, and hope that this paper lays the groundwork upon which to build a more practical and realistic normative foundation for the economic analysis of law. We are aware that much future work needs to be done to reconcile normative law and economics with behavioral insights.

In what follows, we first briefly sketch the normative foundations of contemporary law and economics, as championed by Kaplow and Shavell. We then contrast the assumptions made in this normative program with the realities of individual preference-formation as revealed by recent insights in behavioral economics and explain why the response to these incongruities offered by Kaplow and Shavell falls short of resolving the significant issues of unstable and context-dependent preferences present for a welfarist consequentialism. In section 3, we introduce an alternative normative criterion that circumvents the problems posed by unstable preferences: Robert Sugden's *opportunity criterion.* In section 4, we lay out how this opportunity criterion could be applied to a legal context. Finally, section 5 concludes that a legal opportunity criterion is more suited to dealing with unstable preferences and cognitive biases and would thus resolve many of the problems faced by a welfarist approach to law and economics.

## 2. The Normative Foundations of Law and Economics

Kaplow and Shavell define welfarism as the notion that "social decisions should be based *exclusively* on their effects on the welfare of individuals—and, accordingly, should not depend on notions of fairness, justice, or cognate concepts" (2003, xvii). While welfare "is to be understood expansively, to include everything that is of concern to an individual," in practice law and economist scholars must rely "on individuals' existing preferences, as revealed by their behavior, for the purpose of assessing their well-being" (*ibid.*, 16 and 409).

Kaplow and Shavell's approach of Paretian welfarist consequentialism can be summed up in the following way: what matters for good laws are their consequences; consequences are assessed solely in terms of how much they promote individual welfare; welfare is equated with the satisfaction of preferences, and preference rankings can be expressed in individual utility functions. Further, the relative goodness of legal regime A compared to B is determined by a social welfare function that aggregates over individual utility functions and that is a monotonically increasing function in individual utilities.[1] Fairness, which they reject as a normative criterion, is defined as any theory that considers factors other than the maximization of some social welfare function (*ibid.*, 39). In this framework, the Pareto principle is upheld: if A increases the utility for at least one individual compared to B, and there is no individual whose utility is reduced, then the social welfare function will rank A higher than B.

Kaplow and Shavell's approach follows the logic of neoclassical welfare economics in which each individual is supposed to have deep within them a rational agent with true "well-articulated preferences over all economically relevant outcomes. These preferences are assumed to be *stable* (that is, not liable to sharp changes over short periods of time, and not subject to significant degrees of random variation), *context-independent* (not affected by variations in the 'framing' of what, in terms of economic theory, is the same decision problem), and *internally consistent* (satisfying conventional properties of consistency, such as completeness and transitivity)" (Sugden 2018, 5). If these assumptions hold true, it seems self-evident to equate welfare with preference satisfaction (*ibid.*, 6), reflecting a widely held belief that choice, preferences, and welfare are all closely related. In applying a preferential account of welfare to the economic analysis of law, Kaplow and Shavell similarly assume well-informed preferences to be true preferences that are stable, context-independent, and internally consistent. Leaving alone the question of whether preferences are easily measurable or aggregable,[2] we aim to show that the characteristics preferences are assumed to have in Kaplow and Shavell's framework are incongruous with insights from behavioral economics.

## 2.1 Context-Dependent Preferences: A Serious Challenge for Welfarist Legal Analysis

As we see it, the primary difficulties for welfare analysis in the legal sphere are similar to the difficulties behavioral economists identify as challenging welfare economics more generally. First, individuals exhibit *bounded rationality* and *bounded willpower* (Kahneman 2011). This means that in many cases people fail to enact their preferences due to psychological factors that impair their decision-making process, preventing them from choosing the "right" thing. For instance, people's impulsivity (i. e., their tendency to discount the future hyperbolically) leads them to go for the smaller, sooner reward once placed in front of them and discount the larger, later reward, although they had previously planned to go for the latter. This phenomenon leads to time-inconsistent behavior: one plans something at point $t_0$, but then does something else at $t_1$, regretting one's decision at $t_2$ (Ainslie 2001; Read 2006). While hyperbolic discounting is just one example of bounded willpower, there are many

1 Kaplow and Shavell (2003, 24–27) are not committed to utilitarianism. Any increasing function of utilities that satisfies an anonymity constraint is allowed.

2 We follow Kaplow and Shavell's example in leaving these concerns aside.

more psychological biases that drive a wedge between choice and welfare (for an overview, see Hausman 2011).

Second, an additional and more important factor complicates the view of revealed preferences as being a proxy for welfare: *context-dependent preferences.* According to Sugden, "a recurring finding of behavioral economics is that individuals' choices are sensitive to features of the 'context' or 'framing' of decision problems that seem to have no relevance to individuals' interests or well-being. The implication is that individuals often do not have the kind of preferences that economists have traditionally assumed when treating preference as the central concept in their normative analyses" (2021, 9). For instance, there is robust experimental evidence that suggests that the emotional state ("hot" vs. "cold") we experience at the moment of choice has dramatic consequences for the preference we reveal: when forecasting what they would want at a later point in time, people often incorrectly predict their own behavior and preferences across affective states (Read and van Leeuwen 1998; Lowenstein 2005): when subjects are in an affectively "cold" state (e. g., thinking about a cancer treatment before it is urgent), they fail to fully anticipate how "hot" states (e. g., thinking about a cancer treatment at an advanced stage of the disease) will affect their preferences and behavior, and vice versa. Typically, in these scenarios people overestimate the stability of their current preferences. Also, simply based on a reframing of a decision-problem (from positive framing: "How many lives will be saved by policy A vs. policy B?" to a negative framing: "How many people will die under policy A vs. policy B?"), subjects depict preference reversals. In particular, they become more risk-seeking in the negative frame (Kahneman and Tversky 1989; Druckman 2001). More generally, people's (mostly unconsciously chosen) reference points matter for which preferences they will reveal. A famous study in this context which has been replicated many times is on the endowment effect (Kahneman *et al*. 1990): in an experiment where people are randomly assigned an object or not, the valuation of the object is significantly higher after people received the object. In other words, the reference point of current vs. future endowment matters for people's valuation of the object. In a host of other studies, it has been shown that references points (such as arbitrary anchors like the last two digits of one's social security number) have dramatic effects on people's preferences (Ariely *et al*. 2003). Furthermore, the way information is framed and the terminology used makes a significant difference in our preferences for risk, pro-sociality, and fairness (Kahneman 2011; Bowles 2016). For instance, if the ultimatum game is described in market terminology as a "seller-buyer exchange," subjects are significantly more selfish; if the game is described as a shared resource pool game, subjects behave more pro-socially (Camerer 2003, 75).

Taken together, this body of literature suggests that (a) people's preferences are context-dependent in many decision situations, and (b) although preferences revealed by people in the different contexts are inconsistent with one another, it is not self-evident which (if any) of these preferences should count as "true" or welfare-improving preferences, or more broadly, how welfare should be defined (Sugden 2018, 10). As an illustration of the intricate nature of this issue, consider the problem of *intrapersonal conflicts.* Individuals may hold a preference under frame A, but we can anticipate them holding a conflicting preference under a different frame B. If we wish to evaluate welfare in terms of preference satisfaction in the case of intrapersonal conflict, we must side with the preferences of either the individual in frame A or the individual in frame B. Determining how best to do so is not self-evident. Kaplow and Shavell admit that "what is relevant for normative analysis is what actually matters to individuals, but tastes may differ, for example, regarding ease of measurement, the likelihood that they may change over time or in reaction to policy changes, variation across individuals, and the possible importance of errors in individuals' assessments" (2003, 359). To us, these do not seem like minor points but rather as pivotal issues to the entire preference-based welfarist approach to law and economics.

There is reason to believe that the issues identified by behavioral economics are especially salient in a legal context. Intrapersonal conflicts are likely to arise in situations where a choice is known to come up in the future, something frequently present in legal decisions. Bar-Gill and Fershtman (2004) further show that certain sets of legal rules may encourage preferences for fairness, causing actors to respond differently to the same sets of incentives under different legal rules. Legal rules and doctrines can affect preferences, choices, and behaviors in a myriad of ways, beyond simply altering the incentives faced by individual actors (Sunstein 1997; 2019). Under such conditions of preference endogeneity, it becomes difficult to predict which legal rule would maximize individual welfare or, more generally, how to conceptualize welfare in the first place.

Findings on unstable and context-dependent preferences (for overviews, see Bowles 1998; Loewenstein and Angner 2003; Grüne-Yanoff and Hansson 2009) challenge the long-standing belief that choices are reflective of preferences, whose satisfaction is in turn reflective of welfare. Without this link, the central premise of welfarism in the economic analysis of law—that we should analyze policy purely based on its ability to satisfy preferences—rings hollow. In effect, these behavioral insights question the feasibility of determining what constitutes individual welfare to begin with. At its very core, contemporary law and economics revolves around preference satisfaction, but the discipline never addresses how to proceed in the absence of context-independent preferences.

## 2.2 A Legal Example: Nonreciprocal Accidents

Consider the example of nonreciprocal accidents offered by Kaplow and Shavell (2003, 118). In their example, we have two groups: drivers and pedestrians, of which the former only walk and the latter only drive. Drivers can cause injury, and pedestrians can be injured. We assume pedestrians and drivers are equally well-off. In this case, a negligence rule (i. e., whoever's negligence causes the accident is culpable) might be the lowest-cost and most efficient solution to implement at first glance. We observe a level of incurred costs resulting from accidents $c_1$ under a negligence rule, and a level of costs $c_2$ under a strict liability rule, where $c_1 > c_2$. Now let us imagine that drivers take a level of precautions at cost $x_1$ under a negligence rule, and a level of precautions at cost $x_2$ under a strict liability rule (drivers are always culpable in the case of an accident), such that $x_1 < x_2$. Under the preferences observed prior to any accidents, this seems to be the welfare-maximizing level of precautions, meaning that $x_1 + c_1 < x_2 + c_2$. Now, assume that drivers underestimate the emotional scarring that results from causing another person harm, and an additional (previously unobserved) cost $y$ is incurred by drivers under a negligence rule—in other words, the drivers' preferences are unstable across contexts.[3] Additionally, let us assume that the passing of a negligence rule

[3] For this example, we assume that preferences change as a function of a change in beliefs about costs. This belief-induced preference change is one of the main forms of preference change discussed in the literature (Hansson and Grüne-Yanoff 2009).

makes pedestrians more averse to walking due to a perceived increase in risk, with this change in preferences causing them to incur an inconvenience cost $z$. It may well be that, *ex post*, we find that $x_1 + c_1 + y + z > x_2 + c_2$, and that due to context-dependent preferences the welfarist ideal rule is no longer the most efficient. It is unclear whether the *ex ante* or the *ex post* perspective is correct—both reflect preferences individuals hold at that point. How to weigh or assess them relative to one another is not clear-cut. If we saw "true," stable, and observable preferences, Kaplow and Shavell's emphasis on welfarism would indeed have produced the socially optimal outcome. In its absence, however, it is impossible to say whether an *a priori* focus on preference satisfaction is desirable.

### 2.3 Welfarists' Lacking Response

In their book, Kaplow and Shavell spend some time addressing the concern of preference instability. They respond to the problem of imperfect information in forming preferences. They argue that individuals are often "aware of their own limitations and act accordingly" (2003, 411), for example by acquiring expert advice or by purchasing warranties. In situations where this is not the case, they believe lawmakers could simply step in to provide better information. To us, this seems like an impractical and flawed solution. First, there is no neutral way of providing information. Behavioral economics has shown repeatedly that it matters how information is framed (e. g., whether it is presented in a loss or gain frame, see Tversky and Kahneman 1981) and that preference formation processes are heavily context-dependent (Sugden 2018, 7–12). Second, lawmakers would need to identify situations where individuals fail to instantiate their "true" preferences. For this, they would need to know what constitutes the set of an individuals' true preferences, and how one must frame information in such a way that it nudges people with heterogenous biases toward choices that instantiate those true preferences. While this poses a severe epistemic burden upon lawmakers (Rizzo and Whitman 2021), there is a deeper ontological reason why this program is inherently fraught with problems: if most (or a substantial subset) of our preferences are changing and intrinsically tied to the context they are elicited in, then a core of "true" preferences might simply not exist (Dold 2018). In the absence of true and stable preferences, the preferentialist welfarist framework loses its normative benchmark against which to judge the success or failure of welfare-increasing interventions.[4] Admittedly, Kaplow and Shavell argue that imperfect information makes welfare analysis empirically more difficult, but do not seriously challenge welfarism as the preferred normative standard in legal questions (2003, 417–18). Similarly, they dismiss the preference-shaping effects of the (informational) context or the law as nearly negligible; in the case where they do occur, they argue that we could still measure preference satisfaction based on newly formed preferences *(ibid.)*. This latter point is a flawed answer to the problem at hand: Why should the newly formed preference after the legal rule is implemented have more normative force than the

[4] Information provision might not be as problematic in terms of its relative epistemic burden as other forms of legal interventions (let's say "nudges"). Information is crucial for individuals with evolving preferences to make reflective judgments about which preferences to hold. Yet, even in case where information provision leads to reflective judgments, a severe epistemic problem emerges within the preferentialist welfarist framework: when do we know that preferences are sufficiently reflective, and how can those preferences be fed back into the lawmaking or judicial process? On the complexity of these latter questions, see Fabian and Dold (2022).

one the individual held *ex ante?* We side with Read (2006) who argues that in cases of frame-induced preference endogeneity, analysts would need to make a judgment call which preferences (*ex ante* or *ex post*) should be given normative force. Clearly, such a call would need to go beyond the narrow confines of a Paretian welfarist framework and require additional argumentative defense.

## 3. Alternative Normative Criteria in Economics

The problems mentioned above are not unique to the economic analysis of law. Economists have struggled with how to reconcile the traditional framework of welfare economics with the findings of behavioral economics (McQuillin and Sugden 2012). As Sugden puts it, the problem "is to reconcile normative and behavioral economics—to find a way of doing normative analysis in economics that is compatible with the instability and context-dependence of human preferences" (2018, 13). Just as in law and economics, behavioral findings challenge normative economics' reliance on preferentialist accounts of welfare (Dold 2018). Some of the solutions that have been put forth by economists, however, have not yet made their way into law and economics.[5] This paper will focus on one proposed normative criterion specifically: Robert Sugden's *opportunity criterion.*

It is worth mentioning that other theories of behavioral welfare economics exist, some of which also seem applicable to a context of law and economics (see, e.g., Bernheim 2016, 2021; Sunstein 2021). We choose to focus exclusively on Sugden's opportunity criterion here for three reasons. One, we know of no other scholar that has convincingly addressed behavioral welfare economics' knowledge problem to the degree Sugden has. Two, we write with a contractarian outlook, and Sugden's normative approach seems to us the most directed towards individual agents, rather than social planners, policymakers, or other such figures (Sugden 2021). And, three, perhaps most importantly, we must limit our scope for the sake of brevity.

### 3.1 The Opportunity Criterion

Over the last several decades, Sugden has developed a normative criterion that is compatible with behavioral economic findings, with the most comprehensive account of this effort detailed in his 2018 book *The Community of Advantage.* In it, Sugden (2018, 53–67) takes issue with the assertion common in behavioral welfare economics that individuals have an "inner rational agent" that is impaired by a "shell" of cognitive biases when making decisions. Rather than adopting the "impaired" neoclassical agent theory, Sugden claims there is no known psychological foundation for the assumption of people possessing a core of stable, "true" preferences, or as he calls it: for the assumption of "rational human agency" (*ibid.*, 82). As such, a normative criterion should not judge choices by assuming that welfare is constituted by some formalistic standard of well-ordered preferences. What behavioral insights actually support, according to Sugden, is a conception of preferences as dynamic and context-dependent. If preferences are not static, a normative model based on the fulfillment of "true" preferences, as is common in both behavioral welfare economics and norma-

5 For an overview, see Dold and Schubert (2018).

tive law and economics (Wright and Ginsburg 2012, 1035), becomes unworkable, as there is no clear base for welfare comparisons across legal rules (Sugden 2018, 24; Cowen 1993).

Instead of measuring welfare based on an *ex post* evaluation of whether people's "true" preferences were fulfilled, Sugden proposes a criterion based on "the idea that each individual's well-being or 'advantage' should be assessed in terms of the opportunities from which she can choose, rather than in terms of the outcomes she experiences" (2021, 12). This *opportunity criterion* holds that "it is in each individual's interest to have more opportunity rather than less" (Sugden 2018, 84). Opportunity in this context refers to the size of one's choice set, i. e., the amount of options a person can effectively choose from. Sugden's opportunity criterion echoes the priorities put forth in Sen's capability theory, in which a person's well-being is assessed in terms of the set of combinations of "beings and doings" from which they are able to choose (Sen 1986). Consistent with Sen's account, Sugden puts opportunities (i. e., freedom) center stage and argues that a larger choice set is normatively attractive since it increases the "beings and doings" available to an individual. Crucially, in Sugden's account the extent of an individual's opportunity is assessed without reference to her actual preferences.

The example of an air traveler offered a choice of onboard complimentary drinks helps to illustrate the basic idea behind the opportunity criterion. Airline A might offer opportunity set O = {water, orange juice, coffee, nothing}. Airline B might offer set O' = {water, orange juice, coffee, beer, nothing}. In this case, "O' offers strictly more opportunity than O" since "O' contains all the options that O does, and something in addition that the individual might conceivably want to choose" (Sugden 2018, 85). As such, O' is unambiguously preferable over O according to the opportunity criterion. Sugden's solution skirts the problem of unstable preferences. If we know that our preferences are subject to change, a larger choice set will still be desirable, since having more choices increases the likelihood that one of them will be most preferred at the time of choosing.

In practice, this means that policymakers must not concern themselves with whether individuals have rational preferences or not, but must only attempt to ensure that individuals are able to act on whatever preferences they may hold at the moment of choosing. This significantly reduces the "informational base" (Sen 1985) required: rather than needing information about the interaction between an individual's true preference, the choice context, and active biases, economists need only consider an individual's set of potential choices when doing normative analysis.

### 3.2 Opportunity as a Contractarian Alternative

A key aspect of Sugden's opportunity criterion is its contractarian nature. Sugden follows the contractarian logic of James Buchanan's constitutional political economy with its normative premise that individuals are the ultimate sovereigns in matters of social organization, i. e., individuals are the beings who are entitled to choose the organizational-institutional structures under which they will live (Buchanan [1991]1999, 288). Foreshadowing many of behavioral economists' findings, one of Buchanan's main arguments for contractarianism is the non-existence of stable individual preferences, and the welfare-relevance only of individuals' *real* choices, not of utility functions that are *artificially* constructed by the economist-analyst (*ibid.*). In accordance with these insights, Sugden writes that "the most fundamental requirement for a contractarian criterion is that it can be endorsed by the individuals to whom the economist's recommendations are to be addressed. Each of those individuals must be able to recognize it as a representation of his interests, as he perceives them" (Sugden 2018, 84). Sugden argues that the opportunity criterion fulfills this requirement because it is preferable to have more options to choose from when you know that your preferences are liable to change, but you do not know the extent of your preference change yet.[6] Accepting this contractarian starting point and the fact that preferences are unstable and context-dependent, Sugden follows Buchanan in arguing that individuals have "a clear interest in seeing that [their] choice set… remains as open as naturally possible" ([1979] 1999, 259). At its heart, the opportunity criterion is meant to act "in each individual's interest, as judged by that individual" (Sugden 2018, 83). In contrast, measuring welfare as the satisfaction of "true" preferences, as is common in behavioral welfare economics and law and economics, often revolves around some third-party analyst making judgements on what is actually a person's "true" and well-informed preference (Rizzo and Whitman 2020).[7]

Some objections to the opportunity criterion come to mind.[8] Choice overload, for example, is a well-known phenomenon wherein an overabundance of options leads either to a decline in quality of decision-making or a decrease in motivation (Iyengar and Lepper 2000; Chernev *et al.* 2015). There are also cases in which people may opt to voluntarily reduce their choice sets to avoid self-control problems, as in the famed case of Odysseus and the Sirens (Elster 2000). Sugden dismisses both these concerns as immaterial to the promise of his opportunity criterion. In the case of choice overload, Sugden believes few situations exist wherein more choice is actually overwhelming, and when it occurs it is due to the complexity of the choices present rather than the number of choices in and of themselves. The idea that markets offer too much choice, Sugden argues, stems from "culturally conservative or snobbish attitudes of condescension towards some of the preferences to which markets cater" (*ibid.*, 147). Given the heterogeneous nature of society, Sugden concludes that "[choice overload] is not a serious counterexample to the principle that it is in each person's interest to have more opportunity rather than less" (*ibid.*, 148). Second, genuine preferences for self-constraint are rare enough to be irrelevant in judging the desirability of the opportunity criterion according to Sugden. Self-constraint, i. e., the intentional reduction of one's

6 Admittedly, if one assumed that a person knows (a) the extent of her preference change under a future frame, (b) that this preference change conflicts with her long-term goals, and (c) that the preference change is caused by the larger opportunity set, it is conceivable that she would endorse stripping down the opportunity set to the elements that fit her long-term goals. Yet, such a conceptual move introduces the notion of "true" preferences, just on a higher level of long-term goals (Lewis and Dold 2020). Hence, our critique of section 2 still applies: individuals are typically very bad in forecasting their future preferences, and the existence of stable meta-preferences is not backed up by psychological theory. Under these realistic side constraints, a restriction of the choice set might actually be harmful to the person since it takes off options that she might have chosen if she had a wider menu to choose from.

7 For instance, in the case of law and economics, welfare is measured based on assigning rights or other assets to the party that values them the most which is oftentimes determined by some third-party observer, with an allocation being efficient if the gains are theoretically sufficient to compensate any losers of the ruling. It is doubtful whether all parties involved in a legal dispute would judge this criterion to be acting in their interest, especially if transfers from winners to losers are not mandated.

8 Within the confines of this paper, it is not possible to discuss all major points of criticism against the opportunity criterion. For an overview, see the special issue on Sugden's book in the *Journal of Economic Methodology* (Vromen and Aydinonat 2021).

opportunity set, he argues, should not be confused with "the formation of aspirations or resolutions, which are intended to influence subsequent choices without actually constraining them" (*ibid.*, 151). Also, it is important that private self-constraint is not ruled-out by the opportunity criterion since the latter is meant to be applied in the public realm in matters of law and policymaking.

Whether one agrees with Sugden's response to these objections or not, and whether one thinks that the opportunity criterion should be the sole normative benchmark or one among many normative criteria for public policies and law, we think that Sugden's opportunity criterion looks like an attractive alternative to preferentialist accounts of welfare due to the latter's insurmountable shortcomings.[9] In case of nested opportunity sets, if policy A provides more opportunity as compared to policy B for at least one individual and does not restrict the opportunities of any other member of society, *ceteris paribus*, A should be chosen.[10] While this seems like an attractive standard for policy-making, the normative implications this criterion may have for law and economics are not immediately clear. What does "opportunity" look like in a legal context?

## 4. A Legal Opportunity Criterion

As we see it, the main challenges facing a preferentialist account of welfare in law and economics are people's cognitive biases and, in particular, the unstable nature of their preferences. We hope to posit Sugden's opportunity criterion as an alternative normative benchmark which individuals could potentially find preferrable to the status quo with its focus on efficiency and social welfare maximization. Crucially, we propose the opportunity criterion as a guiding principle in those areas of law that law and economics has traditionally been concerned with, i. e., torts law, property law, antitrust law, copyright law, and so on (Kaplow and Shavell 1999).

As noted above, Kaplow and Shavell's preferentialist framework struggles in dealing with framing effects, the endowment effect, and other cognitive biases (section 2). Since the structure of the legal system itself may frame information or endow property rights in such a way as to change individuals' valuation of whatever items are involved in a case, lawmakers face a near insurmountable knowledge gap before they can determine which allocation or decision would be maximizing a social welfare function (however defined). What if, instead, the guiding principle for lawmakers was to design a system that maximized opportunity for the parties concerned? This would reduce the risk of context-dependent preference change rendering a certain allocation inefficient as a result of the change in context brought on by that allocation. More opportunity remains more opportunity, regardless of how individuals rank each individual choice available to them *ex post.*

9 For a more nuanced discussion of Sugden's opportunity criterion, see Dold *et al.* (2022) and Dold and Rizzo (2021).

10 In doing so, the opportunity framework subscribes to the Pareto criterion. Yet, the crucial difference to the welfarist framework is that it leaves open what constitutes good, i. e. welfare-increasing choices. In other words, it is a way of doing normative analysis without judging the preferences people happen to hold an any given moment.

In order to navigate a larger set of opportunities, individual agency plays a key role (Dold *et al.* 2022; Dold and Rizzo 2021). According to Sugden, we can understand agency as

> the continuing existence of a self-acknowledged locus of responsibility. The intuitive idea is that a person is a continuing locus of responsibility—for short, a responsible agent—to the extent that, at each moment, she identifies with her own actions, past, present, and future. A responsible agent treats her past actions as her own, whether or not they were what she now desires them to have been. She treats her future actions as her own, even if she does not yet know what they will be, and whether or not she expects them to be what she now desires them to be (2018, 106).

If Sugden is corrent in claiming that human beings value their agency, a normative goal should be to allow for this feeling of responsibility to be experienced. In a legal context, both parties typically have an *ex ante* interest in being able to identify with a ruling and view it as fair after that ruling has been handed down. If Sugden's assertion is right, there is reason to believe that a ruling that emphasizes opportunity over the satisfaction of "true" preferences will likely be more suited to this purpose. Given that the parties involved have more paths of action available to them under the opportunity criterion, the chance that they can pursue one that both identify with increases. Again, opportunity as a normative criterion offers more flexibility than does preferentialist welfarism, and it is likely better suited for boundedly rational agents with evolving preferences.

The discerning reader may, however, wonder what the opportunity criterion would look like in practice. What does it mean to prioritize opportunity when designing legal frameworks and resolving legal questions?

## 4.1 Operationalizing Opportunity

Sugden (2018, 84) establishes features he believes any normative criterion that informs policymaking and institutional design should be able to meet. It should be (1) general with respect to individuals, (2) general with respect to applications, (3) be transparent, and (4) be operational.[11] Sugden sets out a convincing rationale for his opportunity criterion meeting these features in the context of economic policymaking. The question is whether this holds true when applied to the legal context.

The first requirement is easily met. As set out earlier in the paper, individuals with evolving preferences have an interest in increasing their opportunity sets, and the opportunity criterion sees an increase in anyone's opportunity set as a positive. In this sense, the opportunity criterion is *general with respect to individuals.* The second requirement is trickier. To be *general with respect to applications*, the criterion should be able to be applied to a wide variety of legal problems. We will make the case that this is at least as true for opportunity as it is for efficiency or social welfare maximization as a normative standard. In other words, opportunity can be productively applied to at least as many types of legal problems as is efficiency or social welfare maximization. The difficulty lies in numbers three and four.

It is difficult from an *a priori* point of view to assess the *transparency* requirement. If a judge or jury that applies the opportunity criterion refrains from laying out their reasoning behind a certain judgement, the logic of the approach would be far from transparent. Trans-

[11] Sugden mentions a fifth feature that we can ignore for the argument of this paper. He believes that any normative criterion for economic policymaking should clearly *engage with* economic theory.

parency is not an *a priori* given, but it should be possible in a concrete case for a judge or jury to detail in which ways their ruling enhances the opportunities of the parties involved. We think that this requirement is not more demanding than standard rulings based on efficiency grounds.

For a criterion to be *operational*, "there must be some reasonably well-defined method for satisfying its informational requirements" (*ibid.*, 84). Amartya Sen coined the term "informational basis" as a reference to the information required to compare social alternatives. Sen (1979) argues the informational basis for traditional, utility-maximizing welfare economics was complicated and insufficient, as it was difficult to translate from individual preferences (or welfare indicators) to social preferences. Applied to Kaplow and Shavell's framework, there might be as many social welfare functions for a society as there are individuals, since individuals all are entitled to their personal preferences but also to their *personal* social preferences.[12] For Sugden's opportunity criterion, there is a different type of informational problem. In this case, it is difficult to unravel the link between legal rulings and resultant opportunities. There is a knowledge problem that endangers the operationalizability of the opportunity criterion. This is not to say that the same does not hold true for welfarism as a normative standard as discussed above. We make a twofold claim here: One, we believe that the informational requirement for operationalizing opportunity is not so great as to be insuperable. Second, we think that opportunity can be used as a normative criterion in any case wherein welfarism is typically applied.

### 4.2 Opportunity as a Touchstone in Rulings: Three Examples

In section 3, we motivated the opportunity criterion by discussing the normative superiority of nested opportunity sets from the perspective of one person. To analyze legal cases with many parties involved on both sides of the market, one needs to expand the opportunity criterion's implication to the social level. Here, the *interactive opportunity criterion* (Sugden 2018, chapter 6) applies: it aims at increasing opportunities for voluntary transactions between individuals. A significant question this paper needs to deal with is whether a judge or jury could conceivably base their ruling on the subsequent opportunities available to the involved parties. The fact that each case is unique complicates matters. In lieu of a one-size-fits-all solution, we use several examples to show that opportunity can be a guiding light in rulings.

The most obvious example may be one found in antitrust law. Take a monopolistic retailer, in the vein of Amazon or Walmart, that controls a majority share of whatever market they operate in. The current antitrust paradigm "authorizes large, powerful firms as the primary mechanisms of economic and market coordination" (Paul 2020, 380), with intervention only being required when monopolies "interfered with consumer welfare and sometimes, still more narrowly, only when it increased prices" (Britton-Purdy *et al.* 2020, 1800). This is consumer welfarism *pur sang:* a monopoly is undesirable only when prices increase for consumers. A framework focused on opportunity would necessarily take a more nuanced approach. Cost is one aspect of opportunity—higher prices equal smaller possible consumption bundles, thereby reducing one's opportunity set. Yet monopolies have other consequences as well. Product diversity tends to decrease (Chen 2004), overall employment

12 We would like to thank one of our reviewers for highlighting this point.

tends to fall (Neumark *et al.* 2008), and wages for those lucky enough to remain employed tend to decrease (Azar *et al.* 2017).

Circling back to our example of a monopolistic online retailer, one might ask whether choice has really decreased in the time of Amazon and its 12 million products. We argue that, unlike small retailers who must compete on product selection in addition to price and therefore have an incentive to prominently display goods that differ from their competitors, Amazon is merely interested in competing on price, creating the illusion of choice to avoid giving consumers the sense that they lack options.[13] Empirical research finds that consumers typically only consider about 10 – 15 options for a given good on Amazon, with Amazon's recommendations playing a significant role in what product gets chosen (Kim *et al.* 2010). Those recommendations often favor the retailer's own brands or serve to disadvantage rivals (Sisco 2022; House Judiciary Committee 2021). Choice overload prevents consumers from considering all the options Amazon lists, so its recommendation algorithm effectively decides the 10 – 15 options consumers get to decide between (Chernev *et al.* 2015). Similarly, it is easy to overestimate the positive impact Amazon has on employment and wages—Amazon has a $15 minimum wage in the US, higher than the minimum hourly wage in many states, and one might assume that this would cause spillover effects to other employers. Yet empirical work finds that previously present employers do not alter their wages in response to the entrance of Amazon into their market (Derenoncourt 2021). Since overall employment tends to fall in a community once monopolies enter, it is unlikely that total wages earned by workers in a community will substantially increase after the entrance of an Amazon warehouse.

There may be a host of other negative consequences, but just these three alone are cause for concern when viewed through the lens of opportunity. An analysis with opportunity as its normative standard would have to carefully weigh the potential opportunity gains received by consumers through economies of scale against the numerous downsides of allowing market power concentration, such as reduced opportunities for voluntary transactions between individuals.

Property law is another area dominated by economic thinking (Shavell 2003; Landes and Posner 2009). In recent years, intellectual property and its protection have become more and more important (Landes and Posner 2009, 3). Disciples of the economic analysis of law have argued that intellectual property protection helped internalize the externalities associated with knowledge production (i. e., it prevented others from freely benefiting from others' research), and hence increased overall welfare (*ibid*; Landes and Posner 1989). "Fair" use, often in the shape of what is called "transformative use," remained permitted in the spirit of encouraging innovation and efficiency (Asay *et al.* 2019). Yet it is often difficult for smaller producers to prove their use is transformative, whereas larger corporations are able to pay the legal fees required to defend their usage of protected intellectual property (Britton-Purdy *et al.* 2020, 1803 – 4). Viewed through the lens of welfare maximization, it may well make sense to privilege large companies in this way. After all, they are more likely to use and transform intellectual property in a profitable way. However, profits do not necessarily equal opportunities. If we apply the logic of the opportunity criterion, the intellectual property calculus shifts in an important way. Now, a balance needs to be struck between securing

13 Since Amazon is already widely perceived as being the largest e-commerce retailer, it is fair to assume consumers aren't worried about limited choice on the site.

the incentives for performing original research without stifling downstream innovation or beneficial use of existing information. A patent for a life-changing drug should be protected so that research and development costs can be recouped, but insignificant changes to an existing drug meant solely to prevent generic versions from being developed should not experience the same level of protection (Feldman 2018). The former increases consumers' opportunity set by offering a new and useful product. Conversely, the latter reduces their individual opportunity sets and opportunities for voluntary transactions by artificially inflating the price of an existing product, reducing the size of possible consumption bundles.

As a final example, let us consider tort law. In 2008, the Supreme Court ruled on *Exxon Shipping Co v. Baker*, a case which arose from Exxon's oil spill in the Prince William Sound. The Court was asked (among other things) to consider whether punitive damages could exceed compensatory damages for the purpose of deterring companies from committing misdeeds. The Court held that the ratio of punitive to compensatory damages should not be excessive, since "a penalty should be reasonably predictable in its severity, so that even [a] 'bad man' can look ahead with some ability to know what the stakes are in choosing one course of action or another."[14] This ruling significantly facilitated cost-benefit analyses for large companies considering whether to skirt the law—in the case of Exxon, the punitive damages it was asked to pay came to a rounding error of its annual revenues (Vicini 2008). A legal system that embraces opportunity as its normative criterion may have struck a balance between not placing an undue burden on corporations while at the same time discouraging the gross negligence that was on display in this case. Greater damages would have allowed the fishermen and those employed in the tourism industry to either move or more thoroughly clean up the Prince William Sound so as to recoup their livelihoods. It would also have allowed them the freedom to simply pursue another course in life. Moreover, a ruling that would have demanded greater punitive damages would not have reduced Exxon's (or its employees') opportunity sets, as greater punitive damages would not have meaningfully interfered with the viability of Exxon as a company. Greater punitive damages may have deterred the company from flaunting safety regulations in the future, which would likely have had a positive impact on opportunities for voluntary transactions between individuals in the future.

These examples are necessarily sketched and imperfect—we as authors cannot establish the optimal level of monopolistic competition allowed under an opportunity criterion, nor can we determine new rules for intellectual property or calculate the optimal level of punitive damages. In a legal case, fairness, precedent, prudentialism, and other legal theories will always play a role in a judge or jury's decision-making process. No one legal theory can be a panacea. We also do not pretend that considering opportunity will result in a Pareto improvement over the status quo. As Sugden states, the opportunity criterion is an interactive one, meaning that "the set of opportunities available to any one person depends on the choices that other people make from *their* opportunity sets" (Sugden 2019, 421). It is up to the legal system, whether in the form of a judge, a jury, or some other deliberative body, to weigh the opportunity sets that result from various rulings. Rather, this article's scope is simultaneously modest and quite ambitious: we hope to have shown that considering situations from a lens of opportunity rather than efficiency or welfare-maximization

14 Excessive in this case was held to mean anything in excess of the actual clean-up costs.

leads to different conclusions; conclusions that we feel more closely align with what individual agents find desirable.

## 5. Conclusion

In the aftermath of the publication of Kaplow and Shavell's book, discussions about the merits of preference-based Paretian welfarism have shaped the economic analysis of law. In the face of new behavioral findings, this welfarist standard becomes more and more difficult to defend. Epistemically, it is difficult to say what the sufficient conditions are that need to hold for individuals to reveal their "true" preferences. And ontologically, if our preferences are evolving and intrinsically tied to the context they are elicited in, then a core of "true" preferences might simply not exist. In the absence of true and stable preferences, Kaplow and Shavell's program becomes difficult or even impossible to implement. There exists a need for a new legal normative criterion, one that citizens can voluntarily recognize as serving their interests. This paper proposes that law and economics learn from current debates in behavioral welfare economics, where creative alternatives to preferentialist welfare accounts are being developed. We have argued that one such alternative, Sugden's opportunity criterion, holds particular promise for the field of law and economics. We made the case that opportunity rather than preferentialist welfarism as the normative criterion for law and economics is more suited to deal with unstable preferences and cognitive biases, and that it might thus rest on a more realistic and acceptable premise.

The case for an opportunity criterion has intuitive appeal. This article has touched upon some of the ways in which its employment would result in what seem to be clear improvements over preferentialist accounts of welfare. We have presented behavioral evidence on the context-dependent nature of preferences that highlight the shortcomings of preferentialist accounts and the benefits of the opportunity criterion. A discerning reader might wonder whether there may not be just as many cases in which the opportunity criterion falls short. Is Sugden's opportunity criterion really an improvement over Paretian welfarism for all parties involved? The short answer is no. Adopting the opportunity criterion in legal practice will inevitably make some parties worse off as compared to the status quo. Take the drug companies mentioned in section 4. A move from social welfare maximization to opportunity would negatively impact their ability to extend patents for non-novel drugs, thereby causing them to lose out on potential profits. We cannot justify the use of the opportunity criterion on the grounds that everyone will be better off unambiguously.

A more pragmatic defense of opportunity does exist, and it lies with the concept of *psychological stability*. For a concept to be psychologically stable, i. e., for it "to reproduce a general belief that its governing principles are fair," (Sugden 2018, 193) people need not believe that they *exclusively* stand to benefit from it. We generally approve of laws prohibiting speeding, for example, even though we may receive a ticket every now and then. The idea is that, on the whole, we would rather see a world with fewer traffic accidents than one wherein we never have to worry about speeding fines since it increases individual opportunities and opportunities for voluntary exchanges between people. This article argues that using opportunity as a normative criterion in legal questions is defensible following a similar logic.

The ultimate judge for the legitimacy of opportunity must be the parties who will live under the legal framework that uses it as a normative standard. While this paper eschewed attempts to operationalize agreement, we presented arguments for why a collective of individuals might prefer the opportunity criterion over alternative standard for legal rulings that are based on preferentialist accounts of welfare. No theorist can answer the question of whether affected citizens would actually prefer opportunity over alternative normative standards in legal matters. But we can present arguments that inform a public debate about the relative merits of opportunities as a foundation for legal rulings.

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