



PREFERENCES, SELF-REGARDING AND OTHER-REGARDING

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1. *Pareto Efficiency*

In the standard understanding adopted here, Pareto efficiency concerns the satisfaction of the preferences of individuals. The basic problem it responds to is the alleged impossibility of interpersonal comparisons of utility (Robbins 1938, Kaldor 1939, Hicks 1939), if, as most scholars maintain, utility cannot be traced back to a single objective scale (as Benthamite views wish instead). If it is impossible to compare the utility of Adam who eats an apple with the utility of Saul who eats a pear or reads a newspaper, it is because the satisfaction of their respective preferences is not susceptible of an evaluation and measurement in cardinal terms (one cannot say whether and by how much Adam's utility is greater than Saul's). One can speculate over the reasons for this. It may be for metaphysical reasons having to do with the constitution of human beings, or epistemic reasons concerning the limited knowledge we have of these phenomena, or technological reasons consisting in the lack of appropriate measurement tools. The fact is that attributing a cardinal value to the satisfaction of someone's preferences is at present impossible. When that is done it is just arbitrary.

Does that mean that we cannot compare and evaluate different allocations of goods and services? Pareto's key idea to this effect was to consider the ordinal preferences of individuals (what they prefer over what) and rank allocations of goods and services in this perspective. Then, in a nutshell, an allocation is Pareto efficient when it increases the wellbeing of at least one individual (according to their own, ordinal preferences) without decreasing that of the others (according to their own, ordinal preferences). Moving to a state of affairs that has a higher position in the ranking of an individual amounts to being better off for this individual, and moving to a state of affairs that is lower-ranked amounts to being worse off.

Going into more detail, Pareto efficiency can be conceptually decomposed into the notions of Pareto *superiority* and Pareto *optimality* (Coleman 1992, pp. 18–19), which consist respectively in this:

- a state of affairs S_2 is Pareto *superior* to another state S_1 if and only if no one is worse off in S_2 compared to S_1 , and at least someone is better off in S_2 compared to S_1 ;
- a state of affairs S_0 is Pareto *optimal* if and only if there is no state S_n such that S_n is Pareto superior to S_0 .

Thus, in light of the ordinal preferences of the individuals involved, an allocation having the properties of S_2 is Pareto superior to an allocation like S_1 , and an allocation like S_0 (whose definition recursively exploits the Pareto superiority definition) is Pareto optimal. Let me stress this point: nothing in the Pareto framework requires a cardinal measurement of the utility that Adam or Saul derives from having some fruit or being given a certain resource, nor does the framework concern the moral value of a certain allocation of resources assessed from an exogenous perspective. If Adam prefers apples over pears, and Saul is indifferent between them, then the allocation that gives an apple to Adam and a pear to Saul (S_2) is superior to the one that gives a pear to Adam and an apple to Saul (S_1). Likewise, if Adam prefers *aguardiente* over spring water, and Saul is indifferent, giving *aguardiente* to Adam and water to Saul is Pareto superior, notwithstanding the fact that liquor can worsen Adam's health. No exogenous moral criteria apply here, nor are paternalistic considerations relevant. Only preferences count.

2. Calabresi's Critique

Can one evaluate legal allocations of economic resources along the lines of Pareto efficiency, namely with Pareto superiority and optimality? Guido Calabresi's answer is skeptical, if not utterly negative, since passing the Pareto test for efficiency requires the unanimity of the "votes", or preferences, of the individuals involved. This seems unrealistic to obtain in contexts such as legislative ones, and by definition it is not obtained in judicial contexts when the claims of one party are accepted and those of the counterparty are rejected. Consider in particular a tort case, with damages awarded. The plaintiff will be better off, the defendant worse off. An outcome like this, which is legally normal, would be impossible under Pareto efficiency – because someone will be worse off. Still, Pareto efficiency makes sense of other legal contexts, such as contractual relationships – where all parties are better off, unless some kind of contractual pathology like duress occurs – and it makes sense of legal arrangements where parties or members have a veto power (consider e.g. the U.N. Security Council). In short, if that is correct, Pareto efficiency has some explanatory and justificatory power in the legal domain but also very serious limitations.

Calabresi's criticism dates back. In the seminal 1972 article co-authored with Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, it is noted on Coase's footing (Coase 1960) that in the absence of transaction costs the Pareto optimum will be achieved with any initial assignment of rights, and that, however, in our world characterized by transaction costs, externalities make it difficult to reach that point (Calabresi and Melamed 1972, pp. 1094–1096, 1103). Among the externalities and their consequences, "moralisms" have a particular role; they are exemplified by the refusal that one can sell their kidney or that one can be willfully reduced to slavery (Calabresi and Melamed 1972, pp. 1112–1113). What Calabresi and Melamed call "inalienability rules" proscribe precisely this sort of transactions. For what matters here, moralisms generally aggravate the problem mentioned above, as they prevent the attainment of unanimity required to move from S_1 to S_2 , or from S_n to S_o . In Paretian terms, the moralist who rejects the legitimacy of a kidney's sale will be worse off in the state of affairs in which someone can sell their kidney; therefore that moralist will not give their consent to this possibility. Notice that, at least in principle, the sale of a kidney will make the parties to the transaction better off, since the kidney-seller would be better off with the money than with the kidney, and the kidney-buyer would be better off with the kidney than with the money. The same applies, though less dramatically, to other transactions like the sale of alcohol, drugs, sex toys, and any other item that is charged with being central to immoral practices. And, vice versa, those who enjoy drinking alcohol and the like would be worse off in the world where alcohol is prohibited for the purpose of making the former moralists better off. All of this has a consequence that is not obvious at first sight. It should be observed that the result of opposing moralisms is a stalemate in which, due to the effect of crossed vetoes, the status quo paradoxically turns out to be the Pareto optimum, since it is impossible to change it without someone being worse off, or at least believing they are worse off. This fuels the objection that Pareto efficiency is biased in favor of the existing allocation of resources, whatever this is.

Calabresi's argument is elaborated on in the 1978 book written with Philip Bobbitt, *Tragic Choices*, where one can find the following claims, among others: (i) Pareto criteria are virtually useless, since a non-market allocation cannot be shown to be Pareto superior to a market one, nor, more importantly, can a market allocation be shown to be Pareto superior to a non-market one; (ii) Pareto criteria ignore distributive problems and their moral, political, and legal implications; (iii) to overcome some of those problems, efficiency can be understood as "potential Pareto superiority with tolerable distributional effects" (Calabresi and Bobbitt 1978, p. 86). I will discuss potential Pareto superiority below; instead, in this work I cannot deal with the issue of the conditions under which market allocations are superior to non-market ones, or vice versa; nor can I address here the issue of what is meant by "tolerable" distributional effects. I limit myself to observing, again, that

Pareto efficiency does not take into account the distribution of resources and favors their current distribution, ratifying the status quo and, paradoxically, the impossibility of changing it when people would like to but do not agree on the way to do it.

Calabresi insists on this line of argument in a 1991 critical essay specifically dedicated to Pareto efficiency and the Coasian approach, *The Pointlessness of Pareto: Carrying Coase Further*. In the presence of transaction costs, any society is always or will soon arrive at the Paretian optimum (Calabresi 1991, p. 1212) – especially, I would add, when “moralisms” proscribe certain changes and transform the status quo into the optimal state according to Pareto efficiency.¹ As a matter of fact, the Pareto test is a request for unanimity which is unrealistic to require in legal contexts (with the exception of transactions like contracts without negative externalities, I would add); therefore, the set of Pareto superior moves is “void” and, as a consequence, the Pareto framework cannot be a normative criterion for the improvement of the status quo (Calabresi 1991, pp. 1215–1216).

In his 2016 book *The Future of Law and Economics*, Calabresi observes again that legal systems frequently take into account “third-party moral costs”, and reiterates the point that “there are costs whose existence makes impossible reorganizations which, if they occurred, would make all people better off” (Calabresi 2016, pp. 22ff, 137).

Now, this line of argument is impeccable but Calabresi himself notes there is a way in which it could be circumvented. As a way to escape such stringent conclusions, the idea goes like this: if we were to use a less demanding Pareto criterion (defining Pareto moves more specifically), we could solve the unanimity problem but we would introduce in the scheme some values that are not unanimously held (Calabresi 1991, pp. 1216–1217). This is precisely the idea on which I think we can still work.

3. *Mill’s Assistance*

The starting step of the argument is John Stuart Mill’s *Harm Principle*. This principle too is susceptible to being specified and understood in different ways. A number of issues depend upon this, especially upon the way “harm” is read (Feinberg 1984). However, let us try to understand the principle in its essential core, according to which we are permitted to interfere with the conduct of an individual only if the conduct of this individual harms other subjects.

That principle is, that the sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their number, is self-protection. That the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant. (Mill 1859, pp. 21–22)

The principle is anti-paternalistic. The own good of an individual is not a sufficient reason to interfere with their conduct. Mill deals with this in relation to forms of prohibition widespread in his time, and in particular he refers to the criminalization of certain forms of conduct by the law, e.g. gambling, drunkenness, fornication (Mill 1859, pp. 144, 177). Now, it should be observed that a violation of the Harm Principle – that is, prohibiting what does not harm others, and, even more so, criminalizing conduct that does not have harmful effects on others – is a *Pareto worsening*. It is so because banning something harmless worsens someone’s position without improving that of others according to their own preferences. Anyone who would like to engage in the conduct in question, given the prohibition, is in a worse situation than without the prohibition, while those who do not suffer any harm from that conduct are not in a better position, since in any case they do not receive any benefit from the ban.

¹ Compare the two points: the Pareto optimum will be reached in the *absence* of transaction costs because individuals will bargain and allocate resources in the best way (Coase 1960), but it will also be reached in the *presence* of transaction costs (and moralisms in particular) when these prevent people from reallocating resources and the actual distribution becomes Pareto optimal. Cf. Singh (2019).

The next step of the argument is the distinction between *internal* and *external* preferences. Economic theory draws basically the same distinction in terms of self-regarding and other-regarding preferences. We can call preferences that concern oneself or one's own conduct "self-regarding", or "internal" for short, and those that concern others or their conduct "other-regarding", or "external" for short.² Prohibition is typically an expression of external preferences on top of internal ones, that is, the requirement that others too refrain from what we do not want. As I will discuss below, there may be hard cases in this respect. There may be cases in which it is unclear whether the relevant preferences are to be classified as internal or external. This should not be taken, however, as an argument against the existence of clear cases of internal and external preferences: e.g., Adam wants to drink *aguardiente* instead of water, and you want him to drink water instead of *aguardiente*.

By distinguishing internal from external preferences (although there will be doubtful cases and the distinction cannot be claimed to be crystal clear), Mill's Harm Principle can be invoked as a moral reason for excluding, from the preferences that validly count, at least some of the "moralisms" pointed out by Calabresi: moral externalities should not make a difference insofar as they generate external preferences unsupported by the Harm Principle, i.e. preferences on what others should be or should do – more often *not* be or *not* do, as these preferences are expressed in the form of prohibitions – unsupported by harm considerations.

Note that some moralisms must be treated differently, though. One thing is the ban on drinking or oral sex; another is the ban on selling oneself as a slave. Insofar as practices like drinking and performing oral sex do not harm those who dislike them and disapprove of them, the Harm Principle makes it unjustified to ban those practices. The state of affairs in which drinking is prohibited is Pareto inferior because someone is worse off and no one is better off *according to their internal preferences*. Those who disapprove of drinking do not get any benefit from the prohibition, apart from the satisfaction of their external preferences. But if these do not count, such a moralism should not be endorsed and enforced by law. The case of the ban on voluntary enslavement is different: Mill (1859, p. 184) points out that, by selling themselves for a slave (assuming this act reflects a genuine desire and preference), subjects "abdicate" their liberty, because they forgo any future use of it, beyond that single act. For Mill, this counts as a defeat of the very purpose which is a justification for allowing people to dispose of themselves – presumably, their wellbeing. What justifies this moralism from a Paretian viewpoint too is the fact that subjects, by "abdicating" their liberty, deprive themselves of the possibility of autonomously satisfying any other internal preferences they might have. The ordinal logic of the Paretian approach is centered on the very possibility for individuals to determine and revise their preferences, which becomes impossible in the enslavement scenario.

It must be admitted that the argument presented above has some weaknesses. The first is a certain vagueness of the distinction between internal and external preferences. Surely there may be dubious and intermediate cases, with respect to which we can try to make the distinction more precise, with no illusion about the possibility of getting rid of difficult cases once and for all. The world is too complex to perfectly fit our definitions.

A second weakness – related to the first but on a more radical point – is that the distinction itself becomes untenable if one considers that any human being has relationships with others and any preference has effects on others. Mill was well aware of the problem.

The distinction here pointed out between the part of a person's life which concerns only himself, and that which concerns others, many persons will refuse to admit. How (it may be asked) can any part of the conduct of a member of society be a matter of indifference to the other members? No person is an entirely isolated being; it is impossible for a person to do anything seriously or permanently hurtful to himself, without mischief reaching at least to his near connexions, and often far beyond them. (Mill 1859, p. 143)

² An analogous distinction is found in Dworkin (1978, p. 234) as he distinguishes between "personal" and "external" preferences (in the context of a critique of utilitarianism which we pass over here). On this and related matters, see also Tuzet (2019).

You can imagine in this respect Adam's wife, Eve, complaining about his drinking *aguardiente*, because this not only will harm his health but also their life together, on top of the money spent to buy liquor. Is Eve's preference about Adam's drinking a merely external one? Responding in the affirmative would distort her argument, which is supported by harm considerations and concerns the bad effects of Adam's conduct for him *and for her*. It is different from the abstract reprimand by someone unrelated to Adam. And there is more, if the argument can be extended to the whole of society.³ However, Mill points out (1859, pp. 146–147) that what we really disapprove of in such situations (or should disapprove of) is not the bad habit in itself but rather the lack of care for someone's relatives, or the fact that someone does not discharge their obligations in other respects (e.g. an unpaid debt because money was spent on alcohol). In these cases interference by morality or law is justified. In the other cases it is not:

with regard to the merely contingent, or, as it may be called, constructive injury which a person causes to society, by conduct which neither violates any specific duty to the public, nor occasions perceptible hurt to any assignable individual except himself; the inconvenience is one which society can afford to bear, for the sake of the greater good of human freedom. (Mill 1859, p. 147)

The “greater good of human freedom” justifies some such costs imposed on society. This seems to assume that some external preferences are supported by harm considerations (and therefore are not purely “external”).⁴ A sensible cost-benefit analysis will dispose of them in the proper way. A third weakness consists in the vulnerability of the argument with respect to the many situations in which the allocation of a good necessarily makes someone better off and someone else worse off, according to the relevant internal preferences. It happens when a scarce resource, such as an organ for a transplant, must be assigned either to Adam or Saul. Then no Pareto improvement is possible even if redefined as above. (Paradoxically, again, the only justified option would be not to assign the good, and maintain the status quo as a Pareto optimum). In such situations, help can come from the efficiency of Kaldor-Hicks, which consists in making certain preferences prevail over others under given conditions (Coleman 1992, pp. 167–169).⁵ We can define it like this:

- according to the Kaldor-Hicks test, S_2 is efficient compared to S_1 if and only if in S_2 the “winners” can compensate the “losers” in a way that no one is worse off compared to S_1 and at least someone is better off compared to S_1 .

Hence, according to Kaldor-Hicks efficiency, resource allocation S_2 must be preferred to allocation S_1 when those who benefit from S_2 have a sufficiently large benefit to compensate those who bear costs, and still be better off given the net benefit. If compensation occurs in such a way that no one in S_2 is worse off compared to S_1 and at least someone is better off, then the move to S_2 is certainly efficient. But note that the Kaldor-Hicks test requires only that compensation *can occur* in such a way, not that it actually occurs. If it actually occurs, an efficient move according to the Kaldor-Hicks test becomes a Pareto superior move (provided that compensation itself does not have too high transaction costs). Thus the Kaldor-Hicks test is also seen as a criterion of potential Pareto superiority. In this sense, as we have seen, Calabresi and Bobbitt (1978, p. 86) refer to a “potential Pareto superiority” test to which they associate “tolerable distributional effects”. So it is correct to say that Pareto efficiency remains in the background of this as a conceptual resource to be integrated with the appropriate normative considerations. This turns out to have the same point of the first argument in defense of Pareto sketched above, there referring to the Coase theorem, here to

³ “I fully admit that the mischief which a person does to himself may seriously affect, both through their sympathies and their interests, those nearly connected with him and, in a minor degree, society at large.” (Mill 1859, p. 145)

⁴ A different way to make the point is to claim that external preferences are indirect internal preferences, i.e. relative to the consequences of the conduct of others on us.

⁵ On Kaldor's and Hicks' contributions, respectively, see Torriti and Ikpe (2019, p. 407).

the Kaldor-Hicks efficiency: Pareto efficiency is not entirely “pointless”, for it remains in the background as a conceptual, if not normative, resource that makes sense of bargaining and reallocations *à la* Coase, and of reallocations *à la* Kaldor-Hicks.

However, there is a crucial problem with using Kaldor-Hicks to rescue Pareto efficiency. Kaldor-Hicks efficiency requires a comparison of someone’s benefits with someone else’s costs. When the “winners” gain more than the “losers” lose, the move is deemed efficient. But this technique of cost-benefit analysis reintroduces a cardinal measurement of the utilities and disutilities of the subjects involved, in place of the Pareto ordinal logic. It reintroduces those interpersonal comparisons of utility that Pareto had tried to exclude from the picture by judging them impossible. The only counterargument I see here in defense of Pareto consists in claiming that Kaldor-Hicks potential compensation can be seen along the lines of ordinal rankings. If the “winners” can make it the case that the “losers” in S_2 are brought back to the same ranking level of S_1 , and notwithstanding this the “winners” in S_2 remain on a higher-ranked level, this state of affairs is Pareto superior and efficient.

Finally, it should be noted that in recent discussion fueled by behavioral economics (Sunstein 2014) the Harm Principle is criticized to the extent that individual preferences may not be in the best interests of their holders. This would justify a paternalistic intervention when individuals are not autonomously able to achieve the goals and wellbeing they wish for themselves. With such intervention they would be protected from their own errors and the costs thereof. This is a line of argument that cannot be examined here, but it should be noted that the possible divergence of wellbeing and preferences is a serious threat to the Pareto logic and the argument presented here, because it puts into doubt the fundamental assumption that wellbeing consists in the satisfaction of internal preferences.

4. *Prospects for Future Research*

In order to summarize the present work, let me repeat that Calabresi has developed a powerful critique of Pareto’s efficiency. Among other things, he has shown that Pareto improvements require the unanimity of the relevant preferences (because they require, at least, that someone is better off and no one is worse off). I have observed that Pareto’s test of efficiency can be defended with an argument built upon Mill’s “Harm Principle” and thanks to the analytical distinction between self-regarding and other-regarding preferences, which, for short, I have called “internal” and “external” preferences. If the core of Calabresi’s critique is the unanimity condition required by Pareto’s test, this requirement can be better satisfied by counting only internal preferences and justifying this with Mill’s Principle. At the same time, I have pointed out some limits and weaknesses of the redefined Paretian approach, and offered considerations that reduce their critical impact. I have also suggested that, for jurists, Pareto superiority is more salient than Pareto optimality.

Now I wish to highlight some prospects for future research. One is the prospect of further analytical work to better clarify the distinction between internal and external preferences. This would also help adjudicate unclear cases and those where external preferences could be seen as indirect internal ones. Eve complains about Adam’s drinking because it harms her too. The workers hired in the morning complain because their fellow workers hired in the evening receive the same money (it is the parable of the workers in the vineyard, Matthew 20: 1-16). When the right to vote is extended from men to women, a man protests that his vote has lesser weight now. When the right to marry is extended to same-sex couples, someone protests that this has costs in terms of social budget (e.g. for the social security and pension system). Work is needed to capture the logic of these arguments, appreciate their distinctive features, and assess their strength.

Another prospect is work on how to implement in practice the distinction between internal and external preferences. How to implement the policy of disregarding external preferences unsupported by harm considerations? Conferring rights whose exercise does not harm others? This

sounds correct but tautological. How to model constitutional design and legislation in this respect? Is constitutional review sufficient for this? Can we imagine a legislative process where external preferences do not count for voting purposes? The threat to the liberty of political opinions and agendas is significant.

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