My theme is an old one, the rule of law, but I hope to say something new. Let me start with the realist approach – the claim that the rule of law is an empty promise. The core of the realists’ point was that rules cannot define the scope of their extension. For any really new issue, there are bound to be competing rules, and the choice among them is just that – a choice. When a court is making a choice, it is a pretense to claim that it is “governed” by a rule. So, said the realists, the rule of law is a sham.

The critique is largely right, but not the conclusion. The fact that there are dawn and dusk doesn’t mean there is no day or night. That “the law” can’t constrain judges in every case doesn’t mean that it can’t often constrain them. When we compare our system with ones where courts do not handle routine disputes impartially, honestly, and more or less expeditiously, and where their judgments often lack binding effect, we see that “the rule of law” is real.

The realist approach is important: It is pointless to sing hymns of praise to the rule of law without taking it into account. But I think we can make progress in thinking about how to reinforce the rule of law by seeing it as an aspect of the broader question of accountability. Law itself serves two types of accountability: First, it gives people a framework within which to make decisions, to use their resources productively. If you get binding promises from a series of firms for future delivery of supplies, and if you keep your part of the bargain, you can count on being able to make those suppliers follow through on theirs – or make you whole if they do not. This kind of accountability – the ability to bind one’s self – is essential to a productive economy.¹

Second, and closely related, the rule of law

¹ In some situations, vertical integration is an alternative to contracts; but for the necessary predictability, this type of integration requires an adequate corporate governance system, which is itself another form of contract.

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is a device for constraining those who wield the power of the state. Unless the law constrains governmental actors, private creativity of every kind – from the most to the least mundane, from widget-building to art – cannot flourish. What kinds of constraints on government are needed is a vast topic; be assured I will not try to cover it. But as the executive branch wields state power most directly, through police, inspectors, the FBI, and, ultimately, troops, surely a minimum requirement is that this branch not be allowed to invade people’s private rights except under a mandate of Congress.2

But how can we maintain a system of accountability if the rule of law as a constraint on judges is itself incomplete – if, as the realists point out, there are cases in which judges may allow their own preferences some sway? Of course, there are some constraints on judges, such as constitutional and statutory limits and the need of most state court judges to face elections. But as solutions to the problem of judicial indeterminacy, these constraints all have their flaws. The legislative agenda is crowded, and getting a top position on it may be a function not so much of genuine social need as of media promotion, populist rhetoric, or the lobbying skill and force of affected interest groups. And once an issue is on the agenda of any of the electoral or legislative systems that constrain the courts, the same distorting forces that determined its place on the agenda will affect the outcome.

We thus face the familiar picture of imperfect accountability for actors who constrain others in the name of the law. But let me again broaden the focus. The state is far from the only source of accountability. Particularly for relations among citizens, an alternative is markets, or, to put it more generally, exit rights. If an employee thinks an employer is not paying him enough or is in some other way inadequate, unfair, or unjust, the employee can, instead of suing, leave the job; vice versa for the employer. If a customer thinks a producer’s offerings in the market are shoddy or overpriced, the customer can shift to another producer.

Commercial markets are not the only sphere in which exit rights operate. In modern matrimony, for instance, the exit rights of husband and wife constrain the behavior of each. And in all long-term relationships, of course, a lot of small-scale bargaining goes on in the shadow of exit rights.

As sources of accountability, exit rights are rather carefully nuanced; the exiting partner knows just what he wants to avoid and is likely to have a pretty good idea of what he will find elsewhere. Exit rights also operate with comparatively little social stress. If some consumers think that a health plan’s coverage of, say, alcoholism recovery programs is worth the incremental cost, while others do not, they can sort themselves out in the market. There is no need for “society” to make a judgment on the issue. And finally, exit rights constitute a sanction that cannot be ignored. They are critical and even devastating instruments of accountability.

Accountability through exit rights is, of course, imperfect. If an industry is monopolized, the disgruntled buyer has no close substitute for the overpriced product. In a company town, an employee can exit only by giving up life in that town. But two facts remain: First, for most of us, in most of our interactions in the world, the main constraint on our behavior is that if we don’t respond to others’ interests – offering adequate goods and services, delivering a quality work product to employers and competitive working conditions for employees – the people with whom

2 Or on the basis of powers directly granted to the President by the Constitution. See Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579 (1952).
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we deal will exercise their exit rights. Second, if the 20th century has shown anything, it is that for a huge range of transactions this mechanism is far more effective than centralized control through political institutions.

Federal judges, incidentally, may be the last to notice the role of exit rights; they have them, of course, but by virtue of their life tenure their employer does not. Journalists appear equally blind to the importance of exit rights: Ask yourself how many times you have heard or seen a journalist bemoan the fact that some transaction is “unregulated,” when what he really means is that it is not subject to state-controlled regulation (apart from general rules of contract, property, and tort). The complainer ignores the pressure of customers’ exit rights.

I won’t try here to specify which issues can best be resolved through markets and which through political institutions. No one any longer favors allocation of all issues to one or the other. But I do want to suggest that in addressing this question, we should remember that the rule of law as a constraint on courts is somewhat flawed, and that all the political constraints on the courts are also flawed because they depend on a flawed agenda-setting process.

In thinking about the proper division between exit rights and legal control, moreover, there seems to me an overlooked anomaly – that at some point the growth of the law has a tendency to shrink the rule of law. The first way in which this happens is rather obvious: As the commands of the state multiply, there is a corresponding decline in the fraction of those commands that people can be expected to comply with. This is illustrated by the so-called “work to rule” strike, in which workers simply say that they will follow the rule book. The strike works pretty well if the rule book has such an encrustation of requirements that compliance brings production to a crawl. This is the ultimate Dilbert scenario.

Thus, in many contexts, proliferation of rules means proliferation of lawlessness; the rules may be too numerous and complex for normal people to master. Or they may even be in conflict with one another. In the same year that Exxon was being sued for negligence in allowing the *Exxon Valdez* to be operated by a captain with a known drinking problem, the company was also being sued for discrimination under the Americans with Disabilities Act – for the offense of having removed workers with drinking problems from safety-sensitive positions. When commands conflict, lawlessness is inevitable. Respect for the rule of law is undermined.

But I want to turn to a more subtle way in which the growth of law may impair the rule of law. While exit rights do not deteriorate merely through the multiplication of issues subject to them, political systems do. To be sure, in a complex economy we sometimes feel flooded with market choices. But the market also generates suitable information for making those choices – for example, in the form of *Consumer Reports*. Further, even for a choice about which most of us are too lazy to inform ourselves, there will typically be some people for whom it is important. We lazy consumers are free riders on their informed actions, which send signals to producers.

By contrast, the more issues that are dumped into the lap of the state, the fuller the agenda, and thus the greater the risk that proper feedback will not occur. Those with confidence in centralized political resolution of issues should ask themselves the following question about some issue dear to their hearts: “How can I get a letter about this onto the President’s desk?” The more law, in the sense

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of more issues purportedly to be resolved by political institutions, the greater risk to true accountability, and in that sense to the rule of law.

Enough generalizations. Let me now address a recent development that I think not only represents the antithesis of accountability, and thus of the rule of law in the larger sense, but also illustrates the risk of indiscriminately shifting issues into the political arena. The major tobacco companies recently agreed to a comprehensive settlement of the 50 states’ claims to reimbursement for increased Medicaid expenses alleged to result from smoking. As a result of the settlement, the tobacco companies will pay the states about $250 billion over the next 25 years; they will also pay private counsel for the states somewhat over half a billion a year (which if we discount it at 5%, means a net present value of something in excess of $10 billion). Given the background fact that the demand for cigarettes is highly inelastic, or at least is generally thought to be so, the terms of the agreement effectively enable the cigarette companies to raise their prices to cover the cost: (1) The agreement binds all the companies; (2) each firm’s share of the payment fluctuates with its share of sales by the participating companies, and (3) there is provision for a reduction of the total payment if some upstart firm begins to make inroads into the sales of the signing companies. Indeed, as the agreement took effect, the companies raised their prices 45 cents per pack; analysts had estimated the cost to them at 43 cents per pack.

Thus, as anyone who took Econ 101 in college will recognize, the settlement is the equivalent of an excise tax on cigarettes, a tax that will fall overwhelmingly on consumers. Moreover, this tax is unusually regressive in its impact. Smoking appears to be rather evenly distributed among income groups, although it tails off at the top of the income spectrum. But a well-heeled smoker doesn’t seem likely to smoke more than a poor one, so the tax functions somewhat like a flat head tax, which is far more regressive than even a sales tax. And because more than $10 billion of the settlement goes to lawyers, this new quasi-tax is also rather regressive in its distribution of the proceeds.

But even more interesting than the tobacco settlement’s equivalence to a regressive tax on consumers is how the settlement came about. There are, after all, many policy arguments for a tobacco tax. If it had been enacted in the classic civics-text way, it surely would not raise any questions about the health of American democracy.

But that was not its origin. Instead, the tax came about as a means of settling liability claims. The key legislative event in the process was a 1994 Florida statute that stripped defendants of their defenses in any suit brought by the state Medicaid agency for reimbursement of medical expenses caused by the defendants’ conduct as third parties – i.e., as persons other than the Medicaid agency itself or persons insured by Medicaid. The law established a sort of subrogation that wasn’t really subrogation. And when I say it stripped defendants of their defenses, I mean just that:

4 2.4 percent of households have incomes over $100,000, but only 1 percent of smokers are in that income group.
5 Exposure to a sales tax rises with income, while exposure to a head tax or the tobacco quasi-tax does not.
6 Nonetheless, a University of Texas law professor is reported in the media as hailing the settlement as a wonderful source of funds for the state: “Texans have a fantastic bounty to enjoy: a legacy of greatly improved public services provided without a tax increase.” Charles Silver, Do Lawyers in Tobacco Case Deserve Billions in Fees?, Dallas Morning News, Dec. 20, 1998, p. 1-J.
Principles of common law and equity as to assignment, lien subrogation, comparative negligence, assumption of risk, and all other affirmative defenses normally available to a liable third party, are to be abrogated to the extent necessary to ensure full recovery by Medicaid from third-party resources. ...

Fla. Stat. § 409.910(1).7

In essence, then, the statute said that if you were in a position in which you would be held liable in the absence of defenses, then, no matter how good the defenses you did have, you couldn’t raise them – against one particular plaintiff, the Medicaid agency. So, in effect, a form of retroactive liability was established for a special class of cases: ones brought by a single favored plaintiff. Of course, the change appeared necessary if the litigation was to succeed, because juries around the country had almost always appeared to find that tobacco plaintiffs had assumed the risk, smoking in the face of well-known health hazards.

Maryland has a similar story. There, a lawyer engaged by the state for a 25 percent contingent fee brought a lawsuit on the state’s behalf, advancing various theories against tobacco companies. On preliminary motions, a lower court held that the state was effectively limited to subrogation in its classical form.8 The legislature responded with a defense stripping measure, not as drastic on its face as the Florida one but evidently enough to send the necessary message to the tobacco companies.9

These statutes seem odd enough. But consider also the judicial environment in which they landed. Neither the Florida nor the Maryland courts, to be sure, had been willing to establish the new liability principles without legislative action. And since none of the cases was litigated all the way to a state’s highest court, we cannot say exactly what the causes of action were. To the extent that the cause of action was “products liability,” it surely benefited from the courts’ current willingness to engage in rather freewheeling judgment on product design.10 But we don’t know whether that was the key. More generally, the outcome surely depended on the courts’ readiness to expand their grasp.

In terms of accountability, how does all of this stack up? You have the equivalent of a large, regressive tax increase enacted without the inconvenience of legislators actually voting for a tax. Where do you find responsibility? Somehow the legislative measures necessary for a tax got onto the agenda and passed. But they got passed in a special form, a form that enabled legislators to describe their activity in the populist rhetoric of the movement against tobacco companies. Not many citizens have taken Econ 101, and fewer still have understood it. So this was a tax shielded from the rhetorical vulnerability of a tax. And surely the processes I mentioned earlier as undermining accountability were at work: media promotion, populist rhetoric, and the lobbying skill and force of various interest groups. Throughout this litigation, the media always depicted it as a war between big tobacco and the people, or between big tobacco and health. So the

7 Of course, the defense-stripping occurred only for a “liable third party.” You could make a clever argument that “liable” is usually the label for someone who loses at the end of a lawsuit, so the party with valid defenses could not be “liable” and thus would retain its defenses. But on that reading, the statute would have no effect.
10 It is now perfectly plausible that a product may be found defective because it contains an ingredient with dangerous side effects, even though consumers all know of the adverse side effects and even though the product cannot exist in anything approaching the form that consumers like without those effects. See Restatement of the Law, Torts: Product Liability § 2, cmt. e.
framing was a populist’s dream, one that tended to obscure the identity of the people who would pay.

As for the lobbyists supporting liability, we know from newspaper accounts that a pivotal legislator in Maryland got hefty campaign contributions from corporations owned by the private lawyer Maryland had hired or by his children. If we ask the standard question in a whodunit – Who has a motive? – it seems a fair guess that similar lobbying efforts must have been at work pervasively. The tobacco companies, of course, must also have been active. But smokers were the parties primarily at interest on the other side, and it seems safe to guess that they had no effective representation.

Let me draw an invidious comparison. In post-communist Russia, we have seen how the so-called oligarchs, using sweetheart deals with high government officials, have commandeered large chunks of the national wealth for themselves, at the expense of the people generally but, most poignantly, at the expense of lower income groups. The tobacco settlement seems to be a local version of the same thing.

One might say for the tobacco settlement, as against the Russian oligarch model, that as much as 95 percent of the take goes to the state, perhaps to be used for worthy ends. But it had been thought that a fundamental requirement of democratic accountability was that taxes could not be imposed unless legislators ran the risk of voting publicly for a tax increase. The tobacco settlement sidestepped that.

Now a word for the law-and-economics buffs. A standard argument would be that tobacco liability is quite sound, on the theory that it merely corrects market failures. The argument would run that consumers are ignorant of the full hazards of smoking and accordingly consume more cigarettes than they would if fully informed. A price increase driven by liability sends them the right signal and will get them to cut their smoking to economically correct levels. In addition, smoking generates medical care costs that are borne by neither smoker nor cigarette company but are externalized. Liability, in this view, will force cigarette makers to internalize these costs.

There are problems with this argument at two levels. So far as consumers are concerned, even smokers appear on average to exaggerate the average health hazards associated with smoking, though not as much as non-smokers do. This is true whether you think in terms of lung cancer risk, overall probability of death from smoking, or (most sophisticated of all) a shortening of life expectancy. The estimates by young smokers seem to be even more exaggerated. Some surveys, to be sure, indicate that a large proportion of smokers, perhaps in an advanced state of denial, manage to believe that they are somehow exempt from the law of averages and that their personal odds will be better than average – like the citizens of Lake Wobegon, where “all the children are above average.” If in fact smokers have an uncommon ability to delude themselves as to their personal risks, a liability-induced price increase seems unlikely to dispel their illusions or to provide an economic substitute for clear thinking. If they do not, it seems unnecessary.
As for government-borne medical costs, the data show that when all effects are taken into account, pre-existing cigarette taxes more than covered the net smoking costs borne by government.\(^{15}\) Besides, insurers in ordinary markets tend to give good signals of costly behavior; they charge higher premiums for people who engage in risky conduct, as indeed life insurance companies now do for smokers. If there are externalities being borne by the state, it is due to the state’s choice not to adjust medical insurance premiums the way a normal insurer would.

Finally, I doubt that the concept of “addiction” adds much to the analysis. About half of all people who have ever been smokers have quit.\(^ {16}\) It seems likely that those who persist in smoking regard the benefits — relaxation, better concentration, greater ease and confidence in social situations, and perhaps frivolous concerns such as a veneer of sophistication — as outweighing the well-known drawbacks. They may even have read that smoking reduces the likelihood of Alzheimer’s Disease.

Thus two branches of our political system joined to produce the quasi-tax on tobacco. The courts set the stage, with their general hospitality to expansions of liability. This expansion of the judicial domain, like every such expansion, increases the risk of rule-of-law violations because it generates new occasions for those choices that the realists convincingly said could not be controlled by existing rules.

And since we look in part to legislatures to control the damage, this expansion helps crowd the legislative agenda. Here the legislatures have stepped into the new territory — in fact to expand liability still further and thus to create a tax in a way that disguises its tax-like quality. In this step, too, I would submit that a pre-existing excess of laws, of legal interventions, played a role. The crowding of the political agenda, in large part with centralized legal rights displacing exit rights, reduced whatever chance there may have been that the issue would receive concentrated, penetrating public analysis. The growth of law, or of legal rules, thus diminished the rule of law.

Of course the maxim “the more law, the less rule of law,” is oversimplified. A lot of law merely provides default terms for contracts and thus spares parties the need to provide expressly for remote possibilities. A lot simply facilitates the creation and transfer of property rights, offering conceptual boxes for packaging rights to resources and allocations of risk. But most recent legal growth, with its creation of new liability (and thus implicit rules of conduct and exposures to juror discretion) deliberately overrides the choices that private persons or firms have agreed on, or would agree on, under a regime of mutual rights to exit (or to refuse to enter). It is this that threatens the rule of law.

To close on a more cheerful note, I do want to repeat my earlier point that the rule of law is still far more robust here than in many other countries. But even here, it cannot be expected to flourish forever if legal rules continue to metastasize. \(\&\)

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\(^{15}\) Viscusi at tbl. 5.