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SIMPLICITY AND COMPLEXITY IN LAW AND IN MARKETS

by: Saul Levmore*

Richard Epstein's *Simple Rules for a Complex World*¹ is true to its title and to the author's demonstrated genius over a long career. It is a libertarian-oriented enterprise in that it requires the reader to share in the belief that government programs are often wasteful and subject to unattractive interest group pressures and corrupt bureaucracies. More generally, *Simple Rules* is framed against a background in which the reader must share the libertarian view that individuals can and should be trusted to look after themselves and to make their own choices. Epstein likes "simple" rules; these include strict liability, a flat tax, fee simple, and so forth. He argues that more complexity invites errors and corruption, and arguments for complexity undervalue individuals' ability to bargain and otherwise fend for themselves. People know what is good for them far more than lawmakers. Anyone who does not share these fundamental views might be frustrated when reading this important book, unless perhaps the belief in redistribution and market failures is so great that one is willing to set aside the enormous costs of government failure. In any event, an insightful and friendly (and terrific) critique of the book has already been written by John Harrison, who thinks of Epstein's book as a myth: What role should law play if the world were as Epstein (and perhaps Harrison and others among us) wishes it to be?² As such, this Essay is neither a review nor a reaction, but instead offers the following two ideas that are stimulated by the book. First, "simple rules" is something of a misnomer; simplicity is in the eye of the beholder. Second, and more significant, the book offers an opportunity to think about the division of labor between private markets and government activity. Thus, Part I of this Essay raises doubts about the idea of simplicity in rulemaking. It is important to take enforcement costs into account when making rules and to see that there is often a trade-off between these costs and the goal of encouraging social efficiency on the part of those subject to these rules. Complexity does often raise administrative costs, but it can also encourage efficient behavior. Part II then takes us in a new direction as it compares the complexity of markets to that of law. It asks why we should yearn for simple rules where law is concerned if the private market often chooses and demonstrates the advantages of

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1. RICHARD A. EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD* (1995).

2. John Harrison, *Richard Epstein's Big Picture*, 63 U. CHI. L. REV. 837, 841 (1996) (reviewing EPSTEIN, *supra* note 1).

complexity. Various answers to this question cast some light on the choice between simple and complex rules.

I. WHAT ARE SIMPLE RULES?

Epstein's simple rules are easy to state, though subject to some line-drawing problems.³ Law is asked to busy itself with enforcing contracts, preventing violence, securing property rights, and presumably providing for the national defense, though Epstein does not dare call for much simplicity in that particular government enterprise. Epstein's central argument is that even in a complex world, or perhaps especially in such a world, the limited number of rules, which is to say necessary government interventions, should be structured as simply as possible to guard against interest groups' attempts to get the government to do things that are not in the public interest. Epstein offers applications of this insight—that laws should be few in number, limited in scope, and simple in structure—on almost every page. For example, he has always preferred strict liability rather than a negligence rule in tort law because a strict liability rule avoids the task of determining what is negligent and what is not. He fairly and cleverly discusses the contrary pressure, namely that a strict liability rule requires law to determine damages more often than does a negligence rule.

The big idea about simple rules is straightforward. It is an idea that can be inserted, even without Epstein's help, in virtually every area of law. For instance, if it is sensible for law to assign property rights in new ideas, there is something to be said for doing so with a patent system. One might then think that it is sensible to have patent terms of different lengths for different classes of inventions; after all, innovations in diverse industries do not all require the same incentive. On the other hand, the simple-rules approach warns us that interest groups are likely to spring into action in support of inefficient patent terms. A single, simple rule in patent law may be better than one that is complex and more subtle. Similarly, a property right offered in perpetuity (as law generally does for real property) is probably better than one that is available for a fixed period and subject to renewal by administrative agencies. A patent period and other strong property rights involve a tradeoff between the monopoly power associated with a property right—intended to encourage innovation (in the case of patents) and investment in improvements (in the case of most real property)—and the benefit of a zero price for something with no mar-

3. To be specific, Epstein's several simple rules for law are the protection of (1) autonomy, (2) first possession (of real and perhaps some intellectual property, though this is not much discussed), (3) contracts, and (4) person and property against aggression. His simple rules also include (5) a limited privilege for cases of necessity (presumably where truly voluntary contracts are impossible), (6) the right of government to take property but only upon payment of fair compensation, and (7) flat taxes (especially when the goal is engaging in redistribution).

ginal cost. Either one is probably better than a yet more complex system in which law must make many assessments of costs and benefits, while responding to various interest groups.

Similarly, and more controversially, Epstein expresses a strong preference for a flat income tax,⁴ as this avoids constant lobbying and arguing about progressive tax rates. It also causes more voters to think carefully about whether a proposed and costly government program is really worth the(ir) candle.

Our income tax system is indeed quite complicated. But it is not simply the ongoing battles over the degree of progressivity that constitute the price of complexity, but also the various deductions and exclusions, many of which are made more complex because of the rate structure of our progressive tax system. Epstein might have favored a head tax, as that would be the simplest rule of all when it comes to funding the government, but that kind of tax would be so regressive, with Bill Gates paying the same amount as the typical law student or still less fortunate citizen. An advantage of a flat tax (e.g., Gates pays 20% of income, as would we all) is that everyone would see that the next spending proposal comes with a cost. With a flat tax, we might all be honest voters who consider the (mostly private) costs and benefits of each government program. Indeed, less wealthy voters might pay more attention to government proposals than would their very wealthy compatriots.

If we wanted to build some progressivity or wealth redistribution into the program, we could add a wealth tax at various intervals. Each clever addition adds complexity to the system and, therefore, opportunities for lobbying and granting favors. The tax is subject not just to a decision about the proper rate, but also to various claims about exclusions and deductions. Is the charitable deduction to remain, and only so for those who itemize? Who will decide which recipients are eligible? What will define 501(c)(3) tax exempt charities? Should churches be taxed on their “incomes”? Should there be deductions for home offices? In short, much of the complexity of the current system would carry over to a flat tax system. Perhaps Epstein does not quite believe in simplicity—or more likely, he recognizes the fact (or problem) that everything in law that can be sensible comes with a degree of complexity, so the question is where to stop. Steve Walt has noted that it is not simplicity that Epstein really espouses, but optimal rules, which involve comparing the cost of applying a rule, which is to say its administrative costs, to its incentive effect on parties.⁵

A fairly simple tax system, or “rule,” might rely on a sales tax rather than an income or wealth tax. The simple-rules approach would attach

4. EPSTEIN, *supra* note 1, at 138–48.

5. Steven Walt, Book Review, 109 ETHICS 193 (1998) (reviewing EPSTEIN, *supra* note 1).

the sales tax to everything, with no exclusions for children's clothing or medicines for instance, so as not to leave room for interest groups and lawmakers to play with exceptions. This did not work well in the era of import taxes—a form of sales or excise taxation—both because of lobbying for exclusions and battling among countries. In any event, is a modern sales tax really a good idea, even given its simplicity? Different jurisdictions have different expenditures because they choose to provide a different set of public goods.⁶ This is sensible to anyone who thinks that individuals can make their own choices. Some might want more public parks, while some might prefer more police, and so forth. But then people who live in one jurisdiction will have the incentive to cross borders on occasion to low-tax jurisdictions. Moreover, the sales tax is, for the most part, regressive; Bill Gates surely buys more goods than less well-off people, but not enough to extract from him that which a progressive or even flat tax system would. In short, a sales tax is simpler than a flat income tax, but it is likely regressive, and it raises some of the inefficient shopping among jurisdictions that a flat income tax avoids.

Even this brief discussion suggests why a property tax is popular, and especially so where crossing borders is inexpensive. Why, then, do we not more completely fund governments with property taxes? For one thing, property assessments are difficult and corrupt.⁷ This is a complexity of law that Epstein might have emphasized more forcefully. Moreover, as any one tax increases, there is apt to be more distortion and inefficiency. If a jurisdiction relies entirely on a tax on wood, people will move to steel. A tax on alcohol leads to the inefficiency and danger of other drugs. A tax on labor will lead to fewer employees and work hours. A high tax on real property might lead (not to rentals because the landlord's property tax is passed on to tenants) to more modest houses but more spending on cars, and so forth. Depending on elasticities, there is likely reason to prefer many small taxes to one large one—and it is not clear which system is more complex. Each comes with administrative costs, which are themselves sources of complexity. In short, even this one example suggests that simplicity is not an easy goal, and an argument for “simple rules” should be understood as encouraging us to think about the trade-offs in law, rather than as telling us exactly how a society should be managed.

The idea that government complexity comes with great costs also depends on the examples that are chosen. It is hard to imagine an

6. See generally Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956), <https://doi.org/10.1086/257839>.

7. See, e.g., Paul Lagunes & Rongyao Huang, *Saving Gotham: Fighting Corruption in New York City's Property Tax System*, in GREED, CORRUPTION, AND THE MODERN STATE: ESSAYS IN POLITICAL ECONOMY 180, 180–81 (Susan Rose-Ackerman & Paul Lagunes eds., 2015).

entity more complex than a well-run military. Officers respond to evolved feelings of loyalty, to promotion opportunities, and to opportunities for pride. There is very little in the way of a price system. Military procurement does suffer from interest group problems, but simplicity hardly seems like a cure. There are other examples of apparently efficient and yet complex government activity. The lesson to draw is that something other than simple rules is at stake. The danger of interest group influences is probably far more important than any agency cost argument.

II. PUBLIC AND PRIVATE SECTORS

A. *The Division of Labor Between the Public and Private Sectors*

A focus on the choice between simplicity and complexity hints at the interesting and more general question of when to trust law and when to leave things to the private market. Some things that are currently attempted by governments can be outsourced to markets, and some that are conventionally taken up in markets can be “insourced” by governments. National defense is in one sector and food production is in another; health care and higher education occupy a significant part of both sectors. In the real world, a place quite distant from Epstein’s mythical land where a small government does little more than protect against the invasion of property and body, the big picture is about the division of labor between the government and the private market, though the government has almost complete control over this division. For example, our health care system is divided between the two, but it could be accomplished or mismanaged by either alone. The private market could handle our environmental problems with tort law at work in the background. Alternatively, the government could take over the problem with many restrictions and retaining walls. And then there are choices to be made between public transit and electric cars, and between public and private schools. Law can encourage dispute resolution in its courts or it can favor contracts that require arbitration. The list goes on. In reality, and given the likelihood of free-riding and diminishing costs, not to mention the ability of voters to redistribute and support inefficient governments, many goods are centrally provided. We can almost imagine a legal system in which residents pay private companies to protect their national borders, and certainly to collect highway tolls and check entry permits. However, larger-scale national defense seems to have sufficient public-good qualities and political consequences, so that it is offered nearly everywhere as a government-provided good. Gone are the days of the Gurkha regiments serving as a nation’s only military force.

In turn, both democratic and authoritarian systems provide basic police services, though here we see private markets offering added protection for banks as well as some stores, neighborhoods, and uni-

versities. Governments could subsidize supplemental protections, but they rarely do so, perhaps because add-ons are usually purchased by businesses or high-wealth individuals. In fact, governments often penalize this kind of private outsourcing (a word used here to refer to a reliance on the private market where convention has put the service or products in the hands of a government), by providing lower levels of service just when it is apparent that privately-owned entities will buy services on their own. This is true not just for policing, but also for many other things; parks are often publicly provided, but then there are private swimming pools and golf courses added on through the market. Roads were once in the private sector, but now they are, for the most part, publicly funded and controlled. Many roads are paid for by taxes on fuel, not to mention tolls on older highways, so that the government is charging user-fees much in the manner of a competitive private market.

B. *The Puzzle of Complex Rules in the Private Sector*

There is a puzzle in the central theme of *Simple Rules for a Complex World* when considering the presence and possibilities of outsourcing or insourcing (i.e., watching the government undertake activities that could be provided in the private market). If simple rules are easy to administer and efficient, then why is the private market, particularly a market in things that can be understood as outsourced, so full of complexity? Complexity is everywhere in the private market. Restaurants normally charge different prices for different foods, and gratuities add more complexity. Uber offers dynamic pricing to affect both demand and supply. FedEx varies prices by the size and weight of packages. Private hospitals charge a wide array of prices for different procedures. Many of these complex “rules” are easily seen as efficient. This is true whether the private market fills gaps in what was once government dominated or whether public provision fills gaps where private markets once stood alone.

Moreover, when the private market is not complex, it is often for reasons other than efficiency. For example, neither state nor private universities use pricing strategies to allocate seats in popular courses, but this is not because the simple rule of a fixed price per term or per credit hour is attractive as a means of controlling rent-seeking or agency costs. It is, instead, likely a response to an egalitarian sensibility. As many other examples confirm, the private market is rarely simple, and it often offers far more complex rules and pricing systems than does the government and its laws. If simplicity is so good, why do we not find it in the private sector? Airline seats and construction projects are packaged in small units and with complex pricing systems—and these seem efficient. Private markets must respond to corruption and other problems in ways similar to those found in the public sector. Why would simplicity be desirable in one setting but not

the other? Indeed, it is often sensible to ask the government to imitate the private market. The postal service could learn from FedEx, much as our public and private space exploration enterprises and the National Institutes of Health and pharmaceutical company research teams could certainly learn from one another.

The puzzle is solved if the agency costs faced by entrepreneurs are much lower than those found in public enterprises. The manager of a farm in the Soviet Union might have faced the problem of unmotivated workers, but the owner of a department store in the United States also faces problems of employee theft and tardiness. If there is a difference between the public and private sectors that is based on agency costs, it must be that when the government is the rule-maker, it is more difficult to use rewards and penalties as motivation. There is no profit to share since civil service and other rules—but note that these are *simple* rules—prevent rewards for good performance; these rules also make dismissal of employees very difficult. But this makes the case for simple rules rather puzzling. The government's disadvantage is that it is bound by simple rules. Lawmakers and bureaucrats have no profit incentive: Car sales-people in the private sector can be motivated by commissions, for example, but if IRS agents or police officers were rewarded for capturing offenders of the law, the public would be outraged and correctly fearful of wrongful behavior.

In principle, it is easier for an entrepreneur to monitor employee behavior and limit corruption. But this confidence in the private market misses the point that the private market must also control the behavior of its workers (and customers to whom it has made promises). The private supplier of safety, prisons, or housing has the same problem in motivating employees as does the government. The best argument for simple rules must have less to do with efficiency at the supply level than first appears because we often see the private market thriving through complexity. It is surely correct that individuals know themselves best, and the private market allows them to benefit from this knowledge. It allows buyers to choose their own foods at different prices, and to choose among Ubers, taxis, and buses, based on their individual calculations regarding costs, time savings, and other benefits. Note that taxi pricing is simpler than Uber pricing (leaving aside the complexity consumers face in the form of not knowing in advance what a taxi fare from point X to Y will be) so, here again, we see the point that the government (in its regulation of taxi prices) is simpler, rather than more complex, than the private market. From an efficiency point of view, it would probably be better if taxis also had surge pricing, and it is hard to believe that complexity breeds corruption or greater administrative costs in this sector.

As already suggested, the private market might tolerate complexity better than the government because it can more easily dismiss em-

ployees.⁸ Epstein might argue for more relaxed civil service rules than for overall simplicity because the latter is more likely to forego the efficient delivery of many goods and services. Another difference between the private and public sectors is that players in the private market are more often controlled by their desire for repeat play. A contractor who renovates a private home is likely to have a seriously incomplete contract—something akin to a standard rather than a rule. The contractor, like many lawyers, might be paid on a cost-plus basis. But the contractor is eager for good recommendations that will attract the friends and neighbors of satisfied customers. The government's tax collector, military force, and high school principal pay less attention to acquiring new and repeat business.

When we pay attention to the big picture of the government and its laws, we can lose sight of all the ways in which the government's complexity is very much like the private market's, at least in terms of efficiently controlling demand. Police and firefighting services are provided with simplicity, and yet governments have come to charge for their services when they rescue mountain climbers. The charge is surely progressive. Similarly, private letter rulings from the IRS now come with charges.⁹ Again, the rule is complex but efficient, and it is not subject to criticism on grounds of wealth inequality. In short, a taste for simple rules must be selective, and that itself is not a simple undertaking.

Things do look different when rent-seeking is allowed center stage. Interest groups might bring about inefficient rules, and they might have an easier time influencing law when the law is complex. In part, this is the case because amendments and small changes in language can help an interest group while dispersing costs among others who will not find it worthwhile to mount a defense. An interest group can influence lawmakers to create exceptions or to provide support in a way that the private, profit-maximizing entrepreneur would have no reason to tolerate. Elon Musk surely tries to influence the government, but it is hard to see how interest groups can influence Musk in a way that is inefficient. If a private entity gets an "exception" in the marketplace, it must pay for the special treatment, and this itself can be efficient. There is less reason to think that an interest group that captures a legislator does so in a way that promotes efficiency. If the group's efforts reflect an intensity or a means of payment, this might match what would happen in a market, but in most cases the interest

8. Generally speaking, only in the private sector is employment at will, though employees have much greater ability to form unions. At-will employment can be especially important inasmuch as private sector employees do not enjoy the right of free speech, as when criticizing an employer.

9. I must confess that the rules for obtaining these rulings, 26 C.F.R. § 601.201, authorized by 26 U.S.C. § 7528, are so lengthy and complex that the reader might immediately be inclined to prefer Epstein's "simple rules."

group is out to circumvent a competitive market of lawmaking that responds to most citizens' preferences.

This may be so, but it does not immediately translate to a case for simple rules. It may be easier for an interest group to encourage a small change in a complex rule, but the consequence is likely to be greater if the group gets a simple—which is to say, more encompassing—rule altered in its favor. For example, an added deduction in our income tax is likely to have a smaller overall impact than a small rate change in the income tax as a whole. In sum, interest groups surely bring about more inefficiency when things are in the hands of the government rather than the private sector, but it is not obvious that simplicity removes this disadvantage of public action, or law quite generally.

C. *Examples of Comparable and Sensible Complexity*

It is useful to consider a few examples of simplicity and complexity in the public and private sectors. Consider the way Disney World ensures that its rides are safe for young children. Many rides are limited to children more than 48 inches in height. Others are limited by other height requirements. The rules are simple in the sense of one rule for each ride, but complex in the sense that a family considering a trip to Disney World must realize that there are at least seven different height requirements around the Magic Kingdom. Meanwhile, some states allow people to get drivers' licenses after a single age limit followed by a short probationary period with some restrictions. Other states have more complex rules that discourage nighttime driving, driving with passengers, driving without the successful completion of a driver's education course, or driving without obtaining good high school grades. There is also, typically, a single height or age requirement, in most but not all states, governing the use of car seats. Disney is somewhat more complex in its rules than are most states. It is easy to imagine more sensible state laws. Why not combine age with height requirements? One aims at maturity and the other the ability to see and to brake carefully. Perhaps the ability to drive a car is more readily self-enforced by parents, or it may be controlled by the need to pass a driving test. Interest groups play only a small role, and the argument for simple rules in a complex world does not seem significant. Again, the private and public sectors are comparable.

In the workplace, private employers often have complex rules about vacation days, salaries, personal days, and sick days. But the government's civil service rules are no less complex.¹⁰ Again, the role of interest groups (including labor unions) seems about the same in the two sectors, and agency cost differences are not obvious. There are

10. See *Federal Government Jobs: Federal Employee Pay & Benefits*, FED. JOBS, <https://federaljobs.net/benefits/> [<https://perma.cc/3KZH-L2WA>].

many such comparisons between the public and private sectors, and most show that the two sectors are similar in terms of simplicity and complexity. If there is a case for more simplicity in the public sector, it is about particular situations where there is reason to think that interest-group pressures create more inefficiency than does complexity, and subtlety (which often takes a complex form) allows for more efficiency. There is no reason to push for a single price for parking, a simple rule for being accepted to a state university, a single speed limit on all roads, a single toll or no tolls on all bridges, or a single metric to judge readiness for war or promotion in the military. The private sector shows us that complexity often has value.

The choice between simplicity and complexity in rulemaking is itself complex. Reliable and clever rule-makers are likely to do a more effective job if given the opportunity to make tailored and complex rules. Where governments are concerned, and a profit motive is unavailable, the goal should be to limit the impact of rent-seeking interest groups and politicians.