

The consumer welfare standard, consumer sovereignty, and reciprocity:

An evolutionary foundation for the positive economic approach to law that actually works

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Abstract. The *Consumer Welfare Hypothesis in Law and Economics* claims that 1) in a partial equilibrium setting, a definition of allocative efficiency with remarkable pedigree uses a consumer welfare maximization standard; 2) this notion of allocative efficiency clearly fits better with EU antitrust and consumer law than the traditional total welfare hypothesis. The second claim is presented as a good reason for taking this notion of allocative efficiency in the economic approach to law seriously. This chapter shows that the consumer welfare hypothesis is supported by an indirect reciprocity mechanism with robust evolutionary credentials. Applied to a market setting, this indirect reciprocity mechanism is supported by the social norm of consumer sovereignty. Among other things, this account straightforwardly connects central themes of Adam Smith's thought: reciprocity, moral equality, division of labour, and consumer sovereignty. Consequently, another advantage of the consumer welfare hypothesis over the total welfare hypothesis is that it can rely on a plausible evolutionary mechanism.

1 Overview of the analysis

In the economic approach to law, all the different notions of efficiency relate to the analysis of allocative problems, namely problems that have to do with the choice of which resources should be used to satisfy which preferences, and under which conditions. A long-lasting critique of this analytical framework is that it fails to give due consideration to distributive concerns. The (perceived) failure to address these critiques has led to the rejection of the economic approach to law in several contexts. Last year, Garoupa and Ulen (2022) have recognized that the limited success of the economic approach to comparative legal research is, at least in part, due to this issue. This is just an instance of a broader phenomenon. Legal philosophers and theorists have long lamented the shortcomings of the monistic approach to efficiency.¹ In recent years, the Law and Political Economy movement has arisen with the clear objective of going beyond the use of efficiency as a central analytical and normative concept.² In the European Union, the view that markets ought to be efficient and that efficiency disregards distribution is intimately intertwined with the instrumentalization critique of EU consumer law.³

For quite some time now, leading scholars in the field have adopted a more pluralist normative approach, where the analysis of legal institutions is performed under a bundle of normative criteria which, typically, include besides efficiency, a concern for the distributive effect of the legal norms for the most disadvantaged members of the community.⁴ On the one hand, this approach reduces the attractiveness of the economic approach to law derived from its promised superior analytical transparency, precision, and increased predictability of court decisions. On the other hand, the above-mentioned trends of rejection of the

¹ For example, Dworkin (1980) and Coleman (1988). For a review, see Mathis (2009).

² See, for example, Collins et al. (2004) and Britton-Purdy et al (2020).

³ Recently, Hesselink (2021), especially pp. 297-9.

⁴ See, for example, Bar-Gill and Ben-Shahar (2013); Posner E. and Sunstein (2022). For a broader analysis of this trend, see Esposito (2017).

economic approach to law suggest that this compromise solution has failed to soothe the irritation among legal scholars caused by efficiency analysis.⁵

My recent book, *The Consumer Welfare Hypothesis in Law and Economics: Towards a Synthesis for the 21st Century*, offers a different way to address the problem. The solution to the irritation for the lack of distributive consideration in efficiency analysis does not lie in normative pluralism. The solution lies in using a different definition of efficiency. A notion of allocative efficiency which includes distributive effects – at least part of them – in the efficiency calculation: only increases in consumer welfare increase the efficiency of the allocation.

Against this background, this chapter will expand the investigation of the conceptual properties of the consumer welfare conception of allocative efficiency. It will do so by connecting consumer welfare with the literature on reciprocity via the concept of consumer sovereignty. In particular, the connection will focus on indirect reciprocity and its evolutionary or adaptive properties. The claim will be that consumer sovereignty can be seen as the manifestation of the broader cooperative force that sustains the division of labour in a variety of contexts ranging from advanced economies to Australian vampires and even the biology of bacteria.⁶ In this way, it will be possible to offer an evolutionary basis for the consumer welfare hypothesis.

This is no little finding, considering that for more than half a century, it was unsuccessfully attempted to identify an evolutionary mechanism that would sustain Posner's original efficiency hypothesis of the common law.⁷ This finding means there is yet another reason to take the consumer welfare hypothesis seriously.

The chapter contributes to several debates in addition to its main target, namely the notion of efficiency used in the economic approach to law and the methodology to perform positive economic analysis of legal institutions to identify the economic concepts that best fit with the legal ones. First, the chapter shows the need to go deeper than social norms when investigating the social mechanisms that lead to cooperation. In fact, a significant body of literature shows that cooperation is possible even in the absence of social norms, so that social norms need to be seen as a complementing mechanism to the more simplistic reciprocity-based ones.⁸ Second, the chapter offers another reason to be suspicious of the conceptual separation between efficiency and normative concepts used in moral and political philosophy as well as in law.⁹ Third, the chapter suggests that a reciprocity-based mechanism exists for the emergence of consumer sovereignty as a social norm.¹⁰ This account connects several themes in Adam Smith's view of human interactions. Accordingly, the resulting account should be particularly palatable to the advocates of 'humanomics', given their call for the restoration of Adam Smith's approach to economics.¹¹

The chapter is structured as follows. Section 2 introduces the consumer welfare apotheosis, focusing on the argument supporting it (Section 2.1) and the reasons to take this hypothesis seriously (Section 2.2). Section 3 introduces the notion of reciprocity this chapter relies upon (Section 3.1) and then focuses on its adaptive or evolutionary properties (Section 3.2). Section 4 shows that the concept of consumer sovereignty can be easily qualified as a reciprocity mechanism as well. Section 5 concludes pointing out directions for future research that build specifically on the qualification of consumer sovereignty as a reciprocity mechanism.

2 The Consumer Welfare Hypothesis in a Nutshell

The Consumer Welfare Hypothesis proposes a bilateral view of the connection (or nexus) between the law and the economy: "as a matter of economic theory, an allocation of resources in a market can be better or

⁵ I am drawing here a parallel between economic analysis and legal transplants and relying on the famous characterization by Teubner (1998) of legal transplants as legal irritants; see, more in detail, Esposito (forthcoming).

⁶ See below, Section 3.2.

⁷ For a discussion of this in particular, see Garoupa and Liguierre (2011), pp. 292-300. For an overall positive overview of the evolutionary economic approach to law, see von Wagenheim (2017); for a more critical analysis, see Deakin and Markou (2021).

⁸ See below, Section 3.3.

⁹ See below, Section 4.

¹⁰ See below, Section 5.

¹¹ See V. Smith and Wilson (2019) and McCloskey (2021).

worse based on the benefits it delivers to consumers; legal structures that are at the centre of the EU market-building project fit with this understanding of allocative efficiency” (Esposito 2022, p. 3).

The first part of the claim is, in other words, that an allocation A1 is more efficient than an allocation A2 in market M1 when the consumers of the products and services offered in the market M1 are better off in A1 in comparison to A2. The second part of the claim is that the content of legal reasoning in relation to EU antitrust and consumer law has a stronger conceptual fitness with this notion of allocative efficiency rather than with the traditional, total welfare-based one.

Four clarifications are in order. First, M1 is just one of the multiple markets that, together, constitute the relevant market economy. For example, M1 could be the market for pineapples, which would be different from M2 (the market for pizzas), M3 (the market for utility cars), M4 (the market for role-playing video games), etc. This clarification should be enough to dispel any confusion that could derive from Bork’s attempt to claim that everyone is a consumer.¹² Second, this definition of allocative efficiency is focused primarily on the inferential component of the analysis, leaving great malleability regarding its referential component. This means that different ways of measuring consumer welfare are compatible with this definition of efficiency, and disagreements about how to best measure consumer welfare remain analytically separate from the claim that – however you measure it – only increments and decrements in consumer welfare determine if an allocation of resources is efficient or not. Third, by design, this definition of allocative efficiency and the hypothesis built upon it is limited to those economic interactions that can be classified as exchanges. This is important because it implies that this hypothesis has very little (but still something)¹³ to say about markets for the allocation of factors of production. In particular, this means that the concept of allocative efficiency has little to say regarding how conflicts between capital and labour should be solved.

Forth, the consumer welfare conception of allocative efficiency is formulated and tested from a merely positive or descriptive perspective. As the next two subsections clarify, the argument supporting it is about how the concept of allocative efficiency is used and how different uses fit with existing legal reasoning. Nowhere is the argument meant to justify one notion of allocative efficiency as superior to the other for its normative properties. It is for this reason that *The Consumer Welfare Hypothesis* follows a method that can be called Legal-Economic Fitness framework and which builds on the so-called *Samuels-Calabresi Theorem*: identify the concepts that fit with both legal and economic reasoning about the legal-economic nexus.¹⁴

It is, however, the case that to the extent that one is concerned by the distribution insensitivity of the total welfare conception of allocative efficiency from a normative point of view, then the consumer welfare hypothesis should offer a normatively more attractive efficiency perspective – although not necessarily attractive.

2.1 The argument in a nutshell

This section summarizes the argumentative structure used in *The Consumer Welfare Hypothesis* in support of the consumer welfare conception of allocative efficiency.

The argument in favour of the consumer welfare conception of allocative efficiency has two main pillars. The first pillar consists in the analysis of the reasons that make the allocation by a first-degree monopoly less efficient than those by a competitive market.¹⁵ Ultimately, the reason for focusing only on the deadweight loss and, by implication, choosing the total welfare standard is a notion of equality that imposes on the decision-maker the duty to treat all market participants equally.¹⁶ The analysis then shows that this equality concern is often ignored in principal-agent models, in particular in corporate governance contexts.¹⁷ At the same time, the concept of consumer sovereignty, once carefully reconstructed, offers a clear equality norm in favor of the consumer welfare standard, namely that we are all treated equally

¹² See Hildebrand (2016), pp. 30-1.

¹³ Esposito (2022), p. 180 explaining the ‘separationist purpose’ of the hypothesis for production contracts.

¹⁴ Esposito (2022), pp. 12-6.

¹⁵ This means, ultimately, that the book searches for ostensive definitions of “allocative efficiency”; McCloskey (2021), p. 6 does the same for “humanomics”.

¹⁶ Esposito (2022), pp. 22-5. For an example of this view, see Cowen and Tabarrok (2011), p. 225.

¹⁷ Esposito (2022), pp. 27-9.

because when we operate as consumers we are suffering, and when we operate as producers we are servant. This passage of the argument will be further developed in this chapter.

For the sake of completeness, it is important to highlight that the first pillar does not end here. In fact, a tailored review of the thought of economists that have fundamentally contributed to the development of the economic approach to law reveals that, in their analyses, it is possible to identify exactly that concern favoring the consumers in a particular market that is at the core of the consumer welfare conception of allocative efficiency. The findings regarding Adam Smith, John Hicks, and Ronald Coase are particularly surprising and consequential.¹⁸ On these grounds, it can be concluded that the consumer welfare conception of allocative efficiency has a notable economic pedigree.

The second pillar of the analysis builds and improves on Richard Posner's path-breaking efficiency hypothesis of the common law. It improves it by avoiding cherry-picking problems, offering a comparative analysis of the relative strength of two competing efficiency hypotheses to – and this is the third improvement – explain the content of legal reasoning, not the effects that the law is expected to have on the basis of blackboard economic analysis.¹⁹ Four inferential disagreements between a total and a consumer welfare hypothesis were tested for their fitness with a significant portion of legal materials from EU antitrust and EU consumer law. The result is overwhelmingly in favour of the consumer welfare hypothesis.²⁰

In a nutshell, the disagreements are:

- Harm: all instrumentally relevant or not?
- Defences and exceptions: internal fuzziness and external clarity or vice versa?
- Sanctions: to deter and redress harm or to internalize social costs?
- Deadweight loss, elasticity, and productive efficiency: quantity-effects over price-effects or vice versa?

The choice of analyzing EU antitrust and consumer law is, first, that EU economic law is my primary field of specialization. Second, and most fundamentally, these branches of EU internal market law “are the extreme poles of the axis representing broader [antitrust] and narrower [consumer law] notion of consumers”.²¹ Hence, if the hypothesis holds here, it is plausible that it will also hold in sectorial contexts.²²

2.2 Reasons to take the consumer welfare hypothesis seriously

This subsection articulates four reasons for taking the consumer welfare hypothesis seriously. By “taking it seriously”, I mean simply paying attention to it, considering it when studying related topics, testing its epistemic strengths, investigating its normative appeal, and reflecting on its connection with a variety of concepts normally used in the economic approach to law.

The first and overarching reason is that, if the hypothesis is accepted,²³ then a new and rich set of research questions needs to be investigated. The list includes descriptive or positive questions about the law. For example, focusing first on antitrust and consumer law: does the hypothesis work also in the European Union, but at the national level? Does it work in jurisdictions outside the European Union, such as the United States, China, Brazil, Canada, etc? Moving beyond antitrust and consumer law: does the hypothesis work equally well in the analysis of merger regulations, state aids, sectorial normative frameworks, but also general contract law? Relatedly, how does the consumer welfare hypothesis require us to reconsider the economic analysis of central contract law doctrines, such as the legal consequences of a contractual breach

¹⁸ Esposito (2022), pp. 40-56.

¹⁹ Esposito (2022), pp. 61-6.

²⁰ Esposito (2022), pp. 175-6.

²¹ Esposito (2022), p. 86.

²² Esposito and Grundmann (2017) and Esposito and de Almeida (2018) offer preliminary investigations in the context of EU financial services and energy law, respectively.

²³ I leave undecided, for current purposes, the epistemological question concerning the conditions for accepting an apotheosis. In particular, I wish to take no position, on whether to accept an apotheosis it these sufficient that it is better supported by the evidence than the alternative or one needs to be committed to the truth of the hypothesis.

(so-called efficient breach),²⁴ or new contractual practices, such as algorithmic price discrimination,²⁵ and new capital creation and accumulation mechanisms, such as permanent secondary NFT royalties?²⁶

This wealth of questions relies also on conceptual guidance derived from the connection between the consumer welfare conception of allocative efficiency and principal-agent theory.²⁷ In general terms, the analytical directive is shifting the attention from transaction costs to agency costs. For example, this leads to a reformulation of the *Normative Coase and Hobbes Theorems* formulated by Cooter and Ulen (2014, pp. 77-9) as²⁸

- *Normative Smith-Hutt Theorem*: the law should minimise agency costs by empowering consumers to monitor producers directly
- *Normative Kaldor-Hicks Theorem*: the law should minimise the agency costs that are not avoided by direct consumer monitoring

The tailored review of the history of economic thought and the finding of systematic misrepresentation of the thought of central economists, and possibly of the very concept of social welfare, raises questions for the historians of economic thought to investigate. How comes the clear concern for the consumers expressed by those economists has later disappeared? Can it all really be explained only because of the supposed professional need of economists to be scientific, understood as avoiding making value judgments as much as possible? Or are there other forces at play? If so, do these forces play a significant role in the development of the economic approach to law?

The consumer welfare hypothesis also needs to be investigated for its normative properties. It was noted above that there is an equality norm supporting it. How convincing is this equality norm? Which are the critiques that are normally moved to efficiency-focused analyses that also apply to an analysis meant to maximize consumer welfare in exchange contracts (as defined above)? Ultimately, can we identify a normative synthesis between different theoretical perspectives that would allow us to focus on local disagreements rather than outright rejections?

Besides the wealth of research questions unlocked by the consumer welfare hypothesis, its practical significance cannot be underestimated. Suppose, in fact, that you are an economist acting as an expert testimony in legal proceedings or an advisor to a policymaker or even a private company. The consumer welfare hypothesis requires you to think carefully about the welfare standard that you intend to use when delivering your opinion. Using the wrong welfare standard will greatly reduce the usefulness of your analysis and possibly harm your professional reputation.²⁹ But the opposite is also true: showing that you have understood (or at least care about) the normative foundations of the legal institutions you are analyzing will greatly increase the reliability in your intervention.³⁰

The rest of this chapter will, in essence, formulate an additional reason for taking the consumer welfare hypothesis seriously. This reason derives from the connection between the hypothesis and the available knowledge on the concept of reciprocity. In fact, this connection shows that the equality norm (that is: consumer sovereignty) supporting the consumer welfare hypothesis can be considered a manifestation of the more general evolutionary processes behind reciprocal behaviour. This means that the consumer welfare hypothesis can rely on a robust evolutionary explanation, something that Posner's efficiency hypothesis of the common law could never really do.

3 Reciprocity as an Evolutionary Mechanism Supported by Norms

This section first offers a taxonomy of the different forms of reciprocity identified by social scientists to then clarify that the type of reciprocity the claim made in this chapter relies upon is indirect and generalized reciprocity (Section 3.1). Next, the chapter reviews the literature attempting to explain the emergence of reciprocal behaviour in an extraordinary variety of contexts, ranging from bacteria to advanced economic

²⁴ See Liao (2017) and Hofmann (2021).

²⁵ Compare the approach in Esposito (2022b) and Bar-Gill (2018).

²⁶ See Murray (2022).

²⁷ Esposito (2022), pp. 27-9.

²⁸ Esposito (2022), pp. 178-9.

²⁹ See Giocoli (2020, 2020b).

³⁰ For multiple testimonies from economists working in regulatory agency going in this direction, see Mantzari (2022).

systems, via Australian bats (Section 3.2). Finally, the chapter focuses on the contribution of norms to support reciprocal behaviour (Section 3.3).

3.1 Reciprocity: mainly, direct or indirect, generalized or not, positive or negative

Reciprocity is one of those terms that has an intuitively clear meaning for ordinary uses, but then receives a very nuanced, and at times conflicting, characterization by academics. Considering that the notion of reciprocity is relied upon by anthropologists, biologists, sociologists, philosophers, zoologists, and more recently economists, this circumstance should not be surprising. In its ordinary meaning, reciprocity refers to “behaviour in which two people or groups of people give each other help and advantages” according to the Cambridge Dictionary.³¹ Already in 1998, writing on the *European Economic Review*, Fehr and Gächter (1998, p. 857) declared the existence of the *homo reciprocans* and qualified it as a “key player in the enforcement of social norms”.

In the following, I will focus primarily on the distinctions regarding reciprocity that are used in the theoretical and empirical literature that studies how reciprocity can lead to stable patterns of cooperative behaviour in controlled settings.³² Depending on the research questions, this literature can aim at identifying conditions where reciprocity is sufficient³³ or, to the contrary, identify additional elements that may sustain cooperation, in particular internalized social norms.³⁴

The first distinction to consider is between direct and indirect reciprocity. The second one is between generalized and not generalized reciprocity. Finally, reciprocity can be positive or negative. These three distinctions are complementary, so there are eight possible combinations.

Reciprocity is direct when (as in the definition given by the Cambridge dictionary), agent A performs an action which impacts agent B, and agent B reacts by performing an action which impacts agent A. Instead, reciprocity is indirect when B reacts by performing an action which impacts agent C.³⁵ Importantly, indirect reciprocity introduces a critical social element in the analytical framework because the relationship between agent A and agent B is fundamentally influenced by the presence of at least one other agent C. One example of direct reciprocity would be to smile back at someone who is smiling at us. An act of indirect reciprocity would be to hold the door to someone after someone has held the door for us.

In parallel, reciprocity can be generalized or not. Here, the critical element is when reciprocation is expected to take place. If the reciprocal action is expected to happen as an almost immediate reaction, then reciprocity is not generalized. If, instead, a significant amount of time is allowed between the action and its reciprocal reaction, then reciprocity is generalized. It is apparent that this distinction is somewhat vague. However, it will prove rather important for the current analysis. As a case of non generalized reciprocity, one can think again about the example of someone smiling back. A common case of generalized reciprocity is having a friend or a colleague insist to pay the bill because you paid the bill last time. Additionally, a spot contract is an example of non generalized reciprocity while a sale with payment in installments is an example of generalized reciprocity.

Finally, reciprocity can be positive or negative. We have positive reciprocity when the reaction is beneficial to the recipient and negative reciprocity when the reaction is harmful to the recipient. Normally, positive reciprocity follows beneficial acts, and negative reciprocity follows negative acts, but this is not a conceptual necessity. For example, someone could react to your smile with a disgusted or annoyed face. This would be an example of a negative reaction following a positive action.

³¹ Cambridge Dictionary online (nd); see also Merriam Webster Dictionary online (nd) defines reciprocity as “the quality or state of being reciprocal: mutual dependence, action, or influence”.

³² For overviews, see Nowak and Sigmund (2005) and Okada (2020). The comparison between the two overviews shows that this literature has reached a certain degree of consolidation over the last two decades.

³³ I include in this strand of the literature also the economic studies exploring the economic significance of reciprocal behaviour; for a useful overview, see Fehr and Schmidt (2006).

³⁴ See below, Section 3.3.

³⁵ Indirect reciprocity is further distinguished between upward and downward indirect reciprocity. See below, Section 3.3. Sometimes, following Kolm (1984, 2008) indirect reciprocity is called “reverse reciprocity”.

3.2 Reciprocity: a formidable cooperation mechanism

Reciprocity in its many forms is very common. Reciprocal behaviour has been observed in nature, in cleaning symbioses, communities of Australian vampire bats, dolphins, primates, and other group-living animals, but also bacteria.³⁶ Moreover, even among economists it is now widely accepted that emotions and feelings support spontaneous cooperation.³⁷

This fact has led scholars to investigate the conditions under which reciprocal behaviour becomes stable and the conditions under which this is not the case. For direct reciprocity, it is now widely accepted that tit-for-tat “can guarantee the highest payoff in the long run given certain features of the situations analysed”.³⁸

The findings in the analysis of indirect and generalised reciprocity are arguably even more surprising. Ohtsuki and Iwasa (2004, 2006) reached an important milestone in this context by identifying eight patterns of stable indirect and generalised reciprocal behaviour based on reputation (“the leading eight”). These patterns share the following properties: being nice, retaliatory, apologetic, and forgiving. The key assumption of the analysis is that the benefit of a good reputation in future interactions must be higher than the immediate cost of cooperation. Note also that the setting studied by Ohtsuki and Iwasa (2004, 2006) allows for cooperation to fail due to error. At the same time, the setting is based on a reputation mechanism based only on the action performed by the agents in the previous interaction. In other words, an agent who cooperated in the previous interaction has a good reputation, and a new agent who did not cooperate in the previous interaction has a bad reputation.

In this setting, being nice means cooperating with agents with a good reputation and to positively reciprocate cooperation. Being retaliatory, on the contrary, means refusing to cooperate with agents who have a bad reputation.³⁹ This behaviour sustains cooperation in the group by punishing non-cooperators; therefore, retaliation should grant a good reputation to the retaliator.

At the same time, it is important to allow agents who have a bad reputation for restoring it. Otherwise, agents with a bad reputation are systematically ostracised by the rest of the players. Systematic exclusion of agents with a bad reputation would be problematic for two reasons. First, as noted above, agents can make mistakes either in assigning reputation to someone else or in acting. This means that a bad reputation is occasionally not deserved. At the same time, even when it is deserved, it is possible for agents who have wilfully refused to cooperate in the past to have understood that cooperation is in their interest. Agents with a bad reputation can restore it via apology and forgiveness. In the setting by Ohtsuki and Iwasa (2004, 2006), an agent with a bad reputation can apologise by playing cooperation; afterwards, his or her reputation is restored.

In sum, relatively simple conditions needed to exist for direct or even indirect and generalised reciprocity to sustain cooperative behaviour in the absence of any normative framework.

3.3 Norms: a formidable complement to spontaneous reciprocity

The circumstance that spontaneous reciprocity is a widely observed pattern of behaviour that is capable of sustaining cooperation does not rule out the possibility of improving the performance of the considered group with additional mechanisms. Indeed, social norms and legal institutions can greatly contribute to sustaining cooperative behaviour. In fact, “norms, conventions, and notions of fairness emerge within communities through repeated interactions among constituent members”.⁴⁰

The relationship between social norms and legal norms and institutions is now one of the standard areas of investigation in the economic approach to law. Remarkably, in this literature, some of the mechanisms leading to effective social norms are, ultimately, the same mechanisms that contribute to reciprocity-based cooperation: “a) coordination in a multiple-equilibriums environment; b) fear of non-legal sanctions; c) internalization”.⁴¹

³⁶ Seminal, in this regard Trivers (1971). See also the discussion in Ridley (1988, pp. 70-2) pointing out that, albeit observed, reciprocal behaviour is rather limited among animals; for a discussion of this point, see Freidin, Carballo, Bentosela (2015). Ridley (1988, p. 14) go as far as extending the insight to bacteria.

³⁷ See, for example, Gintis and Bowles (2011, pp. 186-194).

³⁸ Perugini et al. (2003), p. 252. See also Axelrod (1984) and Axelrod and Dion (1988).

³⁹ See also Fehr, Fischbacher and Gächter (2002) referring to retaliators as ‘strong reciprocators’.

⁴⁰ Salazar et al. (2022), p. 1. See also, Young (1993).

⁴¹ Carbonara (2018), p. 467.

The idea of coordination in a multiple-equilibriums environment is readily respected in the context of reciprocal cooperation. Agents have a reason to cooperate if they believe the other agent will cooperate; and defect otherwise. The exception is defection as a sanction for previous non-cooperative behaviour (that is, retaliation); as noted above, however, retaliation is a form of cooperation with the rest of the group rather than with the direct counterparty.

What is missing in the properties of the leading eight is internalisation. Internalisation requires the existence of a value or a social norms that agents make their own. Once internalized, the value or social norm has a motivating capacity independent of sanctions. At least since Gouldner (1960) seminal paper on the “norm of reciprocity”, the status of reciprocity as a social norm has been widely studied and is considered uncontroversial.⁴² For example, Jon Elster (2011, p. 328), writing specifically on the relationship between reciprocity and norms, feels comfortable in simply “assum(ing) that when people reciprocate, return good with good and bad with bad, they do so because they think it is right or morally required”. Hence, social norms complement direct and indirect reciprocity in supporting cooperation in the absence of legal norms and institutions.⁴³

However, it is uncontroversial that legal norms and institutions may contribute to cooperation. In fact, the legal system is constituted of institutions, tools, and mechanisms that can be used to complement reciprocity and social norms in sustaining cooperation. In fact, what happens in a context when a legal norm makes cooperation obligatory?

First, cooperation is selected as the desirable equilibrium. Second, detection and retaliation are strengthened by legal enforcement. Third, the phenomenon called the “expressive function of the law” constitutes an additional mechanism for the internalisation of the required behaviour.⁴⁴

Since it is clear that both social and legal norms complement reciprocity in supporting cooperation, it is useful to make explicit some descriptions of the social norms that are associated with indirect (and generalised) reciprocity:

- “I do to you what I think is appropriate based on your reputation from prior interactions with others”⁴⁵
- “help somebody if you receive help from someone”⁴⁶
- “You scratch my back and I’ll scratch someone else’s” and “ I scratch your back and someone else will scratch mine”⁴⁷

In light of this discussion, it is possible to go back to the consumer welfare hypothesis, and in particular to focus on the idea of consumer sovereignty, to show that it constitutes a norm of indirect and generalised reciprocity.

4. Consumer Sovereignty as a Norm of Indirect and Generalized Reciprocity

In the original, and still unparalleled definition of consumer sovereignty provided by William Hutt (1936, p. 257),

The consumer is sovereign when, in his role of citizen, he has not delegated to political institutions for authoritarian use the power which he can exercise socially through his power to demand (or refrain from demanding).

The reciprocity norm, as will be shown, is more easily identified by focusing on this catchphrase: “[a]s consumer the individual is sovereign; as producer he is subject”.⁴⁸

⁴² Okada (2020) points out that more than 100,000 papers on indirect reciprocity have been published in the last 30 years; note, however, that the criteria for identifying this number have not been made explicit in the paper, in violation of systematic reviews best practices.

⁴³ See Perugini et al. (2003) reviewing the literature on the internalization of the social norm of reciprocity and providing one of the first experimental results showing this norm at work. See also Burger et al. (2009), p. 11 who showed that “individuals return favors even when the initial favor giver will never know of their behavior”.

⁴⁴ Cooter (1998) offers an interesting analysis of this matter in the economic approach to law. See also, Sunstein (1996), McAdams (2015), Basu (2018) and Sardo and Esposito (2020).

⁴⁵ Salazar et al. (2022), p. 2.

⁴⁶ Voelkl (2015), p. 17.

⁴⁷ Nowak and Sigmund (2005), p. 1291.

⁴⁸ Hutt (1936), p. 257.

Before doing so, it is crucial to point out that Hutt did not claim ownership of the concept of consumer sovereignty. To the contrary, Hutt (1936, p. 34) presented it as “as much a criticism as a vindication of those who have been led to build on the traditions of orthodoxy”. This account seems accurate, at least with regard to some of his predecessors, namely Adam Smith, Frank Knight, Marshall, and Pigou.⁴⁹ In particular, Smith (2007 [1776], p. 426) wrote:

Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident, that it would be absurd to attempt to prove it.

Importantly, the concept of consumer sovereignty emerging from this literature is normatively more demanding than the one used in the economic approach to law (see Schwartz 1988; Sunstein 1999; Liscow and Markovitz 2022). According to this literature, it is sufficient that consumer preferences determine what is exchanged. It is however clear that, once properly reconstructed, consumer sovereignty incorporates also distributive concerns about the relationship;⁵⁰ after all, can consumers who are systematically taken advantage of be meaningfully considered sovereign?

It is also particularly noteworthy that Walraevens (2020) points out the centrality of the idea of reciprocity in Adam Smith’s system of thought. The idea of consumer sovereignty offers a straightforward connection between this (allegedly) self-evident pro-consumer maxim and Smithian moral egalitarianism via reciprocity. Smith, in fact, believed that “one of the multitude [is] in no respect better than any other in it” so that “we are fundamentally moral equals”.⁵¹ Before this consumer-centric account is offered, it is useful to consider an alternative, still egalitarian view, that is arguably tightly connected to the view that a market is efficient when it maximises total welfare, irrespective of its distribution.

In stark contrast with the widely shared view that efficiency as a normative concept is different and often in conflict with the normative concepts used in moral and political philosophy as well as in legal discourse, it is apparent that an equality-based justification for the total welfare conception of allocative efficiency exists.⁵² According to this view, treating with equal respect all market participants prohibits from considering monopolistic rents a reason to condemn the monopoly. This position follows from the premise that transfers cancel out each other, so that the benefit of the monopolist is equal to the loss of the consumers caused by rents. Therefore, equal respect implies focusing on another property of monopolies that make them undesirable; this property is the deadweight loss.

As just seen, Smith strongly rejected such a view. Once we look at all agents not only in their capacity as consumers or producers in one single market, but as producers in one market and consumers in all the others, a different equality norm becomes apparent. According to this equality norm, all agents are equal because they are sovereign when they act as consumers and they are servant when they act as producers. In other words, the proper unit of analysis to apply the notion of equality is not that of a single market but instead that of a market economy. It follows that more complex economies make reciprocity mechanism not based on norms weaker (that is, they make reciprocity more generalized) for a number of reasons: difficult detection, limited information about reputation and opportunity to punish, etc. Accordingly, stronger social and institutionalized norms are needed to let agents reap the benefits of the division of labour.

Following this account, the mechanism of indirect reciprocity at play specifies the norms of indirect reciprocity seen in the previous section as follows (emphasis added to signal the modification):

- I do to you, *consumer*, what I think is appropriate based on your reputation *as producer* from prior interactions with *your consumers*
- help *a consumer* if you receive help from *a producer*
- You scratch my back, *producer*, and I’ll scratch *a consumer’s* and I scratch your back, *consumer*, and *a producer* will scratch mine

A remarkable feature of this account is that it connects the idea of the division of labour to the idea of reciprocity and, eventually, to consumer sovereignty. In fact, the evolutionary benefits deriving from reciprocity have been connected both in biological studies and in the analysis of markets to the possibility of specialization permitted by the division of labour. Most interestingly, for current purposes, in the context of an analysis of this sort, Alexander (1988, p. 159) specifically criticises as narrowly focused the view that

⁴⁹ See, for more details, Esposito (2022), pp. 42-49 and 53-54.

⁵⁰ See Esposito (2022), pp. 31-34.

⁵¹ Smith (1759) and Anderson (2016), p. 158.

⁵² See above, Section 2.1.

indirect reciprocity is irrelevant to market allocations without, however, considering the importance of distinguishing between consumers and producers.⁵³

At the same time, the present investigation shows the centrality of the distinct roles of consumer and producer while recognizing the centrality of the broader community in which the exchange takes place (Esposito 2019). It is true that a competitive market economy reaches an optimum in terms of production. It is however also true that consumer sovereignty turns the mechanism of indirect reciprocity that stimulate effort among producers into a social norm. Moreover, as noted in Section 2, at least in the context of the European Union, such a social norm has been also institutionalized by EU law.

In light of the above, it is clearly possible to complement the consumer welfare hypothesis with a straightforward and robust connection between the institutional role played by consumer welfare, the importance of consumer sovereignty as a social norm, and reciprocity mechanisms. In other words, rational self-interested *hominem reciprocantes* would naturally develop social norms that support the division of labour in a market economy as they are individually advantageous. Consumer sovereignty is a norm that supports such an equilibrium. Unsurprisingly, then, consumer sovereignty was institutionalized by EU law.

5. Conclusions

This chapter has used research on reciprocity to offer an evolutionary mechanism that explains why EU law fits with the consumer welfare hypothesis – that is, why “legal structures that are at the centre of the EU market-building project fit” with consumer welfare maximization and not total welfare maximization (Esposito 2022, p. 3). The argument has essentially three steps.

First, the proposed explanation moves from the features of behavioural regularities that support cooperation under indirect (and generalized) reciprocity. These features are: being nice, retaliatory, apologetic, and forgiving. Second, social and institutionalised norms contribute a great deal to supporting cooperative behaviour. Finally, consumer sovereignty has the features of the social norms that support cooperative behaviour. In this context, in line with recent appeal to a more humane economics (humanomics), a straightforward connection between different threads of Smithian thought was identified, namely between reciprocity, moral equality, the division of labour, and consumer sovereignty became apparent.

As semi-final word, it is worth mentioning that the account offered here has structural features similar to the one proposed by Calabresi (2007) to overcome the apparently irreconcilable conflict between economic and moral accounts of tort law. The core of his argument is that, in torts, “compensation was simply an effective way of charging activities with their costs” (Calabresi 2007, p. 5). However, Calabresi (2007, p. 9) continued,

if – in order to deter by charging certain activities “their costs” – a society gives people the right to recover, such recoveries will surely affect what people think their rights are. And that in turn will surely affect that society’s notions of corrective justice.

Notably, Calabresi did not rely on notions of reciprocity in his analysis. Yet, and ultimately unsurprisingly, his acumen and experience of the relevant social and institutionalized norms let him fill the evolutionary gaps between the economic and moral accounts of tort law and present them as two views of the same Cathedral.

The Consumer Welfare Hypothesis offers

a novel account of central institutions of the market economy by developing the legal–economics nexus built on the consumer welfare hypothesis and supported by its fitness with EU antitrust and consumer law.⁵⁴

Based on this account, a bunch of new research questions come to the forefront. This chapter is just an example of the possibilities *The Consumer Welfare Hypothesis* opens. An example, however, that delivers a powerful blow to the traditional total-welfare foundations of the economic approach to law: while Posner’s efficiency hypothesis fails to rely on a plausible evolutionary mechanism, the consumer welfare

⁵³ Alexander criticizes Titmuss (1971), p. 239. For recent analyses by experts in the importance of reciprocity missing this point, see Gintis (2016), pp. 67-87, Sugden (2018), Oliver (2019), pp. 76-92, V. Smith and Wilson (2019), pp. 205-7, and Richter and Siemoneit (2022). The framework by Richter and Siemoneit (2022) is, nevertheless, largely compatible with the one presented in this chapter and in Esposito (2022).

⁵⁴ Esposito (2022), p. 177.

hypothesis can. This is what progressive research programs do: they gradually solve the anomalies in incumbent research paradigms.⁵⁵ Behavioural studies did it for economics in the last thirty years or so: perhaps it is now time for the Legal-Economic Fitness framework to do the same for the economic approach to law?

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⁵⁵ See, Lakatos (1970). For a clear and easily accessible discussion, see Musgrave (2016).

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