

The Law and Economics Movement of Chinese Legalists

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Abstract

By investigating the economic thoughts of Chinese legalists, the paper finds that there was an active law and economics movement in the Eastern Chou period of ancient China. (722 to 221 B. C.) In this movement, Chinese legalists made explicit their views on the economic aspect of human behaviors. Nonsatiation of wants and selfish motives of human beings were clearly articulated, and cost-benefit calculus was applied to analyze social-political-economic problems of the time. In addition, the legalists recognized effects of legal rules on human behavior through the same economic analysis. More significantly on the objective and principle of establishing laws, we find that Hsun Tzu and Han Fei Tzu, the two leading legalists, developed a primitive version of Posner's wealth maximization theory of law. More general to Coase' emphasis on the definition of property rights, their theory emphasized the definition of various boundaries to man's seeking for personal gains so that the public interest would be advanced.

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1. Introduction

The development of economics in last thirty years is fascinating in many dimensions. Among various achievements of the recent development, the expansion of its scope from traditional explicit markets to nonmarket areas stands out as most significant in bettering our Understanding of human behaviors in general. A leading example of the territorial expansion is the application of economic analysis to law. In his Richard T. Ely Lecture, Posner lays out three premises for the modern law and economics movement.¹ The first premise is that people act as rational maximizers of their satisfaction. The second premise is that rules of law operate to impose prices on these nonmarket activities. The third premise is that common law rules are often best explained as efforts to bring about Kaldor-Hicks efficient outcomes. These premises also constitute Posner's wealth maximization theory of law.² Though the law and economics movement has in a short time made great impact on both economics and legal professions, the wealth maximization theory of law is not received in entirety by all. Nevertheless, the interest in applying economic analysis to law can certainly be traced way back to the eighteenth century, when Adam Smith and Jeremy Bentham elaborated their economic views on the principle of legislation.³ Though with different terminology and less rigor, their analyses of law basically met the first and the second premises laid out by Posner. In brief, the modern law and economics movement distinct itself with the articulation of the third premise. In this paper, we intend to report a much earlier law and economics movement in the Eastern Chou period of ancient China, which spanned approximately from 722 to 221 B.C.. Further, we intend to show that Chinese legalists have touched upon the three premises of modern law and economics movement.

A very brief introduction of the historical background is helpful. In the period of Spring and Autumn which preceded the era of Warring States, Confucius, the most reputable ancient Chinese scholar, and his disciples traveled all over China to teach '*Je*' (benevolence) and

persuade feudal rulers toward exercising self-restraints and following 'li'--the rites established by ancient sage kings.⁴ However, Confucius effort to save China from disruption was not successful. Similar attempts by Mencius, who attained prominence only next to Confucius, in the early era of Warring States were also futile.⁵ Contrarily, contemporary scholars who emphasized rewards and punishments were more successful in helping feudal rulers to build powerful states and attain hegemonies. Owing to their emphasis on legal rules, as opposed to that on benevolence and rites of the Confucian school, these scholars were traditionally called legalists.⁶ The Chinese law and economics movement involved the articulation of legalists on the economic aspect of human behaviors and its relation to law. In the following we will investigate the economic thoughts of Chinese legalists, which were unfortunately neglected by both Chinese economists and Sinologists to this date, to show that they had clear understanding of economics and did consider legal rules as operating prices of nonmarket activities. In addition, we focus particularly on the thoughts of two leading scholars, Hsun Tzu and Han Fei Tzu, to show that they had developed a primitive version of Posner's wealth maximization theory of law by the end of the Warring States era.⁷

The framework of our presentation of Chinese legalists' economic thoughts parallels those premises laid out by Posner. In order to convince readers that there was indeed a law and economics movement, we adopt the strategy that enables the ancient scholars to speak for themselves. The drawback of this strategy is that the paper contains

many translated quotes from Chinese classics, which are unfamiliar to economists in general. Therefore, we will frequently shorten the quotes and occasionally make some interpretations without distorting their original meanings to make the paper flow more naturally.⁸ An outline of the paper is described below. In section two, we introduce ancient Chinese Legalists' observation on human nature and their conceptions of tradeoffs in decisions. In addition, we collect evidences to show that cost-benefit calculus was applied in their policy proposals and explanations of social phenomena. In section three, we develop that they recognized the influence of legal rules on human behaviors. We then move on in section four to unfold their

wealth maximizing theory of law. In the end, we make some concluding remarks about the ancient Chinese law and economics movement.

2. Rational Maximization of Man and Applications of Cost-Benefit Calculus

The evidence from ancient literature suggests that property rights and markets of some commodities existed at the time of Eastern Chou. As early as in the Spring and Autumn period, markets and price movements were not overlooked. The earliest legalist Kuan Tzu (Riding Horses) described, "The market is the place where commodities are gathered."⁹ In addition, Kuan Tzu (Inquiry) said, "The market is the apparatus of heaven and earth to gather wealth and is the place where people are gathered to gain." Observing the movement of prices, Kuan Tzu (National Savings) noted, "Price falls when goods are plenty and rises when goods are dear." In the same essay, Kuan Tzu made it clear that the price is relative rather than absolute by saying that "other goods must be cheap when the grain is dear and other goods must be dear when the grain price is cheap." _ Observations on the selfish motives of human behavior were gradually developed in the Warring States era. On man's desires, Hsun Tzu (Man's Nature is Evil) clearly stated, "Phenomenon such as the eye's fondness for beautiful forms, the ear's fondness for beautiful sounds, the mouth's fondness for delicious flavors, the mind's fondness for profits, and the body's fondness for pleasure and ease--these are all products of the emotional nature of man."" In the same essay, Hsun Tzu thought that these desires were common to all people and said, "The sages Yao and Shun possessed the same nature as the tyrant Chieh or Robber Chih, and the gentleman possesses the same nature as the petty man."" Regarding to the nonsatiation of wants, Hsun Tzu (Honor and Shame) said, "For food they want to have meat. They want to have their clothing beautiful and embroidered. In travelling they want to have carriages or horses. In addition, they desire abundant riches and store up wealth. However, when a man is poor for many years together, he does not realize that his desires are not satisfied--these are the facts of man's nature.""³ Han Fei Tzu (Six Contrarities) was also aware of the nonsatiation and said, "Chieh, having the dignity of the

son of Heaven, was not content with the honor; and, having the riches within the four seas, was not content with the treasures."⁴

Man not only has wants but also seeks ways to satisfy his wants. Hsun Tzu (Man's Nature is Evil) said, "Whatever a man lacks in himself he will seek outside....What a man already possesses in himself he will not bother to look for outside."⁵ More vividly on human behaviors, Kuan Tzu (Abstinence and Concealment) said, "Taking advantage when seeing it and avoiding danger when seeing it are human nature. Merchants hurriedly travel on the road days after nights and do not complain the thousand-mile distance, because there is profit ahead. Fishermen sail a hundred miles days and nights against treacherous currents, because the profit is deep down under the water." Were these drives for gains out of self-interests or benevolence to others? Han Fei Tzu (Outer Congeries of Sayings, Upper Left Series) said, "Indeed, in the case of workmen selling their service in sowing seeds and tilling farms, the master would at the expense of his housekeeping give them delicious food and by appropriating cash and cloth make payments for their services. Not that they love the hired workmen, but that, they say, by so doing they can make the workmen till the land deeper and pick the weed more carefully. The hired workmen, by exerting their physical strength, speedily pick the weed and till the land, and, by using their skill, rectify the boundaries between different tracts of ground and the dykes separating different fields. Not that they love their master, but that, they say, by their so doing the soup will be delicious and both cash and cloth will be paid to them. Thus, the master's provisions and the workmen's services supplement each other as if between them there were the compassion of father and son. However, their minds are well disposed to act for each other because they cherish self-seeking motives respectively."⁶ More bluntly, Han Fei Tzu (Guarding Against the Interior) also said, "The physician sucks patients' cuts and holds their blood in his mouth, not because he is intimate with them like a blood relation, but because he expects profits from them. Likewise, when the cartwright finishes making carriages, he wants people to be rich and noble; when the carpenter finishes making coffins, he wants people to die early. Not that the cartwright is benevolent and the carpenter is cruel, but that unless people are noble, the carriages will not sell, and unless people die, the coffins will not be bought.

Thus, the carpenter's motive is not a hatred for anybody but his profits are due to people's death."⁷ These are clear evidence on selfish motives of human behaviors; however, if man is only selfish, why does he desire to do good? Hsun Tzu (Man's Nature is Evil) answered, "Every man who desires to do good does so precisely because his nature is evil. A man whose accomplishments are meager longs for greatness; an ugly man longs for beauty; a man in cramped quarters longs for spaciousness; a poor man longs for wealth; a humble man longs for eminence."⁸ All these quotes on desires and selfishness show that legalists' observation on human behavior was on par with that of Adam Smith's. Man has wants; however, the world is not ideal and his decisions involve costs. What was ancient legalists' perception of costs? Hsun Tzu (Rectifying Names) said, "When men acquire something, they never get only what they want and nothing more; when men reject something, they never rid themselves only of what they hate and nothing more."⁹ Using a specific example, Kuan Tzu (Exposition of Situations) said, "Unless the ruler has no desire for gold, jade, money, and goods, satisfying his desires requires exchanges. What are exchanged are noble posts."²⁰ More vividly, Han Fei Tzu (Six Contrarities) expounded, "Whoever regrets the waste of the falling hairs and forgets the gain of the growing hairs, does not know the doctrine of expediency. Indeed, opening boils causes pain; taking drugs causes bitter taste. Yet, if boils are not opened on account of pain and drugs not taken on account of bitterness, the person will not live and the disease will not stop."²¹ Thus, it is clear that ancient legalists' cost concept was based on the comparison of alternative opportunities. Realizing preferences and costs, Hsun Tzu further advised decisions be made after balancing likes and dislikes and calculating the gains and losses. He said, "The balance between likes and dislikes and that between giving and taking are: Whenever one sees something likable, he must consider to and for the dislikes. Whenever one sees something of gains, he must consider to and for the losses. One determines his likes and dislikes and taking and giving only after balancing the two sides and careful calculations. As such, he will never fall into failure."²² The quote suggests that Hsun Tzu uttered an ancient variant of the necessary equality between the marginal rate of substitution and the relative price for utility maximization.

Given their observation of human behaviors and cost concept, it is not surprising to see that cost-benefit calculus was extensively used in ancient legalists' persuasion to rulers of feudal states. Several examples are given below. On alternative ways for territorial expansion, the notorious legalist Lord Shang (The Encouragement of Immigrants) said in the period of Spring and Autumn, "At the victories in the Chou and in the Hua battles, Ch'in extended its territory eastward by cutting off heads, but it is clear that there was no advantage in this eastward expansion, and yet officials regard these events as great accomplishments, because loss was inflicted on the enemy. Now if the people of the three Chin states are induced to immigrate by means of grasslands and cottages, and if they are made to occupy themselves with primary things, then this way of inflicting damage on the enemy is just as real as a victory in war and Ch'in will have the advantage of obtaining agricultural products. Conversely, by this plan, two birds will be hit with one stone."²³ On a war waged against a strong country whose people would defend to death, Han Fei Tzu (Five Vermin) analyzed, "All-under-Heaven would find little gain in occupying their lands and great harm in attacking their states, so that even a state of ten thousand chariots would not dare to come to camp beneath their well-fortified city-walls and expose its weakness to the attack of strong enemies."²⁴ The cost-benefit calculus was also applied to the optimal timing for removing wicked ministers. Explaining the suggestion of Tzu Hsia, Han Fei Tzu (Outer Congeries of Sayings, Upper Right Series) said, "On the whole the wicked deeds, repeatedly committed, become a pile. When the pile is mature, the urge to commit further villainy becomes strong. When the urge is strong, it is liable to extend to murder. uproots them early."²⁵

Therefore, the enlightened sovereign

Social phenomena and customs were also analyzed within the cost-benefit framework. On grave-digging, Lu's Spring and Autumn (Early Winter) analyzed, "Suppose one engraves on the tombstone with 'Things inside are pearl, jade, antique, money, and precious goods and you are invited to dig the grave. Digging the grave can make you rich and enable your descendants to ride carriage and to eat meat.', then every one must laugh at him and take him as a fool. Today's extravagance in burial is exactly like this."²⁶ On popular preference for

sons over daughters, Han Fei Tzu (*Six Contrarities*) analyzed, "(P)arents in relation to children, when males are born, congratulate each other, and, when females are born, lessen the care of them. Equally coming out of the bosoms and lapels of the parents, why should boys receive congratulations while girls are ill-treated? Because parents consider their future convenience and calculate their permanent benefits."²⁷ Even the rites taught by Confucius and his disciples were considered to have cost-benefit elements by legalists.²⁸ Explaining mourning rites, Hsun Tzu (*A Discussion Of Rites*) said, "It is the custom in all mourning rites to keep changing and adorning the appearance of the dead person, to keep moving him farther and farther away, and as time passes, to return gradually to one's regular way of life. It is the way with the dead that, if they are not adorned, they become ugly, and if they become ugly, then one will feel no grief for them. Similarly, if they are kept too close by, one becomes contemptuous of them, one begins to loathe them, and if one begins to loathe them, one will grow careless of them and cease to treat them with reverence.... (The gentleman) is ashamed to have such a thing happen, and therefore he adorns the dead in order to disguise their ugliness, moves them gradually farther away in order to maintain the proper reverence, and in time returns to his regular way of life in order to look after the wants of the living."²⁹ Similarly on the rite of three years of mourning for the deceased, Hsun Tzu explained, "The three-year mourning period comes to an end with the twenty-fifth month. At that time the grief and pain have not yet come to an end, and one still thinks of the dead with longing, but ritual decrees that the mourning shall end at this point. Is it not because the attendance on the dead must come to an end, and the moment has arrived to return to one's daily life."³⁰ On the purpose of some other rites, Hsun Tzu (*A Rich Country*) stated, "If the union of male and female, the separation from other males and females inherent in the relation of husband and wife, the making of engagements by the relatives of the groom and bride to be, the sending of betrothal presents and the going to get the bride, are not according the rule of proper conduct (Li); if this is the case, then men will have the trouble of losing their mates and the calamity of having to struggle to gain any sex relation."³¹ While Confucius and his disciples emphasized rites on ethical grounds, Hsun Tzu apparently thought that these rites served important economic functions.

3. Effects of Legal Rules on Human Behaviors

Evidence suggests that ancient China indeed had written laws. Kuan Tzu (Establishing Polity) said, "On the first day of January the ruler gathers various official in the hall to announce orders and display laws to the nation; magistrates and high officials all receive laws from the minister. On the day of official assembly, magistrates and high officials learn laws in front of the ruler. The laws are booked and collected in the storing place after being displayed. Another copy of the law is sent to the ruler...."³² Similarly, Han Fei Tzu (Deciding Between Two Legalistic Doctrines) said, "Law includes mandates and ordinances that are manifest in the official bureaux."³³ However, laws were not all written. Hsun Tzu (Kingly Government) said, "He who when there is law, acts according to the law, but when there is no law, decides according to the analogies of cases, is doing the utmost possible in holding court."³⁴ The earliest existing book on public law is Chouli, or Institutes of Chou, which describes some of the functions and posts of the Chou Dynasty. Penal law and procedures were first mentioned in some length in the chapter of Lu's Punishments of the Book of Documents. In this section we develop that legalists recognized effects of legal rules.

With respect to whether legal rules were perceived as operating prices on human behavior outside the market areas, we proceed by answering the question that can human behavior be modified? With keen observation on man's desire, Lord Shang (Establishing Laws) explained plainly, "For a prince there exists the fact that people have likes and dislikes, therefore, for it to be possible to govern the people, it is necessary that the prince should examine these likes and dislikes. Likes and dislikes are the basis of rewards and punishments."³⁵ Explaining it further in terms of gains and losses, Kuan Tzu (Prohibiting and Concealing) said, "The law regulates people's behavior like the ceramicmaker does to the soil and the goldsmith to the metal. Therefore, people's gains and losses must be carefully examined." Not only likes and dislikes and gains and losses but also the constraint that one is subjected to was recognized by legalists as determinants of human behaviors. More vividly on the effect of the binding behavioral constraint, Han Fei Tzu (Five Vermin) said, "Now suppose there is a boy who has a bad character. His parents are angry at him, but he never makes any change. The villagers in the neighborhood reprove him, but he is never thereby moved. His master teaches him, but he never reforms. Thus with all the three excellent

disciplines, the love of his parents, the conduct of the villagers, and the wisdom of the masters, applied to him, he make no change, not even a hair on his shins is altered. It is, however, only after the district magistrate sends out soldiers in accordance with the law to search for wicked men that he becomes afraid and changes his ways and alters his deeds."³⁶

A series of dialogues between Huan-kung and Kuan Tzu shows that even people's responses to taxing rules were clearly understood in the Spring and Autumn period.³⁷ Huan-kung asked, "May I levy tax on platforms and porches?" Kuan Tzu replied, "This amounts to making platforms and porches destroyed." Huan-kung then asked, "May I tax on trees?" Kuan Tzu said, "This makes them chopped off." Huan-kung then asked, "May I tax on domestic animals?" Kuan Tzu replied, "This would kill domestic animals." Huan-kung asked, "How about a head tax?" Kuan Tzu said, "That would make people hide." The dialogue is perhaps the earliest analysis of individual's tax evasion behaviors. If legal rules are operating prices on human activities, then the distinction between incentives and disincentives are important. Indeed, they were not overlooked. An interesting story was adopted in Han Fei Tzu (Inner Congeries of Sayings, Upper Series) to emphasize this distinction. Once there was fire in the feudal state of Lu. Finding no one to put out the fire, the ruler asked Confucius what to do. Confucius said, "Indeed, hunting animals is a pleasure and incurs no punishment. But putting out the fire is a hardship and promises no reward. That is the reason why the fire is not put out." Being aware of different effects of punishment and reward, Confucius further said, "It is untimely, however, to offer rewards just in time of emergency like this. If Your Highness has to reward all the participants in the suppression of the fire, then even the whole state wealth is not enough for rewarding them. Suppose we enforce the policy of punishment for the time being."³⁸ In addition, the quote below suggests that even the marginal principle was fairly understood and applied to law.³⁹ Emphasizing the distinction within rewards and punishments, Han Fei Tzu (Regulations and Distinction) said, "(T)he science and philosophy of politics should by all means emphasize the distinction between degrees of penalty and of reward....If any ruler goes down, it is because in regulating rewards and penalties he makes no distinction between different degrees. Who governs the state, always distinguishes between reward and punishment. Therefore, some people might regard the distinction between reward

and punishment as distinction, which should not be called distinction in the strict sense."⁴⁰ The quote also suggests that, contrary to the traditional criticism of severe and ruthless punishments of legalists, Han Fei Tzu was in fact advocating some optimal degree of punishment.⁴¹

Rewards and punishments were understood by legalists as we have described. Moreover, the incidence of improper rewards was recognized. Reportedly, the law of Lord Shang stipulated that a soldier would be promoted in ranks or given a bureaucratic position according to the number of heads he cut in the war. Commenting on the inadequacy of Lord Shang's rewarding system, Han Fei Tzu (*Deciding between Two Legalistic Doctrines*) said, "Now supposing there were a law requesting those who cut off heads in war to become physicians and carpenters, then neither houses would be built nor disease be cured. Indeed, carpenters have manual skill; physicians know how to prepare drugs; but, if men are ordered to take up these professions on account of their merits in beheading, then they do not have the required abilities. Now, governmental service requires wisdom and talent in particular; beheading in war is a matter of courage and strength. To fill governmental offices which requires wisdom and talent with possessors of courage and strength, is the same as to order men of merit in beheading to become physicians and carpenters."⁴² Legalists were also sophisticated enough to heed informational problems. On the clarity and feasibility of orders and laws, Han Fei Tzu (*Eight Fallacies*) said, "What can be understood only by clear-sighted scholars should not be made an order, because people are not all clear-sighted. What can be practiced only by wise men should not be made a law, because the people are not all wise."⁴³ Being concerned with the imperfect detection of crimes, Han Fei Tzu (*Five Vermin*) said, "Thus, if no harm at all should come to them, people would not give up eight or sixteen feet of cloth; but if their hands would always be hurt, they would never dare to pick up even two thousand pounds of molten gold. Therefore, the intelligent ruler makes punishments definite."⁴⁴

Warnings on the adjustment cost of changing laws were not neglected. Han Fei Tzu (*Commentaries on Lao Tzu's Teachings*) commented, "(If laws and decrees are altered,

advantages and disadvantages will become different. If advantages and disadvantages are different, the duties of the people will change. Change of duties is said to be change of works. Therefore, by reasoning I can see that if tasks are big and many and are frequently shifted, then few of them can be accomplished; that if anybody keeps a great vessel and moves it too often, it will incur many damages; that if, when frying small fish, you poke them around too often, you will ruin the cooking; and that if, when governing a big country, you alter laws and decrees too often, the people will suffer hardships."45 Lord Shang (The Elimination of Strength) cautioned, "If penalties are removed by means of penalties, the country will enjoy order, but if penalties are set up by penalties the country will be in disorder."46 These two quotes hence bring us to the deeper issue of the purpose of law and the principle on which the law was made. 4 Legalists' Wealth Maximization Theory of Law

In this section, we show that the legalists, with Hsun Tzu and Han Fei Tzu in particular, have indeed developed a primitive version of the wealth maximization theory of law advanced by Posner. A wealth maximization theory of law inevitably involves some efficiency criterion and definition of rights. These are difficult tasks even to today's wealth maximizing theory.⁴⁷ Before we restructure and present legalists' wealth maximization theory of law, we give several quotes below to show that such a theory was indeed explicitly advanced. First, there was an interesting statement concerning the penal law in the Book of Documents, which is one of the earliest written record in China. The chapter of Lu's Punishment recorded, "*The directors of criminal cases did not end by (applying) severely. they ended by (creating) happiness.*"⁴⁸ Second, the same view of a wealth or welfare enhancing penal law was carried on by 'ruthless' legalists. For instance, Han Fei Tzu (Surmising the Mentality of the People) echoed, "The sage in governing the people considers their springs of action, never tolerates their wicked desires, but seeks only for the people's benefit. Therefore, the penalty he inflicts is not due to any hatred for the people but to his motive of loving the people."⁴⁹ Third, there was a lengthy paragraph which discussed in detail the wealth maximizing law and its potential achievements. Hsun Tzu (Kingly Government) said: "For he who rules as righteous king tries to enrich the people.... He does not honor those who are without virtue; he does not make those who have no ability officials;

he does not punish those who have no guilt. In his court there are no positions for favorites; among the people there are none who live off the country. He advances the worthy and employs the able, and does not neglect any grade. He represses the unprincipled and restrains the overbearing; yet his punishments are not extreme. The people are observant, and all know that he who is virtuous in his home will receive reward at the court; he who is evil in secret will receive punishment in public.... (These are) the methods of a righteous king. He grades taxation and rectifies the amount of service to be given; he regulates everything in order to nourish all his people. He levies a tithe on the land. At the customs houses and market places he inspects travelers but does not levy duties. He prohibits or permits forestry and fishing, according to the season; but he does not tax it. He appraises the land and assesses its tax. He regulates tribute according to the distance of the place. There should be a circulation of valuables and grain without restriction or hindrance, enabling foodstuffs to be freely transported, and all within the four seas to be like one family....On the north sea there are swift horses and great dogs; if this policy were carried out, then China could obtain, raise, and use them. On the south sea there are fine feathers, ivory, rhinoceros hides, copper, cinnabar, and Cornelia; then China could get them, and be enriched thereby. On the eastern sea there is purple, coarse linen, fish, and salt; then China could get them and wear and eat them. On the western sea there are felt rugs, furs, dyed yak-tails; then China could get them and use them. Then people who live on the borders of the sea would have a sufficiency of wood; people who live in the mountains would have plenty of fish; farmers would have a sufficiency of implements without chopping, scraping, making pottery, or smelting; the workman and the merchant would have sufficient pulse and millet without plowing the fields. For the tiger and leopard are fierce, yet the gentleman could have them skinned and use them. For nothing which heaven covers or the earth sustains would fail to yield up all its goodness and be brought for his use. On the one hand they would adorn the worthy and the good, and on the other they would nourish the people and give them happiness. This is what it means to be a great ruler."⁵⁰ A few remarks can help our appreciation for the quote clearer. First, Hsun Tzu's wealth maximizing law extended beyond the penal law in Lu's Punishments to cover respects, rewards, government posts, taxation, and other affairs. Second, the tone of minimal state intervention on markets was clear. Third, specialization, division of work, and free trade

were fully conceived to be facilitating to resource exploitation and social welfare.⁵¹ How did these remarkable views come about as early as in the era of Warring States? What were legalists' concepts of efficiency? Were they aware of the pivotal role of property right definition in a wealth maximization theory of law? And what was their position on wealth distribution? Let us take up these questions in turn. We first delve into legalists' concepts of efficiency. Can a law help people to attain Pareto efficiency? Han Fei Tzu (Commentaries on Lao Tzu's Teaching) affirmed and explained, "If the people dare not violate the law, then the sovereign does not have to apply penalties on the one hand nor does he have to work to the advantage of his own investments on the other. If the sovereign neither has to apply penalties nor has to work to the advantage of his own investments, the people will multiply and prosper. When the people are multiplying and prospering, their savings and hoarding will flourish....Hence the saying: 'Since neither will do harm, therefore their virtues will be combined.' This means that the virtues of high and low flourish and in both cases are combined into the well-being of the people."⁵² Imagine this was uttered more than two thousand years before Vilfredo Pareto did! Pareto efficiency is a useful concept but difficult to obtain in a real world of many agents, let alone the turbulent era of Warring States. Conceivably, a weaker criterion of potential Pareto improvement was not unimaginable and we find an evidence of it. Consistent with the concept of Kaldor-Hicks efficiency, Han Fei Tzu (Eight Fallacies) said, "Laws are means to controlling affairs; affairs are means to celebrating merits. When laws are made and found to involve difficulties, then the ruler must estimate the difficulties. If he finds the task can be accomplished, then he must enact them. If he finds the accomplishment of the tasks involves losses then he must estimate the losses. If he finds gains will exceed losses, then he must transact them. For there are in All-under-Heaven neither laws without difficulties nor gains without losses."⁵³ By all means, we must admit that these two quotes did not touch on more abstract concepts of utility and marginal utility of income which are at the center of Pareto and Kaldor-Hicks efficiencies. However, the quotes do show that Han Fei Tzu did have a firm grip of these efficiency concepts.⁵⁴

Were actual laws made with consideration of Kaldor-Hicks efficiency? On the criminal law in general, Hsun Tzu (Honor and Shame) said, "He who fights against others forgets himself, his kins, and his ruler. Not controlling his momentary anger so as to lose his life is forgetting himself. Making his family hurt and causing his parents punished is forgetting kins. Doing what the ruler dislikes and the law forbids is forgetting the ruler. Forgetting himself below, his kinship within, and his ruler above is what *the criminal law does not forgive* and what sage kings *did not allow*."⁵⁵ More explicitly, Hsun Tzu (On The Correction of Errors) said, "The origin of all punishment is the restraint of violence, the hatred of evil, and the warning against its future occurrence. *That a murderer should not die, or a man who injures another should not be punished, is favoring violence and being liberal to robbers, not hatred of evil*."⁵⁶ There was a much more concrete discussion of a specific law in Han Fei Tzu (Inner Congeries of Sayings, Upper Series). The law of Shang dynasty would punish anybody throwing ashes to the streets. Tzu-kung regarded the law as too severe and asked Confucius about it. Confucius said, "They knew the right way of government. Indeed, ashes thrown into the streets would blow into the eyes of the passers-by and obscure their sight. And if anybody obscure the sight of others, he would irritate them. When irritated, they start quarrelling. On quarreling, each side would mobilize their three clans to slaughter the other. It means that throwing ashes into the streets lead to the mutual onslaught between the three clans of both sides. Therefore, it is right to punish any offender. Indeed, heavy punishment is disliked by the people, but throwing no ash is easy to them. To make people do easy things and not ignore their dislike is the right way of government."⁵⁷

We now shift to answering the second question. A story in the chapter of Early Spring of *Lu's Spring and Autumn* was used to explain why order can be obtained when ancient sage kings governed the state in public interests. The story was about a man of Ching who lost his bow and did not search for it. People was curious and asked why didn't he search for it. The man replied, "People of Ching lost it and people of Ching will pick it up. Why need I search for it?" Confucius heard the event and said, "Omitting the words 'of Ching' in his reply is sufficient." Lao Tzu heard the event and said, "Omitting the words 'people of' is sufficient." The author then praised that Lao Tzu was the one who knew public interests best. Despite that

the author did not make clear how such conclusion was derived, it is clear that, while Confucius was concerned with all people, Lao Tzu was concerned with the state of Ching. In any event, both Confucius and Lao Tzu thought the public interest was equally served regardless whoever obtained the bow. As we understand from the celebrated Coase theorem, the public interest does not change with initial assignments of property rights, if there was no transaction cost.⁵⁸ When there are transaction costs, resources will be wasted in searching for lost objects. Therefore, the story suggests that ancient scholars were close to grasping the message of Coase. Regarding the actual law on lost objects, Hsun Tzu (Digests) said, "The law of the nation prohibits picking up lost articles to prevent people from obtaining objects without a boundary."⁵⁹ Given that Hsun Tzu advocated free trade, as shown in the previous lengthy quote, we are not too far-fetched in interpreting that by boundary he meant markets. But, why was boundary considered important and was public interest thought to be related to the setting of boundaries?

We move on to investigate how legalists related public interest and boundary to the making of law. Stressing the distinction between public and private interests, Han Fei Tzu (On Pretensions and Heresies) said, "It is the duty of the sovereign to make clear the distinction between public and private interests, enact laws and statutes openly, and forbid private favors. Indeed, to enforce whatever is ordered and stop whatever is prohibited, is the public justice of the lord of men. To practice personal faith to friends, and not to be encouraged by any reward nor to be discouraged by any punishment, is the private righteousness (interests) of ministers. Wherever private righteousness (interests) prevails, there is disorder; wherever public justice obtains, there is order. Hence the necessity of distinction between public and private interests."⁶⁰ Relating public interests to law, Hsun Tzu (The Ways of the Sovereign) said, "The greatest deed exhibits itself in the following. *If honoring the rite and perfecting the law keeps the nation in order.* Respecting the wise and using the able makes the people understand what is right. Thorough debates and open examining of cases makes people doubtless. Rewarding the diligent and punishing the lazy makes people active. Hearing both sides and seeing all directions attracts all people in the world. Hence, if duties are divided, business are started, skills are employed, able persons are

appointed to government posts, and all affairs are executed orderly, then the public road will open and the private door will close. *Therefore, public interests will stand out and private interests will be stopped.*"⁶¹ We thus can see that legalists' perfect law is intended to promote public interests and stop private favoritism. Not only public interests but also the connection between boundaries and people's benefits were clearly recognized. Hsun Tzu (Enriching the Nation) expounded, "Man cannot live alone. Living together without boundaries will lead to fighting among one another. Fighting leads to disorder and disorder leads to poverty. Therefore, the man's biggest loss is having no boundaries. *Boundaries help lead to the greatest benefit for all*."⁶² Further, by reinterpreting the functions of rituals, he made it clear that boundaries were instituted through rituals by sages. Hsun Tzu (A Discussion of Rites) explained, "What is the origin of ritual? I reply: man is born with desires. If his desires are not satisfied for him, he cannot but seek some means to satisfy them himself. If there are no limits (boundaries) and degrees to his seeking, then he will inevitably fall to wrangling with other men. From wrangling comes disorder and from disorder comes exhaustion. The ancient kings hated such disorder and therefore *they established ritual principles in order to curb it, to train men's desires and to provide for their satisfaction.* They saw to it that desires did not overextend the means for their satisfaction, and material goods did not fall short of what was desired. Thus both desires and goods were looked after and satisfied."⁶³

These quotes indicate that the definition of boundaries stands at the center of Hsun Tzu's theory of law and rite. On why the definition of boundaries would work, Hsun Tzu (Kingly Government) said, "Water and fire have essence, but not life; herbs and trees have life, but no knowledge; birds and beasts have knowledge but no sense of what are rights (Yi). Man has an essence, life, knowledge, and in addition has a sense of human rights (Yi); hence he is the highest being on earth. His strength is not equal to that of the bull; his running is not equal to that of the horse; yet the bull and horse are used by him. How is that? Men are able to form social organizations, the former are not able to form social organizations. How is that men are able to form social organizations? Because of their distinctions. How is it that distinctions can be carried out? Through rights (Yi). For class rights (Yi) are harmonized through social distinctions. When people are harmonious, they can unite; when united, they

have great strength; when they have great strength, they become strong; when strong, they can dominate nature. Hence they can have palaces and houses for habitation. Hence they can order their actions according to the four seasons and control all things. Hence they can enjoy the goodness of the whole world. They gain this for no other reason than that they have social distinctions and class rights (Yi). Hence, if men are to live, they cannot get along without forming a social organization. If they form a social organization, but have no social distinctions, then they will quarrel; if they quarrel, there will be disorder; if there is disorder, people will fail to cooperate; if they fail to cooperate, they will be weak; if they are weak, then they will not be able to dominate nature."⁶⁴ Two Chinese words were improperly translated in the quote and need to be clarified here. First, Dubs translated the Chinese word *fen*, as social distinctions. Second, he translated the word 'Yi' as class rights. Consequently, the quoted translation unfairly gives an impression that Hsun Tzu was talking about Marxist's social class. In view of the correct translations of 'quarrel', 'disorder', and 'cooperate', it is clear that they are incompatible to the social class interpretation. As parsimoniously alluded in previous footnotes, 'fen' means division by boundaries and 'Yi' is involved with some efficiency concepts. Properly interpreted, Hsun Tzu was saying that people can form social groups because there are dividing boundaries. And, a dividing boundary works because people share some efficiency concept.

Though the exact tradeoff between public and private interests were not clearly spelled out by the legalists, our evidences of legalists' views on criminal law in general and specific laws against throwing ashes and picking up lost objects suggest that they were consistent with Kaldor-Hicks' compensation principle. In this sense we claim that Hsun Tzu and Han Fei Tzu developed a primitive version of the wealth maximization theory of law. If legalists' did conceive a wealth maximization theory of law, it can be expected that they would support changes of law with economic conditions. Indeed, we find explicit statements of such thinking. For example, Han Fei Tzu (*Surmising the Mentality of People*), "If laws are adjusted to the time, there is good government. *If government fits the age, there will be great accomplishment.* Therefore, when the people are naive, if you regulate them with fame, there will be good government; when everybody in the world is intelligent, if you discipline them

with penalties, they will obey. While time is moving on, if laws do not shift accordingly, there will be misrule; while abilities are diverse, if prohibitions are not changed, the state will be dismembered. Therefore, the sage in governing the people makes laws move with time and prohibitions change with abilities."⁶⁵

Finally, we briefly discuss ancient wealth maximizers' view on the distribution of wealth. Hsun Tzu (Honor and Shame) said, "(W)hen the benevolent (*Jen*) man is in control, the farmers by their strength will be expert at the fields; the merchants by their knowledge of values will be expert at using wealth; all kinds of artisans by their skill will be expert at using tools; none of those above the grade of Officer and Perfect, up to the Duke and Marquis will fail to fulfill the duties of their office according to benevolence, generosity, wisdom and power--then this will be called the Great Equableness. Then whether a man's emolument is the whole empire, he will not think it too much for himself; or whether he is gate-keeper, receiver of guests, keeper of the gate bar, or night watchman, he will not think it too little for himself. Hence it is said: Irregular but uniform, oppressive but favorable, unlike but alike--these are the human relationships."⁶⁶ Evidently, Hsun Tzu's did not think low income as unfair, neither equality of outcome as appropriate. More interestingly, the quote suggests that in his view the low-earning people would not complain in a society of ideal laws. There was also an interesting story on the same subject in Han Fei Tzu (Outer Congeries of Sayings, Upper Right Series).⁶⁷ Tzu-lu once made rice gruel with his own grain to feed those who worked for the ruler on digging ditches. Hearing about this, Confucius sent Tzu-kung to overturn the food and break the vessels. Tzu-lu angrily complained, "Master, do you dislike Yu (Tzu-lu) practicing benevolence and righteousness? What Yu has learned from you is benevolence (*jen*) and righteousness (*yi*). *To be benevolent and righteous is to give All-under-Heaven one's own possessions and let them share one's own profits. Why do you consider it wrong for Yu to feed the people with the grain out of his private emolument?*"⁶⁸ Confucius replied, "How crude Yu is! I thought you would know as much as this. Yet really you have not come to that. Thus you do not know the rules of propriety (*li*). Now, by feeding them you think you love them. To be sure, according to the rules of propriety, the Son-of-Heaven loves All-under-Heaven, the feudal lords love people within their respective domains,

High officials love their official duties, and scholars and warriors love their families. Who goes beyond the sphere of his love is called 'offensive'. Now that the Ruler of Lu rules over the people while you attempt to love them at your pleasure, it means you are offensive. Aren't you absurd?" The story then ended in reporting that the ruler angrily walked in to complain about Tzu-lu's deed. It can be seen from the story that the kind of benevolence and righteousness exhibited by Tzu-lu was neither appreciated by the ruler nor by Confucius. Though it is not very clear why they did not approve the philanthropic deed, the story suggests that Confucius' view on rites, benevolence, and righteousness were close to that of Hsun Tzu and adopted by Han Fei Tzu. Thus the story lends an additional support to our views on the wealth maximizing legalists. More importantly, our research shows that the wealth maximizers in ancient China, like their contemporary western counterparts, did not consider wealth distribution as an important issue.~ 8. Summary and Concluding Remarks

We have tried in this paper to use ancient Chinese legalists' own words in developing their wealth maximization theory of law. Our study show that while earlier legalists as Kuan Tzu and Lord Shang were familiar with human behaviors, the primitive wealth maximization theory of law was developed by Hsun Tzu and Han Fei Tzu. The Chinese law and economics movement was similar to the utilitarianism of the West in the eighteenth century; both movements emphatically related human's pleasure and pain to the principle of the making of law. A brief comparison between the two movements can help present the salient features of the Chinese law and economics movement. First, at the center of the movement was the definition of boundaries, which covered more dimensions than the modern counterpart of property rights and was neglected by Bentham. Second, in the Chinese law and economics movement, the efficient outcome of free trade was perceived to be the result of the wealth maximizing law, instead of the natural law perceived by Adam Smith. However, it remains to be investigated that why momentum was gathered in the eighteenth century of Europe and more rigorous classical economics was initiated in the nineteenth century, whereas the Chinese law and economics movement only faded away.

The ups and downs of Chinese states over the last two thousand years seem to suggest that actual Chinese laws simply did not evolve according to legalists' normative theory. The reason of it cannot be summarized better than Han Fei Tzu's own observations. In the essay of Deciding between Two Legalistic Doctrines, Han Fei Tzu said, "Kung-sun Yang, while governing Chtin established the system of denunciation and implication and called the real culprit to account; he organized groups of ten and five families and made members of the same group share one another's crime. Rewards were made liberal and certain; punishments were made severe and definite....However, if he had no tact whereby to detect villainy, by enriching the state and strengthening the army he benefited nobody other than the subsequent ministers."⁶⁹ Further in the same essay, he said, "As Shen Pu-hai neither enforced the law nor unified the mandates and ordinances, there were many culprits. Thus, whenever old laws and earlier orders produced advantages, they were followed; whenever new laws and later orders produced advantages, they were followed too. So long as old and new law counteracted each other and the earlier and later orders contradicted each other, even though Shen Pu-hai advised Marquis Chao ten times to use tact, yet the wicked ministers still had excuse to twist their words."⁷⁰ These two quotes, which identified the selfish motives of ministers and rulers, clearly pointed to the emphasis of modern public choice theory as the alternative to the theory of the making of law. However, we are not suggesting that the wealth maximization theory of law does not have positive content. Further study on ancient Chinese laws in the domain of common law may indeed show that they accorded well with Posner's theory.

In the end, the paper is not aimed in showing that 'we knew this stuff long ago'. In fact, the line of thoughts was nearly ostracized after the fall of Tang Dynasty and unknown to later Chinese scholars. By putting the wealth maximization theory *of* law in historical perspective, the paper is intended to offer new research agenda. First, further research into the impact of the theory on Chinese civilization may help our understanding of the rise and decline of the Chinese state, which as taught by Chinese scholars to date is almost entirely unsatisfactory. Second, further comparative study may shed lights on the future direction of modern economic analysis of law. Certainly, these research await more economists to join.

ENDNOTES

1. For the modern law and economics movement, see Richard A. Posner, The Law and Economics Movement, *American Economic Review*, 77 (2), 1-13, 1988.
2. Posner suggests that wealth maximization is a value because it can help develop other attractive features. See Richard A. Posner, "Utilitarianism, Economics, and Legal Theory", 8 *Journal of Legal Studies*, 1979. A strong voice of rejection of the wealth maximization theory can be found in R. M. Dworkin, "Is Wealth a Value?", 9 *Journal Legal Studies*, 191-208, 1980.
3. Our understanding of Adam Smith and Jeremy Bentham is from Robert B. Ekelund, Jr. and Robert F. Hebert, *A History of Economic Theory and Method*, 2nd. ea., New York: McGraw-Hill Book Company, 1983.
4. These two sub-periods constitute what was also known as Eastern Chou. Preceding to Eastern Chou, Western Chou overthrew Shang Dynasty which obtained power from the fall of Hsia Dynasty. From the literature of Eastern Chou, kings of early Hsia, Shang and Western Chou were as benevolent as legendary sage kings of Yao, Shun and Yu around 2357 to 2205 B.C.. It was also recorded that kingdoms established by these benevolent kings were all in peace and order until their heirs indulged in sensual desires and ignored the wants of people. The tragical pattern reappeared in the late Western Chou.
5. During the warning years of Western Chou, feudal lords looked down upon the Son-of-Heaven (king) and started to compete for powers. In the period of Spring and Autumn, historical records showed that luxurious demands of feudal lords impoverished the economy. Annexations of lands by strong feudal lords caused several minor conflicts; however, regicides were very common. The social-political-economic unrest continued for hundreds of years. The era of Warring States was even witnessed with constant battles among feudal states. The period was so chaotic that reportedly casualties of major battles reached hundreds of thousands of people. Crimes of theft, robbery, grave

digging, illegal minting, deforesting, and so on were very common. The turmoil era of Warring State ended at 221 BC when Ch'in, the strong feudal state of the west, conquered and unified other states.

6. Traditionally, Confucian School was praised for its teaching of benevolence, whereas the Legalist School was severely criticized for its teaching of ruthless laws and severe punishments. As we will show later, the historical animosity toward the Legalist School was unjustified. For these two schools of thoughts, please see Hsiao Kung-chtuan, *A History of Chinese Political Thought*, translated by F. W. Mote, Princeton: Princeton University Press, 1978.

7. We are aware that Hsun Tzu was traditionally thought to belong to the Confucian School. Since Hsun Tzu was Han Fei Tzu's teacher and that they shared same economic views, we decide to include Hsun Tzu as one of the leading scholar of the Legalist School. Though it is contrary to conventional demarcation, it accords with Hsiao's view that Hsun Tzu was closer to the Legalists. See Hsiao, *ibid.*, p.33.

8. With few exceptions, English translation of the quotes of Chinese classics are adopted from the existing translated works of Sinologists. When an exception arises, we will explicitly explain why our own translation is needed.

9. The chapter from which the quote originates is put in the parenthesis throughout the paper. This unconventional practice can help reduce the amount of footnotes and make the paper more readable. Kuan Tzu is generally thought to be compiled by scholars in the Han Dynasty. Nevertheless, it is the earliest book which contains many economic analyses on monetary and fiscal policies of pre-Ch'in China. For details please see W. Allyn Rickett, *Kuan Tzu. A Repository of Early Chi~zese Thought*, Hong Kong: Hong Kong University Press, 1965.

10. That the price is determined by the interaction of supply and demand is not the patent of Kuan Tzu. There are many similar statements scattering in literature of the time, such as *The Book of Lord Shang*, and *Lu's Spring and Autumn*.

11. It is Hsun Tzu's observation on human nature that distinguishes himself from Confucius and Mencius. See Burton Watson, *Hsun Tzu: Basic Writings*. New York: Columbia University Press, 1963, p.160.

12. See Burton Watson, *ibid.*, p.164. The quote appears in Holmer H. Dubs, *The Works of Hsuntze*. London: Arthur Probsthain, 1928, p. 63.

14. Not until recently, the economic thought of Han Fei Tzu was overlooked both in the East and West. Choi is the first one who reconstructs Han Fei Tzu's ideas about selfish bureaucrats. Our paper distincts from Choi's by focusing on the theory of law. The interested readers can refer to Young Back Choi, "Political Economy of Han Fei Tzu," *History of Political Economy* 21.2 367-390, 1989. For translated works of Han Fei Tzu, please see W. K. Liao, *The Complete Works of If an Fei Tzu*. London: Arthur Probsthain, 1959, p.246.

15. See Burton Watson, *ibid.*, p.164. Benjamin I. Schwartz is the first one who thinks that legalists were behavioral scientists in ancient China; however, he does not consider Hsun Tzu as a precursor to legalists. The quote shows that Hsun Tzu was in fact a behavioral scientist. Later, we will have more quotes showing that our inclusion of Hsun Tzu as one of the leading scholar of the Legalist School is proper. See, Benjamin I. Schwartz, *The World of Thought in Ancient China*, Cambridge: Harvard University Press, 1985, 290-349.

16. Liao, *ibid.*, Vol. II, p.44-45. 17. Liao, *ibid.*, Vol. I, p.147.

18. See Burton Watson, *ibid.*, p.161. The kind of thinking that good deeds are done as man's strategy toward fulfilling own interests were shared by ancient scholars of the West and the East.

Recently, Akerlof and Frank respectively made this point explicit. See George A. Akerlof, "Loyalty Filters," *American Economic Review*, 73, March 1983, 54-63. And see Robert H. Frank, "If Homo Economics Could Choose His Own Utility Function, Would He Want One with a Conscience?," *American Economic Review* 77, September 1987, 593-604.

19. See Burton Watson, *ibid.*, p.153.

20. Similar statements are also scattered around various literature. For instance, Lu's Spring and Autumn (Collection of Observations, Precautions to Being Great) said, "One cannot obtain two gains; loyalties cannot be paid to two masters. One cannot obtain the greater gain without leaving the smaller gain; unless the smaller loyalty is removed, the greater loyalty would not arrive. Therefore, smaller gains damage greater gains and smaller loyalty is the thief of the greater loyalty. Sages forgoes the small and choose the great."

21. Liao, *ibid.*, Vol. II, p.239.

22. The English translation is ours. The quote appears in Book III of Hsun Tzu, which was not translated by Holmer Dubs.

23. Vitaly A. Rubin considers Shang Yang as the founder of the Legalist School; however, as historians in general he thinks that Shang Yang and other legalists were for the establishment of a totalitarian state. In contrast, we use this particular quote to show that even Shang Yang was not merely a militarist as Confucians thought and that the 'founder' had some economics in mind. See Vitaly A. Rubin, *Individual and State in Ancient China*, trans. Steven I. Levine, New York: Cambridge University Press, 1976. For translated works and the historical background of Shang Yang, see J. J. L. Duyvendak, *The Book of Lord Shang. A Classic of the Chinese School of Law*, Chicago: University of Chicago Press, 1963, pp. 271-72.

24. Liao, *ibid.*, Vol. II, p.295.

25. Liao, *ibid.*, Vol. II, p.92. Tzu-hsia, a disciple of Confucius, said, "Regicides and parricides as recorded in the *Spring and Autumn Annals* number tens. None of them was an outcome of one day's fermentation. It always grew from a bud and developed into maturity." The modern analysis emphasizing incapacitation rather than deterrence shows the point made clear by Han Fei Tzu. See

Steven Shavell, "A Model of Optimal Incapacitation", *American Economic Review*, 77, May 1987, 107-110.

26. Hsun Tzu in his chapter of Rectifying Popular Wisdom also discussed grave-digging. Though he thought the root cause of the problem is due to feudal kings' deviating policies, his analysis was still based on cost-benefit calculus. Lu's Spring and Autumn is yet to be translated to English.

27. Liao, *ibid.*, Vol. II, p.239. In some cases 'lessen the care' means infanticide. Whichever it is interpreted, the cost-benefit character of the quote is not changed.

28. Whereas Benjamin I. Schwartz makes a breakthrough by relating the rite to the network of hierarchy and authority on which the Confucius' normative socio-political order is based, instead of a system of religious or ethical codes, we move a step further by emphasizing the economic aspect of the rite, which is generally neglected by Sinologists. Since the Book of Rites is considered to have been compiled in the Han Dynasty and it contains many records similar to the following quotes, we can safely infer that the economic aspect of the rites was not overlooked at this time. See Benjamin I. Schwartz, *ibid.*, p.71. For the translated works, see James Legge, *The Li Ki (Book of Rites)*, in *The Chinese Classics*, Hong Kong: Hong Kong University Press, 1960 (reprint).

29. See Burton Watson, *ibid.*, pp. 99-100. 30. See Burton Watson, *ibid.*, p.106.

31. See Holmoer Dubs, *ibid.*, pp. 152-53.

32. Benjamin I. Schwartz is exactly correct in noting that the Chinese word 'fa' carries many different meanings other than the translation of 'law'. However, for our purpose that consideration is not important. By law in this paper we mean exactly as the next quote defined; thus, it covers the public law, the penal law, and the organization of the government. Liao, *ibid.*, Vol. II, p.212. See Holmer Dubs, *ibid.*, p.123. Duyvendak, *ibid.*, p. 241. Liao, *ibid.*, Vol. II, p.282-83.

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37. These dialogues were recorded in Kuan Tzu (The Kingdom by the Sea). We note here that this observation of tax evasion behaviors had tremendous impacts on government finances throughout later Chinese history.

38. Liao, *ibid.*, Vol. I, p.296. The modern law and economics movement has made great effort in studying price effects of legal rules; however, to our knowledge, the kind of income effect which leads to the asymmetry of reward and punishment is yet to be clearly elaborated.

39. The marginal principle applied to criminal punishment in the western literature goes way back to Jeremy Bentham, *Theory of Legislation*, New York: Harcourt Brace Company, 1931. The modern economic analysis begins with Gary S. Becker, "Crime and Punishment: An Economic Approach," *Journal of Political Economy*, 76 (2), 1968, 169-217.

40. Liao, *ibid.*, Vol. II, pp.330-31. Of course, the words of science and philosophy in the English translation cannot be literally interpreted; however, their meanings are not too distorted.

41. It is noted here that Lord Shang indeed has advocated severe and ruthless punishments. In other instances, Han Fei Tzu also stressed that severe punishments were proper. Later, we will explain his reasoning of such needs.

42. Liao, *ibid.*, Vol. II, pp. 215-26.

43. Liao, *ibid.*, Vol. II, p. 250.

44. Liao, *ibid.*, Vol. II, p.283. Han Fei Tzu was fully aware of informational costs and emphasized the importance of monitoring and examining. The paper cannot do full justice to

this emphasis; nevertheless, we note here that Han Fei Tzu's elaboration on 'shu' (strategy) involved a great deal of systematic solution to incomplete information and gaming situations.

45. Liao, *ibid.*, Vol. I, pp. 184-85.

46. Duyvendak, *ibid.*, p. 203. Again, the tone of these legalists do not sound to be that of advocates of totalitarian rule and ruthless laws and severe punishments.

47. Dworkin criticized Posner's theory on two accounts. First, the theory falls into the danger of circularity. And, secondly, the theory is efficient in uttering its position on the wealth distribution. We will see that the legalists' theory is not completely free from such criticism. See Dworkin, *ibid.*

48. The quote can be found in Bernhard Karlgren, *The Book of Documents*, Bulletin of the Museum of Far Easter Antiquities, no. 22, Stockholm, 1950, p.76. The Book of Documents, or The Book of History, is a collection of historical documents of Hsia, Shang and Western Chou. Though the quoted English translation is clear enough in transmitting the message, it misses a few words. Without distorting its original meaning, we prefer to translate it as "Criminal punishments does not end in deterring people, but ends in enhancing their wealth."

49. Liao, *ibid.*, Vol. II, p. 326.

50. See Holmer Dubs, *ibid.*, pp. 133- 134.

51. Benjamin I. Schwartz is also praiseworthy in linking Hsun Tzu as a utilitarian. Our quotes of Hsun Tzu and Han Fei Tzu lend more support to his view and suggest that their views were close to those of utilitarian like Jeremy Bentham, though without the concept of utile. See Schwartz, *ibid.* p. 299. For a brief introduction of the eighteenth century utilitarianism, see The New Palgrave Dictionary of Economics, (eds.) John Eatwell, Murray Milgate, and Peter Newman, London: The Macmillan Press Ltd., 1987.

52. Liao, *ibid.*, Vol. I, pp. 186-87. 53. Liao, *ibid.*, Vol. II, pp.252-53.

54. We cannot do full justice to the formation of such efficiency concepts in ancient China in the paper. Nevertheless, we note here that much of these concepts were developed by Mo Tzu, the leader of Moists, in the early era of Warring States. For an introduction of Mo Tzu' economic thoughts, see Kung-chuan Hsiao, *ibid.*, p. 225-34.

55. No translation exists and the translation is ours.

56. See Holmer Dubs, *ibid.*, p.194.

57. Liao, *ibid.*, Vol. I, pp.293-94. If Han Fei Tzu did not make up the story out of air, then even Confucius may be considered to share legalists' emphasis on punishments. Confucius'(or Han Fei Tzu's) explanation sounded exactly like the Hand formula repeatedly emphasized by Posner in tort law. See chapter six of Richard A. Posner, *Economic Analysis of Law*, 3rd ed., Boston: Little, Brown and Company, 1986.

58. Though Coase didn't phrase it as a theorem, the examples he gave are quite telling. For the original text, see Ronald, H. Coase, "The Problem of Social Cost," *Journal of Law and Economics*, 3 (1), October, 1960, 1-44.

59. There is no existing translation and the translation is ours.

60. Liao, *ibid.*, Vol. I, p.167. The discussion of public and private interests can be searched back to Mo Tzu. Public interests and public justice were translated from Chinese words '*kung yi*'. In other translations, the word 'yi' was translated as righteousness. Here, we see that the translator made explicit distinction between public justice and private righteousness. However, 'private righteousness' seems to be hardly understandable. When we cannot but make our own translation, we simply use "private interest' instead.

61. No translation exists and the translation is ours.

62. There is no existing translation and the translation is ours.

63. See Burton Watson, *ibid.*, p.89. While both Watson and Dubs translated the Chinese key words '*fen jich*' as 'limits', their meaning should be 'dividing by boundary' as we used. In the same essay, Hsun Tzu said, "The rite is the great basis of law." In an earlier quote we already see that Hsun Tzu used the words 'rite' and 'law' together; hence, we think that by discussing on the rite Hsun Tzu also meant to cover the law.

64. See Holmer Dubs, *ibid.*, pp.136-37.

65. Liao, *ibid.*, Vol. II, p. 328. Vitaly Rubin uses similar statements to argue that legalists were for the totalitarian ruler. However, our quotes on changes in law can refute his thesis.

66. Holmer Dubs, *ibid.*, p.66. 67. Liao, *ibid.*, Vol. II, p. 93. 68. Nevertheless, the Book of Rites called for state's supports for widower, widow, orphan, the childless aged, the handicapped, and the ailing. Thus, some form of actual redistribution of wealth was implied. Whether the state's care for such disadvantaged people was the legalists' method to channel compensation is uncertain and awaits further research.

69. Liao, *ibid.*, Vol. II, pp.213-14.

70. Liao, *ibid.*, Vol. II, p.213.