Applications of Economic Analysis to Marital Law:
Concerning a Proposal to Reform the Discretionary Approach to the Division of Marital Assets in England and Wales

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In this paper, I apply the economic analysis of law to examine recent proposals in England and Wales for the reform of the law affecting financial settlement after divorce. The starting point is an examination of the wide discretion currently afforded to the courts and the impact this has on incentives for divorcing parties and their legal representatives. Two specific reforming measures have been proposed to reduce this judicial discretion. First, a mathematical formula, such as a rebuttable presumption to divide equally the whole pool of assets upon divorce—a form of community property—could be used. It would be applied in the absence of agreement between the parties dividing assets, as in many countries in continental Europe. Second, legal enforceability could be accorded to prenuptial agreements, again after a continental pattern. Broadly, I conclude that changing to community property and enforceable agreements should be welfare improving but would need to be forward looking and applied to marriages, rather than divorces. © 2000 by Elsevier Science Inc.

I. Introduction

This paper resulted from a request from the Lord Chancellor’s Department (the justice department in England and Wales) for an examination, from the perspective of the economic analysis of law, of recent proposals for the reform of the law affecting ancillary relief (financial settlement) after divorce. The reforms are concerned with division of the whole pool of assets in a failed marriage. Therefore, this paper concentrates on assets and is not directly concerned with maintenance payments, which are considered only in relation to capital matters.

The starting point is an examination of the wide discretion currently afforded to the courts and the impact this has on incentives for divorcing parties and their legal
representatives. Two specific reforming measures were proposed in 1998 to reduce this judicial discretion. First, a mathematical formula, such as a rebuttable presumption to divide equally the whole pool of assets upon divorce, could be used. Such a formula would be a variant of a system of community property similar to the one used in Scotland, in some U.S. jurisdictions, and in continental Europe. It would most likely operate in the absence of agreement between the parties dividing assets. Second, legal enforceability could be accorded to prenuptial agreements, which could support a move to community property, with the default rule (equal shares) only operating in the absence of such an agreement.

In earlier papers [Dnes (1997, 1998)] I argued that marital law creates incentives for opportunistic behavior (essentially cheating relative to earlier promises) by marriage partners.1 This will occur if transfers of property (or alimony) after divorce are set too low for at least one partner, relative to earlier promises (to an ex-spouse) of providing a certain lifestyle. I shall examine community property and enforceable prenuptial agreements partly from this angle: Will they enhance or reduce incentives for opportunism.

Generally, reducing the incentives to cheat on marriage promises might be expected to enhance the attractiveness of marriage compared with a less reliable environment. The uncertainty attached to the value of marriage would be reduced. There is some robust statistical evidence that increasing contractual uncertainty in marriage, which might be expected to increase incentives for opportunism, does indeed deter marriage. Brinig and Crafton (1994) and Friedberg (1998) found that the introduction of no-fault divorce in U.S. states significantly reduced the number of marriages, after controlling for population and other trend effects.2 It is important to test the effects of divorce-law reform on marriage. Introducing no-fault divorce may well only have temporary effects on divorce rates as marriage rates adjust to the new rules [Ellman and Lohr (1998); Zelder (1993)], although other sophisticated recent work does support a long-run impact on divorce [Friedberg (1998); Brinig and Buckley (1998)].

There also has been growing concern in Britain about the public costs attached to the growth of divorce. As divorce has grown from around 40,000 cases in 1966 to over 150,000 cases in 1999 (reflecting the highest divorce rate in western Europe), considerable strain has been placed on the court system and, given the impecunious nature of many divorcees, on the budget for legal aid. Therefore, there is interest in whether community property rules might help to reduce complexity and costs. If uncertainty over the courts’ rulings encourages investment by both parties in legal services and lengthens conflict in the courts, simplification might encourage disinvestment from conflict, with associated cost savings all round.

The structure of the paper follows the questions raised above. I begin with a brief commentary on the discretionary nature of the current law, followed by an analysis of the incentives it creates for opportunistic and adversarial divorce. I then assess the impact that moving to a system of community property might have on divorcing couples and on the costs imposed on the courts. In assessing the impact, I make use of the idea

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1The arguments are also developed in Dnes (1998).

2They also found introducing no-fault divorce significantly reduced birth rates and significantly increased violence toward spouses, again after controlling for other likely influences. The story on births is that women may be less willing to make highly marriage-specific “investments” like child raising if vulnerable to divorce at will (their re-employment prospects are poor). On violence, the penalty for egregious behavior becomes lower when the financial consequences of divorce are not affected by behavior.
of property versus liability rules [Calabresi and Melamed (1972)], borrowed from the economic analysis of conflict over property rights (nuisance) to compare clear property rules with court discretion. It does seem likely that current law encourages a “prisoner’s dilemma” [Rasmusen (1994)] in which parties are trapped into excessive costly litigation. I also examine whether there is conflict between community property and meeting the needs, in particular, of children, and what scope a rule of community property would have. Broadly, I conclude that changing to community property and enforceable agreements should be welfare improving but would need to be forward looking and applied to marriages, rather than divorces, from a well-defined date.

II. The Current Discretionary Legal Position

In England and Wales, contemporary divorce law (e.g., the Family Law Act 1996 or the Matrimonial and Family Proceedings Act 1984) embodies a mixed focus on expectations, rehabilitation, and the needs of the parties. There is a dominant, statutory requirement to meet the needs of dependent children. The law [Hoggett et al (1996)] is based on separate ownership of property within the marriage and gives considerable discretion to be exercised by the courts in dividing assets on divorce. Successive governments have had many opportunities to move toward a different, in particular a community-property, system and/or to establish firm rules of property division, but they have not done so. Parliament opted instead, as Thorpe recently noted, “for a wide judicial discretion that would produce a bespoke solution to fit the infinite variety of individual cases.”

Notable characteristics of the law in practice are the trading of asset transfers within a settlement and the trading of assets for maintenance payments. The non-housing needs of children have come to be treated separately after the Child Support Acts of 1991 and 1995, under which Child Support Payments are channelled from absent parents through the Child Support Agency (CSA).

Divorce law has never operated to enforce the material side of marital promises [Dnes (1997, 1998)]. To do so would be to treat marriage contractually, awarding (expectation) damages for breach of contract and denying support or capital payments to a breaching party. Even in the days of fault-based divorce, the cost to a husband of divorcing even an adulterous wife would include making some support provision for her [Hoggett et al. (1996, p. 295)]. Historically and for the most part, divorcing parties with means have not been permitted to leave divorced parties destitute. The 20th century liberalization of divorce law is associated with a move to no-fault divorce procedures, provision of legal aid for petitioners, development of the court’s ability to transfer assets, and the focusing on a mixture of expectations, needs, restitution, and rehabilitation standards of awards. Note also that no-fault divorce may still be equivalent to breach of contract (e.g., when a husband divorces his wife without her consent after abandoning her for 5 years).

Several reasons can be given for avoiding an expectation-damages standard when dividing marital assets on divorce. It is inconsistent with the modern development of divorce law that increasingly emphasizes the “rehabilitation” and independence of abandoned spouses (although most of the problems that might be cited have really
arisen in the context of lifetime support obligations that are not based strictly on an expectation-damages approach). The Law Commission (1982) came to the conclusion that the imposition by the Matrimonial Causes Act 1973 of a duty to place the parties in the position they would have been in had the marriage not broken down was “not a suitable criterion,” based largely on a perceived movement in public opinion against the idea of lifetime support. However, examination of their earlier analysis [Law Commission (1980)] shows that this was not really an attack on expectation damages but on the practice of the courts. In particular, the standard was not to be operated only in cases of breach of the marital contract but was more of a lifetime support obligation (hence, “parties”). Following from the Law Commission’s reports, the 1984 Act modified Section 25 of the 1973 Act to place more emphasis on meeting the needs of the parties (particularly with regard to children) and to enabling transition to full independence of the divorcees.

The Commission was sensitive to problems like the imposition of support liabilities on innocent parties forced to divorce against their will, or ex-wives who chose to cohabit rather than marry so as not to lose the right to maintenance from an ex-husband. These problems need not arise in the careful construction of a system based on expectation damages. From the perspective of welfare economics, a more powerful criticism of focusing on expectation elements in divorce settlements is that they might be difficult to calculate. A great deal of legal argument is likely to concern who promised what to whom and when. It may well be that it was never efficient for the courts to attempt to untangle these matters and that little more could be done than to protect children and to prevent ex-spouses from being treated with obvious harshness.

The main alternatives (other than need) to taking an expectation-damages approach to divorce are approaches based on restitution or reliance, which are often confused with each other. The reliance approach compensates an ex-spouse for the opportunities foregone in entering the failed marriage and has been criticized for being tough on poor women who married wealthy men [Trebilcock (1993)]. Reliance is also difficult to calculate: Eekelaar and Maclean (1986) note that the principle (as the status quo ante) was put forward by Gray (1977) but was rejected by the Law Commission (1980) as requiring too much speculation about what might have happened in the distant past. In Dnes (1998), I suggest that reliance will generally be less than expectation damages and that this difference can cause an incentive for opportunistic divorce (essentially, divorce may be too “cheap,” as the petitioner for divorce will not be required to compensate for lost promises).

In a restitution framework, divorcees are compensated, at market value, for investments made in the other party’s career or business [Carbone and Brinig (1991)]. The principle is one of the elements in the current discretionary basis to divorce law in England and Wales, as in the case of Conran v. Conran. Restitution is only relevant where there is a market value to divide, where it is difficult to calculate, and where it is not likely to be as high as expectation damages, because it will not cover the entire expected benefits from the marriage. Again, a restitution standard invites opportunistic behavior because divorce may become cheap relative to meeting promises made earlier in the marriage. Furthermore, there may be the problem of negative restitution: The ex-spouse may have hindered the petitioner’s career or business.6

5Conran v. Conran (1997) 2 FLR No. 5 (assessing reasonable requirements in relation to past contribution).
The other principal elements in the current law affecting divorce settlements are needs-based assessments, rehabilitation, and a partnership approach. Again, none of these bases for dividing assets matches expectation damages and may risk creating an incentive for “cheap” (opportunistic) divorce. Just meeting an ex-spouse’s welfare needs (and those of the children) may be a low-cost alternative to fulfilling or compensating for the loss of earlier promises. Similarly, only being expected to rehabilitate the former spouse may be a relatively modest requirement that will be likely to encourage divorce, particularly among wealthy men seeking “greener grass.”

A partnership approach potentially fits in with a community-property rather than separate-property regime, and therefore is of particular relevance, given the proposal to introduce a presumption of equal sharing of assets. A point worth noting is that if partnership is the modern expectation in marriage, equal sharing could potentially give the same result as an expectation-damages standard for dividing marital assets, and therefore might fare better than most standards in deterring opportunism. The Law Commission (1982) recognized the analogy between partnership and marriage in its discussion of the “clean-break” principle, under which the divorcees would be placed into financial independence as rapidly as possible. In the neighboring Scottish jurisdiction, the Family Law (Scotland) Act specifically requires equal sharing of property acquired during marriage unless special circumstances dictate otherwise (i.e., “deferred” community property). Partnership still could be an accurate interpretation of a marriage even when equal sharing were not the norm, as perhaps indicated in a prenuptial agreement, inasmuch as there are different degrees of partnership across business relations. Imposition of the wrong partnership shares does run the risk of creating incentives for opportunism, e.g., it would be a “cheap” divorce if the award were equal shares when a greater amount was needed to maintain the lifestyle of the spouse who was involuntarily divorced.

The law as it stands runs the risk of making divorce too “cheap” because the standards of compensation do not embody the full value of promises made (Cohen, 1987). In Dnes (1998) I describe this as leading to a form of opportunistic behavior that most likely affects wealthy men, which I called the “greener-grass” effect. Even if we prefer not to regard marriage in contractual terms, or if we prefer that the courts do not devote time to calculating marital expectation or determining breach, it is the case that marriage involves costly long-term promises. There is therefore a real danger that failing to enforce promises will create an incentive for divorce among some people whenever they see a preferred relationship and realize that they need not fully meet their earlier financial obligations.7

It is also possible to identify a further adverse incentive encouraged by the current law. As awards are often made without any or much regard to fault, damages are not linked to breach of contract. A possible consequence is that a party might petition for (no-fault) divorce in anticipation of receiving a substantial share of the marital assets. Again, this would be deterred if damages were restricted to “innocent” victims of breach. As this incentive is likely to affect women, who typically receive assets from men, I call it the “black-widow” effect [Dnes (1998)]. In principle, the black-widow could sometimes be bought off by reworking the implied terms of the marriage in her favor. However, reworking may not be possible where the benefits to individual marriage

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7 In terms of the economic analysis of law, it would be efficient (wealth maximizing) for the divorce to go ahead if, having compensated the ex-spouse for lost expectation, the petitioner for divorce still wished to proceed.
partners (e.g., enjoyment of association with the children) are not transferable between them [Zelder (1993)].

To conclude these brief comments on the existing judicial discretion over asset division, there is a problem that adverse incentives are created over the decision to divorce. The problem is caused by divergence from a contractual ideal in which expectation damages would be awarded for breach of contract (subject to a duty to mitigate losses. It is, however, difficult to see how the variety of marital expectations could be enforced (either as performance or as compensation) as nothing in the current law aids in their identification. It is possible that the setting of a statutory norm (equal shares) together with an opportunity for the couple to indicate their expectation over assets if it differs from the norm (using a prenuptial agreement) may overcome the problem of identifying marital expectations. We return to this issue after considering the details of community property regimes and prenuptial agreements further below.

### III. The Current Incentives for Adversarial Divorce

The incentives to divorce or to remain married are not the only issues affected by current discretionary divorce law. The other important area concerns how the divorce will be pursued. In particular, will the divorcees have an incentive to negotiate privately, to negotiate reasonably amicably with professional assistance, or to pursue their cases in a litigious manner. This last possibility is of public concern in that litigation tends to drive up legal-aid bills and court costs that are met from general public funds.

One way to look at the incentives for legal conflict is to consider whether divorcees become trapped into a highly litigious approach when a less conflict-orientated approach would suit them better. The key here may be to reassure a party that a more cooperative stance will be reciprocated and not taken advantage of by the other. The need is really to encourage both parties to simultaneously disinvest from unnecessary conflict.

The current incentive structure in divorce negotiations is probably similar to the incentive structure thought to be present in many litigation situations. Individuals invest in legal services out of a fear that if they do not, and their opponent is “tough,” they will be seriously disadvantaged. The availability of legal aid would exacerbate the problem. The correct way to examine anxieties about too much litigation is with a simple model from game theory.\(^8\) Assuming a divisible marital asset (e.g., shares) worth £100 (e.g., thousands), Table 1 shows possible settlements depending on the structuring of litigation.

\(^8\) The divorce game is analogous to the “prisoners’ dilemma” [Dnes (1996), p. 24].

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<th>He</th>
<th>Nonlitigious</th>
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<td>Nonlitigious</td>
<td>50,50</td>
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<td>Litigious</td>
<td>60,15</td>
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Note: Table values given as He, She.
In Table 1, if both divorcees are nonlitigious and limit their instructions to their legal representatives to taking care of paperwork, each receives a half share of the asset. For simplicity, we assume paperwork is costless. The equal shares result (top-left corner) is just a convenient starting point because, in reality, people might agree on other shares. However, if “She” instructs a lawyer to play tough, and “He” continues to act nonlitigiously, the settlement changes. The top-right corner shows He receives only 15, while She obtains 60, with 25 being consumed in legal costs. The bottom-left corner shows a reversal of this asymmetric result when He moves to being litigious and she remains nonlitigious. Finally, the bottom-right corner shows what happens if both are litigious: each receives 25, and a total of 50 (25 each) goes into legal costs. With the benefit of hindsight, the jointly litigious outcome (25/25) is the worst possible result because the joint asset value is reduced to 50 by legal costs.

If a divorce “game” were structured this way, economic analysis predicts that the joint pessimum (25/25) will be selected as the outcome. Both parties will be litigious because each cannot risk the “sucker’s payoff” of being cooperative when the other party decides to be litigious. The resulting low payoff of 15 is far worse than the 25 obtained if both parties are litigious. “Litigious” dominates “nonlitigious” as a strategy for each divorcee. Litigation is the better strategy for each divorcee regardless of what the other plans to do.

The divorce game captures the worry that people are overlitigious in divorce cases. If the structure of the game is a good description of what goes on, a mechanism to guarantee that “playing” cooperatively rather than being litigious cannot be punished by the other party’s tough litigation would force divorcees to the result seen in the top-left corner of Table 1 (the joint maximum characterized by 50 for each party). In contrast, the joint pessimum (25/25) can be criticized as reflecting socially wasteful expenditure. The 50 for legal costs does nothing to create any new real output in the economy—it is paid for work that simply distributes existing assets. From the normative perspective of welfare economics, e.g., wealth maximization, we would wish to stop the legal expenditure: It is better that the divorcees keep all of their wealth and that the lawyers use their time to better effect.

Table 1 is a plausible account of many divorce incentive structures. We do not know for sure what the relative payoffs to cooperation and litigation are, but we reasonably might worry that Table 1 is an accurate description. Furthermore, there is empirical evidence, albeit away from the divorce area, that there is overinvestment in litigation. In a study of public employee wage disputes and dismissal cases, Ashenfelter and Bloom (1994) found that hiring a lawyer increased the chances of persuading an arbitrator to accept proposals from approximately 50% to 70%. However, when both sides hired lawyers, the odds of winning reverted to the original 50%. The results are likely to be generalizable. In cases in which the arguments are about the division of fixed values, it would be better for the parties to settle between themselves. However, if each party realizes that legal representation influences outcomes, it will be a dominant strategy to hire a lawyer. When both parties do this, the result is little or no different from when neither party is represented and both parties are worse off by the amount paid to the lawyers.

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9It might be wrongly objected that it does not matter whether the lawyers or divorcees have the money. This is wrong because the lawyers’ services are taken away from other areas of the economy. They could be more constructively employed (e.g., drawing up reliable contracts, in work that would support and encourage fresh economic activity). The problem in the divorce game is that division is of a fixed amount—pretty much any effort expended on this looks somewhat wasteful unless major issues of justice arise.
A firm presumptive rule for property division could, by reducing uncertainty, attenuate the incentive for wasteful legal representation. Given that representation is unlikely to improve the settlement from the viewpoint of either party, but that they become trapped into a conflict-laden approach, such a move should prove generally acceptable. The presumptive rule and the grounds for rebutting the rule also should command general assent, providing that they reflect generally held expectations about modern marriage.

IV. Community Property: A Property-Rights Perspective

Dividing the assets of a marriage at divorce is a question of defining property rights or possibly of resolving conflict over property rights. Earlier work in the economics of law has generated several insights into sensible ways to settle conflict over property rights. Such conflicts frequently occur in cases of nuisance, which are usually characterized by ill-defined entitlement to make a particular use of land. The area is a long way from marriage, but the principles may be borrowed as it turns out there is little logical difference between conflict over use and conflict over ownership.

According to Calabresi and Melamed (1972) conflict over property rights can be solved by adopting either a “property” or a “liability” rule, depending on the bargaining costs likely to arise between the parties. Thus, in a simple case of nuisance spilling over between two neighboring landowners a property rule may be followed because bargaining costs are likely to be low because there are just two parties involved.

Under a property rule, the entitlement to create the nuisance can, as one possible solution, safely be given to the neighbor generating the nuisance. If the “victim” values freedom from the nuisance more than the “generating” neighbor values the entitlement to create the nuisance, money will change hands because the victim will bribe the generator to stop. Thus, the “entitlement” will end up in the ownership of the hands of the neighbor who values it most highly.

It is equally efficient for the entitlement to be given to the victim, who would then obtain an injunction stopping the nuisance. If the generator of the nuisance is the highest valuing party, money will again change hands and the generator will effectively bribe the victim to condemn the injunction. With low bargaining costs, from the point of view of economic efficiency, it does not matter who has the entitlement [an application of the Coase (1960) theorem] because bargaining will ensure that the entitlement goes to the highest valuing user. Therefore, the courts can avoid the costly determination of issues in such cases by issuing or denying an injunction, depending on their views of distributing benefits between the parties, secure in the knowledge that bargaining will take care of efficiency.\footnote{This result assumes that there is no technical advantage (e.g., an abatement-cost advantage) in giving the entitlement to either party.}

In the case of ancillary relief, the problem is not nuisance but, rather, one of determining who owns what from the point of divorce onwards. Marriage is clearly a case in which bargaining costs are low, in that two people are involved who can be expected to communicate, at least in a technical sense. Thus, a property rule, in the sense of Calabresi and Melamed (1972), should be appropriate. It should be possible to
choose a simple guideline for property division upon divorce and then to rely on marrying couples to form their precise marital expectations based on the existence of that rule. In a sense, it should not matter much what exactly the rule is because the important point is simply to give some focus to bargaining.

One could as easily start from a presumption that divorcees will split marital assets equally as from a different assumption. Presumptions that assets might be split in other proportions would not cause problems. Knowing what the rebuttable presumption is (e.g., take an extreme case like 100% to one party), a couple would negotiate a prenuptial agreement to produce the division (e.g., equal shares) they actually wanted. Negotiation would be straightforward: The parties would agree what would happen in the event of divorce at the time they agreed to marry. As long as the presumptive rule were well known in advance of marriage and people were free to negotiate enforceable contracts around it, bargaining should result in optimization for individual cases.

To be sure, care needs to be taken to consider two possible objections from the recent literature to such a strong application of the Coase theorem. The first has been raised by Rasmusen and Stake (1998), who note that information asymmetry might deter efficient bargaining, e.g., a party asking for minimal support obligations signals a certain lack of commitment. With asymmetric information, it could be worthwhile to signal greater commitment and obtain more in return, because the other party would have no real way of checking. In fact, this is a substantial problem only if there is no way to break up the asymmetry, which is not the case with marriage. Thus, a host of social conventions having the characteristics of sunk costs, such as periods of time spent together, periods of engagement, gift giving (e.g., a ring), and rules over who pays for what leading up to marriage, operate and must match with the commitment level implied by the marital contract. In short, there are checks on commitment apart from what is said by the parties.

The second objection to applying the Coase theorem has been raised by findings in economic psychology referring to the “endowment effect.” Recent empirical evidence [Korobkin (1998)] suggests that setting a default property rule may affect bargaining outcomes. Contrary to standard neoclassical consumer theory, the same elements in a choice set may be valued differently, depending on whether we are before or after the legal change, and independently of possible wealth effects. Although the endowment effect is disturbing from the point of view of neoclassical theory, and although it means that property rights may not be neutral in relation to Coasian bargaining, the objection is a technical one that does not carry real welfare significance. From a welfare perspective, there is no reason to prefer the choices made before or after the endowment effect, which is in this sense a curiosum. There would likely be a once-and-for-all effect from changing the law, as the contracts entered after the change could differ from the form they would have taken had the law remained unaltered. The proposal for a presumptive rule of equal shares coupled with enforceable prenuptial agreements can be seen as an application of a Calabresi and Melamed (1972) style property rule. The proposal is likely to support the welfare of married and divorcing couples, providing that it results in a clear presumptive rule and given that the use of prenuptial agreements allows bargaining to occur. This line of reasoning would support the application of any new rule to marriages, rather than divorces, from a certain date onward. Such a forward-looking approach would allow couples to find their optimal asset plan knowing exactly what they must do to achieve this if they do not like the presumptive rule. However, imposing the rule on divorces at a point in time would be confusing: Unless the couple happened to have a prenuptial agreement (unlikely, as these were unenforceable
previously) they would be forced into the presumptive rule. Newly marrying couples
would not be forced into the presumptive rule, because they would have a clear
opportunity to enter a prenuptial agreement.

It is worth noting a few more points about the use of a property rule. First, it could
operate after meeting a maintenance requirement to support children of the marriage,
or even to support an ex-spouse with child-care responsibilities. As long as fundamental
obligations and the presumptive rule are well understood, individuals can be expected
to negotiate clear agreements if they wish to establish their preferred rule for division.
In fact, needs-based support obligations would act as a baseline affecting all possible
presumptive or privately negotiated rules. Negotiation could therefore have the char-
acter of agreeing asset division (and possibly maintenance payments) over and above
certain needs-based support payments (e.g., CSA obligations) that all parties realize will
be enforced anyway. Again, the key thing is that such obligations be widely understood.

Second, the use of a presumptive rule for asset division, linked to the use of prenup-
tial agreements, must be contrasted with the current uncertain position. At present,
wide discretion is practiced in the divorce courts and people cannot enforce prenuptial
agreements. The current law gives tremendous scope for (possibly opportunistic)
argument at the point of divorce, when everything is “up for grabs.” In the terms of
Calabresi and Melamed (1972), the courts are effectively applying a liability rule in a
small-numbers bargaining situation where it is not needed. The current position does
not reflect a property rule and is a poor basis for negotiation between divorcees.
Consent orders that are agreed between divorcees, and usually ratified by the court,
reflect parties’ perceptions of how discretion is likely to be applied rather than a
considered view taken at the start of a failed marriage.

V. Effects of a Community-Property Rule in Divorce Proceedings
In terms of the analysis of Calabresi and Melamed (1972), establishing a rebuttable
presumption of equal shares and enforceable prenuptial agreements would be a move
to a “property rule.” The prenuptial agreement would allow people to deviate from the
presumption of equal shares in a clear manner and is needed to support the implied or
explicit bargaining on which the property-rule approach to conflict over property rights
relies. The courts would thereafter pay attention to such agreements, enforce the
presumption of equal shares, or consider arguments for exceptions to be otherwise
made.

If the presumptive rule and the enforceability of prenuptial agreements is widely
recognized, we could be sure that marriages were established on terms that reflected the
interests of both husband and wife. All the standard arguments concerning the gains
from trade under voluntary exchange in regular markets would carry over into the
“marriage market.” A corollary is that the incentive toward opportunism under current
divorce law would be attenuated. Individuals would know what the rules of asset division
were and that these could not be distorted, and that, therefore, a divorce settlement
would bear close relation to initial marital promises concerning assets. Generally then,
the worries raised above about “inefficient” (opportunistic) divorce would be allayed by
the change to a community property rule.

The incentive to litigate also should be reduced, providing that the formula was well
understood and not susceptible to influence in the courts. Providing that was true,
divorcees should not feel vulnerable to receiving the “sticker’s payoff” in the prisoners’
dilemma that was illustrated and discussed above. There should be no disadvantage
from failing to hire legal representation at the stage of discussing asset division as a part of settling ancillary relief. If the fear of vulnerability is lifted by a clear property rule, the incentive to be litigious should be reduced. The prisoners’ dilemma is paradoxical precisely because withdrawal from conflict would result in higher welfare for both parties but, unfortunately, neither party can trust the other. The relevance of trust is reduced because the simplification of rules would make it much less likely that a litigious approach would change anything for either party.

The considerations just raised suggest that courts should be firm in their enforcement of a property rule, which needs to be utterly transparent. This would involve firm enforcement of prenuptial agreements or of the alternative presumption (e.g., equal shares). If routes are introduced through which agreements might be overturned retrospectively, or that could cause deviation from the equal-shares presumption, the incentive to be litigious would grow accordingly. Furthermore, there would be the danger that current levels of discretion would be returned to the courts “by the back door.”

Observers of the operation of the Scottish system of property division have argued that it sets out to be non-discretionary by presuming equal shares but ends up expending too much effort over considering exceptions to the rule [Law Society (1991)]. The Family Law (Scotland) Act 1985 (§9(1)) lists four further principles to be applied in addition to that of sharing marital property ‘fairly’. These cover economic advantage or disadvantage derived or suffered by either party, child-care responsibilities, rehabilitation of a dependent ex-spouse, and the possibility of creating financial hardship. Section 10 of the Scottish Act defines fair division as equal shares unless there are special circumstances to be considered.

Cretney (1986) comments that the Scottish Act may have replaced the unlimited discretion of the English divorce court with several areas of poorly delimited discretion. Dewar (1989) and Wasoff et al. (1990) thought that the Scottish courts relied to an “unexpected degree” on the fifth principle of relief from serious financial hardship to avoid arbitrary results. This type of problem indicates a need for creating a firmer legal environment affecting divorce settlements if a major aim is indeed to reduce uncertainty. The Scottish Act has not suppressed incentives for litigation, given the willingness of the courts to continue the exercise of discretion.

The Scottish Act seems not to have done away with discretion, which leads to the question of whether discretion is unavoidable, or at least whether there may be grounds for retaining it. Based on an examination of the welfare of the divorcees and the costs faced by courts, after the analysis of earlier sections of this paper, we would want to firmly enforce prenuptial agreements or the presumptive rule of equal shares. This is to reduce the incentive for opportunism and litigious behavior. The only reasons for moving from that conclusion would be if overwhelming interests of other parties would be wrongly ignored. We return to the issue of external effects onto other parties later.

**VI. Postnuptial Agreements and Contract Modification**

There is a case for enforcing prenuptial agreements but generally not to enforce postnuptial agreements. The literature on contract modifications is extremely pessimistic over the prospect of welfare gain from enforcing mutually agreed and compensated modifications [Aivazian et al. (1984); Dnes (1995); Jolls (1997)]. This is because of the difficulty of distinguishing between genuinely beneficial revisions and those resulting from opportunistic behavior, which can amount to duress. Consider the difficulty in
marriage contracts in distinguishing between a genuine modification (because a party now has improved prospects) and the case in which a party threatens to make their spouse’s life hell unless certain terms are agreed.

Contract modifications (postnuptial agreements) will not set up incentives for opportunism if, in the context of unforeseen events, (1) it is not clear who is the lowest-cost bearer of the risk, (2) the events were judged of too low a value to be worth considering in the contract, or (3) it was not feasible for either party to bear the risk.11 Generally, the view that supporting all modifications is desirable because there appears to be a short-term gain is unsound: long-term instability may result since fewer people will make contracts if it is difficult to protect them from opportunism.12

The idea that modifications can be legally supported when events unfold for which it would not have been clear early on who should have benefited or borne a fresh cost does give a clue to a role for the court. It can determine whether some change was foreseeable and whether the attendant risk would have been clearly allocated (e.g., one’s wife’s aging is not a reason for scooting off without compensating her, but, on the other hand, mutually tiring of each other is a risk that would have been hard to allocate to one party).

Compared with simple, classical contracting, a more appropriate fundamental model of the marriage contract would be as a relational contract. Macneil (1978) has suggested that complex long-term contracts are best regarded “in terms of the entire relation, as it has developed over time.” Special emphasis is placed on the surrounding social norms rather than on the ability of even well-informed courts to govern the relationship (Macneil calls governance that emphasizes third-party interpretation “neo-classical” contracting). An original contract document (for example, marriage vows) is not necessarily of more importance in the resolution of disputes than are later events or altered norms. Courts are likely to lag behind the parties’ practices in trying to interpret relational contracts.

A relational contract is an excellent vehicle for thinking of the fundamental nature of marriage, but it may be of limited help in designing practical solutions to divorce issues unless it is possible to fashion legal support for the relational contracting process. Crucially though, the idea emphasizes flexibility. Many of the problems associated with the division of marital assets arise because social norms change (e.g., the wife has no entitlement to lifetime support) but the individual marriage partners fail to match the emerging marital norm (e.g., a homely woman married in 1956 is much more likely to have specialized in domestic services). Therefore, a possible approach to divorce law is to enforce prenuptial agreements or the equal-shares rule to guard against opportunism but to allow the interpretation of expectation to be governed by differing “vintages” of social norms.

The law could help in this process by indicating a range of possible forms of marriage and associated prenuptial agreements. This develops the approach adopted recently in Louisiana, where two forms of marriage contract exist side by side. In the Louisiana

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11As explained fully in Dnes (1995).
12The literature on contract modifications is complex. The fundamental problem alluded to is the high cost of distinguishing between “genuine” changes that allow a move to a jointly preferred position and opportunistically contrived changed circumstances. The exceptions just listed in the text are cases in which making a modification cannot induce opportunism. The possibility of opportunism resulting in apparently “voluntary” modifications (e.g., threatening to divorce unless new terms are agreed) raises questions about the nature of free choice compared with duress.
case, covenant marriage is much harder to dissolve compared with regular marriage contracts and carries greater liabilities to the other party. Laying out several alternative contracts to capture changing or differing marital norms, from among which couples can choose, would help people to visualize the possibilities. This would seem to be a useful role for the state, and it accords with the idea of enforcing prenuptial agreements. The argument is that it may be asking people to do a lot if we expect them to draft comprehensive marital contracts \textit{ab initio}. It is probably more realistic to expect them to make a reasonable match when models are presented to them, covering at least the principal cases (e.g., traditional marriage, equal-shares partnership, and separation of property).

As long as expectations are clarified, the inefficient and opportunistic breach of marital contracts could be broadly suppressed. Providing usable models of prenuptial agreements would assist in this clarification. It also would help to avoid the problem that seems to have arisen in Scotland, where the presumption of equal shares has resulted in courts preferring to maintain discretion.

VII. Recognizing the Needs of Children

Family lawyers might well be expected to express concern that after economic analysis and moving to a property rule could fail to meet the needs of parties to a marriage, especially those of any children. English law does currently contain a dominant requirement to meet the needs of children and then the needs of the dependent former spouse. In some respects, the recent focus on needs in family law reflects genuine concern with maintaining the welfare of children and (typically) of divorced wives. In many ways though, much of the impetus behind the meeting of needs in a settlement can be seen as reflecting a legitimate concern that the state does not pick up the bill for individuals’ failed marriages.

Although the state does not succeed in avoiding a bill for welfare payments following from the growth in divorce, inasmuch as many divorcing couples are welfare dependent in the first place and this dependency is extended by divorce, recent statutory changes have limited the state’s liability. The Child Support Act 1991 created a scale of income-related payments to be transferred between the absent parent and the parent with care to meet non-housing needs. It is notable that payments under the Act (and its 1995 successor) include a payment to the carer equal to the single person’s supplementary benefit rate. Child-support claims must be made if the parent with care claims welfare benefits, and privately structured child-maintenance settlements are only possible in the absence of such claims. The effect of the Act is to prevent the court from exercising discretion in a way that allows divorce settlements to proceed on the basis that (typically) a divorcee will be receiving welfare payments meeting her needs and those of the children.\textsuperscript{13} That courts in the past did indeed assume the availability of welfare payments in dividing assets or structuring settlements is reported by Eekelaar and Maclean (1986).

From the perspective of public finance, there is a legitimate worry about running up welfare bills to subsidize private citizens’ marital failures. It is less obvious that such

\textsuperscript{13}Working through CSA calculations suggests that the claims are targeted at recipients who would otherwise become welfare claimants. The recipient’s income can increase by high factors without altering the payer’s liability by any significant amount. In particular, there is no facility to remove the carer’s allowance if the recipient has an income, which suggests this possibility is not seen as likely.
welfare payments also cause a problem from the point of view of the long-term welfare of marriage partners. If the state subsidizes child care or the maintenance of a dependent divorcee in these cases, there is a risk that opportunistic divorce will be encouraged, along the lines described earlier. Divorce may become “too cheap” so that the “greener-grass” phenomenon is generated, with some individuals tempted to initiate divorce knowing they will not have to compensate the divorced party, for whom liability can be dumped on the state, for the lost standard of living. The “black-widow” form of opportunism also could be encouraged, with some individuals divorcing because welfare payments available to them seem generous, possibly in conjunction with the retention of assets or income from the marriage, compared with continuing in the marriage. The state support may distort the attractiveness of sustaining a marriage compared with other options like adopting single status or remarrying.

The problem attached to such a distortion of incentives for couples is that marriage may seem a more uncertain state than would otherwise be the case. Changes in the welfare system might suddenly remove the attractiveness of remaining married long after marriage occurred and when the marriage would otherwise continue. This could cause some people to avoid marriage altogether (e.g., “He could just dump me onto welfare in my 50s”). The state’s involvement is not just a matter of public finance.

Therefore, far from causing problems for private divorce settlements, statutory child-support requirements make it clear that the state will not indemnify marriages against failure by picking up the bills for child support. This clear obligation becomes something to be taken into account when entering marriage (really on contemplating having children because the obligation is independent of marital status and simply applies to parents). Also, the obligation can be established so as to prevent parents divorcing in a manner that would impose costs on children. The support levels can be set to hold onto a reasonable lifestyle for the children, and a property rule (like equal shares) can operate around child-maintenance obligations.

The conclusion just reached is undermined if child-support payments are set too generously, fail to take account of transfers of capital assets, or ignore benefits provided by an absent parent. As might be expected, action by the CSA to obtain payments from absent parents (mandatory when the caregiving parent claims income support) has come into conflict with the clean-break principle under which courts have awarded transfers of property in place of periodical payments. The courts seem to be beginning to recognize the danger of double counting payments of capital and income when the CSA imposes a payment order on a pre-1991 case as in Smith v. McInerney.\textsuperscript{14} The danger in ignoring capital payments made in lieu of child maintenance when enforcing CSA rules is that private incentives to divorce will be distorted. Specifically, a black-widow incentive may arise during a period when courts are confused and persist in old-style capital awards even though generous child-support payments are also being enforced. Some of those liable to be the principal carers of children may be tempted to divorce if aggregate settlements suddenly become overgenerous as a result of a period of confused adaptation.

The area of needs-based child maintenance shows that care must be taken not to focus on the public finances to the exclusion of other considerations, particularly where the distortion of private incentives may arise. There seems to have been an early period

\textsuperscript{14} Smith v. McInerney (1994) Family Law Review 2:1077 (Order on appeal to return a cash lump sum and readjustment of housing property transfer to offset subsequent action by the CSA).
of applying the CSA when the state could be satisfied that it was controlling unwarranted subsidy of divorces involving children, but when it was guilty of "overkill" in ignoring past transfers of capital. No doubt this resulted from the CSA being targeted at all absent parents, not just the divorced ones. If one wrongly thinks no further than the public finances, there is no reason to attend to "oversupporting." However, the argument here is that it is important to think about the distortion of private incentives, particularly if this could increase divorce rates when no increase is intended.

The above reservations aside, there is no reason in general to suppose that an obligation to meet children’s needs after divorce should conflict with a property rule covering asset division. People will bear in mind the obligation when entering into marriage and writing prenuptial agreements. It would help them if the obligations are well understood. The obligations, as it were, operate first, and everyone knows this. Thus, it can be assumed to be well known that there is an obligation to pay child support and to meet housing needs of children at the point of bargaining. This amounts to a clear statement to the parties that they cannot impose costs on children or on the taxpayer.

Housing need is in many ways the starting point of the current English law on postdivorce financial obligations, and the majority of cases do not reveal sufficient family resources to go much beyond the allocation of housing to the spouse with responsibility for care of the children. This is particularly the case because the clean-break principle favored transferring assets in lieu of periodical payments. Housing has typically been transferred to meet both the children’s and dependent ex-spouse’s needs, using a Martin 15 order where there are too few assets to house both parties (a life interest is created typically for the wife in a housing asset that technically remains the property of both divorcees with sale delayed until she leaves, dies, or becomes dependent on another man). A variation is the Mesher 16 order, in which there are more assets and delaying sale of the house does not simply store up a problem: The life interest is established until the children grow up.

The courts can distinguish between allocating the rights to use a property from allocating ownership of the property. After a move to a property rule for asset division, such a distinction could be maintained. Orders like the Mesher or the Martin could continue to have a role. Consider the case in which the presumption was not rebutted in favor of equal shares in the marital assets and in which there were no assets other than the marital home. Then ownership would be divided, but eventual sale would have to be delayed if there were too few assets to house all parties and the housing needs of the children could only be met by keeping them in the former marital home. So really, the principle of distinguishing between rights to use and eventual ownership could simply be maintained to safeguard adequate housing for children.

There is, therefore, no necessary conflict between meeting housing needs and establishing a property rule such as equal shares of marital assets on divorce. Dangers may exist if the court is insufficiently careful and overkills the problem of need. To avoid distorting incentives to divorce or remain married, the court really should divide assets, if at all possible. People may be reasonably viewed as able to realize that marriage implies housing and other maintenance obligations toward any children of the mar-

16 Mesher v. Mesher & Hall (1980) 1 All ER 126n, CA (creating life interest in housing asset until children lose minority).
riage. They may, therefore, be expected to enter prenuptial agreements aware of the commitments over housing needs.

The view taken here is that people should not be able to vary their (currently) statutory obligations over meeting the needs of children when negotiating a prenuptial agreement. This would allow them to dump child-maintenance costs on the state or to impose costs on their children, which appears to run counter to current policy more broadly interpreted. As discussed above, after the establishment of a property rule, there need be no distortion to private incentives, beyond those desirable from the point of view of ensuring that people recognize their personal responsibilities, from enforcing certain baseline rules over meeting needs.

Thus, it would be more accurate to describe the type of community property rule contemplated here as an "ordering" in which certain needs must be met and thereafter equal division of assets may be presumed unless altered by a prenuptial agreement. It is not expected that the needs part of the ordering can be negotiated.\textsuperscript{17} It helps that the rule is contemplated as operating over the whole pool of assets. It may often be the case that housing needs can be met for the parent with care and that other assets can be distributed to the absent parent so that a clean break is achieved for property while sticking to the terms of a prenuptial agreement.

Even in cases in which assets are insufficient to do more than meet the needs of the parent with care, incentive problems need not arise providing that, at the time of marriage, meeting need was seen as a minimum expectation to which (typically) wives and children would be entitled. Thus, marital expectations would be formed analogously to the restricted contracts that may possibly be justified in areas like lending to the poor [Posner (1995)]. The logic would be along the lines that at the point of marriage it would be understood that the financially stronger party had an obligation to meet the needs of children and of the parent with care. That is a restriction placed by society as a "cost" of entering marriage in the first place and will not be affected by subsequent behavior. The purpose is to prevent large costs being imposed on the children or the taxpayer.

\section*{VIII. Focusing on Equal Shares}

There does seem to be popular support for the idea that modern marriage is like an equal partnership with an attached expectation of equal shares of assets. Weitzman (1985) found that 68\% of women and 54\% of men in her sample of divorcées in Los Angeles County, California, believed that "a woman deserved alimony if she helped her husband get ahead because they are really partners in his work." This was similar to the proportion supporting alimony on the grounds of the need to maintain small children. However, only 9\% of women and 3\% of men interviewed believed in a right to alimony because "her husband promised to support her for the rest of her life."\textsuperscript{18} Davis et al. (1994) note the prevalence of the presumption of an equal split in their discussion of "folk myths" associated with divorce.

Feminist writers on family law also have argued [Singer (1989)] that the typical income and capital disparity between ex-spouses results from a series of joint decisions and should be regarded as joint income and property. In addition, the equal division of

\textsuperscript{17}Technically, the ordering is lexicographical or serial in nature.

\textsuperscript{18}Subsequent work has questioned Weitzman’s methodology, which was always potentially problematic owing to its basis in small samples.
property and income would meet demands for compensation for lost career opportunities, and could allow for "rehabilitating" a divorsee. Carbone and Brinig (1991, p. 1002) describe Singer’s analysis as problematic in using conventional justifications for postdivorce support without identifying the links between them, and in failing to determine initial property rights. Nonetheless, there is some force to such arguments, which were used (but in an expectations-based rather than restitution-based fashion) in the previous section.

It is also possible to cite more philosophical approaches to support the idea of equal shares as a good presumptive rule. Following the contractarian approach of John Rawls (1972), one could ask whether the rule would be selected under a "veil of ignorance" that prevented a group of people from knowing exactly who they would be in a world to which the rule would apply. So, if one did not know whether one would be a financially dependent or dominant divorsee, would one choose equal shares in preference to some other rule like just meeting needs or giving a higher proportion to the dependent one? I think the equal shares rule, as a presumptive and rebuttable rule with the attached requirement that children’s needs must be met, does have salience in such a mental experiment.19

There may be several reasons then why the selection of equal shares could be a good default rule. Although, we should note again that the precise rule is not that important as long as people know in advance what the rule is and can negotiate around it, which is supported by the envisaged role of prenuptial agreements.20 The existence of enforceable prenuptial agreements would mean that the Rawlsian experiment is redundant owing to the clear statements made by people who did have a good idea of where they would stand in the order of things.

**IX. The Scope of a Community-Property Rule**

The question of scope is not relevant if prenuptial agreements are required to define the range of assets over which an agreement is to apply. Broadly, the choice is between including all assets of the parties, which is a system of full community property, with a system covering just the assets acquired during marriage, which is a system of "deferred" community property similar to the one used in Scotland, on the continent, and in several U.S. states.21 If the deferred system is chosen, there can be problems when community pool assets are in any way commingled with premarriage separate assets. Commingling can easily arise in the context of marriage, e.g., when separate assets are mortgaged to buy or service joint assets. This problem is likely to cause incentives for legal argument upon divorce, unless the parties are given strong incentives to agree early on the precise assets that are joint, given the definitions in their prenuptial agreement and the subsequent history of asset management. There may be a case here for encouraging arbitration rather than litigation, perhaps by limiting legal aid for these definitional purposes. A similar point concerning the scope for endless arguments over valuation may be made in relation to human capital, e.g., joint investments in human capital, which logically should be included in the scope of marital property. In the case

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19Interestingly, Rawls’ political philosophy corresponds with an approach in welfare economics in which we use a lexicographical ordering. In his more general case, political freedom comes first and cannot be traded against pecuniary gain.

20Even a firming up of the current discretionary system as proposed by Thorpe (1998) could provide the basis for individual optimization using prenuptial agreements.

21Community of property is essentially deferred until divorce.
of human capital, it might be necessary to operate valuation rules of thumb (along the lines of "spousal support while training gives entitlement to so many years return at such and such percent of the higher income").

Where the equal-shares property rule is to apply by default, a definition of the scope of the rule will be needed. The history of English law would in some ways support the idea of a full community-property system in that all (separately owned) assets of divorcees have been open to redistribution by the court. Also, if the aim is to contain debate and the costs of litigation, a full community-property approach would avoid argument over whether an asset were within or outside of the settlement. However, this is not the approach taken in Scotland, and consistency within the United Kingdom might suggest a partial system with an associated need to define links between community and separate property to avoid undue costly debate.

X. Conclusions

In this article, I have examined the effects on individual incentives, including the incentive to litigate, of removing judicial discretion in favor of a presumptive rule of awarding equal shares of marital assets to divorcees. The presumption could be rebutted by the existence of a prenuptial agreement and might indeed be expected to put parties on notice to state their expectations at an early stage. The presumptive rule would represent a move to community property and would require the scope of marital property to be carefully defined and to include items like human capital and pensions.

The presumption would not so much be rebutted by requirements to meet the needs of children, or even of dependent ex-spouses, as it would be required to work around such socially imposed obligations. There is no necessary conflict between needs-based obligations and a negotiated property rule: People would take the obligations, and the presumptive rule, into account in framing their own prenuptial agreements. This does not mean that the existence of obligations after divorce has no effect: Weaker marriages should be deterred as people become increasingly aware of their obligations.

The presumption of equal shares is a property rule of the kind likely to be successful in solving conflict over property rights in small-numbers bargaining cases. The courts at present try to assign liability when this is not necessary, and it may well be a relatively costly approach. Given the small numbers (two-party bargaining) in a marriage, a clear statement of a default rule should be enough to drive people to tailoring prenuptial agreements to their marital expectations. These agreements would prevent opportunistic divorce, otherwise caused when promises can be avoided and divorce effectively becomes too cheap. They would also provide less incentive to become litigious. Overall, the proposal to move to a community-property rule may be judged to be a good idea from the perspective of the economic analysis of law. Incentive structures would improve compared with judicial discretion.

It does not matter too much exactly what the property rule is, although a presumption of equal shares may well accord with contemporary expectations. The aim should really be to drive people into forming their own agreements. To this end, it could be useful for a range of standard models to be provided (e.g., traditional marriage, partnership marriage, and so forth) from which people could select an appropriate agreement. Such standards might naturally arise in solicitor’s offices. It is more important to define the scope of the rule, in terms of the assets covered, comprehensively.

A final very important conclusion is that the presumptive rule should not be applied retroactively. This means that it should be applied to marriages from a certain date
rather than to divorces. Otherwise, there is a danger that inappropriate marital expectations will be imposed in many cases, which would distort the incentives to divorce.

References


