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AN APPRECIATIVE COMMENT ON COASE'S *THE PROBLEM OF SOCIAL COST*: A VIEW FROM THE LEFT

PIERRE SCHLAG*

Professor Coase's article, *The Problem of Social Cost*, played a significant role in launching the law and economics movement. Coase's insights have been used extensively by the law and economics movement as authority and inspiration for the development of an essentially right-leaning approach to law. In this Article, Professor Schlag undertakes to reexamine the original article. He shows that Coase's deconstructive moves opened up a series of volatile and radical inquiries. He then argues that the law and economics movement, in general, and Judge Posner, in particular, shut down the dangerous radicalism of these inquiries by hypostasizing Coase's insights and formalizing Coase's approach into a set of stereotyped formulae. By appeal to Coase's original insights, Professor Schlag demonstrates that the claims of the right to exclusivity in Coase's approach are unjustified. He concludes by showing that Coase's insights can yield some left-leaning implications for the understanding of law and its relation to economics.

In this Article, the analysis has been confined, as is usual in this part of economics, to comparisons of the value of production, as measured by the market. But it is, of course, desirable that the choice between different social arrangements for the solution of economic problems should be carried out in broader terms than this and that the total effect of these arrangements in all spheres of life should be taken into account. *As Frank H. Knight has so often emphasized, problems of welfare economics must ultimately dissolve into a study of aesthetics and morals.*

Ronald Coase¹

Human beings are not 'individuals' to begin with . . . The values of life are not, in the main, reducible to satisfactions obtained from the consumption of exchangeable goods and services. Such desires as people have for goods and services are not their own in any original sense, but are the product of social influence of innumerable kinds and of every moral grade,

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1. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1, 43 (1960) (emphasis added).

largely manufactured by the competitive system itself. The productive capacities in their own persons and in owned external things which form the ultimate stock in trade of the human being are derived from an uncertain mixture of conscientious effort, inheritance, pure luck and outright force and fraud. He cannot be well or truly informed regarding the markets for the productive power he possesses, and the information which he gets has a way of coming to him after the time when it would be of use. The business organizations which are the directing divinities of the system are but groups of ignorant and frail beings like the individuals with whom they deal. (In the perfectly ideal order of theory the problem of management would be nonexistent!) The system as a whole is dependent upon an outside organization, an authoritarian state, made up also of ignorant and frail human beings, to provide a setting in which it can operate at all. Besides watching over the dependent and non-contracting, the state must define and protect property rights, enforce contract and prevent noncontractual (compulsory) transactions, maintain a circulating medium, and most especially prevent that collusion and monopoly, the antithesis of competition, into which competitive relations constantly tend to gravitate. It is in the field indicated by this summary list of postulates, rather than in that of the mechanics of exchange relations, that we must work the ultimate critique of free enterprise.

Frank H. Knight²

I. INTRODUCTION

To suggest that a perspective from the left has anything appreciative to say about the article which launched the law and economics movement may seem bewildering.³ The left has not been (and is unlikely to be, any time soon) particularly appreciative of the law and economics movement or its program. But that is history. And I want to put history and its ironies aside if only for a moment to consider the insights of Coase's article independently of their deployment by the law and economics movement. (Part II). As will be seen, Coase's creative

2. Knight, *Some Fallacies in the Interpretation of Social Cost*, 38 QUART. J. ECON. 582, 605-06 (1924).

3. Posner, for instance, traces the origin of the law and economics movement back to Coase's, *The Problem of Social Cost*, *supra* note 1 and Calabresi's, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499 (1961). R. POSNER, *ECONOMIC ANALYSIS OF LAW* 19 (3d ed. 1986).

insights opened up a series of volatile inquiries. (Part III). Despite their volatile nature, these insights were internalized by the right-wing law and economics movement. As an examination of Judge Posner's brand of law and economics will show, the right managed to rationalize and formalize the productivity of the Coasian insights. (Part IV). This relatively uncontested and virtually exclusive exploitation of Coase's insights by the right was a normal and predictable development—even though it shows clear signs of intellectual market failure. Indeed, the right eclipsed the more radical thrusts of Coase's article and the left did not appropriate them. (Parts V & VI). In the end, however, the claims of the right to exclusivity in Coase's insights are unjustified and Coase's seminal article (as the quotes above indicate) ultimately refers us to the questions that the left seeks to address. (Part VII).

II. THE COASIAN INSIGHTS

Few articles in the recent past have had more significance for legal thought than *The Problem of Social Cost*.⁴ In that piece, Ronald Coase turned welfare economics on its head by devastating the received wisdom that legal rules should be designed so as to "internalize externalities." Until Coase's piece emerged, it was widely believed (in economically attuned circles) that law should compel an activity which visits undesirable externalities upon another to take those costs into account.⁵ Thus, for instance, a polluting factory should be made to take into account the costs of its smoke (an undesirable externality) upon the candy store next door.⁶ Likewise, a railroad should be made to take into account the costs of crop fires caused by the sparks of its locomo-

4. Coase, *supra* note 1.

5. Even at Chicago, the Pigovian injunction that legal rules should be structured to internalize the externalities was accepted wisdom. Stigler recalls Coase's initial presentation of his views at a faculty seminar.

[I]t contained Aaron [Director], Milton [Friedman], John McGee, Gregg Louis, Reuben Kessel, Al Harberger, Martin Bailey. It was a collection of theorists who were simply superb. At the beginning of the evening we took a vote and there were twenty votes for Pigou and one for Ronald [Coase], and if Ronald had not been allowed to vote, it would have been even more one-sided. The discussion began. . . . At the end of that evening the vote had changed. There were twenty-one votes for Ronald and no votes for Pigou.

Kitch, *The Fire of Truth: A Remembrance of Law and Economics at Chicago, 1932-1970*, 26 J. LAW & ECON. 163, 221 (1983) (comments of George Stigler). Judge Posner, cautions, however, that Pigou had little impact on legal scholarship. R. POSNER, *supra* note 3, at 20.

6. Roughly stated, an externality is a benefit or a cost visited by one party upon another without compensation. The meaning and significance of the term before Coase was elusive. See, e.g., Scitovsky, *Two Concepts of External Economies*, 62 J. POL. ECON. 143 (1954). One typical definition prior to Coase's article was:

External effects exist in consumption whenever the shape or position of a man's indifference curve depends on the consumption of other men. [External effects] are present whenever a firm's production function depends in some way on the amounts of the inputs or outputs of another firm.

tives. The received Pigovian wisdom suggested that smoke is a cost of manufacturing and fires are a cost of railroads; legal rules were thus to be structured to make the offending activities (manufacturing and railroading) bear the full costs of their offenses.⁷ This bit of economic thought, of course, converged with established common law principles which found moral difference between operating a candy store or growing corn on the one hand and polluting the air or starting fires, on the other.⁸

Coase's article shattered this happy coincidence between Pigovian welfare economics and these common law principles.⁹ Coase noted that where it is costless for two parties engaged in conflicting activities to negotiate and enforce an agreement, the parties will always reach the efficient mix of activities regardless of which activity is initially protected by a rule of law.¹⁰ If it is costless to negotiate and enforce an agreement (i.e. if there are no transaction costs) then by definition it is costless for the parties to reassign any initial entitlement bestowed by law. And if there are no transaction costs, then each party, in making rational economic decisions, must consider not only the returns made from engaging in her or his own activity, but the returns that could be made by curtailing the activity in exchange for payment from the other party.¹¹

One simple implication of Coase's insights then is that so long as the various regimes (legal or otherwise) under consideration yield negligible transaction costs, the choice among these regimes is efficiency neu-

Buchanan & Stubblebine, *Externality*, 29 *ECONOMICA* 371 (1962) (citing J. DE V. GRAAF, *THEORETICAL WELFARE ECONOMICS* 18, 43 (1957)).

7. The injunction that legal rules and policy aim at internalizing externalities is attributed to A. C. PIGOU, *THE ECONOMICS OF WELFARE* 172-203 (4th ed. 1932) by Coase. Coase, *supra* note 1, at 28.

8. Coase's suggestions about the relation of common law decisions and economic principles (his own and those of Pigou) are somewhat ambivalent. See *infra* note 15. But see, R. POSNER, *supra* note 3, at 20 (noting that Coase suggested that the English law of nuisance had an implicit economic logic).

9. For a provocative article suggesting that the psychological structure of Coase's insights are incompatible with the psychological commitments of lay persons and the common law, see Gjerdingen, *The Coase Theorem and the Psychology of Common Law Thought*, 56 *S. CAL. L. REV.* 711 (1983).

10. Coase, *supra* note 1, at 6; P. BURROWS & C.G. VELJANOVSKI, *THE ECONOMIC APPROACH TO LAW* 10 (1981).

11. Coase, *supra* note 1, at 2-8. Coase's argument is based on the concept of opportunity cost: the cost of engaging an activity is the price that the production factors would obtain in their next best use. R. POSNER, *supra* note 3, at 6-7.

Of course, there are some limitations on Coase's insights about what would happen in a world without transaction costs. As Coase notes, it is necessary to know what legal regime is in force since without an initial definition of rights, there can be no market transactions to transfer and recombine these rights. And it is likewise clear that changes in legal regimes in a world without transaction costs have wealth distribution effects. See, e.g., Demsetz, *When Does the Rule of Liability Matter?*, 1 *J. LEGAL STUD.* 13, 22 (1972).

tral. As Coase notes, this sort of scenario is extremely unrealistic.¹² And, as will be seen later, Coase's own arguments suggest good reasons for thinking it is unrealistic.¹³

The bite of Coase's article, however, pertains to those choice situations where the possible regimes (legal and otherwise) do entail significant transaction costs. These costs include information costs, negotiation costs, policing and enforcement costs, various third party effects such as the free rider and the holdout phenomena.¹⁴ When transaction costs are significant, the choice among alternate legal regimes can have efficiency effects. The reason is simple: when transaction costs are high and the parties encounter difficulty altering the allocation of entitlements imposed by law, that allocation may well remain the final one. Transaction costs may well be so significant, that it is impossible for the parties to circumvent the initial allocation imposed by law.

Coase's insights are the intellectual offspring of two powerful deconstructive moves. One such move is a frontal attack on the common law's traditional conception of causation. The common law in its definition of contract, tort and property traditionally advances the notion that whenever alternative resource uses conflict, one activity has caused, and is thus responsible for the ensuing harm.¹⁵ By describing

12. Coase, *supra* note 1, at 15. And moreover, as Coase noted later, [W]hile considerations of what would happen in a world of zero transaction costs can give us valuable insights, these insights are, in my view, without value except as steps on the way to the analysis of the real world of positive transaction costs. We do not do well to devote ourselves to a detailed study of the world of zero transaction costs, like augurs divining the future by the minute inspection of the entrails of a goose.

Coase, *The Coase Theorem and the Empty Core: A Comment*, 24 J. LAW & ECON. 183, 187 (1981).

13. See *infra*, note 36.

14. Given the singular importance of the concept of transaction costs in the legal literature, the original version is surely worth another glance:

In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on. These operations are often extremely costly, sufficiently costly at any rate to prevent many transactions that would be carried out in a world in which the pricing system worked without cost.

Coase, *supra* note 1, at 15.

15. See H.L.A. HART & I. HONORE, CAUSATION IN THE LAW 62-68 (2d ed. 1985) (discussing the importance of and the connection between causation and responsibility in law); *id.* at 84-86 (summarizing the role of causation in contract, tort and criminal law and noting that causation questions are an element in the determination of responsibility).

I think there is probably room for disagreement about the extent to which the common law, prior to the advent of the law and economics movement, relied on this traditional conception of causation as opposed to a vision which more closely approximates Coase's insight into the reciprocal nature of harm. Coase, himself, was somewhat ambivalent about the extent to which the common law tracked his insights:

The reasoning employed by the courts in determining legal rights will often seem strange to an economist because many of the factors on which the decision turns are, to an

affirmative causes of action and defenses, the common law establishes standards and burdens by which the trier of fact can decide which of two conflicting uses caused the harm and thus ought to bear the loss in those economically unrewarding encounters.¹⁶ Coase liberates us from these legal commitments by reminding us of the reciprocal nature of conflicting resource use: the railroad no more caused the fire than did the farmer who decided to grow corn next to the railroad tracks. Likewise, the factory no more caused damage to the candy store than did the confectioner who continued operations when the factory moved next door. Coase thus reminds us that the innate order of things is rather mute when it comes to answering the question of who caused what.¹⁷ According to Coase, then the problem for law is not to decide who caused what, but to determine who shall be responsible for minimizing the costs associated with unfortunate encounters.¹⁸

Coase's insight into the reciprocal nature of harm runs contrary to the quaint (though deeply mistaken) notion that common law principles are or can be drawn from the natural order of things.¹⁹ Few ten-

economist, irrelevant. Because of this, situations which are, from an economic point of view, identical will be treated quite differently by the courts.

Coase, *supra* note 1, at 15.

A thorough examination of the presuppositions of the courts in trying such cases would be of great interest but I have not been able to attempt it. Nevertheless it is clear from a cursory study that the courts have often recognized the economic implications of their decisions and are aware (as many economists are not) of the reciprocal nature of the problem. Furthermore, from time to time, they take these economic implications into account, along with other factors, in arriving at their decisions.

Id. at 19.

In a world in which there are costs of rearranging the rights established by the legal system, the courts, in cases relating to nuisance, are, in effect, making a decision on the economic problem and determining how resources are to be employed. It was argued that the courts are conscious of this and that they often make, although not always in a very explicit fashion, a comparison between what would be gained and what lost by preventing actions which have harmful effect.

Id. at 27-28. One thing is clear: Coase thought that at least some of the time, the common law did rely (erroneously) on concepts of linear causation ("Who caused the nuisance?") to decide liability. *Id.* at 13.

16. Property law tends to discharge this function by establishing a status hierarchy of entitlements and notions of who complied with the necessary formalities to perfect the entitlement first. Tort law generally implements conceptions of fault and blameworthiness to define the standards for attributing harm. Contract law relies essentially on the private legislation of the parties to furnish the context for attributing harm to one activity or the other.

17. Coase's attack on the traditional conception of causation is reminiscent of Felix Cohen's earlier attack upon the circular reifications of legal formalism. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809, 820 (1935). For a provocative discussion of the contemporary significance of Cohen's article, see Peller, *The Metaphysics of American Law*, 73 CALIF. L. REV. 1151 (1985).

18. Coase, *supra* note 1, at 14-15.

19. See Cohen, *supra* note 17, at 809-12 (discussing the inadequacy of deciding the jurisdictional power of a court over corporations by asking such questions as "Where is a corporation?" "Was this corporation really in Pennsylvania or in New York, or could it be in two places at

dencies in the common law have been more pernicious than this one. The common sense intuitions of the common law about which types of activities cause harm are at best a crude reflection of political, economic or moral judgments. Not only are these intuitions parasitic and derivative, but they are also impervious to intellectual exploration. If in unfortunate encounters, both conflicting activities cause the harm, as Coase maintains, then it is pointless and nonsensical to ask which one really and truly caused the harm. Instead, we should ask a question we are capable of answering: which activity should be responsible for avoiding the costs associated with unfortunate encounters. This is a very different question—for it can be answered in political, moral or economic terms. For Coase, the mission of law is not to defer value choices to some mystical vision of the natural order of things, but to decide what this order should be in light of what we can make of it.²⁰ The common sense of the common law, by contrast, owes its parentage to metaphysics or nonsense.²¹

Coase's second important deconstructive move is a contribution to the dialectical view of law.²² In contrast to much common law thinking, Coase insisted that proposed solutions to a conflicting use problem should be evaluated by examining how the solutions would affect the conflicting uses in their totality.²³ The failure to examine *all* these effects was a mistake prevalent not only in the common law but in the Pigovian prescriptions that decisionmakers should internalize the unde-

once?"). Felix Cohen described this propensity of courts to answer normative legal questions by reference to the natural order as a conceptual reification: the treatment of legal concepts as if they were empirical entities.

20. As Coase suggests,

A better approach would seem to be to start our analysis with a situation approximating that which actually exists, to examine the effects of a proposed policy change and to attempt to decide whether the new situation would be, in total, better or worse than the original one. In this way, conclusions for policy would have some relevance to the actual situation.

Coase, *supra* note 1, at 43.

21. Coase concludes one of his discussions of the English common law treatment of conflicting resource use with the observation that many of the factors employed in legal reasoning to determine legal rights are irrelevant from an economic point of view. Coase, *supra* note 1, at 15.

22. A useful starting point for an introduction to the dialectical thought is S. WARREN, *THE EMERGENCE OF DIALECTICAL THEORY* (1984)—particularly at 182-98, which contains a sketch of dialectical thought. For examples of dialectical approaches to law, see Cornell, *Toward a Modern/Postmodern Reconstruction of Ethics*, 133 U. PA. L. REV. 291 (1985); Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976); Schlag, *Rules and Standards*, 33 UCLA L. REV. 379 (1985).

23. Coase, *supra* note 1, at 44. By contrast, "[t]he classical theories of private and criminal law support the view that courts should focus exclusively on the merits of the case before them." Fletcher, *Paradoxes in Legal Thought*, 85 COLUM. L. REV. 1263, 1292 (1985). See *infra* notes 120-21 and accompanying text for a discussion of the limited perspective of the analytical reasoning process used in common law decisionmaking.

sirable externalities of the offending activity.²⁴ Not only did Coase recognize (with rather devastating effect) that both conflicting activities are implicated in the production of undesirable externalities, but he also recognized that where transaction costs are significant (and cannot be eliminated) any attempt to reduce the undesirable externalities of one activity will likely increase the production of undesirable externalities by the other.²⁵

By drawing attention to this feedback loop, Coase advanced a dialectical vision of the relation between a legal problem and its solution.²⁶ Suppose that a railroad operates its trains without regard for the fire risk posed by the locomotive sparks to the corn fields. Suppose also that the railroad and the farmers cannot negotiate an agreement to deal with this problem. If the railroad is not liable, it has no incentive to prevent such fires and the fires will continue. The Pigovian solution is to "internalize the externalities" by imposing liability on the railroad.²⁷ Pigou promised that efficiency would be achieved if the railroad is made to bear "the full cost of its activity." Coase exposed the deception in this promise by showing that liability may result in an underproduction of railway service and a sort of "moral hazard" problem on the part of farmers who will plant dangerously close to those rail tracks.²⁸ Because the transaction costs are significant, the railroad liability regime may well not be the optimal one: to decide whether it is, Coase notes that we must look at the effect that the change in legal regime will have on the rate of production of both activities. We cannot blindly assume that the change in legal regime will affect only the rate of production of the externality.²⁹

The feedback loop demonstrates that in deciding upon a legal rule, we cannot assume that the only thing we are changing is the matter that is subject to the rule. In our example, a rule imposing liability on railroads for crop fires affects the rate of railway service and crop production. The rate of railway service and crop production in turn affects the frequency (and perhaps severity) of crop fires. Thus, Coase recognized that adoption of a solution would have a wide scale effect, not only on the matters encompassed by the solution, but also on the background

24. Coase, *supra* note 1, at 34.

25. Coase, *supra* note 1, at 32-34. A similar insight had been voiced before by Frank Knight: "The portion of the productive process carried on in a particular [technical production] unit is an accidental consideration. External economies in one business unit are internal economies in some other, within the industry." Knight, *supra* note 2, at 597. As Coase himself has noted, Frank Knight was an important influence on his work. Kitch, *supra* note 5, at 213.

26. See *supra* note 22.

27. A.C. PIGOU, *supra* note 7, at 183-92.

28. Coase, *supra* note 1, at 32-33.

29. *Id.* at 32-34.

conditions which allowed the problem to arise (and to be stated) in the first place.³⁰

III. THE ECONOMIC IMPLICATIONS OF THE COASIAN INSIGHTS

Coase's devastation of Pigovian welfare economics, his view of the reciprocal nature of unfortunate encounters, and his description of the feedback loop, lead to a number of important ideas for legal decision-making and rulemaking.³¹ In fairness to Coase, I must note that *The Problem of Social Cost* did not crystallize his insights into prescriptive criteria for the construction of legal rules.³² Still, I think that Coase's article might be stretched (in increasing order of stretch) to suggest the following:

1. Where the various legal rules under consideration will not produce significant transaction costs, the choice will not have implications for the allocation of resources and/or efficiency.³³
2. Where at least one of the legal rules under consideration, including the present state of affairs, would yield significant transaction costs, the choice will have resource allocation and/or efficiency implications.

30. Later, the same sort of dialectical insight would be stated by Leff in a universal (and more nihilistic) form: "If a state of affairs is the product of n variables, and you have knowledge of or control over less than n variables, if you think you know what's going to happen when you vary 'your' variables, you're a booby." Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV. 451, 476 (1974).

31. Although caution is required: Coase was an economist and was most interested in the relation of law to economics for its implications upon the latter, not the former. Kitch, *supra* note 5, at 192-93. Coase has said, "I do think some knowledge of legal institutions is essential for economists working in certain areas, but it's what it does to economists that interests me, not what it does to lawyers." *Id.* at 193.

32. In terms of positive prescriptions, Coase seems to have limited his statements to the most general advice about how to conceptualize and resolve problems. See *supra* note 20 and *infra* note 160.

33. This is as close as Coase's article comes to stating his theorem:

It is necessary to know whether the damaging business is liable or not for damage caused since without the establishment of this initial delimitation of rights there can be no market transactions to transfer and recombine them. But the ultimate result (which maximizes the value of production) is independent of the legal position if the pricing system is assumed to work without cost.

Coase, *supra* note 1, at 8. The economic interpreters of this statement can be divided into two main camps. There are those who claim that in a world of zero transaction costs, the choice of legal regime does not affect the mix of goods produced. And there are those who, in addition, claim that in such a world, the choice of legal regime does not affect efficiency. C.G. VELJANOVSKI, *THE NEW LAW AND ECONOMICS* 49 (1982). For a more elaborate survey of the various interpretations accorded by economists to Coase's insights, see Veljanovski, *The Coase Theorem and the Economic Theory of Markets and Law*, 35 KYKLOS 53 (1982).

3. Where the various options in designing legal rules will necessarily result in significant transaction costs, legal rules should be structured so as to:
 - a. redefine initial entitlements to minimize the loss associated with the transaction costs and/or³⁴
 - b. approximate the sort of welfare enhancing agreements that would be reached in the absence of transaction costs.³⁵

I have some doubts that the third proposition is fairly attributable to Coase's article—but let us assume, *arguendo* that it is.³⁶ As a whole these propositions suggest lines of inquiry across a wide array of mat-

34. This imperative as well as the next one are sometimes attributed to Coase. There is some support for this view where Coase, states, "Even when it is possible to change the legal delimitation of rights through market transactions, it is obviously desirable to reduce the need for such transactions and thus reduce the employment of resources in carrying them out." Coase, *supra* note 1, at 19. *But see infra* note 36. On the derivation of similar approaches from Coase's article see *infra* notes 55-56 and accompanying text.

35. See *supra* note 34. This approach has been popularized by Judge Posner under the name of "hypothetical market". R. POSNER, *THE ECONOMICS OF JUSTICE* 61-65 (1981). In turn, Posner's notion of "hypothetical markets" is derived from the concept of Kaldor-Hicks efficiency. R. POSNER, *supra* note 3, at 12-15. A reallocation of resources is Kaldor-Hicks efficient if the winners receive an increase in value sufficiently large so that they could fully compensate the losers. Coleman, *Efficiency, Exchange, and Auction: Philosophic Aspects of the Economic Approach to Law*, 68 CALIF. L. REV. 221, 239-42 (1980). See Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 ECON. J. 549 (1939); Hicks, *The Foundations of Welfare Economics*, 49 ECON. J. 696 (1939).

Again, there are some doubts about whether the proposition in the text can be fairly attributed to Coase's article. Indeed, it is hardly clear that the article provides such definitive prescriptions. See *infra* note 36. With regard to transaction cost problems, Coase does say that "What has to be decided is whether the gain from preventing the harm is greater than the loss which would be suffered elsewhere as a result of stopping the action which produces the harm." Coase, *supra* note 1, at 27.

36. I will argue later that with regard to determinate prescriptions for legal rules, Coase's article says less than many of his right-wing interpreters' claim. See text accompanying *infra* notes 52-96. In my view, however, a better interpretation of Coase's article is that in the presence of significant transaction costs, there are several options: the market, the firm, and government regulation.

All solutions have costs and there is no reason to suppose that government regulation is called for simply because the problem is not well handled by the market or the firm. . . .

But equally there is no reason why, on occasion, such governmental administrative regulation should not lead to an improvement in economic efficiency. . . .

It is my belief that economists, and policy-makers generally, have tended to over-estimate the advantages which come from governmental regulation. But this belief, even if justified, does not do more than suggest that government regulation should be curtailed. It does not tell us where the boundary line should be drawn. This, it seems to me, has to come from a detailed investigation of the actual results of handling the problem in different ways. But it would be unfortunate if this investigation were undertaken with the aid of a faulty economic analysis. The aim of this article is to indicate what the economic approach to the problem should be.

Coase, *supra* note 1, at 18-19. *But see supra* note 34.

ters relevant to the rule of law. To be sure, some of Coase's core concepts and their interrelations bear a great deal of conceptual responsibility. And his article does not promise that they will be able to discharge their theoretical obligations. But that is virtue, not vice — as will be seen.

One theoretical difficulty relates to the definition of transaction costs. Coase's article presents examples of transaction costs, but leaves the concept undefined and unlimited.³⁷ (Most of the popular law and economics writers have left the concept in the same shape since.)³⁸ The absence of a definition or a limit for the concept is, of course, no small problem: indeed, that absence makes it difficult to decide whether some cost is an inherent cost of production which the law should (perhaps) refrain from subsidizing or whether it is instead a "legitimate" transaction cost and thus eligible for Coasian legal aid.³⁹

Rather vexingly, this problem of delimiting transaction costs turns out to be the displaced replication of the problem that Coase sought to avoid with his reciprocal vision of harm. In the Pigovian world, we were told to internalize externalities. This imperative raised a terrible problem in deciding "what is a cost of what?" Enter Coase—who disposes of this problem with his reciprocal notion of harm and who intimates that the question, "what is a cost of what?" is sheer nonsense. But now, Coase requires us to answer a suspiciously similar question: is a cost an ("intrinsic") cost of production or is it some ("external") transaction cost? Or to phrase the question in more general terms, is a cost attributable to the system of coordination for production, or is it attributable to the production which occurs within that system of coordination? Under either formulation, the question bears an uncanny resemblance

37. See *supra* note 14 for Coase's illustration of the concept of transaction costs.

38. See, e.g., A. M. POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 12 (1983) ("In general, transaction costs include the costs of identifying the parties with whom one has to bargain, the cost of getting together with them, the costs of the bargaining process itself, and the costs of enforcing any bargain reached."). As actually used by the courts and commentators, the term "transaction costs" seems to include any friction which precludes the attainment of efficiency. C.G. VELJANOVSKI, THE NEW LAW AND ECONOMICS *supra* note 33, at 52-53. As Veljanovski notes this definition is tautological. Veljanovski, *The Coase Theorems and the Economic Theory of Markets*, *supra* note 33, at 57. For a discussion of the difficulties attending the delimitation of the concept of transaction costs, see *id.* at 57-67.

39. This is no small problem. Consider, for instance, information acquisition. In part, obstructions in information acquisition can be considered a transaction cost precluding efficient transfers. The implication might be that we should develop legal rules to reduce information acquisition costs. But information acquisition is also supplied by a market. There are firms and entire industries which devote substantial resources to the production and acquisition of information. One implication of this observation might be that information production and acquisition is just another factor of production and elimination of these costs by legal rules would supplant market determined efficiencies in information production and acquisition. See Barzel, *Transaction Costs: Are They Just Costs?*, 141 ZEITSCHRIFT FÜR DIE GESAMTE STAATSWISSENSCHAFT 4, 13-14 (1985); Veljanovski, *The Coase Theorem and the Economic Theory of Markets*, *supra* note 33, at 63-69.

to the impossible question Pigou forced us to ask and Coase sought to avoid: "what is a cost of what?"

Of course, Coase's notion of reciprocity can be invoked to resolve this problem: whether some cost is a cost of production or instead a cost of the system of coordination within which production occurs is the wrong question. The problem is a reciprocal one. The real question is whether we should retain the system of coordination and leave production within this system to respond to the cost or whether we should alter production by restructuring the system of coordination.⁴⁰ The problem is to avoid the more serious harm.⁴¹ Framed this way, of course, the problem has radical dimensions.⁴²

Another problem with Coase's brave new world arises when we decide that transaction costs are significant. In such circumstances the basic options are to redefine the initial legal entitlements in a way which minimizes transaction costs or to take the opposite approach and attempt to replicate by law the sort of agreement we think would have occurred in the absence of transaction costs. This problem has significant implications because the two approaches lead to opposite extremes.⁴³ The redefinition of initial entitlements is aimed at lowering

40. Or phrased differently: the real question that has to be decided is whether we should treat it as a cost of production or as a cost of the system of coordination.

41. This is, of course, an extended paraphrase of the original Coasian notion of the reciprocity of harm:

The traditional approach has tended to obscure the nature of the choice that has to be made. The question is commonly thought of as one in which A inflicts harm on B and what has to be decided is: how should we restrain A? But this is wrong. We are dealing with a problem of a reciprocal nature. To avoid the harm to B would inflict harm on A.

The real question that has to be decided is: should A be allowed to harm B or should B be allowed to harm A? The problem is to avoid the more serious harm.

Coase, *supra* note 1, at 2.

42. See *infra* notes 124-60 and accompanying text.

43. It is interesting to compare, for instance, Posner's recommendations when transaction costs are low with his recommendations when such costs are high. "Absolute rights play an important role in the economic theory of the law. The economist recommends the creation of such rights—to ideas, land or labor, for example—when the costs of voluntary transactions are low, But when transaction costs are prohibitive, the recognition of absolute rights is inefficient." R. POSNER, *THE ECONOMICS OF JUSTICE* 70 (1981). Instead, where transaction costs are prohibitive, Posner believes "that in many cases a court can make a reasonably accurate guess as to the allocation of resources that would maximize wealth." *Id.* at 62. See also R. POSNER, *supra* note 3, at 14.

So in essence, Posner offers two radically different approaches. Where transactions costs are low, absolute rights granted to the highest valued user are appropriate. Where transaction costs are high, the court should replicate the market transaction that would have occurred absent transaction costs. The two regimes are obviously not fungible and hardly allow for any easily discernible middle ground. The identification of transaction costs as high or low thus becomes critical in the choice of regime. In turn, the definition of the market (that which is or would be traded) becomes critical to the assessment of whether transaction costs are high or low. The very difficulty in making these determinations perhaps explains why Coase referred welfare economics "to a study of aesthetics and morals." See Coase, *supra* note 1.

To complicate matters, it is even more difficult to decide upon a legal regime if the transaction costs are neither low nor high, but sort of "middle": almost prohibitive but not quite. In those

transactions costs and permitting bargains. The other approach, by contrast, replicates rather than facilitates market transactions and accordingly raises transaction costs significantly. Rather vexingly, there may be no happy medium combining the two approaches in a manner that enhances welfare. On the contrary, in most problems that come before the courts, the welfare enhancing solutions are likely to be found at the extremes—not in some cheerful middle.

Choosing which of the two extreme approaches to follow in any given case is difficult. A sensible choice would require some understanding of the relation between private and social values and the extent to which we can make collective judgments about the latter without too much evidence of the former.⁴⁴ If social value is nothing more than the aggregate of private market valuations, then perhaps it is sound to prefer the minimization of transaction costs over court-imposed bargains.⁴⁵ But if social value is not simply the aggregate of private market valuations, the answer is quite unclear: where the aggregate of private market valuations and social value diverge, the realization of the latter might well require supplanting the market. The reason for resisting the hypothesis that private market valuations are exhaustive of social value is that the operation of the market itself can be seen as skewing private market valuations by producing false needs and brutalized human beings.⁴⁶ The relation of private value to social value is obviously a very difficult question. What must be noted is that the answer given is itself a matter of social value.⁴⁷

situations, it is extremely difficult to decide which of the two incompatible approaches to follow. An interesting, problem would arise if it turned out that the controversial, interesting or important questions in law were most often framed in a context attended by "middle" transaction costs.

44. As Posner himself notes, in order to say that even voluntary market transfers are efficient, it is necessary "that everyone affected by the transaction be a party to it, and this requirement is almost never satisfied." R. POSNER, *supra* note 3, at 13. The question of how private valuations may be evidenced for purposes of making efficiency judgments is far from clear. *Id.* at 11-15.

45. And Posner clearly favors this approach: "Since, however, the determination of value made by a court is less accurate than that made by a market, the hypothetical-market approach should be reserved for cases, such as the typical accident case, where market-transaction costs preclude use of an actual market to allocate resources efficiently." R. POSNER, *THE ECONOMICS OF JUSTICE*, *supra* note 43, at 62.

46. See *supra* text accompanying note 2. See *infra* notes 125-32 and accompanying text. Generally, however, microeconomists assume that individual preferences are stable. As Becker states, "Since economists generally have had little to contribute, especially in recent times, to the understanding of how preferences are formed, preferences are assumed not to change substantially over time, nor to be very different between wealthy and poor persons, or even between persons in different societies and cultures." G. BECKER, *THE ECONOMIC APPROACH TO HUMAN BEHAVIOR* 5 (1976).

47. To anticipate the conclusion of this Article, I think that the question of how private and social value are related ought to be treated in Coasian terms: the problem is of a reciprocal nature, implicates a feedback loop and ought to be assessed from the perspective of the totality. See *infra* notes 125-60 and accompanying text.

The specter of a divergence between the aggregate of private market valuations and social value, of course, raises problems even when transaction costs are minimal. If there is a divergence, then it may well be welfare enhancing for the courts to intervene and create all sorts of transaction costs that will effectively prevent "voluntary exchanges." For his part, Coase did not speak of social value or private value. Indeed, he resisted making statements about social cost and its relation to private costs.⁴⁸

It is a singular virtue of Coase's article that it makes no attempt to definitively resolve these problems. Instead, Coase maintained a healthy distance from and skepticism about the application of his insights. This distance and this skepticism give the article its intellectual power. As will be seen later, the lessons Coase has to impart are not merely relevant to microeconomic theory as traditionally understood. They have something to offer in the way of a general methodology for explaining and understanding the development of law.⁴⁹ And the Coasian insights have something to offer to "non-economic" moral and aesthetic approaches to law as well. But then again, Coase told as much: "As Frank Knight has so often emphasized, problems of welfare economics must ultimately dissolve into a study of aesthetics and morals."⁵⁰

Economists are fond of saying that the economic approach has something to say about all values and all spheres of life.⁵¹ In Part VI, I plan to take them at their word. I think that Coase's approach has much to say about the moral and aesthetic aspects of law. And it has something to say about its own status as the near-exclusive property of the right.

48. For his part, Coase stayed away from the concept of social cost, except of course, in the title of his article. "In fact, I would say that the title of my paper came from Frank Knight and the title of the paper was rather to indicate the topic I was talking about, because, of course, I don't think the concept of social cost is a very useful one and I don't ever refer to it." Comments of Ronald Coase in Kitch, *supra* note 5, at 215. See *supra* notes 12, 20. See *infra* note 160.

49. See *infra* notes 119-25 and accompanying text.

50. Coase, *supra* note 1, at 43. See *supra* text accompanying notes 125-60.

51.

Indeed, I have come to the position that the economic approach is a comprehensive one that is applicable to all human behavior, be it behavior involving money prices or imputed shadow prices, repeated or infrequent decisions, large or minor decisions, emotional or mechanical ends, rich or poor persons, men or women, adults or children, brilliant or stupid persons, patients or therapists, businessmen or politicians, teachers or students. The applications of the economic approach so conceived are as extensive as the scope of economics in the definition given earlier that emphasizes scarce means and competing ends.

G. BECKER, *supra* note 46, at 8. But note that economists typically assume the stability of individual preferences. See *supra* note 46.

IV. THE RIGHT-WING APPROPRIATION OF COASE’S INSIGHTS

My attempts to set forth what Coase said (and refrained from saying) in *The Problem of Social Cost* are very much an essay in intellectual retrieval—for Coase’s insights have become canonized in what is popularly known as “the Coase Theorem”. The popularization of Coase’s thought in legal circles was accomplished primarily by right-wing law and economics scholars—who were probably more subservient to the demands of legal decisionmaking than to the integrity of economic thought. The result was a neoclassical and normative gloss on the Coasian insights.⁵² As a rule, lawyers like their theory to be serviceable, to be clear and to be consistent. The right-wing law and economics scholars obliged, but in translating Coase into some instrumentally serviceable rules of thumb, they used an ideological razor:

HOW THE
COASIAN INSIGHTS

BECAME
RIGHT-WING FOLKLORE

1. Where the various legal rules under consideration will not produce significant transaction costs, the choice will not have implications for the allocation of resources and/or efficiency.

Courts should not interfere with or disaffirm market transactions.⁵³

2. Where at least one of the legal rules under consideration, including present state of affairs, would

Where the situation is one where transaction costs are high, the choice of legal regime will have ef-

52.

Although, as I have pointed out elsewhere, transaction cost analysis is not in itself neoclassical microeconomic analysis, it is nevertheless so closely associated with such analysis—and is so essential to endow microeconomic analysis with some degree of both sense and reality—that the two often go hand in hand. . . . Thus, it is appropriate to include the transaction cost school under the heading of neoclassical microeconomics.

Macneil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L. REV. 483, 495-96. *But see* Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1201 (1984) (suggesting that neoclassical economics, which views the firm as a production function, treats non-standard forms of organization as having monopoly purposes or effects, while transaction cost economics views firms, markets and hybrids as alternative governance structures).

53.

[T]here is the evidentiary point that willingness to pay can be determined with great confidence only by actually observing a voluntary transaction. Where resources are shifted pursuant to a voluntary transaction, we can be reasonably sure that the shift involves an increase in efficiency. The transaction would not have occurred if both parties had not expected it to make them better off. This implies that the resources transferred are more valuable in their new owner’s hands.

R. POSNER, *supra* note 3, at 13.

yield significant transaction costs, the choice will have resource allocation and/or efficiency implications.

efficiency implications.⁵⁴

3. Where the reallocation of entitlements through the market entails significant transaction costs there are a number of possible responses. . .

Where the situation is one where transaction costs are high. . .

- the firm
- government intervention
- doing nothing at all

- the optimal solution is to (re)assign the legal entitlement so as to minimize transaction costs⁵⁵ and/or
- approximate the bargains that would have been made on a free market by the maximum sum of dollar-choices if there had been no transaction costs.⁵⁶

54. "When transaction costs are high, legal rules produce efficient results only if they prescribe the result the parties would have arrived at had they been able to reach a bargain." Easterbrook, *Foreword: The Court and the Economic System*, 98 HARV. L. REV. 4, 14 n.13 (1984).

55.

What converts a harmful or beneficial effect into an externality is that the cost of bringing the effect to bear on the decisions of one or more of the interacting persons is too high to make it worthwhile, and this is what the term shall mean here. . . . One condition is necessary to make costs and benefits externalities. The cost of a transaction in the rights between the parties [internalization] must exceed the gains from internalization.

Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV., Papers & Proc. 347, 356-57 (1967) (Demsetz argues that various property regimes develop in ways that aim at internalizing externalities).

The normative basis for deciding whether to adopt or retain any particular regulatory program depends on whether the program increases social welfare by lowering transaction costs or by replicating the effects of market exchanges that might occur only if transaction costs were lower.

Diver, *Regulating the Regulators* (Book Review), 132 U. PA. L. REV. 1243, 1249-50 (1984).

56. "The right inquiry is always what the parties would have contracted for had transaction costs been zero." Easterbrook & Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 298 (1986).

The need for much of tort law arises from the existence of transactions costs. Often such costs are so high that no real [that is, negotiated] contract is possible at all, and yet individuals, if they could overcome these barriers, would make mutually advantageous bargains. Here the state comes to the aid of these individuals. It writes into law the terms they would have agreed to if they could have bargained.

Bishop, *The Contract-Tort Boundary and the Economics of Insurance*, 12 J. LEGAL STUD. 241 (1983) (citing Coase, *supra* note 1).

The right-wing lawyer-economists, in their attempts to make the Coasian insights serviceable for lawyers and judges eclipsed the original and creative ambiguity which these insights had originally possessed.

One significant alteration was the transformation of Coase's descriptive theory into a serviceable prescriptive (and in some cases, explicitly normative) model for legal decisionmaking. On the intellectual plane, this remains a stunning transformation—for Coase's article, as George Priest notes, is rather nihilistic.⁵⁷ Indeed, Coase's article suggests that economic thought has precious little to contribute in the way of prescriptions for law. Instead, Coase offers us a way of thinking about legal rules and offers some insights about the alternative types of coordinating arrangements that can be used: the firm, the market and the government. But that's it: Coase did not dispense legal prescriptions.

Closely related to the "normative" reading given the Coase article is the right-wingers' conflation of social and private value. For the right-wing lawyer-economists, social value is nothing but the sum of private valuations actually registered on a market or the sum of private valuations they think would be registered on a market but for the presence of transaction costs.⁵⁸ This abbreviation of Coase's insights is an immensely useful move for the lawyer-economists because it permits prescription of legal rules based upon an assessment of what sorts of market transactions would likely occur absent transaction costs.⁵⁹ In turn, this sort of assessment can be given some plausibility by examining who has money to spend and what they would likely spend it on. It takes no stretch of the imagination to recognize that it is primarily those who have dollar votes (wealth) and visible market preferences (clear taste preferences) who are likely to benefit most from this clever reformulation.

A second move made by the right-wingers is to hypostatize Coase's analysis by ascribing the presence of transaction costs to "situations"

"When [transaction] costs are high, the legal system should select the rule closest to this joint-maximization outcome." Easterbrook & Fischel, *Optimal Damages in Securities Cases*, 52 U. CHI. L. REV. 611, 623, n. 18 (1985) (citing Coase, *supra* note 1).

57. Priest, *Gossiping About Ideas*, 93 YALE L. J. 1625, 1635 (1984) (reviewing B. ACKERMAN, *RECONSTRUCTING AMERICAN LAW* (1985)).

58. See, e.g., R. POSNER, *supra* note 3, at 11-15 (adopting registered market transactions and the Kaldor-Hicks test as the measure of efficiency).

59. It is an abbreviation of Coase's insights in that it reifies the concept of market. Coase gives no indication in his article that it is possible for an actual market to function costlessly. On the contrary, Coase advocated a comparative assessment of the costs entailed by firms, the market and the government as alternative coordinating mechanisms. Coase, *supra* note 1, at 18. See *supra* note 36. The notion of a market without transaction costs is for Coase a heuristic tool, not a representation of actual pricing markets. See *supra* note 12. There is simply no reason to assume that there are no transaction costs associated with price markets. See *infra* note 132 and text accompanying notes 125-32.

rather than to the dynamic relation of consumer preferences, legal rules and other coordination mechanisms.⁶⁰ Coase, by contrast, was careful to note that transaction costs do not inhere in “situations”, but rather are related to legal rules and regimes.⁶¹ Thus, if agreements between the railroads and farmers are precluded by high transaction costs, that is not simply a function of the geographic proximity of farms next to railroad tracks, but a function of the legal entitlements held by farmers and railroads as well.⁶² The distinction is important because it is possible to conceive of legal regimes where the transaction costs between farmers and railroads would be trivial. (If the farmers were organized in a cooperative, rather than in individual firms, for instance, the transaction costs might be insignificant.) The right-wing elision, however, serves to excise the radicalism of Coase’s approach: we are told that some situations present transaction cost problems and we are thus invited to forget that these transaction cost problems are traceable to the broad scale legal entitlements that we created in the first place. But it is not Coase who invited us to forget this.

Still, even if the right-wing lawyer-economists eclipsed the subtlety and ambivalence of Coase’s insights, their product hardly warrants a perfunctory dismissal. The right-wing, after all, played a significant role in popularizing the Coasian insights. And among the right-wing lawyer-economists, none has played a more visible or influential part than Judge Posner. Posner’s book, *The Economic Analysis of Law*, for in-

60. See text accompanying *infra* notes 65-89.

61. Thus, Coase took Pigou to task for distinguishing between the natural tendencies of the market and state action and his recommendation that the latter be used to improve upon the former. Coase, *supra* note 1, at 28-31. Coase, of course, realized that transaction costs are associated with of the entitlements (legal or otherwise) held by economic actors. In his conclusion, he states:

A final reason for the failure to develop a theory adequate to handle the problem of harmful effects stems from a faulty concept of a factor of production. This is usually thought of as a physical entity which the businessman acquires and uses [an acre of land, a ton of fertiliser] instead of as a right to perform certain [physical] actions. We may speak of a person owning land and using it as a factor of production but what the land-owner in fact possesses is the right to carry out a circumscribed list of actions. The rights of a land-owner are not unlimited. . . . For example, some people may have the right to cross the land. Furthermore, it may or may not be possible to erect certain types of buildings or to grow certain crops or to use particular drainage systems on the land. This does not come about simply because of Government regulation. It would be true under the common law. In fact it would be true under any system of law. . . . But in choosing between social arrangements within the context of which individual decisions are made. . . . we have to take into account the costs involved in operating the various social arrangements (whether it be the working of a market or of a government department). . . .

Coase, *supra* note 1, at 44.

62. Most likely the transaction costs arise because the farmers adjoining the railway own their own individual plot of land and are thus exceedingly costly to bargain with. Aside from the costs of making numerous individual contracts, there are serious free rider problems (if the railway is not liable) and holdout problems (if the railway is liable).

stance, is a masterful application of the Coase Theorem across the mid-west of the law.⁶³ Over and over again, the Coasian insights are used to:⁶⁴

rationalize an admonition that the government desist from supplanting pricing markets and that courts cease from disaffirming bargained-for terms among private parties.⁶⁵

rationalize the law's distribution and delimitation of initial entitlements on the grounds that they are given to the highest valued user.⁶⁶

63. R. POSNER, *supra* note 3.

64. Not wishing to taxonomize the whole of Posner's book, I have limited myself to Posner's first two chapters on the substantive law (property and contract) or roughly one hundred pages of the text. See *infra* notes 65-74, which relate Posner's explanations or justifications for specific legal rules with the structural economic principles or economic problems he indicates are at stake.

The aim of this micro-taxonomic exercise is to demonstrate, that the economic architecture (to the extent it provides determinate legal solutions) is not all that complex and that most of the work of law and economics lies in knowing which economic principle or economic problem to invoke when. That sort of knowledge, however, cannot be supplied by law and economics, but must instead be borrowed from some moral, political or aesthetic architecture. Because (in contrast to Coase) law and economics scholars generally refuse to acknowledge the dependence of their work on such foreign architectures, the formal economic principles deployed by law and economics scholars such as Posner are extremely vulnerable to deviant interpretations.

65. *Id.* at 67 (questioning the efficiency of the Rule in Shelley's case and the Doctrine of Worthier Title on the grounds that they are paternalistic and prevent the grantor from dividing ownership in the ways the doctrines prevent); *id.* at 74 (suggesting that there is no basis for government ownership of national parks); *id.* at 88 (rationale for refusal of courts to inquire into the adequacy of consideration); *id.* at 96-97 (noting that contracting party should not have a generalized obligation to disclose information unknown to the other party that affects the value of a contract); *id.* at 103 (holder in due course provisions in consumer sales should be enforceable as the consumer may prefer to give up legal remedies rather than pay a higher cost for the product purchased); *id.* at 115 (noting that *Hadley v. Baxendale* rule limiting contract damages does not apply where what is unforeseeable is the other party's lost profit); *id.* at 116 (noting that penalty clauses in contracts may be voluntarily negotiated provisions serving to communicate promisor's reliability or compensating promisee for high risk of default).

66. *Id.* at 37-38 (explaining reason for the grant of trademark and the extinction of the right when the mark becomes generic); *id.* at 38-39 (justification for extension of privacy right in name and photographic likeness); *id.* at 40 (rationalizing a proposal to award FCC radio licenses on the basis of auction or other sale and criticizing present system as only a partial approximation of willingness to pay); *id.* at 46 (justifying English common law rule viz easement of light as against adjacent construction but not distant obstructions); *id.* at 49 (rationale for power of eminent domain); *id.* at 56 (rationale for the non-absolute character of nuisance doctrine which allows pollution if reasonable under the circumstances); *id.* at 60 (restrictive covenants may well become obsolete and no longer reflect highest valued use and thus termination devices may be justified); *id.* at 84-85 (determination of whether some failure to carry through on undertaking is a breach of contract depends upon whether liability will create incentives for value-maximizing conduct in the future); *id.* at 117-18 (justifying use of specific performance serves as a substitute for damages where there are no good market substitutes to permit easy valuation); *id.* at 119-21 (doctrines of substantial performance and material breach serve to allocate contractual performance to the highest valued user).

rationalize legal rules on the grounds that they approximate the agreements that the (relevant) parties would have reached had they been able to bargain in the absence of transaction costs.⁶⁷

rationalize legal rules on the grounds that they minimize the transaction costs that the parties will have to encounter.⁶⁸

The concept of transaction costs itself is refined and formalized into some classic analytical constructs (that are also applied over and over again):

free rider⁶⁹

67. *Id.* at 38 (explaining fair use doctrine in copyright law on the grounds that it enhances the value of the copyright to the owner); *id.* at 46-47 (justifying attractive nuisance doctrine regarding child trespassers); *id.* at 68-69 (suggesting that limits on the transferability in Western water rights and FCC licenses serve to protect third parties who may value these rights more); *id.* at 81 (noting that implied term of good faith in contracts where one of the terms is within one party's discretion approximates the agreement the parties would have made had they thought about it); *id.* at 82-83 (in contract law where parties did not foresee a contingency or were precluded from dealing with it because of transaction costs, the role of the court is to imagine what the parties would have agreed upon in the absence of transaction costs); *id.* at 90 (suggesting that the doctrine of mutual mistake in contract law can be fruitfully approached in terms of how the parties would have allocated the risk of the contingency had it been foreseen); *id.* at 93-94 (explaining the contract doctrine of impossibility in terms of which party is the cheaper insurer of the risk); *id.* at 104 (rationale supporting admiralty rule which refuses to enforce salvage rescue agreements made under duress and entitles salvor only to reasonable fee for saving the ship); *id.* at 113-14 (justifying the rule in *Hadley v. Baxendale* of consequential damages in that where only one party knows of the risk, he/she can most cheaply insure or take other precautions against the realization of the risk); *id.* at 122-23 (role of implied contract doctrine is to replicate agreement that would have been reached had it been possible for parties to bargain).

68. *Id.* at 36-37 (explaining the grant of copyright and patent right in that both protect returns on investment); *id.* at 58 (rationalizing compulsory unitization in oil and gas states which allows a substantial majority of the owners of an oil and gas field to bind the minority as if under common ownership); *id.* at 59 (explaining use of restrictive covenants as opposed to mere contracts to govern land use); *id.* at 61 (explaining that restrictive covenants are only enforceable if the promises "touch and concern" the land on grounds of facilitating market information and transfer of land); *id.* at 64 (justifying the doctrine of waste to regulate the relation of the life tenant and the remainderman); *id.* at 71 (denying purchaser valid title in stolen goods raises transaction costs for operation of a market in stolen goods and presumably reduces transaction costs of preventing theft); *id.* at 80-81 (suggesting that the fundamental function of contract law is to encourage the optimal timing of economic activity and minimize the need for costly self-protective measures); *id.* at 86 (doctrine of consideration in contracts minimizes transaction costs of those who want to deal and those who don't by establishing formal regime for exchange); *id.* at 99 (failure to impose liability for lies in contracts for the sale of goods would increase inspection and self-protection costs); *id.* at 102 (standard form contracts should not be analyzed as a species of duress and should be enforceable in that they minimize the transaction costs of negotiating and drafting separate agreements); *id.* at 118 (justifying general preference for damage remedies over specific performance inasmuch as the latter increases transaction costs).

69. *Id.* at 55-56 (explaining undesirability of granting absolute property rights in pollution context and explaining nuisance doctrine that allows pollution if reasonable under the circumstances); *id.* at 60 (damage remedy as opposed to injunction remedy may be more appropriate to avoid this problem when there is a change in land use).

holdout/bilateral monopoly⁷⁰
 information acquisition and production⁷¹
 policing of agreements/detection of breach⁷²
 valuation difficulties⁷³

70. *Id.* at 49 (explaining power of eminent domain and criticizing its use where holdouts are unlikely to be present—e.g. location of schools, post offices, etc.); *id.* at 56 (undesirability of granting absolute property rights in pollution context served by nuisance doctrine that allows pollution if reasonable under the circumstances); *id.* at 56 (compulsory unitization in oil and gas states designed to avoid this problem); *id.* at 87 (doctrine of consideration in contract law prevents opportunistic revisions of original agreement by party whose power is enhanced by the sequencing of performance); *id.* at 104 (admiralty rule allowing salvagor only a reasonable fee for rescuing ship in distress designed to avoid holdout problem); *id.* at 116 (suggesting that enforcing contractual penalty clauses may create a bilateral monopoly problem); *id.* at 118-19 (suggesting that specific performance can create a bilateral monopoly problem); *id.* at 120-22 (suggesting that the doctrines of substantial performance and material breach serve to avoid bilateral monopoly problems).

71. *Id.* at 36-37 (explaining grant of copyright and patent right); *id.* at 37-38 (explaining grant of trademark protection and extinction of protection when mark becomes generic); *id.* at 61 (explaining that restrictive covenants are only enforceable if the promises “touch and concern” the land on the grounds that otherwise buyers would not have easy access to information about what they were buying); *id.* at 67 (suggesting that the possible inefficiencies stemming from the paternalism of the Rule in Shelley’s Case and the Doctrine of Worthier Title may be justified insofar as the grantor lacks information about the problems caused in the absence of such legal rules); *id.* at 96-97 (explaining why party with information affecting the value of a contract generally should not be obliged to disclose it to the other party who does not have the information); *id.* at 99 (liability for lies by seller in the sale of goods serves to relieve buyer from engaging in inspections and information acquisitions that are very costly); *id.* at 113-14 (justifying the rule in *Hadley v. Baxendale* on consequential damages in that where one party has comparative advantage regarding magnitude and significance of the risk, he/she is given an incentive to disclose risk or take other precautions against the realization of the risk); *id.* at 115 (noting that *Hadley v. Baxendale* rule limiting contract damages does not apply where what is unforeseeable is the other party’s lost profit).

72. *Id.* at 36-37 (explaining withholding of patent for fundamental ideas because it is too difficult to identify the products in which they are embodied); *id.* at 71 (denying purchaser valid title in stolen goods reduces incentives to steal and thereby reinforces system of legitimate entitlements); *id.* at 80-81 (suggesting that one of the functions of contract law is to prevent opportunistic behavior and minimize the costs of self-protective measures); *id.* at 82 (implied term of good faith is part of every contract to prevent opportunistic uses of the sequential character of contractual performance); *id.* at 86-87 (function of consideration in contract law is to distinguish legally enforceable contracts from gratuitous promises, careless use of language, and opportunistic revisions of original agreements); *id.* at 90 (noting that in the sale of goods involving mutual mistake, the risk should generally be placed on the seller who can more cheaply acquire information about his/her property at a lower cost than the buyer); *id.* at 103 (by making collection suits cheaper and more certain, holder in due course provisions reduce the costs of concluding a contract and obtaining financing); *id.* at 116 (suggesting that penalty clauses in contracts can serve to communicate reliability of promissor).

73. *Id.* at 40 (proposing an auction system for FCC radio licenses as more closely approximating willingness to pay); *id.* at 51 (method of calculation of just compensation under eminent domain justified by difficulty of valuing subjective preferences of owners of condemned property); *id.* at 64-65 (doctrine of waste to regulate relation of life tenant to remainderman avoids problem of bilateral monopoly); *id.* at 84-85 (determination of whether some failure to carry through on undertaking is a breach of contract depends upon whether liability will create incentives for value-maximizing conduct in the future); *id.* at 88 (explanation for judicial refusal to inquire into the adequacy of consideration); *id.* at 89-90 (whether the law should enforce promises of rewards for lost goods to finders who did not know of the reward is not clear because it is

negotiation costs⁷⁴
and so on.

Judge Posner's economic distillation of the law is no trivial accomplishment. His chemistry inspires awe and wonder. Over and over again, each bit of common law doctrine precipitates in the economic solutions. This, of course, raises a question: just how did we get from the nihilism of Coase to the fecundity of Posner?

Posner provides a few epistemological moves that deftly resolve much that Coase had left open. Thus, Posner resolves the relation of social value and private value in one swift move: social value is simply defined to be the aggregate of private value.⁷⁵ Next he offers some simplifying (albeit rather paternalistic) definitional moves to limit the manner in which private value choices can be made to count in the construction of legal rules. Posner tames the mischievous and unruly term "value" by reducing it to mere "willingness to pay."⁷⁶ Willingness to pay, in turn, is a technical term which can only be evidenced in some very special ways. The best evidence of willingness to pay is to be found in actual market transactions.⁷⁷ Such evidence, of course, is not always available, so the alternative approach is to try to guess whether, if a transaction had been feasible, it would have occurred.⁷⁸ These simplify-

difficult to perform a comparative valuation of the efforts of casual finders vs. active searchers); *id.* at 117-18 (noting that specific performance serves as a substitute for damages where there are no good market substitutes to permit easy valuation).

74. *Id.* at 46 (justifying English common law rule bestowing easement of light as against adjacent, but not distant construction); *id.* at 46-47 (justifying attractive nuisance doctrine in regard to child trespassers); *id.* at 68-69 (suggesting that Western water rights systems and FCC licensing are structured to overcome negotiation costs among all the affected parties); *id.* at 82-83 (noting that in contractual relations, negotiation costs prevent rational parties from providing for every contingency and that role of court is thus to approximate what would have been agreed upon in the absence of these costs); *id.* at 90 (noting that mutual mistake doctrine in contract law serves to overcome difficulties about negotiating over unforeseen eventualities); *id.* at 102 (standard form contracts should be enforceable as they serve to minimize the transaction costs of negotiating and drafting many separate agreements); *id.* at 122-23 (justifying implied contract doctrine where one party bestows benefit on the other where prior negotiation was not possible but would have produced an agreement).

75. Thus despite Posner's caveats, it is clear that the third edition of his book retains individual "willingness to pay" as the ultimate criterion for determining the efficiency of legal rules. Posner suggests that efficiency denotes "that allocation of resources in which value is maximized"; value, in turn, "is measured by willingness to pay"; willingness to pay in turn, is evidence by voluntary market transactions or conditions that seem to satisfy the Kaldor-Hicks concept. R. POSNER, *supra* note 3, at 12-13. For explanation of the Kaldor-Hicks concept of efficiency, see *supra* note 35.

In the second edition of his book Posner had stated flat out: "'Efficiency' means exploiting economic resources in such a way that 'value'—human satisfaction *as measured by aggregate consumer willingness to pay* for goods and services—is maximized." R. POSNER, *ECONOMIC ANALYSIS OF LAW* at 10 (2d ed. 1977) (emphasis in original).

76. R. POSNER, *supra* note 3, at 11-12.

77. *Id.* at 13.

78. *Id.* at 14.

ing moves help stabilize the volatile world opened up by Coase. And they give content and meaning to the formulas and constructs set forth above.⁷⁹

It remains, of course, no mean trick to know which formula to use when. And it's important to know since each of the formulas produce very different reactions. But Posner knows. For the skeptics, some questions linger. For instance, where transaction costs are significant, do we approximate the outcomes a costless free market would have produced or do we instead try to reduce the transaction costs? And then too, how do we identify free riders, what they are riding on and how much they would pay for the ride? And when is information acquisition a cost of production, and when is it simply a transaction cost that can sensibly be reduced by the grace of law? Or consider this: when do we forbid agreements on the ground that third parties would be willing to pay? How can we identify these third parties and determine what they want and how much they are willing to pay? These are not questions for a spare Sunday afternoon.

How does Posner know, for instance, whether a good would be traded in the absence of transaction costs? The view from Chicago is not clouded by the ying-yang skepticism of the West coast or perverted by the nail-chewing self doubts of the Eastern seaboard: in Chicago, one can safely appeal to common sense. One simply looks at who has money to spend, and decides whether they have the inclination to spend their money for that type of good. Just count up the "dollar/taste votes." That's it! If some good is not traded, and common sense would indicate that the dollar/taste votes would not purchase it, then it does not matter that transaction costs are high. And where some good is traded, the task of the law is to facilitate the market transaction, unless of course there are some heavy dollar/taste votes out there who would be willing to pay to forbid traffic in that particular good.

Ultimately, however, the power of Posner's alchemy dissolves in his epistemological solutions. His depiction of various elements of the common and constitutional law are little more than the relentless application of the same formulas to an ever increasing sample of law data. The plan is economic in form, but most of the work is done with the epistemology of common sense and common law. And that raises some problems. One problem is that both common sense and common law are suspect sources of knowledge and thus provide only the weakest sort of foundation for the definition of markets and the identification of transaction costs.⁸⁰ But even putting this problem aside, there remains

79. See *supra* text accompanying notes 65-74.

80. See Cohen, *supra* note 17, at 809-21 (criticizing the common sense use of spatial and temporal metaphors to resolve legal problems as the reification of legal concepts).

something askew in the epistemological structure of Posner's edifice. On the one hand, common sense and common law are apparently good enough to define actual and potential markets and to identify and assess transaction costs. On the other hand, we must (for some reason) disregard the common law and common sense intuitions that value does not reduce to mere willingness to pay and that consumers are not always rational maximizers of self-interest. What then is the epistemological basis for recognizing the validity of common law and common sense in one situation, but not the other?⁸¹ The short answer is that this is the role of assumptions in theory.⁸² True enough, but what are we to do with a body of formalized principles such as Posner's whose root assumptions seem to contradict the very knowledges (common sense and common law) that it deploys to produce conclusions? Even if this is not cause for epistemological doubt, it does create a haunting sense of *deja vu*. Posner's steady reliance on his formulas, his studied application of the same technical patterns of transaction costs, and his abiding faith in deductive reasoning are not wholly novel. Likewise, his brave denial of the insights of other disciplines is something we have seen before.⁸³ It's all uncannily reminiscent of the architectural beauty of legal formalism.⁸⁴

Still, one can only make so much of the epistemological and aesthetic shortfalls of Judge Posner's approach. It might be that Posner's efforts to explain ever more aspects of the law with his particular brand of microeconomic theory could nevertheless be quite useful. The very performance of this feat would demonstrate the consistency of microeconomic thought with common law principles. As the number

81. The objection here is not to a lack of realism in the economist's assumptions, but rather to the epistemological inconsistency in Posner's approach. He has not given us any criteria (other than his assumptions) as to when it is permissible or not to look to the common law or common sense as sources of knowledge. To put it simply: if you can look to the common law or common sense for guidance some of the time, why can't you look there all of the time? The problem is not that there are no answers to this question. Rather, the problem is that the answers one might give are probably not consonant with the rest of Posner's enterprise.

82. R. POSNER, *supra* note 3, at 15.

83.

The economic theory of law is the most promising positive theory of law extant. While anthropologists, sociologists, psychologists, political scientists, and other social scientists besides economists also make positive analyses of the legal system, their work is thus far insufficiently rich in theoretical or empirical content to afford serious competition to the economists.

R. POSNER, *supra* note 3, at 24.

84. The legal formalists viewed law as a closed, self-sufficient, structured and deductive system. See e.g., Summers, *Pragmatic Instrumentalism in Twentieth Century American Legal Thought—A Synthesis and Critique of our Dominant General Theory About Law and its Use*, 66 CORNELL L. REV. 861, 866-68 (1981) (describing the key features of legal formalism). But like Posner, the legal formalists were compelled to complete and supplement their architectural vision of law by incorporating the foreign (and ultimately dangerous) realm of common sense. See Cohen, *supra* note 17.

and variety of legal rules explained in economic terms increases, the credibility of economic theory as an explanation of law increases as well. Indeed, this is one of the classic ways in which one vindicates a theory: an attempt is made to show that the theory explains just about everything under the sun.⁸⁵ This exercise validates the power and serviceability of the theory.

There is at least one situation, however, where this strategy (the sort used by Posner) does not work very well.⁸⁶ It arises where the theory is composed of disparate and contradictory principles which cannot be reconciled in the abstract. And this is precisely the state of Posner's economic thought.⁸⁷ In such cases, the trotting out of the theory to account for ever more situations does not validate the theory in the least—for the contradictions allow any event to be interpreted in terms of the disparate categories. If you are not convinced, try explaining the world in terms of (good and evil) or (phallic and vaginal) or (inside and outside). (I guarantee success. I also guarantee that in terms of the intellectual validation of the theory, the marginal returns on an additional application are de minimis beyond, say, fifty pages or thirty applications.)⁸⁸

The very irony of Posner's text is that although it purports to be an explanation, it is in fact an interpretation of law. And as interpretation, it falls into that class that we usually call translation.⁸⁹

85. Posner believes that one test of theory is its explanatory power. R. POSNER, *supra* note 3, at 16.

86. Another situation is one where our interest in knowledge is not to exercise power or to control, but merely to understand. The traditional aesthetic criteria we use to assess theory (i.e. coherence, elegance, integrity, sweep, etc.) may be irrelevant when we have no interest in using theory to control or in using knowledge as power.

87. The formulas used by Posner to rationalize legal rules that are discussed above are contradictory in the sense that each formula recommends a different solution. To be sure, they are not contradictory if there is some stable and credible method for deciding which formula to use when. But here we encounter a difficulty because Posner has not given us an account of his epistemology, his interpretive theory or his aesthetics. His work reveals that he tends to refer to the common law and to common sense in large but widely varying doses to supply the missing elements. See *supra* notes 64-75. This unstable compound might be called Posner's hunches. See Baker, *The Ideology of Economic Analysis of Law*, 5 J. PHIL. & PUB. AFFAIRS 22-47 (1975) (noting that Posner draws his hunches about the purposes of laws, from the laws themselves or common sense); Leff, *supra* note 30, at 466 (pointing out that Posner can find a practice or rule inefficient only by assuming that what society does and what it wants are different—yet he has furnished no epistemological grounds for making such a judgment).

88. This is not to say that theories built upon contradiction are necessarily wrong. See *supra* note 22. Nor does this mean that repeated application of such theories to new data is useless. There are obviously lots of reasons and many of them good ones to continue the systematic application of a theory built on contradiction over an entire field. It's just that *intellectual validation* of the theory is not one of them.

89. See Leff, *supra* note 30, at 459 (dubbing Posner's approach "American Legal Nominalism" for its propensity to reduce explanation and interpretation to naming and defining.)

V. IN DEFENSE OF COASE

I think that the author of *The Problem of Social Cost*⁹⁰ should bristle at Posner's uses of his insights. Posner's approach accomplishes precisely what Coase warned us against. Posner approaches legal problems as if the goods and resources at stake were already defined and given. In large part, though not consistently, Posner looks to the common law or common sense for a definition of what conflicting uses or resources are at stake in a given area of law.⁹¹

Coase warned us against hypostatizing legal problems in this way. He suggested that in developing an efficient regime, one had to examine the effects of a proposed legal rule *on all* the affected activities.⁹² The Coasian insight suggests that the establishment of any legal rule is likely to raise transaction costs for the production and transfer of some good. In a sense, this should seem obvious: even the establishment of a free market in good X will raise transaction costs significantly for those who would be willing to pay for the prohibition of a market in X. And it does no good to say that these people have a "paternalist" interest not worthy of consideration. Their interest is not paternalistic in the least: they would be willing to pay to stop the traffic in good X. And what they call their interest is probably good Y, something like an environment free of heroin, flesh peddling, hierarchy, institutional oppression or whatever.⁹³

Thus, the Coasian approach requires the consideration of all possible markets that might be affected by the legal rule. This means that one must be a bit more skeptical than Posner in describing markets and in identifying which markets might be affected by a legal rule.⁹⁴ All possible markets (including existing ones) are worth considering under the Coasian approach. By contrast to the Posnerian view, Coase accords no special privilege to those markets which the common law recognizes

90. Coase, *supra* note 1.

91. Much of Posner's explanations for the various common law doctrines borrow heavily (albeit, selectively) from the "noneconomic" articulation of justifications often found in the case law or in the exposition of the rules by traditional legal commentators. *See supra* notes 64-75. But it is also true that many of his explanations borrow heavily from a common sense notion of value. *See Baker, supra* note 87, at 22-47. The problem, of course, is that Posner has not offered any criteria allowing us to choose between these two sources of knowledge when they conflict. Likewise, he has also failed to provide us with any account of why these are more appropriate sources of knowledge, than say, anthropology, sociology or psychology. Leff, *supra* note 30, at 469-77. And this is a serious problem: as Leff points out the only way Posner can criticize a legal rule as inefficient is to assume that it is aimed at achieving something other than what it actually achieves. Posner has not given an account of how he (or anyone else) can, within his framework, know that what is desired is something other than what is achieved. Leff, *supra* note 30, at 466.

92. *See supra* text accompanying note 1. *See infra* note 160.

93. *See infra* notes 125-126 and accompanying text.

94. *See Baker, supra* note 87, at 22-47.

in its principles.⁹⁵ On the contrary, to the extent that the common law embraces a crude non-reciprocal conception of causation it should be suspect as source for the definition of goods, activities and markets.⁹⁶ Coase likewise refrained from offering up common sense as an epistemological basis for economic reasoning.

He thought it crucial that one examine the likely effects of any proposed change in the legal order. And in stark contrast to the popular right-wing lawyer-economists, he conceived the relation of law to the allocation of resources in a dialectical manner. A change in the specific content of a legal rule could, according to Coase, be expected to yield changes not only with respect to the matters covered by the rule, but also with respect to matters extrinsic to the purported operation of the rule. Thus, if accompanied by significant transaction costs, a rule about the liability of trains for failure to monitor spark emissions could be expected to alter not only the frequency of railway service, but also the rate of conversion of land to combustible crops, and even the rate of substitute forms of transportation. Against the background of the dialectical approach offered by Coase, the formulaic crystallization of his thought launched by the right-wing lawyer-economists seems voluntaristic—a political move.

VI. RECLAIMING COASE: AN ESSAY IN RETRIEVAL.

It is, of course, no secret that the Coasian insights have largely been appropriated by the right-wing lawyer-economists. It is also not a secret why this should have happened. Coase, after all, is a Chicago School economist.⁹⁷ And his article can be read (though it is an impoverished reading) as a having an intrinsic right-wing tilt.⁹⁸ It does have a right-wing tilt, but the tilt is not intrinsic to Coase's arguments or to his insights.

95. As Coase states:

The reasoning employed by the courts in determining legal rights will often seem strange to an economist because many of the factors on which the decision turns are, to an economist irrelevant. Because of this, situations which are, from an economic point of view, identical will be treated quite differently by the courts.

Coase, *supra* note 1 at 15. Coase was somewhat ambivalent about how well the common law understood the economic implications of its decisions. See *supra* notes 15, 20.

96. See *supra* notes 15, 20.

97. See Priest, *supra* note 57, at 1635 (noting Coase's hostility to the activist state and governmental regulation).

98. See Coase, *supra* note 1, at 18 (suggesting that economists and policy-makers overestimate the advantages of government regulation).

Coase set out to attack the wrong-headed Pigovian thinking that lent support to government intervention and regulation of markets.⁹⁹ In attacking the Pigovian tradition, Coase also questioned the wisdom of the governmental policies it produced. In contrast to the right-wing lawyer-economists, however, Coase did not conclude that because Pigovian thinking was wrong and led to government regulation that government regulation was necessarily wrong-headed also.¹⁰⁰ Coase's thought was far too sophisticated to lapse into this error. And his article carefully maintains a theoretical ambivalence about the appropriate uses, not only of government intervention, but also of market mechanisms and market bypass mechanisms such as the firm.¹⁰¹ As Priest notes:

Coase's message is ultimately nihilistic. After presenting repeated examples in which attempts to correct market failures only further reduce social welfare, Coase concludes that economics provides no guide whatever to social policy. "As Frank H. Knight has so often emphasized," Coase announces, "problems of welfare economics must ultimately dissolve into a study of aesthetics and morals."¹⁰²

This is certainly not the way the right-wing read Coase. But if Priest's reading of Coase is correct, then why were Coase's insights left to the right?

99. See Kitch, *supra* note 5, at 220-22 (recounting the genesis of *The Problem of Social Cost* and Coase's initial triumph over Pigovian thought in a seminar at Chicago). See also, *supra* note 36.

100. It would be difficult (putting it mildly) to characterize Coase as an active supporter of the welfare state. Indeed, much of Coase's other work both before and after the 1960 article, *The Problem of Social Cost*, was aimed at criticizing government regulation of markets. See, e.g., R. H. COASE, *BRITISH BROADCASTING, A STUDY IN MONOPOLY* (1950); Coase, *The Choice of the Institutional Framework: A Comment*, 17 J. LAW & ECON. 493 (1974). See also, Priest, *supra* note 57 at 1635 (noting that Coase was no friend of the activist state). For a recent compilation of Coase's works, see Landes, Carlton & Easterbrook, *On the Resignation of Ronald Coase*, 26 J. LAW & ECON. iii (1983).

Coase is a Chicago School economist, but the significance and implications of his article are hardly confined to that particular school. It would be a mistake to overlook the extent to which political commitments influence intellectual production. But I think it would be equally a mistake to conceive the relation between the two as one of simple cause and effect or even in terms of a perfect correspondence.

101. As Coase states,

From these considerations, it follows that direct governmental regulation will not necessarily give better results than leaving the problem to be solved by the market or the firm.

But equally there is no reason, why, on occasion such governmental administrative regulation should not lead to an improvement in economic efficiency.

Coase, *supra* note 1, at 18. See generally, *id.* at 15-18 discussing the comparative advantages of firm, market and government mechanisms in terms of efficiency.

102. Priest, *supra* note 57, at 1635 (citing Coase, *supra* note 1, at 43).

There is a certain degree of symbolism surrounding the political conduct of legal discourse. The unfortunate (though probably unavoidable) result is that useful or creative ideas are often dismissed because they emanate from a "politically incorrect source."¹⁰³ This tendency may have affected the treatment of Coase's article.

In any event, it is hardly surprising that the liberal center and the left did not extend a gleeful welcome for Coase's article. The language of microeconomics generally presumes much that the left would like to question.¹⁰⁴ And so for the left, Coase's article was often classed with the other law and economics apologists who were to be either challenged or ignored.¹⁰⁵ As for the liberal center, it had no need of Coase. From the perspective of the liberal center, the positive law of the 60's and the early 70's was just fine (or close to it).¹⁰⁶ Microeconomics was simply superfluous to the center liberal project. When the liberals eventually awoke to see the havoc wrought by the right-wing lawyer-economists, they largely abandoned law and economics and attempted to retaliate with scholarship in law and. . . (anything but economics).¹⁰⁷

103. And correspondingly, wrong-headed ideas are accepted (or at least gain currency) when they are offered by "politically correct" or "institutionally sanctioned" sources. See Fish, *Anti-Professionalism*, 7 CARDOZO L. REV. 645 (1986).

104. For instance, market definitions of value seem to skew the production and distribution of goods to favor the rich rather than the poor and tend to favor production activities as opposed to consuming activities. Baker, *The Ideology of Economic Analysis of Law*, 5 J. PHIL. & PUB. AFF. 3 (1975). There are also questions about the origins of individual tastes and desires along with doubts about the uncritical servicing of these tastes and desires via market mechanisms. Heller, *The Importance of Normative Decisionmaking: The Limitations of Legal Economics as a Basis for a Liberal Jurisprudence—As Illustrated by the Regulation of Vacation Home Development*, 1976 WIS. L. REV. 385. There are also some questions about the validity and reach of the neoclassical assumption that consumers make "rational" choices. Kelman, *Choice and Utility*, 1979 WIS. L. REV. 769. And there are questions about how legal rules and regimes affect consumer tastes and preferences. Kelman, *Consumption Theory, Production Theory, and Ideology in the Coase Theorem*, 52 S. CAL. L. REV. 669 (1979). Another problem is that law and economics prescriptions depend upon controversial descriptions of initial entitlements. Baker, *Starting Points in Economic Analysis of Law*, 8 HOFSTRA L. REV. 939 (1980); Kennedy, *Cost-Benefit Analysis of Entitlement Problems: a Critique*, 33 STAN. L. REV. 387 (1981). These types of inquiries and problems are typically excluded from the practice of law and economics scholarship.

105. Obviously, it is difficult to cite examples of neglect of Coase by the left. But it is not difficult to cite leftist challenges of Coase. Indeed, much of the recent literature of CLS targeting law and economics places Coase within its sights. See, e.g., Horwitz, *Law and Economics: Science or Politics?* 8 HOFSTRA L. REV. 905, 907-09 (1981); Kelman, *Consumption Theory*, *supra* note 104.

106. See Fiss, *The Death of Law*, 72 CORNELL L. REV. 1, 14-15 (1986). As Horwitz puts it, "the boldest stroke in Coase's article was to deny the interventionist premises of welfare economics at just the moment it had achieved hegemony." Horwitz, *supra* note 105, at 907. There was, of course, some lag time in the transmission of Coase's message throughout the legal academy. And the liberals did not receive the bad news about Pigou's fate until some time later.

107. According to Horwitz, an alternative approach used by the liberals was to expand the concept of transaction costs, find them everywhere and thereby justify intervention. Horwitz, *supra* note 105, at 908. See Ackerman, *Foreword: Law in an Activist State*, 92 YALE L.J. 1083, 1107-13 (1983) (provocative attempt to coopt the Coasean paradigm to the liberal cause).

But for the right, the Coase article was a godsend.¹⁰⁸ From the right's perspective, Coase's insights warranted both a special hostility towards government regulation as well as the elevation of the market to the status of a Platonic form.¹⁰⁹ Here finally was the Archimedean point from which to launch attacks on the paternalism of the welfare state and its senseless over-regulation of everything—well, not quite everything, but everything that shouldn't be regulated—you know.

There is a point to this qualification. The beauty of Coase's insight (for the right) is that the theory allowed a radical questioning of both paternalistic regulation and the liberal attempts at wealth redistribution without, however, lapsing into the sort of self-defeating naturalistic laissez-faire approach that the right had championed unsuccessfully in earlier eras.¹¹⁰ The Coasian approach left a powerful interventionist role for the law to play: the facilitation of market transactions. Indeed, there is some irony in the fact that law and economics theory has been attacked for its highly individualistic, non-interventionistic character and for its disregard of community values.¹¹¹

108. Witness the excitement of the neoclassical economists at the emergence of Coase's article. Kitch, *supra* note 5, at 220-21.

109. The "market" is the lawyer-economist's main ideal and major metaphor. Voluntary market transactions are generally presumed to be the most efficient. *See supra* note 53. Other forms of allocation such as the various modes of government allocation or the various types of firms are justified to the extent that they facilitate operation of the market or to the extent that they approximate the idea of the market better than an actual market would. *See supra* notes 45, 54, 55. There is, of course, a serious problem with this exaltation of the market as the ideal: the market is costly to operate. Veljanovski, *The Coase Theorem and the Economic Theory of Markets*, *supra* note 33, at 69. *See infra* text accompanying notes 125-32.

These costs become more visible when we realize that there is virtually no human behavior which can escape the reach of the market metaphor. *See, e.g.*, R. POSNER, *supra* note 3, at 127-30 (describing the economics of the nuclear family and suggesting that love is a form of altruism which "facilitates cooperation; it is a cheap and efficacious substitute for (formal) contracting." *Id.* at 129). Love means never having to say you're sorry? (This cuts both ways.)

110. *See* Kennedy, *The Role of Law in Economic Thought: Essays on the Fetishism of Commodities*, 34 AM. U. L. REV. 939 and particularly notes 20-25 (1985). Kennedy notes that the classical economists sought to limit state intervention in economic life beyond the definition and protection of labor inputs and the system of free exchange by invoking the values of freedom, justice, and naturalness. The political/legal implications of the classical view are familiar enough:

The basic message of the whole was very simple: there were laws of economic life, analogous to the physical laws of nature; the natural operation of those laws brought about just outcomes; most of the proposals of social reformers involved coercive modifications of those outcomes and could only work if economic laws were somehow suspended. So long as they continued in operation, the egalitarian impulse to redistribute wealth by manipulating the legal system inevitably involved both injustice and a counterproductive reduction in total wealth.

Id. at 958.

111. There is irony, but there is also some truth to the charge. First, the truth: right-wing microeconomic thought tends to premise its analysis on the supposition that all valued experiences take (or at least can take) a commodity form. Kennedy, *supra* note 110, at 960-61. In turn, this supposition leads to a devaluation and underproduction of communal goods that are (almost by

That sort of attack could work well enough against the rhetoric of Spencer's Social Statics, or Justice Peckham's opinion in *Lochner v. New York* or the work product of the classical right-wing economic luminaries.¹¹² But as against the modern right-wing economic thinkers, this sort of attack has become a shadow passing by its own ship in the night. What the right has done with Coasian insights is transform them into a powerful vehicle and justification for selective government intervention. The notion of transaction cost, for instance, is used quite often to justify judicial approximations of the bargain that the parties would have reached in the absence of transaction costs.¹¹³ Indeed, the concept of transaction costs is a powerful interventionist tool as Bruce Ackerman, a prominent liberal scholar, has recently noted.¹¹⁴ And the right-wing economic thinkers molded this tool to their vision of community: it is not a ruggedly individualistic culture they worship, but a streamlined capitalistic machine where the state plays an active role in creating, repairing and improving production for market.¹¹⁵ It is a community where the only relevant indicium of human satisfaction is willingness to pay.¹¹⁶ And, of course limiting the individual's input into the development of collective rules to such a grudgingly narrow channel as willingness to pay hardly seems to be a celebration of individualism. It seems rather, well . . . paternalistic.¹¹⁷

In short, the right's appropriation of Coase's insights is no surprise. Nor is it surprising that his insights were freeze-dried into some serviceable prescriptions and presumptions to govern the production of legal rules. This simplification is not only conducive to the right's political program, but it is a normal outgrowth of the political constraints on scholarly production in law. The sort of nominalistic and anti-dialecti-

definition) not subject to private appropriation: love, meaningful work, a sense of purpose, collective aesthetics, etc. *Id.* at 972.

Now for the irony: right-wing microeconomics has a fairly well developed sense of the ideal community: it is one where the state intervenes frequently to facilitate market transactions or to replicate the transactions that would occur if a free market were possible. See authorities cited in *supra* notes 54-56, 66-74.

112. For discussion of the classical economic theories and their relation to legal thought, see Kennedy, *supra* note 110, at 939-58.

113. See *supra* note 111.

114. B. ACKERMAN, *RECONSTRUCTING AMERICAN LAW* (1985). See also Ackerman, *supra* note 107, at 1099-1114 (1983).

115. See *supra* notes 54-56, 66-74, 111.

116. See *supra* note 75.

117. And indeed, POSNER'S *ECONOMIC ANALYSIS OF LAW* (3d ed. 1986) is far from a celebration of individual freedom. Rather it is a sustained tribute to paternalism. The paternalistic moment in the lawyer-economist's moves is difficult to uncover because it occurs very early in the enterprise: it is the initial claim that the only valid indicium of human satisfaction is "willingness to pay." This initial step serves as a formal constraint on how desires and needs can be expressed to influence the construction of the legal and political order. And as formal constraints go, this one is highly paternalistic. See generally notes 66-74.

cal approach propounded by Posner, for instance, can be understood in part as a lawyer's effort to transform scholarship into authority.¹¹⁸ This tendency is common to legal academics of virtually every political stripe. For theories to rise to the level of authority (in our legal culture) they must be relatively unequivocal; they must yield clear implications and serviceable prescriptions; and they must present a unified, coherent and consistent front. It is thus no surprise that in the canonization of theory to authority, legal academics routinely attempt to strip the theories of ambiguity, uncertainty, subtlety, and contradiction. What we get out of the process are unstable authorities and questionable theory.

Even if none of this is suprising, it seems nonetheless unfortunate that Coase's article has become more or less the exclusive property of the right-wing lawyer-economists.¹¹⁹ For there is nothing essentially right-wing in *The Problem of Social Cost*. On the contrary, the insight into the reciprocal nature of harm in conflicting resource use, is a powerful tool for disestablishing the privileges accorded to certain select activities by the law. It offers the possibility of questioning and examining the value preferences ensconced in legal doctrines. It also reminds us that we are responsible for making these choices and that we cannot avoid this responsibility by deferring to the natural order of things.

Coase depicts our world as one of continual and systemic interference. He thus removes the illusion of a reconciliation of conflict so tempting to legal academics who seem bent on dissolving contradiction in syntheses that deny the continued presence of interference and conflict. His reciprocal view of causation implies that any solution (legal or otherwise) has a cost and that the notion of legal harmony or synthesis is illusory.

There is something radical and dialectical in this view: Coase's insight not only destabilizes the received wisdom of the common law and its conventional moral and aesthetic architecture, but it puts us on guard against thinking that a new architecture would somehow solve our problems.¹²⁰ Coase's description of the reciprocal nature of harm demands that we continue to question the *modus vivendi* adopted to

118. For a discussion of the sort of market failure this cartel among lawyers, judges and academics can produce, see Schlag, *The Brilliant, The Curious and The Wrong*, 39 STAN. L. REV.— (forthcoming 1987).

119. Theoretical attempts to reclaim Coase from the right wing are relatively rare and have occurred later rather than sooner. Ackerman's book, *RECONSTRUCTING AMERICAN LAW*, *supra* note 114, and the parent article, *Foreword: Law in an Activist State*, *supra* note 107 at 1107-13 are provocative attempts to coopt Coase to the liberal cause. The fact that these two attempts are rare and provocative is revealing given that Ackerman's article comes some 23 years after the publication of *The Problem of Social Cost*. Coase, *supra* note 1. *But see* Horwitz, *supra* note 105 (suggesting that liberals routinely expand the concept of transactions costs). For equally late attempts to reclaim Coase from the right, see *infra* note 126.

120. In contemporary terms, the Coasian perspective might be described as "anti-foundationalist". See T. EAGLETON, *LITERARY THEORY* 127-50 (1983) (discussing poststructuralism).

adjudicate the competing claims of rival activities. It systematically draws attention to what we may have lost, given up and overlooked in adopting a particular legal rule or legal regime. I think these Coasian insights point left.

The same could be said of Coase's injunction that we examine the consequences of any legal rule not just in terms of the matters covered by the legal rule, but on the background of associated activities as well. More important, we have to consider the consequences of the legal rule not just in terms of the background activities as they were initially described, *but in terms of the background activities as they have been altered by adoption of the rule.*

This admonition warns us against the fatly reified analytical mode of thought inculcated so forcefully (and very often successfully) in the first year of law school. In that mode of thinking, the professor's typical question about what the legal rule should be is presented against a fixed and frozen background of related legal rules. The inquiry then proceeds by examining the implication of various possibilities against this background. Next there is the demonstration that adoption of any legal rule would alter the fixed and frozen background surrounding the subject matter of the rule. And perhaps the point is made that adoption of the rule would change the character of the problem as it was initially posed. But rarely is it made clear that the wisdom (if any) of the proposed legal rule is to be ascertained against the dynamic background which the proposed rule has just defrosted. Coase exposes the weakness of failing to make this last move and ultimately impeaches the conventional analytic mode in favor of a more dialectical vision of law. Proposed rule changes not only affect the background conditions of the problem, but affect the depiction of the problem as it was initially posed. And it is in terms of this changed depiction that the wisdom of the proposed rule must be ascertained.

What Coase offers here is nothing short of a view of law as displacement. Legal rules not only displace the problems they are designed to resolve, but they displace the very context or background which gives rise to the problem in the first place. Coase invites us to look at the effect of legal rules on the totality and to avoid freezing the totality in thought or deed. Here too Coase's thought points left.

It is not just the general methodology Coase employs that is useful to a radical understanding of law, but his treatment of specific substantive concepts. For instance, the Coasian attack on the Pigovian tradition is an assault on the reification of the social product. The substantive implications of Coase's treatment of Pigou call for a radical reexamination of possible visions of the social product under alternative regimes. Coase concludes his devastation of the Pigovian compari-

son of private and social cost by noting that: "The belief that it is desirable that the business which causes harmful effects should be forced to compensate those who suffer damage. . . . is undoubtedly the result of not comparing the total product obtainable with alternative social arrangements."¹²¹ According to Coase, the social product obtainable under various regimes must be assessed in totality.¹²² What is more, the social product associated with a particular legal rule is not something that can be assessed merely by comparing the private product of production with the value of the product and its externalities (i.e. the social product). Rather a legal rule imposing significant transaction costs must be seen as having an effect not just on the activity which it regulates, but also on conflicting, substitute, and associated activities as well. If this is correct, then the concept of social product cannot be defined or explored intelligently merely by positing idealized conditions in the market in question.

Coase illustrates this point with a simple traffic example. A motorist late at night stops for a red light even though there is no risk of accident. He does so because of the *in terrorem* effect of traffic fines. If he ran the red light, the total product would increase because he would save time without increasing anyone's costs. Coase points out that we can hardly conclude from this particular market situation that the social product would increase if we eliminated traffic fines.¹²³ Yet this is precisely the sort of reasoning that the Pigovian comparison of private cost to social cost encourages. As Coase explains,

The comparison of private and social products is neither here nor there. . . . The Pigovian analysis shows us that it is possible to conceive of better worlds than the one in which we live. But the problem is to devise practical arrangements which will correct defects in one part of the system without causing more serious harm in other parts.¹²⁴

Coase thus suggests that by projecting an idealized vision of the market under scrutiny, the Pigovian tradition offers a frozen and rather unrealistic conception of social product. In turn, deployment of this conception of the social product for fashioning legal rules is likely to produce deleterious effects in other markets. Coase invites us instead to develop alternative visions of the social product based upon an examination in total of all the markets likely to be affected by a proposed rule. This approach, of course, radicalizes the definition and exploration of social product by casting it free from the identification of the specific market

121. Coase, *supra* note 1, at 40.

122. See *supra* note 20.

123. Coase, *supra* note 1, at 34.

124. *Id.* at 34.

governed by the legal rule. The approach thus focuses attention and inquiry upon the identification and description of the markets affected by the rule. No longer can the relevant markets be defined by the content of the proposed rule. And no longer can the social product be identified by a formalistic projection of the markets identified by the content of the legal rule to their idealized conditions. Coase wanted us to see things whole. And he was quite careful to avoid formalistic and mechanistic constructions of the whole. On the contrary, he invited us to examine alternative possible wholes. I think this is an invitation that the left can readily accept.

Even the Coasian conception of transaction costs has a radical edge. Once we are freed from the Pigovian formalism (the equation of relevant markets with rule content and the construction of social product by idealizing relevant markets) the concept of transaction costs provides a powerful tool to examine critically any regime. In marked contrast to what the right would like us to believe, it does not at all follow from Coase's article that the preferable legal regime is the one which creates the lowest transaction costs. Nor does it inevitably follow that such a regime can be equated with the "free market."

In fact the author of *The Problem of Social Cost* should disagree with these nuggets of right-wing wisdom. The concepts of reciprocal causation and feedback loop, together with the Coasian defrosting of the concept of social product argue powerfully against the right's interpretation. In the Coasian world, the idea of a regime which creates low transaction costs is most often a *non-sequitur*: the reciprocal nature of harm conception suggests as much.¹²⁵ Indeed, the establishment of initial entitlements in good X together with the right of free market exchange for good X will in all likelihood create significant transaction costs for the market in good Y. Good Y here would be some good which can only be appropriated or protected when good X is not freely traded. If good X can be freely traded, then the persons desiring good Y will have to pay those who consume or produce good X to cease from doing so. If the costs of identifying actual (and potential) traders in good X are significant, if individual contracts have to be established and enforced, the transaction costs for those who want to trade in good Y are likely to be significant. Let me describe some right-wing visions of what good X and Y might look like:

125. See *supra* note 15-29. See *infra* note 161.

FREE TRADE IN
GOOD X
obscenity
homosexual conduct
dissident speech
sex
abortion

RAISES TRANSACTION COSTS IN
GOOD Y
moral culture
God fearing living
patriotic exaltation
the family
the sanctity of human life

It is, of course, quite possible to give a left-wing schematic of good X and good Y:

FREE TRADE IN
GOOD X
commodities
labor
development of markets
bureaucratic expertise

RAISES TRANSACTION COSTS IN
GOOD Y
meaningful work
self-realization
non-alienated relations
self-determination¹²⁶

Now, of course, an aficionado of right-wing law and economics would likely respond to this second chart with the observation that "There is simply no evidence that persons are precluded by transaction costs from producing or purchasing goods such as meaningful work or self-realization, or self-determination etc."¹²⁷ But this response is wide of the mark. There can be no serious question that from a left perspective, "free trade" in labor and commodities impedes both meaningful work and self-realization.¹²⁸ Ultimately then, the right's response depends upon some notion that whatever obstacles preclude the production of such values do not count as transactions costs.

To illustrate the point, suppose, as is generally the case, that assembly line workers (in the steel mill or in the law school) do not or cannot pay their employers a sufficient premium to deroutinize production and make it more meaningful. Perhaps the workers have not thought of the idea, or they think it likely to fail or perhaps they simply

126. For earlier explorations of this type of schema, see Boyle, *The Politics of Reason: Critical Legal Theory and Local Social Thought*, 133 U. PA. L. REV. 685, 699 (1985) (citing Duncan Kennedy). Peller, *Book Review: The Politics of Reconstruction*, 98 HARV. L. REV. 863, 872-73 & n.13 (1985); Schlag, *An Attack on Categorical Approaches to Freedom of Speech*, 30 UCLA L. REV. 671, 678-80 (1983).

127. I have only heard this response in faculty lounge conversation, but it seems quite plausible given the preference of right-wing microeconomists for market registered transactions. See *supra* note 53.

Horwitz, for instance, suggests that what distinguishes liberal from conservative law and economics is that the former are inclined to find transaction costs everywhere, whereas the latter are instead inclined to deny them and thereby preserve the sanctity of market regimes. Horwitz, *supra* note 105, at 908.

128. See Kennedy, *supra* note 110 at 972. K. MARX, *THE ECONOMIC AND PHILOSOPHIC MANUSCRIPTS OF 1844 106-19* (Int. Pub. 1971) (discussing the structure of alienation associated with the commodity production process).

have not developed a taste for meaningful work. Who knows? The question that confronts us then is how to interpret the workers' failure to pay something in return for more rewarding work.

There are two explanations which I want to consider. The right-wing lawyer-economist would probably interpret the workers' inaction as signifying an absence of market demand for non-boring work. The Coasian perspective, however, might provide insights for a more left leaning interpretation. It might be that the lack of any indication of demand for non-boring work is a function of the transaction costs which inhibit the creation of such a market.¹²⁹ Indeed, once we recognize that the creation of a market economy (free labor and commodity exchange) affects taste, cognition, and the availability of information, we must recognize that these effects can become transaction costs precluding the creation and production of certain values. There is a feedback loop here which the Coasian approach suggests we ought to examine.

Nor can we, as the right-wing lawyer-economists are wont to do, elide this inquiry with the supposition that human beings are rational actors who act to maximize their self interest.¹³⁰ This supposition may or may not be true, but even if it is true, human beings are only rational within the context of the personality and ideological development that they have experienced. Once we see human rationality, not just as an origin, but also as something that is produced (sometimes rather coercively), the right-wing lawyer-economist's radical supposition of rationality loses much of its value.¹³¹ If we are serious about following

129. The structure of the argument is borrowed from the right-wing economists: 1) The good is not traded on the market. 2) We have reason to believe that this good is highly valued. 3) Therefore, the inference arises that transaction costs preclude the existence of the market for that good.

130. As assumptions go, this one really flies. The right-wing law and economics scholars can deduce most of the world with this one. Demsetz put it this way:

Although they [Coase & Director] seem to be different and to address different problems, there was a common theme, and that was to assume that people try to maximize and that really there is competition in the attempt to maximize, and to use those working assumptions to try to explain a lot of things, like why you have firms, why you have particular pricing practices. All the conclusions derive from the attempt of maximizers to overcome certain kinds of costs impediments to maximizing which we now subsume under the name of transaction costs. These things become readily explainable—readily, that is, looking backward—if you take those two assumptions and keep pushing them.

Kitch, *supra* note 5, at 104 (comments of Harold Demsetz). See also R. POSNER, *THE ECONOMICS OF JUSTICE*, *supra* note 43, at 146-227 (discussing the economy of primitive societies on the basis of rational adjustment of behavior in light of costs and scarcity). Demsetz, *Towards a Theory of Property Rights*, *supra* note 55, at 351-53 (interpreting the emergence of property regimes as rational adjustment to scarcity). I think there is little doubt that the right-wing microeconomists lived in Paris in a prior life.

131. It loses value both as a descriptive and normative matter. With the former, the assumption loses value because any behavior no matter how stupid, self-loathing or destructive can be found rational. And that suffices to clinch the normative bankruptcy of the assumption and its

Coase's insights, we should examine the various types of rationality available under alternative social arrangements.¹³² In the next section, I propose to draw out the implications of this suggestion by examining the implications of Coase's insights for the construction of normative legal theory.

One of the implications is to retrieve the subject of production as germane to normative theory. This alone would entail a change in direction for the bulk of contemporary normative legal theory. Normative theory in law typically focuses on problems of distribution and on the correction of invasions of distributional entitlements.¹³³ Production is almost invariably treated by the legal moralists as a derivative (albeit limiting) concern. The economists, by and large, do the opposite: production is their field and the concepts of distribution and correction are treated as derivative (but again limiting concerns).¹³⁴ I think that

productions. We have no reason to be attracted to efficiency as a value if that concept is the maximization of behavior that includes stupidity, self-loathing or self-destruction.

This use of the term "rationality" by the law and economics scholars is what I call an "idiosyncratic definition." See P. SCHLAG & D. SKOVER, *TACTICS OF LEGAL REASONING* 14 (1986) (the words used borrow on the moral or political charge of the terms, while committing us to a peculiar definition). The right-wing microeconomist defines rationality (and, by the way, efficiency as well) in highly technical ways that depart significantly from the moral baggage we bring to these terms.

132. And Coase has come quite close to suggesting the same thing himself:

[T]here is one respect in which I hold a heretical view. Most economists make the assumption that man is a rational utility maximiser. This seems to me both unnecessary and misleading. I have said that in modern institutional economics we should start with real institutions. Let us also start with man as he is. I am not calling into question that more is demanded if something becomes easier to get or that more will be supplied if the price is raised. But what is being maximised? Some of my colleagues quote a statement of Bentham's to the effect madmen also calculate. This is a correct and, I believe, a very important statement. But I would stop there. I do not think that we should draw the conclusion that madmen are also rational.

Coase, *The New Institutional Economics*, 140 *ZEITSCHRIFT FÜR DIE GESAMTE STAATSWISSENSCHAFT* 229, 231 (1984).

133. Thus, for instance, the major contemporary works of normative theory popular in legal circles frame the problem of social justice in distributional terms. See, e.g., J. RAWLS, *A THEORY OF JUSTICE* (1973); R. NOZICK, *ANARCHY, STATE AND UTOPIA* (1974). And when speaking of social justice, we are prone to thinking of that concept in terms of "distributive justice."

I think there is an unreflective ideological tilt in framing the question this way: the conception of social justice in distributive terms mirrors the commodity form for the production of value. Human goods are conceived as discrete entities (rights, privileges, opportunities, etc.), which are held as property, can be capitalized and transferred.

134. Thus, a typical caveat in the microeconomic literature is that the distributional effects of legal rules may have some efficiency effects in some circumstances. See, e.g., R. POSNER, *supra* note 3, at 15. Another typical caveat in the microeconomic literature is that efficiency analysis is not exhaustive of social virtue and that there are other considerations such as distributive concerns, and "moralisms" that may have to be taken into account in fashioning legal rules. See, e.g., Calabresi, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 *HARV. L. REV.* 1089, 1113-14 (1972); A. M. POLINSKY, *AN INTRODUCTION TO LAW AND ECONOMICS* 7-10 (1983). There are, of course, a number of microeconomic scholars who suggest that distributional concerns are resolved as a matter of historical actuality or normative appeal or both in terms of efficiency. R. POSNER, *THE ECONOMICS OF JUSTICE*, *supra* note 43, at 48-118 (equating justice with

much could be gained on the normative side if instead of conceiving of normative legal theory in terms of the metaphors of distribution and correction, we framed the problem more broadly to include human production: just how should we produce ourselves?

VII. EXTENDING THE COASIAN INSIGHTS TO THE DEVELOPMENT OF NORMATIVE THEORY.

It may seem odd to think of rationality or conceptualization as an economic good. Yet if economic theory is capable of encompassing all social values (as economists are fond of reminding us) then consciousness and rationality cannot be banished from the reach of economics.¹³⁵ I think Coase offers some criteria for evaluating the production of consciousness and rationality. By way of example, I will focus on the implications of the Coasian insights on the production of normative theories about law.

First, Coase's insight into the reciprocity of harm provides a critique of the classic approach to normative theory. The classic approach (much like the Pigovian tradition) typically sections off some part of the legal universe (such as distributive justice, the obligation to obey law, etc.) and then attempts to optimize conditions in that particular market.¹³⁶ Following again in the tracks of the Pigovian tradition, the classic approach to normative scholarship extends virtually no consideration for how the reorganization of the section under inquiry will alter the excluded and frozen background. Coase's feedback loop, of course, suggests that this is a dangerous oversight. Indeed, the feedback loop suggests that the advancement of any social value is quite likely to alter the background conditions which made that social value attractive in the first place. Legal scholarship is full of examples of commitments to optimize a particular social value in a particular market with the result that background conditions are so altered that the social value loses some of its initial appeal. A number of ironic twists can be noted here:

efficiency). See also, R. POSNER, *supra* note 3, at 25-26 (suggesting that efficiency is not exhaustive of the concept of justice). For a rare law and economics piece which places distributional concerns at the center of inquiry see, Calabresi, *First Party, Third Party, and Product Liability Systems: Can Economic Analysis of Law Tell Us Anything About Them?* 69 IOWA L. REV. 833 (1984) (analyzing the distributional impact of various tort liability regimes). Calabresi notes that many of the practitioners of law and economics claim that because nothing scientific can be said about the distribution of initial entitlements or distributional values, these must be ignored. *Id.* at 833-34.

135. See *supra* note 51.

136. For a brief discussion of this problem see Schlag, *supra* note 118.

the attempt to humanize through contextualization¹³⁷ . . .

can be expected to yield a degeneration of law into bureaucracy and an expansion of the latter as it comes to encompass the full richness of human relations.¹³⁸

the view that distributive justice is the first virtue of social institutions¹³⁹ . . .

can be expected to create deficiencies and dislocations in the way we produce ourselves as human beings and to ultimately complicate the problem of distributive justice.¹⁴⁰

137. Contextualization seems to have much appeal in a number of politically diverse academic constituencies. The Liberal Center: See Tushnet, *Truth, Justice and the American Way: An Interpretation of Public Law Scholarship in the Seventies*, 57 TEXAS L. REV. 1307-38 (1979) (CLS Scholar suggesting that just about every other article on constitutional law adopts a flexible balancing test to be applied as appropriate in the circumstances). See also, Tushnet, *Anti-Formalism in Recent Constitutional Theory*, 83 MICH. L. REV. 1502 (1985) (discussing the embrace by political liberals of the antiformalist style). Critical Legal Studies: Kennedy, *supra* note 22 (ultimately praising the flexible contextualist standard as against the predictable and certain rule); Gabel & Harris, *Building Power and Breaking Images: Critical Legal Theory and the Practice of Law*, 11 N.Y.U. REV. L. & SOC. CHANGE 369 (1982-83) (praising contextualization). *Feminist Jurisprudence: Scales, The Emergence of Feminist Jurisprudence: An Essay*, 95 YALE L.J. 1373 (1986) (suggesting that the method of feminism is consciousness raising and equating the personal with the political). The moves towards contextualization in legal scholarship are inspired? supported? or ratified? by some broader scale works currently in fashion. C. GEERTZ, *LOCAL KNOWLEDGE* (1983) (Advocating the virtues of "thick description"); M. FOUCAULT, *POWER/KNOWLEDGE* 87-140 (1980) (questioning the relation of truth and power, suggesting that their relation is a local one and advocating the avoidance of totalizing systems of thought); C. GILLIGAN, *IN A DIFFERENT VOICE* (1982) (differentiating male and female ethics by likening the former as given to abstraction and the latter as in touch with the concrete).

The political implications of contextualization are far from clear. To an extent it can be seen as the well-advised strategic retreat of reason designed to preserve some jurisdiction for humane approaches to life and thought in the postmodernist world. It can also be seen as a renunciation of the attempt to use knowledge as power or theory as a control device. See *supra* note 86. Such a renunciation of power in favor of understanding is attractive, but it does present some problems. Contextualization is not immune from the charge of formalism. See P. SCHLAG, *supra* note 22. And contextualization could easily lead to (and rationalize) the bureaucratic management of all sectors of life by the empirical experts.

138. And it can also be expected to defer to contextual extra-legal norms such as convention, custom, common sense or the what-goes-without-saying. See P. Schlag, *supra* note 22, at 410-11 (suggesting that standard context-oriented regimes are likely to defer to external norms).

139. This statement is taken from J. RAWLS, *A THEORY OF JUSTICE* 3 (1973). Rawls suggested that justice was the first virtue in the sense that it is the *sine qua non* of social institutions—the value which requires realization first in a moral sense. In legal circles, there is not much competition for this honored spot. Utility, efficiency and some coarse concept of effectiveness seem to be the recognized prime contenders.

140. The view that justice is the first virtue of social institutions tends to emphasize the way in which goods are distributed among the various participants. Such a view systematically deemphasizes inquiry about what should be produced, by whom and how. In turn, the failure to consider these questions (in theory and in fact) leads to or reinforces the valuation of goods as commodities and exacerbates controversies over the distribution of rights, opportunities and wealth. In commodity production regimes, law is often a zero-sum game—and questions about the nature of justice become increasingly controversial.

the glorification of individual rights in constitutional jurisprudence¹⁴¹ . . .

can be expected to lead to an impoverishment of the community and communal values and thus to undermine the shared cultural commitments that support individual rights.¹⁴²

Countless other ironic twists in the positions taken in the legal literature could be cited.¹⁴³ I don't think any one is immune from this problem.

But I do think that the Coasian feedback loop is an important contribution to the development of an adequate legal theory. At its extreme, this feedback loop suggests that an adequate legal theory should take into account the effect that its particular adoption would have in all the relevant markets. A theory should thus be self-conscious of its historical role. I suppose that if we took this criterion seriously, we would move closer to dialectical thinking—which seems to be one mode of thought which provides a sophisticated and self-conscious understanding of the relation of theory to practice.¹⁴⁴ At any rate, even if Coase does not impel us to take the dialectical road, he at least cautions us that the positivist and foundationalist route is a dead end.¹⁴⁵

A second suggestion for legal theory that can be derived from Coase's article is that we resist deciding what to do by comparing the existing state of affairs with an idealized projection of that state of affairs. Not only is the idealization of that state of affairs likely to produce the difficulties posed by the reciprocity of harm and the feedback loop, but it is likely to create other problems as well. As Coase states:

A second feature of the usual treatment of the problems discussed in this article is that the analysis proceeds in terms of a comparison between a state of laissez faire and some kind of ideal world. This approach inevitably leads to a looseness of

141. We have some big constitutional anniversaries coming up: 1787 and 1791. My guess is that we will see a lot of symposia, conferences, T.V. shows and general media brouhaha about the wonderfulness of constitutional rights.

142. The current surge of interest (among legal scholars) in the Republican tradition may be a reflection of this tension. This tradition offers an image of political community which emphasizes connection, collective self-rule, civic virtue and public dialogue. Michelman, *Foreword: Traces of Self-Government*, 100 HARV. L. REV. 4 (1986); Sherry, *Civic Virtue and the Feminine Voice in Constitutional Adjudication*, 72 VA. L. REV. 493 (1986). This yearning for a more ennobling vision of political community may well be a response to the products of liberal rights-based jurisprudence and its emphasis on separateness, autonomy, and self-interest. See Sherry, *id.*

143. The center liberals' efforts to rationalize the activism of the liberal Warren court by validating extra-constitutional interpretation and by devaluing conventional interpretive approaches may be of some use to help out the activist aspirations of Reagan's right-wing judicial appointments. See Posner, *The Meaning of Judicial Self-Restraint*, 59 IND. L. J. 1, 14 (1983) (arguing that judicial self-restraint is a contingent, time and place—not an absolute—good).

144. See S. WARREN, *supra* note 22.

145. For a cogent summary of dialectical theory see, S. WARREN, *supra* note 22, at 177-98. See also Cornell, *supra* note 22. On anti-foundationalism, see *supra* note 120.

thought since the nature of the alternative being compared is never clear. . . . Actually very little analysis is required to show that an ideal world is better than a state of laissez faire, unless the definitions of a state of laissez faire and an ideal world happen to be the same. But the whole discussion is largely irrelevant for questions of economic policy since whatever we may have in mind as our ideal world, it is clear that we have not yet discovered how to get to it from where we are.¹⁴⁶

Of course, this quote could be read as advising quietism, resignation and maintenance of the status quo (whatever that is). But, I think Coase is hinting at something far more powerful and incisive.

Idealized visions lead to the you-can't-get-there-from-here problem. Ideal normative theory in law (as elsewhere) tends to blind itself to the normative dilemmas involved in moving from this world to a better one. Consider, for instance, the "end-state" and "historical principle" theories of distributive justice.¹⁴⁷ End-state theories (the Rawlsian approach, for instance) suggest that whether a society is just or not depends upon whether goods and opportunities are allocated in that society in conformity with some structural principle of just distribution.¹⁴⁸ One Rawlsian principle, for instance, requires that certain inequalities be structured so as to redound to the benefit of the least advantaged.¹⁴⁹ Historical principle theories, by contrast, require a determination of whether the process by which entitlements and opportunities have been gained or transferred is just. Historical principle theories (such as desert or merit) thus require an examination of the actual historical process by which entitlements have been acquired.¹⁵⁰ The important point is that neither type of theory inquires seriously about what to do when there is a discrepancy between the actual and the ideal. Of course, they often make no claims to pursue such inquiries—in fact, they often make claims that they will not engage in such inquiries.¹⁵¹ But that is the problem. End-state theories focus their attention on developing an ideal end-state—but do not indicate how to get there justly.¹⁵² The question of how redistribution should occur is simply not examined or

146. Coase, *supra* note 1, at 43.

147. The distinction is borrowed from R. NOZICK, *supra* note 133, at 150-55.

148. *Id.* at 153.

149. J. RAWLS, *supra* note 133, at 83, 302 (for various statements of the "difference principle").

150. R. NOZICK, *supra* note 133, at 153-55.

151. *See infra* notes 152 and 155.

152. This question is excluded from the scope of Rawls' work, for instance. J. RAWLS, *supra* note 133, at 8. And in some sense it has to be excluded: the attractiveness of an end-state theory of justice, like Rawls' theory, depends on suppressing historical processes. Once historical processes surface in the account, it becomes apparent that end state principles cannot tell the whole (or even the main) story about distributive justice. *Cf.* R. NOZICK, *supra* note 133, at 154.

not examined with sufficient depth. As for historical principle theories, they are exceedingly modest on how to correct or repair a historical process that has gone awry in the distribution of goods. Generally, the significance of these problems is greatest when the discrepancy between the ideal and the actual is systemic or total.¹⁵³

The failure of normative theories to give serious consideration to this problem invites the sort of errors that Coase warned against. For when one has no guidance as to how to move from an actual world to a rather distant ideal world, the temptation is to begin reform by replicating at the micro level what the ideal would have us do on the macro level or more broadly, to move in the direction of the ideal even if we know we can't get there.¹⁵⁴ Rawls does not make this move, but the temptation remains.¹⁵⁵

The move is a mistake, because as Coase warned, changes in regimes must be assessed from the perspective of the totality. And from the perspective of the totality, achievement of the macro-ideal may at times require doing exactly the opposite of replicating the macro-ideal at the micro-level. Ideal normative theories do not inexorably lead to this sort of mistake, but by neglecting the here-to-there dilemma, they certainly invite the error.

Overall, I think that Coase can be read to offer some powerful suggestions for normative theory. The last contribution he offers is applicable to normative theory as well as to the explicit and implicit theoretical suppositions and structures that underlie all normative and prescriptive scholarship in law. By way of shorthand, these suppositions and intellectual structures may be called "conceptualization". I think that conceptualization is a type of regime which imposes its structure on the

153. That is because in those situations, we can't employ our culturally favored approach: going one step at a time. The Coasian feedback loop poses serious problems for incrementalism if the problems are systemic or total. Each incremental step changes the total situation.

154. As Leff puts it:

[I]n complex processes [which most social processes are] a move in the right direction is not necessarily the right move. To pick a simple illustration, if I am on a desert island, subsisting solely on coconuts and oysters and beginning to hate it a lot, and across the bay from me there is another island, lush and fertile, I do not improve my position in life by swimming half way across.

Leff, *supra* note 30, at 476. For another exploration of this "problem of the second best" as it relates to the practice of law and economics scholarship, see Rizzo, *The Mirage of Efficiency*, 8 HOFSTRA L. REV. 641, 652-53 (1980).

155. J. RAWLS, *supra* note 133, at 7-11, 54, 84. R. Nozick, for instance, recognizes that Rawls limited the application of his principles to the basic structure of society. R. NOZICK, *supra* note 133, at 204-205. And Rawls later articulated more fully his vision of the "basic structure" of society as the subject of distributive justice. See J. RAWLS, *Basic Structure as Subject* in VALUES & MORALS 47 (1978).

practice of and the reflection about law. The Coasian insights suggest an economic approach to conceptualization:¹⁵⁶

1. Where conceptualization imposes no transaction costs on the subsequent attempts to understand human behavior or to enhance the social product, the choice of which conceptualization to adopt will have no impact on the allocation of intellectual resources or the social product.¹⁵⁷
2. Where, however, conceptualization does impose transaction costs on subsequent attempts to understand human behavior or to enhance the social product, the choice of which conceptualization to adopt will have allocative effects on the deployment of intellectual resources and will have implications for the social product. In such cases, one should either:
 - a. try to eliminate these transaction costs as much as possible by deconstructing and exposing the mystifying effects of existing conceptualizations;¹⁵⁸
 - b. one should attempt to discern the sort of conceptualizations we would have arrived at in the absence of ideological distortion and the unreflective commitments of convention.¹⁵⁹

Of course, these suggestions are not Coase's: they are displaced paraphrases of what some lawyer-economists have inferred from *The Problem of Social Cost*. Perhaps then, the best (or rather, the least awful) thing to do is to remain loyal to the nihilistic thrust of Coase's article—in which case, the point is: "In devising and choosing between. . . (various ways of conceptualizing) . . . we should have regard for the total effect. This, above all, is the change in approach which I am advocating."¹⁶⁰

156. This approach might be seen as an economy of theoretical conceptualization. There is nothing particularly shocking or novel in this concept. After all, we already apply aesthetic criteria to evaluate our normative theories: consistency, sweep, elegance, coherence, etc. Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103, 110 (1979). The relation of these aesthetic criteria might themselves be considered a certain economics of style. Elegance, for instance, is little more than an imperative to develop economies of scale. Coherence is achieved by minimizing the factors of theoretical production used. Sweep is a function of the rate of marginal substitutability with other theories. And so on.

157. "This is, of course a very unrealistic assumption." Coase, *supra* note 1, at 15.

158. J. DERRIDA, *WRITING AND DIFFERENCE* (1978).

159. J. HABERMAS, *THE THEORY OF COMMUNICATIVE ACTION* (1984).

160. Coase, *supra* note 1, at 44.