Liberal feminist jurisprudence

Liberal feminism is based on the belief that women are rational autonomous individuals who are entitled to the same rights as men. Women are capable of making rational decisions about their own interests and should be treated equally under the law and have equal opportunities with men. Liberal feminist jurists uphold the basic principles and institutions of liberal society and seek to use them to better the conditions of women. Their object is to make liberal laws more truly liberal in relation to women.

Liberal feminists realised that despite formal legal assurances of equality they were not always equally treated by the law. Equality, as understood in liberal jurisprudence, is the equal treatment of persons in similar conditions. Equality does not require that children and adults receive the same punishment for a crime, or that the poor and the rich pay income tax at the same rate, or that infants should have voting rights at the general election, or that clergymen and women should perform military service like everybody else. Different treatment of persons similarly placed defeats the aim of equality. So does the similar treatment of differently placed persons.

Liberal feminists argue that the law sometimes treats men and women differently when it should treat them the same way, and treats them the same way when it should treat them differently. The Idaho statute struck down by the US Supreme Court in *Reed v Reed* 404 US 71 (1971) gave preference to males over females in the appointment of administrators to administer the estates of deceased persons. The Supreme Court could not see any material difference between men and women that allowed the state law to treat them differently. This success was the culmination of sustained legal research and advocacy by liberal jurists such as Ruth Bader Ginsburg, a professor of law at Rutgers and Columbia universities who is now a justice of the United States Supreme Court. At the other end we find laws that do not recognise material differences. Some rules and doctrines of criminal law and tort law seem not to acknowledge special circumstances that differentiate the condition of men and women. Criminal law in the past did not accept that women who are subject to continual domestic violence and abuse ('battered women') could plead diminished responsibility for killing their spouses or partners unless it was done in self-defence. Common law courts now admit evidence of the mental condition of battered wives in determining the defence of provocation: see, for example, *R v Ahluwalia* (1992) 4 All ER 889; *R v Thornton (No. 2)* (1996) 2 All ER 1023; *R v Charlton* (2003) EWCA Crim 415; *The Queen v Epifania Suluape* (2002) NZCA 6.

The defence of provocation reduces liability from murder to manslaughter where the killing results from a loss of self-control in response to provocation, in circumstances where an ordinary person could also have lost self-control. The 'ordinary person' tended to be identified with the 'ordinary male person'. The ordinary male person has no experience of being a battered spouse. Hence, the category did not accommodate the special condition of women. The

efforts of the lawyers in the cases mentioned resulted in the reformulation of the category. Liberal feminist litigation seeks to break down male-oriented categories and thereby attune the law to women's experiences. This is entirely consistent with classical liberal thinking.

An important debate within feminism concerns the sameness of men and women and the difference between them. Should the law treat men and women as formally equal, or should it recognise women's special circumstances and needs? Formal equality requires that the law does not acknowledge sex-based distinctions. Liberal feminists tend to favour the sameness thesis. They say that differences between men and women have been used to discriminate against women. Women, for example, were barred from many kinds of employment on grounds that they were physically or psychologically unsuited for the work involved. Sameness feminists argue that the emphasis on differences weakens women's abilities to gain equal rights. Women do not have to deny their differences from men, but they can gain more by discrediting false differences that are used to deny them opportunities open to men. Wendy Williams expressed the equality argument this way:

> We who are different share in this particular context at this particular time a quality, trait, need or value that locates us on the same platform for this particular purpose. We see a connection in a particular respect that we who are different think entitles us to partake in the same meal, drink at the same trough, or march to the same drummer – at least in this particular parade. (1989, 104)

Cultural feminism

Cultural feminists emphasise differences between men and women. Liberal notions of law, legality and legal process, they believe, are shaped by masculine values and views of the world. Men think of themselves as individuals disconnected from each other, whereas women think of themselves as connected to others. The difference is illustrated by Carol Gilligan's hypothetical dilemma posed to sixth graders Jake and Amy. They are told that Heinz's wife will die without a certain drug that Heinz has no money to buy. Should he steal the drug? Jake opts for stealing, giving priority to saving life over being honest. Amy, on the contrary, says that 'they should talk it out and find some other way to make the money'. Gilligan concluded: 'Amy's judgments contain the insights central to the ethic of care, just as Jake's judgments reflect the logic of the justice approach' (1982, 30). Gilligan accepted that this was not a scientific study, but presented it as an illustration of what she believed is an important difference in the way men and women develop psychologically. Cultural feminism has been greatly influenced by Gilligan's work on gender difference.

Robin West argued that virtually all modern legal theories explicitly or implicitly embrace what she called the separation thesis about what it means to be a human being. This is the view that a human being is physically separated

from every other human being. West gave the following statement by political philosopher Michael Sandel as the definitive statement of the separation thesis:

> [w]hat separates us is in some important sense prior to what connects us – epistemologically prior as well as morally prior. We are distinct individuals first, and *then* we form relationships and engage in co-operative arrangements with others; hence the priority of plurality over unity. (Sandel 1982, 133; West 1988, 1–2)

West argued that even CLS theory is based on the separation thesis. Liberals celebrate the separateness and fear its destruction, whereas CLS theorists lament the separation and long for association (West 1988, 5).

West presented the 'connection thesis' as the central insight of feminist legal theory. According to this thesis, 'women are "essentially connected," not "essentially separated" from the rest of human life, both materially, through pregnancy, intercourse, and breast-feeding, and existentially, through the moral and practical life' (West 1988, 3). West claimed that women are 'more nurturant, caring, loving and responsible to others than are men'. She said: 'Women think in terms of the needs of others rather than the rights of others because women materially, and then physically, and then psychically, provide for the needs of others' (1988, 21). West and Gilligan have been accused by other feminists of essentialism. Essentialism is the belief that an entity (such as, say, 'woman') invariably displays certain essential characteristics – a charge that they have denied. Obviously there are women who do not fit West's stereotype. Many women 'attain atomistic liberal individuality' but, West said, 'just as obviously most women don't' (1988, 71).

The legal system, from the cultural feminist standpoint, fails to reflect the way women live their lives and think about life. It is too focused on rights and individuality that reflect the male nature. Yet men and women live in a common space in society. Cultural feminists imagine a utopian world where the legal system 'will protect against harms sustained by all forms of life' (West 1988, 72).

Radical feminism

Radical feminists agree with cultural feminists that women are different from men. Unlike cultural feminists, they believe that these differences are constructed through male domination. Men have defined women. The main difference between men and women is power. Men have power and women are subject to power. A leading feminist radical, Catharine MacKinnon, argued that feminists are mistaken in fighting for equality, which is a liberal ideal. Equality means sameness, and men and women are different. MacKinnon wrote:

> Put another way, gender is socially constructed as difference epistemologically; sex discrimination law bounds gender equality by difference doctrinally. A built-in tension exists between this concept of equality, which presupposes sameness, and this concept

> of sex, which presupposes difference. Sex equality thus becomes a contradiction in terms, something of an oxymoron, which may suggest why we are having such a difficult time getting it. (1987, 32–3)

MacKinnon's point is that to gain equality women have to be the same as or similar to men. This confirms domination. MacKinnon urged feminists to abandon the male ideal of equality and shift their attention to the real but neglected issue of subjection of women. She called this approach the dominance approach. The dominance approach calls on feminists to focus on rape, sexual assault of children, which is endemic in the patriarchal family, the battery of women in a quarter to a third of homes, prostitution and pornography, which exploit women for profit.

How radical is MacKinnon's feminism? Liberal jurists agree wholeheartedly with MacKinnon about the subjection of women in these ways. They would also like to see this subjection eliminated. On pornography they differ, because censorship gives the state the power to define what acceptable sex is for women. Lucinda Finley pointed out that not all women share MacKinnon's view of acceptable sex (1988, 382). MacKinnon treated women as a class, neglecting differences among women themselves. Problems such as domestic violence and child abuse, which usually happen in homes, cannot be fought with law enforcement alone. Feminists are surely right in pointing out that nothing short of a cultural and moral transformation of male dominance (to the extent that it exists) will be sufficient to address these problems.

Postmodern feminism

The reader would not have failed to notice the influence of CLS and postmodernism on feminist jurisprudence. Postmodernism informs feminist theory in two ways. First, it challenges the rationalism on which mainstream Western philosophy and science are based. Postmodernists deny that knowledge can be objectively established, and hold that all truths are contingent on subjective experience. Thus, what is true from the male point of view may not be true from the female point of view. Second, postmodernists say that the categories that we use in speech, such as 'man' and 'woman', have no privileged meanings, but only meanings that are given to them by the language community or by the community's 'epistemic authority' or the 'authorised knowers'. In one way or another, these categories are 'socially constructed' and have no independent validity. Feminists conclude from this proposition that these categories have been established by men according to the masculine point of view.

If these categories are socially constructed, it must be possible to socially reconstruct them, provided that the social forces that created the categories in the first place are tamed or reformed. This is what most feminist theories try to promote, through intellectual discourse and political action. One form of postmodernist thinking, namely deconstruction theory, poses a problem for feminist

goals. Deconstructionist theory, like other postmodern views, exposes the lack of a transcendental reality and denies the possibility of objective knowledge. It provides a powerful analytical tool for deconstructing established categories and knowledge claims in society. Yet it turns out to be too powerful for feminist purposes. According to deconstruction, the very idea of a category is nonsensical. Every category disseminates into the hopeless indeterminacy that Derrida called *aporia*.

Feminists such as Drucilla Cornell who have embraced deconstruction theory use it to deconstruct male-oriented categories, but they also refuse to construct female categories in their place, since they deny the very possibility of categories. The problem for feminist action is obvious. As Cain pointed out, any theory requires some degree of abstraction, and if women are considered to be situated in their individual realities, as deconstructionist philosophy suggests, it is not possible to develop a theory or strategy to combat the injustices they face. According to deconstruction theory we create our worlds through myth and allegory. Cornell's answer is that women should create their own allegories and myths to counter those that are used to suppress them. This would involve collective imagining on the part of women. In other words, women should write their own story and create their own 'reality in which they achieve a superior way that is valued' (Cornell 1990, 699).

Challenges to liberal jurisprudence: concluding thoughts

The radical jurisprudence discussed in this chapter has raised new questions and contested long standing assumptions about the law. This is an unambiguous good. These theories have proved useful in providing analytical tools to break down stereotypes and to expose the artificialities of concepts assumed to be natural in law and society. In many ways, these theories have added new dimensions to the sociology and psychology of law. They have brought to centre stage the issue of social construction of legal language and the structural injustices that flow from the law's insensitivity to the experiences and circumstances of different groups. They have generated new awareness among liberal jurists and, to use Kant's words, awoken some of them from their dogmatic slumber.

The common theme among CLS scholars, postmodernists and feminists is the insight that concepts, categories and methods of law are socially constructed. The term 'construction' suggests deliberate designing on the part of someone or some group. Society as a whole cannot construct anything in this sense. Society is not a person with an independent mind, but a community of interacting individuals. Social construction, therefore, must mean construction in the following ways. First, certain persons or bodies, such as rulers, parliaments and their delegates, claim to represent the will of the society and to have the

authority to make law for society. A great deal of law has been constructed in this manner in liberal societies. One needs only to look at the thousands of volumes of statutes, subordinate legislation and law reports in law libraries. Second, there is a great deal of law that has not been deliberately designed in this way. I include within this body of law the common law and all the informal social rules such as customs, traditions, etiquette, and even superstitions. They all affect the way social relations are formed and changed. In what sense have these rules and the categories that they create been socially constructed? As discussed in Chapter 10, these rules arise spontaneously from the interactions of members of society.

Spontaneous emergence does not mean that particular individuals or groups have not had superior or dominant influence on the law's growth. It is certain from what we know of the natural history of the human race that men from the beginnings of society would have had greater influence than women in the way social rules developed. Common law judges have historically been males from the upper ranks of society, and their worldview would have certainly influenced the development of the law. What spontaneous order means is that countless factors – including ecology, biology, psychology, economics of survival and, as Lyotard pointed out, sheer happenstance – are involved in the emergence of the complex order that we call society. The males of the human species, brutes as they are, cannot claim the honour of sole responsibility for the way civilisation has turned out. If we do not recognise the complexity of our condition we diminish our capacity to make our condition better.

CLS theorists, postmodernists and feminists wish to transform society to one extent or another. Unlike the political revolutionaries of the past, they do not propose violent change. Quite rightly, they do not trust violent revolution to produce the kind of society they envision. In any case, liberal societies have proved resilient against revolutions of the violent type. Liberal social and legal structures have remained largely intact, and in some respects have become stronger. The strengthening of international trade and commerce and the democratisation of many previously authoritarian nations provide the strongest, but not the only, evidence of this trend. Radical legal theorists aim to change the legal order by changing the minds and hearts of people through intellectual persuasion. Significant changes have occurred in the past four decades, and radical theorists deserve a generous share of credit. However, in the field of women's advancement I think the greatest credit goes to the liberal feminists, who tirelessly and unrelentingly pursued the cause of law reform through the institutions of the liberal state.

Radical legal theorists of every kind should ask the following questions and answer them honestly. Will their cause be served better by tearing down the liberal state and the liberal legal system? What kind of society and power structures will emerge if their theories overturn democratic liberalism? Will they be stable or will they fall prey to sectarian interests? How can utopian conditions be maintained without force? If force is granted to authorities, how can it be contained

and directed solely to its proper end? Liberal society and liberal law are imperfect, and liberal thinkers know it. Yet liberal societies have proved stable and workable. The idea that liberal law is pervasively oppressive has proved difficult to sell among the general public. There might be a lesson in this. Radicals need to ask whether they could be wrong after all. The gains that have been made by disadvantaged groups have been through the political institutions of liberalism. Alternative imaginings and utopian speculation are useful as tools of analysis and criticism. It is mainly in this sense that they have served the causes of the disadvantaged in society.

9

Economic Analysis of Law

What has law got to do with *economics*? Most lawyers will probably say 'nothing' or 'not much'. However, if the question posed is 'What has law got to do with the *economy*?', most lawyers are bound to answer, 'quite a lot'. The laws of property and contract allow people to trade in goods and services. Consumer protection laws place restrictions on how traders may conduct trade. Labour laws regulate the labour market. Competition law aims to increase competition and prevent monopolies. Tort law gives protection to person and property from wilful or negligent harm, without which trade and commerce would be seriously restricted. How can farmers grow wheat and sell their crops if their land is not secure from trespass and their crops not protected from theft? How can General Motors or Ford make and sell cars if they have no ownership of the cars that they produce? International trade and investment law promotes trade and investment among nations. There will be little foreign trade or investment if states do not recognise the rights of citizens of other states. Even laws concerned with private morality have economic effects. Prohibition of alcohol consumption in the United States gave rise to a new industry known as bootlegging. Most lawyers accept that laws affect the economy, directly or indirectly.

Lawyers also have no difficulty in recognising that economic factors have quite a lot to do with legislation passed by parliaments. Governments, depending on their philosophies, react to economic forces in different ways. They may promote or suppress competition. They may enact laws to counter what they think is inequitable wealth distribution caused by markets. They may seek to limit rising costs of products through price controls, or try to support producers by subsidies. They fight inflation and deflation using whatever legislative devices they can find. So, what can economic science teach lawyers about law that lawyers do not already know? It turns out to be quite a lot. This chapter

examines the contributions that economic science has made to the understanding of law.

The large body of theory and empirical studies produced by economic analyses of law and legal institutions is commonly known as law and economics (L & E). There are, in fact, three major branches of law and economics. They are:

1. *Transaction costs economics*, which evaluates the efficiency of legal rules with a primary focus on private law. The term 'law and economics' usually refers to this branch of learning.
2. *New institutional economics* (NIE), which develops economic explanations of the emergence and change of institutions. 'Institutions' in this context does not mean organisations like firms, government departments and central banks. It means all the constraints on human action, including formal legal rules as well as the more informal customs, traditions and social rules. (The term derives from the Latin *institutiones*, which refers to established rules.) The field includes game theory as applied to the study of institutional evolution.
3. *Public choice theory*, which is concerned with the study of democratic decision-making processes using the insights and methods of microeconomics. Public choice theorists typically study how majority voter coalitions are formed and votes are traded in legislative assemblies and the electorate, and the phenomenon of rent seeking.

New institutional economics is discussed in some detail in Chapter 10. This chapter mainly discusses transaction costs economics, but it includes a short discussion of the central ideas of public choice theory. The discussions in this chapter begin with a brief introduction to some basic concepts in economics that are central to understanding economic analyses of law. This is followed by an examination of the problem of transaction costs and its bearing on the formation of legal rules. The hypothesis that the common law system by nature tends to produce efficient rules is critically examined. The chapter proceeds to a brief discussion of the economics of legislation as revealed by public choice theory, and closes by considering some of the moral objections to the economic approach to law.

Background and basic concepts

The branch of economic analysis of law generally known as law and economics arose out of the work of American lawyer-economists Ronald Coase, Guido Calabresi and Henry Manne on the efficiency of common law rules concerning property and nuisance. The studies expanded into other areas of law as the field attracted a growing number of scholars in the United States and Europe, in law schools and economics departments of universities. One of the most prolific and influential current writers is Richard Posner, Chief Judge of the United States Court of Appeals for the Seventh Circuit.

Law and economics, in its 'pure' sense, is positive as opposed to normative. It is about the world as it is rather than as it ought to be. It is about the economic cost (or social cost) of different rules, and not about the morality or justness of rules. It does not tell judges and legislators what rules to make, but tries to inform them of the relative costs of alternative rules. Consider, for example, the ongoing efforts of governments in industrialised nations to reduce carbon dioxide emissions to address the global warming problem. Economists may show that legalising nuclear power plants is an efficient way to reduce emissions, and they may well be right. Although a government may rule out nuclear power for moral or emotional reasons, at least it will know the economic cost of its moral decision.

It is always possible to draw normative conclusions from positive science, and many writers of law and economics move back and forth between positive and normative theorising. The normative conclusions from L & E studies have tended to favour free markets and limited government regulation of property and contract. It is not surprising that law and economics have many strident critics. Some of the attacks do not distinguish between the positive and normative aspects of L & E theory, leading to much confusion in scholarly debate.

Positive L & E has narrower and broader versions. The narrower version concentrates on calculating the economic efficiency of particular rules and their possible alternatives. The broader version also does this, but goes further to claim that the common law system by its nature gravitates towards efficient rules. This is known as the 'efficiency of the common law hypothesis'. It is logical to proceed from the narrower to the broader version. However, we must start with some basic concepts in economics without which L & E cannot be understood.

Cost, price, value, utility

It is important distinguish these four concepts to get anywhere in this field. Imagine the following case. A is a carpenter. He makes a writing table with wood that he buys from a timber yard and with tools that he has bought from the hardware store. He spends three days making the table, and afterwards offers it for sale at his showroom with a price tag indicating that he is willing to sell it for $100. Many people inspect the table but do not buy it. Eventually B, a wealthy customer, offers $80 for it. C, who is a student on a subsistence income, would pay up to $110 for the table but has only $50 to spare. A sells the table to B. All the expenses that A incurred in making the table and the value of the time he spent making it constitute A's *costs*. The amount of $100 stated on the price tag is the *price*. The amount that B is willing to pay, namely $80, is the *value* of the table for B. C's need for the table is greater than B's need and the $110 that C is willing to pay may represent the *utility* of the table to C.

Value and utility are distinct ideas in economics. Value is what a person is willing to pay for a good or service. Utility is the subjective worth of the good or service to an individual. Utilitarians such as Bentham regarded the utility of

a thing in terms of the pleasure it brought to an individual. Utility is difficult to measure, as it is subjective. Value is simply a fact. Hence, economic calculation is usually based on value. The disregard of utility makes economics distasteful to some people. Cost and price are also distinct. A might have incurred only $50 in costs to make the table. The price of $100 is what he thinks someone will be prepared to pay. The profit of $50 may seem very large and unreasonable, but that is again a subjective judgment. A is in the business to make an income so that he can pay his mortgage and household bills, send his children to school and do the kinds of things that most people like to do in life. Of course, he might find that no one is prepared to pay $100 for the table, so that he may have to keep reducing the price to the point at which it sells. If he is forced to sell products below cost, he will close his business and do something else. We assume that B buys the table for $80, which is the eventual price. However, B's cost of buying the table is more than the price, as B had to find the table, bargain with A and then transport the table home. The cost to B is the price plus all the other expenses and the time spent.

The concept of price has enormous significance. The price at which A finally sells the table ($80) conveys a large amount of information about what is going on in society. It tells us that $80 is likely to be the highest value that people attach to the table. At $81 B will find something better to do with the money. It tells us that people think that the extra $1 is not worth spending on the table. We are talking about just one product here. Since this is the case with all transactions, the mechanism of price is critical in the efficient allocation of resources to those who value them most, though not necessarily to those who need them or deserve them most.

Economic efficiency

Efficiency is achieved when more output is gained from the same resources. A car that runs 15 kilometres on a litre of petrol is more fuel efficient than a similar car that runs only 10 kilometres on a litre. When all the mathematics, tables, graphs, models and regressions are peeled away, economics is revealed as common sense (Gwartney *et al*. 2005). Most of us make economic calculations in living our lives, though we may have never taken a course in economics. We try to make efficient use of our resources. Apples are expensive to day, so should I buy some other fruit? Should I pay more for a stylish jacket or buy a cheaper one that keeps me warmer? Should I go to the movies tonight or stay at home and study for my exam? Should I join a law firm where I will earn more money, or work for Legal Aid and gain more personal satisfaction? Should I give to Charity A or Charity B? How should I invest my savings? Sometimes we sacrifice our short-term interest to achieve long-term goals. Families avoid luxuries for a few years so they can collect a deposit to buy a house with a bank loan. In short, we try to work out our preferences, value them and make the best choice. If we normally try to make efficient decisions in our personal lives, we would expect

the same of our governments and law makers. So, what is efficiency in economic calculation?

There are many ideas about economic efficiency. The one used most widely by law and economics scholars is 'Kaldor-Hicks efficiency', named after the economists who formulated the concept – Nicholas Kaldor and John Hicks. The Kaldor-Hicks concept is a refinement of 'Pareto efficiency', named after the Italian economist Vilfredo Pareto. Let us start with Pareto efficiency.

According to Pareto efficiency, an outcome is more efficient if at least one person is made better off and nobody is made worse off. Let us say that A wishes to sell a painting that she values at $1000. B likes it so much that he is happy to pay $2000. However, he offers $1500, which A accepts. Both parties are better off and neither is worse off. The transaction is Pareto efficient. If a law reduces the tax on petrol (gasoline) and the reduced revenue has no impact on any of the services provided by the state, the law will be Pareto efficient. Pareto *optimality* (the level of greatest efficiency) is reached when no further improvement can be made without making a single person worse off.

The problem is that, in the real world, an action that affects a large number of persons will hardly ever be Pareto efficient. A reduction in income tax will benefit most taxpayers, but the resulting loss of revenue is likely to be felt elsewhere by others who rely on social services or state employment. A reduction in import tariff will make consumers better off but local producers worse off. A noisy textile factory will benefit the community generally but will cause nuisance to those living nearby. Any major change is likely to make at least one person worse off. Kaldor and Hicks proposed a new definition of efficiency, taking account of this reality. A measure is Kaldor-Hicks efficient if *in theory*, those who are made better off can compensate all those who are worse off. Kaldor-Hicks efficiency does not require that every person adversely affected *must be compensated*, only that the gains made by the winners should be sufficient to compensate the losers. Australia had a state-owned telecommunications monopoly over a long period, until it was ended in 1997. Some employees lost their jobs and the government lost revenue. However, the value of the benefits that consumers gained by the entry of new companies far outweighed the losses. The important point to remember is that Kaldor-Hicks efficiency can and does leave some people worse off. This is the nature of the real world. The Kaldor-Hicks formula remains the economic principle underlying cost and benefits analysis of laws and policy.

Wealth and wealth maximisation

A basic premise of law and economics, and one closely related to efficiency, is wealth maximisation. Wealth maximisation, in its technical sense, is not the maximisation of individual wealth but the increase in the wealth of society as a whole. Robbers increase their wealth by robbing banks, but decrease the wealth of the banks and their customers. The effects of the robberies flow on to the

community at large, as the banks spend more on security and pass on the costs to consumers. What is society's wealth, and how can it be measured?

Wealth is not utility, and wealth maximisation is not utility maximisation. Utility refers to the happiness a person gets out of having something. Happiness is impossible to measure. Hermits may be happy with bare sustenance, while millionaires may be unhappy with all their riches. What can be measured even roughly is what a person is prepared to pay for a thing. In technical language, this is the value of a thing to a person. Hence, wealth is measured by the value that persons place on goods and services. Value, as we have seen, is not the same as the price of a thing. A customer might be prepared to pay $100 for the table in our example, but it has already been sold for $80. Wealth, then, is the aggregate of the values that people attach to things from their point of view and in their personal circumstances. The quest for measuring social utility is abandoned in favour of social wealth.

Economic analysis of law takes as its guiding principle the maximisation of wealth, not of the individual but of society. The moral objections to this approach are considered at the end of this chapter.

Transaction costs and the law

If economic efficiency requires the comparison of costs and benefits, it is important to identify all the costs. One type of cost that remained unnoticed for a long time is transaction cost. Classical economic theory did not consider transaction costs in a serious way until the arrival of L & E. Transaction costs include all the costs incurred in completing a transaction.

Here is a common scenario. Driving through farm country you notice that farmers are selling apples at $2 per kilo, but you find that your local greengrocer sells apples of the same kind and quality for $3 per kilo. You might think that the greengrocer is making a big profit, but that is because you are taking no account of her transaction costs. Clearly the greengrocer (if she has bought at $2 per kilo) is making a profit of somewhere between $0 and $1 per kilo. She incurs all manner of transaction costs to bring the apples to the point of sale. She must find reliable suppliers, strike bargains regarding price, quality and quantity of the fruit and pay for the transport of the fruit to the store. If the fruit is found to be substandard, she has to find a way of recovering the loss, as a last resort by court action. The major part of transaction costs relates to finding trading partners and goods (information costs), bargaining with them (bargaining costs) and enforcing contracts (enforcement costs). The greengrocer must take account of all her transaction costs in fixing the price of her apples.

The modern L & E movement, with its emphasis on transaction costs, is widely thought to have started with Coase's ground-breaking article, 'The problem of social cost', published in 1960. Coase (b. 1910) is an English economist, a product of the London School of Economics, who migrated to the

United States in 1951. He taught at the University of Buffalo and the University of Virginia (where he wrote 'The problem of social cost') before commencing tenure at the Chicago Law School. He was awarded the Nobel Prize in Economic Science in 1991. Coase revealed the basic insight behind L & E, namely the existence of transaction costs, decades earlier in his article 'The nature of the firm', published in 1937 when he was still at the LSE (Coase 1937).

Firms produce a great proportion of the goods and services in a modern industrialised society. Firms include incorporated companies and partnerships. The publisher of this book is a firm. The university that employs me is a firm. My superannuation is managed by a firm. My local supermarket is a firm. My lawyer is a partner in a firm. Life in commercial society is full of dealings with firms. Coase asked why firms emerge at all in a market economy, where individuals can simply make contracts with others to obtain what they want (Coase 1937, 390). The reason, Coase argued, is transaction costs.

Consider the case of Bev the builder, who makes a living out of building houses for others. She needs to hire architects, concreters, carpenters, bricklayers, electricians, plumbers, accountants, cleaners and scores of other technicians. One way of obtaining these services in the open market is by making contracts with individual craftsmen. Bev might hire A to build the walls, B to tile the roof, C to do the plumbing, D to do the electrical wiring, and so forth. Bev finds this terribly frustrating because of the difficulty in finding reliable tradespeople and in negotiating contracts for specific jobs and suing the tradesmen when they don't deliver the promised services. In other words, she incurs a lot of 'transaction costs'. It makes more sense for Bev to employ some of these technicians on an ongoing basis on an agreed salary. She can simply fire them if they don't perform. Look at it from the point of view of, say, D the electrician. He too faces costs in finding people who need his services, in concluding contracts and in enforcing them. He also finds that his income rises and falls according to seasonal and other factors. It would make sense for him to become an employee in Bev's firm, with a guaranteed monthly income. Thus the firm expands to embrace all sorts of specialists. Bev is able to do the transactions within the firm, where she is boss, instead of doing them in the open market.

However, things may not stay that way. The firm may get so big that the cost of managing further transactions within the firm may exceed the cost of doing them in the open market. Or else Bev may find that there is wastage of the labour employed (Coase 1937, 394–5). Labour laws may increase the costs of employing workers. New technologies may reduce the cost of outsourcing jobs. (My university once employed a small army of cleaners, but now has engaged a cleaning company to clean our buildings. The university once did its own printing, but now uses a printing company. Some universities even outsource teaching on their off-shore campuses.) Most building companies these days prefer to use sub-contractors rather than employ their own skilled workers. The expansion and contraction of firms depends, ultimately, on transaction costs.

Coase's next major insights were that: (1) law has much to do with transaction costs; and (2) transaction costs spread to society as a whole. What may appear as a problem between two parties may actually have economic consequences for the wider community. Coase explained these insights through his searching analysis of common law decisions on nuisance.

Try to imagine a world with zero transaction costs. It will look very much like the world of Robinson Crusoe in Daniel Defoe's famous novel. Crusoe, the sole survivor of a shipwreck, finds himself on an uninhabited island. Since there is no one else on the island he commands all of its resources. Crusoe hunts animals and grows crops, builds a home and lives a life that is constrained only by the laws of nature. He has zero transaction costs because he has no one to transact with.[1] Crusoe lives in what Richard Epstein called the world of the single owner. 'The single owner knows his own preferences and the various distributions of resources under his command . . . His sole task is to order his own preferences and find the right techniques to satisfy them' (Epstein 1993, 556). Law has no meaning in a one-person world, as law is concerned with relations between persons.

Real societies have many persons interacting with each other. Coase argued that if there were no transaction costs it would not matter what the law was. If the law allowed me to pollute my neighbour's land with smoke, my neighbour could pay me to use cleaner fuels, re-tool my factory or even close it down. If the law prohibited me from polluting my neighbour's property, I could buy from her the right to pollute. Either way, we would bargain to the most efficient arrangement under which the activity that was valued most would continue. All that would be needed would be clear property rights and the freedom of contract. Consider the following concrete example. Assume that the law makes the owner of a factory liable for damage caused to neighbours by the factory's emissions. A owns a factory and B owns the adjoining farmland. The smoke from A's factory causes $10 000 worth of damage to B's crop. It is possible for A to prevent this damage by installing a smoke prevention device at a cost of $5000. Hence, it makes economic sense for A to install the device, as otherwise she will lose $10 000 in a damage payout. Now let us assume that the law is the reverse. A is not liable for damage caused by pollution from the factory. It makes sense for B to offer $5000 to A to install the device. In fact he may decide to offer $6000 as inducement. A is likely to accept the offer and install the device because B is bearing the cost and she is gaining a profit of $1000. B cuts his loss from $10 000 to $6000. In either case, the device will be installed and the efficient solution will be achieved. What if B does not have $6000 to pay A? This is not a serious problem, because he is saving a crop worth $10 000, so he can borrow the money against that value. We are assuming, of course, that transaction costs are zero and that the markets are working smoothly.

1 Crusoe is eventually joined by Friday, whom he rescues from a band of cannibals that use the island occasionally for human barbeque picnics, and later by Friday's father and a Spanish sailor whom Crusoe and Friday rescue on another occasion.

Coase's counterintuitive insight was to recognise the reciprocal nature of such problems:

> 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 1960, 2)

However, the real world is not free of transaction costs. Even in our simple example, the parties have to measure the extent of harm, agree on the dollar value and negotiate to reach a bargain. They also need to ensure that the bargain that is struck is carried out. It is usually very expensive to enforce the bargain if either party dishonours it. Just think of lawyers' fees! Again, if the pollution harms not just one neighbour but all persons residing within surrounding areas, it will be impossible to strike bargains with all of them. The problem may be caused by the cumulative effect of emissions from many factories and motor vehicles, making bargaining even more difficult. The existence of these transaction costs makes the initial allocation of rights matter.

Assume that the rule is that a factory owner must compensate every person harmed by the factory's emissions. Assume also that the factory is producing textiles used by the community at large. If the cost of striking bargains with every affected person is less than the benefit from being able to continue operating the factory, the owner will incur the bargaining cost and keep the factory running. If the bargaining cost is higher than the value gained by continued production, the factory owner is likely to close down the factory. The closure affects not only the factory owner but also the general public. Unless the common law courts (or the legislature) change the rule to limit the factory owner's liability the local production of textiles may cease permanently. This is the problem of social cost. The general point is that legal rules that allocate rights and duties have a critical bearing on the efficiency of the economic system. As Coase pointed out, where it is too costly to rearrange legal rights by market transactions, 'the courts directly influence economic activity' (1960, 19).

The problem of initial entitlements

According to the Coase theorem, in a zero transaction cost world it does not matter whether A has the right to pollute B's land or B has a right not to be polluted by A. If A has the right to pollute B can pay her to stop the pollution, and if A has a duty not to pollute she can pay B to acquire the right to pollute. In both cases, A and B will reach the most efficient solution and there will no cost imposed on society. In other words, in a zero transaction cost world the initial allocation of rights between A and B does not matter to society in an economic sense. Although there is no *social cost*, there will be a *private cost* to A or B depending on how the law allocates rights and duties. If A has a right

to pollute, B will have to spend money to get A to stop the pollution, or endure the loss. If B has the right not to be polluted, A has to buy the right to pollute, or spend money to prevent the pollution. Initial entitlements matter in the real world.

The economic approach has been criticised for its alleged neglect of the issue of initial entitlements. This is not actually true, as a number of L & E scholars have addressed the issue. The contribution of Calabresi and Melamed in 'Property rules, liability rules and inalienability: one view of the cathedral' (1972) is seminal on this topic.

It is obvious that we cannot travel back in time and reset the initial property or liability arrangements. Such an attempt would take us all the way to the primordial existence of our hominid ancestors in small family groups. Even if a time-travelling machine was available today, such an attempt would be utterly futile as the entitlements that we established would soon change. We have no choice but to work from the current distribution of entitlements. Then we can consider questions like the efficiency or justice of the distribution and how entitlements can be protected or changed.

The logical first question is: why have entitlements at all? Imagine that there is a large and valuable area of land called Hundred Acres. No one has any right over this land, not even the state. There are 100 cattle producers who use this land to graze their cattle. Unless they all agree on a scheme of sharing the use of the land there will be conflict and the stronger will gain larger shares at the expense of the weaker. Might will become right. Now assume that the law provides that all persons have equal rights to enter and use Hundred Acres. A different problem arises which, in game theory, is known as the 'Tragedy of the Commons'. (This term was coined by Garrett Hardin in his article 'The tragedy of the commons' published in 1968 in the journal *Science*.) In this scenario, each of the cattle producers will try to increase their own gain (say, by raising more cattle), while the cost will be borne by all the cattle producers. Unless they agree to a scheme of fair and sustainable use, the land will be over-grazed and degraded. The tragedy of the commons is not just a theory; it happens. It is the reason that in many traditional societies the use of commons is regulated by custom, and in modern states by statutes. Over-fishing, over-hunting, unrestrained logging, unregulated irrigation are contemporary examples of limited resources being depleted by unlimited entitlement. The tragedy of the commons is averted by creating separate entitlements or property rights. Thus, there is a strong efficiency argument for establishing some form of property rights.

The next question concerns how entitlements are established or should be established. Calabresi and Melamed identified three possible principles: efficiency, distribution and other justice reasons.

Efficiency reasons

Some societies in history have embraced the idea that the most efficient way is to abolish private property and instead to have a government that administers all

resources for the benefit of all the people. The system involves central planning and command and control of methods of plan implementation. Most of the societies that trialled the system have abandoned it. The chief reason for its failure is the inability of a central authority to command and deploy effectively all the knowledge of resources, needs and preferences of people. The administrative option is too inefficient.

Other societies have, to varying degrees, adopted the market mechanism, under which resources find their way to persons who most value them. The system will leave current entitlements as they are and try to reduce transaction costs that inhibit more efficient use of property. Consider the typical prosperous society of our age. Wealth is unequally distributed. Some people have inherited wealth and others have wealth created through their own skills and industry. This is not seen as a problem as long as there are no legal or other constraints on exchange transactions. The property owner who inherits a farm from a parent but has no interest in farming might sell the land to one who wants to farm it, and then use the money to invest or buy what she values. If the farmland has become unproductive, a property developer might buy it for a residential development. One way or another, according to the efficiency argument, the society will be better off.

Distributional reasons

Distributional reasons are all the reasons except efficiency reasons. Societies historically have distributed entitlements in different ways, not necessarily on grounds of efficiency. Plato and Aristotle justified the social stratification of their time, by which some human beings (slaves and women) were the property of others and status determined how property and wealth were distributed. Even today, some societies distribute entitlements according to caste or class status. Liberal democracies have progressively reduced the legal and social barriers to entitlements, but they have not embraced equality of wealth as a goal. As Calabresi and Melamed pointed out, absolute equality is impossible to achieve. If everyone has equal liberty to make noise, noise lovers will be better off than silence lovers. If everyone is entitled to the fruits of their labour, the more intelligent, skilful and industrious persons will become wealthier. Beautiful people will have advantages over those less well endowed (Calabresi & Melamed 1972, 1098–9). Equality of wealth can be maintained only by constant redistribution of wealth, which will be destructive of the incentives to create wealth.

Market oriented liberal-democratic states have usually engaged in limited forms of wealth redistribution. Most of them have recognised the notion of 'merit goods', which refers to the essential goods that a person needs to have a decent chance of improving their condition in an exchange economy. They include healthcare, education, housing and sustenance. This wealth redistribution is usually provided by free services and income supports funded through the tax system.

Other justice reasons

Calabresi and Melamed defined distributional reasons as all reasons that are not efficiency reasons. Hence, distributional reasons include justice reasons. In fact, most distributions that depart from efficiency are rationalised on grounds of justice. Plato and Aristotle defended a system of distributive justice that allocated wealth, public offices and honour according to merit. The virtuous and the wise person received more entitlements than the sinner and the fool. In modern society, demands for wealth redistribution are presented as claims for social justice. It not entirely clear what Calabresi and Melamed meant by 'other justice reasons'. An example that they provided is the entitlement to make noise or to have silence. Society might determine that the interest of the silence lover is more worthy than the interest of the noise lover. Calabresi and Melamed seemed to understand 'other justice reasons' as a subset of distributional reasons (1972, 1105).

Protection and regulation of entitlements

Most liberal democratic societies allocate entitlements variously on grounds of efficiency and distributional considerations. Allocations have little value unless they are protected by law. Ownership of a piece of land has value because the law of trespass and nuisance prevents others from interfering with its use. The liberty to drive on the highway is secured by road rules and the law of negligence. The right to personal safety is secured by the criminal law and tort law. Calabresi and Melamed identified three types of rule that protect entitlements:

1. property rules
2. liability rules
3. inalienability rules.

Property rules and liability rules

Property rules, as Calabresi and Melamed conceived them, protect entitlements in two ways: (a) they protect entitlements against all attacks through the criminal law; and (b) they enforce voluntary contracts by which entitlements are exchanged. In a world without transaction costs the property rules may be all that is required. In the real world people face two kinds of common problems: holdouts and free riding (see discussion below). Hence, there is a need for liability rules. The essential difference between property rules and liability rules boils down to this. Under property rules entitlements are transferred by voluntary contract. Under liability rules the state intervenes to bring about the transfer. Calabresi and Melamed argued that although property rules are usually more efficient, there are circumstances where prohibitive transaction costs prevent the achievement of the desired goal through contract. In some other cases contracting is simply not feasible. They give two examples to illustrate the argument: eminent domain and accident compensation.

The use of the eminent domain doctrine, according to Calabresi and Melamed, is more efficient than market transactions in a limited type of case where holdouts and free riding are likely. The doctrine of eminent domain (which is called 'compulsory purchase' in England and 'resumption' in Australia) allows the state to acquire private lands for public purposes on the payment of compensation determined by the state. In this hypothetical case, the residents of a town desiring a public park wish to buy an extent of land owned by several persons in equal parcels. If the townspeople value the land at $10 000 000 and the owners value it at $8 000 000, the transaction is likely to happen. However, one or more owners may hold out for a higher price, or one or more of the town residents may refuse to contribute their share of the purchase price, hoping for a free ride. If the cost of reaching unanimous agreement is too high the public park will not be established. This kind of problem can be overcome if the state compulsorily acquires the extent of land, at an administratively determined rate of compensation, and then sells it to the townsfolk (Calabrese & Melamed 1972, 1106–7). It is more efficient economically, but not necessarily more just. Some owners, for example, may value their parcels more highly because of sentimental reasons and they will not be justly compensated.

Most people live their lives without ever encountering eminent domain problems. However, the issue of compensation for accidental harm is ever present in our lives. I risk accidental harm every time that I drive out of my house. I might negligently cause damage to another motorist or a pedestrian, or suffer damage by the negligence of another road user. I cannot possibly know who I will hurt or who will hurt me. I also cannot know in advance how much damage I will cause to another, or how much damage I will suffer from another person's negligence. This is not something that can be contractually settled beforehand. I cannot make contracts with every other road user, stating: if you break my arm you should pay me $1000 and if you fracture my skull you must pay me $5000. The solution is provided by third-party determination of compensation if and when the accident occurs. The third party is usually a court or the legislature. In the common law system, the court determines the amount of compensation according to established precedents. In some cases, the legislature fixes rates of compensation, as in the case of workplace injuries.

Inalienability rules

An inalienable right is one that is regulated by law and cannot be waived or altered by contract. An inalienable right can be dealt with only as permitted by law. In every society there are laws that ban persons giving away particular entitlements or that limit the way a person can deal with their entitlements. In most societies people cannot sell themselves into slavery. Most societies ban trade in human organs. Many societies prohibit euthanasia that allows suffering patients to terminate their lives. Heritage laws prevent certain buildings being torn down or even modified. Conservation laws prevent certain lands being subdivided and ban owners from logging trees that they own. Animal protection

laws prohibit cruel forms of animal sports. Minors are banned from buying alcoholic drinks or watching pornographic movies. The list goes on.

Conservation limits placed on land use may be seen as a way of preventing environmental harm to the community at large. Since the harm is difficult to cost in relation to each individual, liability rules are unhelpful. The goal can be achieved by a prohibition. Sometimes the harm to others cannot be measured in money, as in the case of cruelty to animals or selling oneself to slavery. These kinds of acts harm others by shocking their conscience or moral sense. The harm is real, but immeasurable. Inalienability rules are seen as more efficient in these cases. Calabresi and Melamed pointed out that inalienability rules often have distributional effects: 'Prohibiting the sale of babies makes poorer those who can cheaply produce babies and richer those who by some non market device get free an "unwanted" baby' (1972, 1114). Laws that create parklands within towns make nearby house owners better off but will make land more scarce and expensive for others.

Choosing between property rule and liability rule

Calabresi and Melamed used their analysis to consider, from an efficiency point of view, when a court should apply the property rule and when it should use the liability rule. Consider the pollution case where P (the plaintiff) sues D (the defendant) over damage caused to P's crop by D's factory. There are four possible judgments the court can make:

1. D must not pollute P's property unless P allows it. The court will grant an injunction to P and P acquires a tradable right. He may be paid by D in return for giving D permission to pollute. The court has chosen the *property rule*. This rule is efficient where it is cheaper for D to prevent the pollution than for P to do so.
2. D may pollute but must compensate P for the damages caused. Here the court applies the *liability rule*. It holds that D commits nuisance, but awards only court-determined damages. This option is more efficient where there are many persons affected by pollution, i.e. there are many Ps. The transaction costs of getting the agreement of all victims are very high and some of them may hold out for more. The liability rule overcomes the problems of holdouts and free riding.
3. D may pollute at will and can only be stopped if P buys the right from D. The court applies the property rule, but in D's favour. D can trade off her pollution right. This is more efficient where P is in a better position to prevent the harm.
4. P may stop D from polluting, but if he does he must compensate D. The court applies the liability rule, but in favour of D. Calabresi and Melamed illustrated a case where this rule would be the most efficient. A factory in a rich neighbourhood uses cheap coal. It also employs many poor workers. Under Rules 1 and 2, the factory is likely to shut down and workers will lose their jobs. Rule 3 will be efficient if the harm to the rich homeowners

> is greater than the cost of switching to clean coal. The homeowners can agree to buy off D. However if there are holdout problems among the homeowners, it will be more efficient for the court to calculate the cost of switching to clean coal and impose it on the homeowners as damages under Rule 4. The problem with Rule 4 is that very few common law courts would claim to have power to make such strange orders.

The Calabresi and Melamed article provides an analytical framework that assists courts and law makers to understand more clearly the choice of rules available to them. They may sacrifice efficiency for distributional or social justice reasons, but do so with a better understanding of potential costs.

Efficiency of the common law hypothesis

The efficiency of the common law hypothesis postulates that the common law system tends to produce more efficient rules than legislatures would. This was first suggested in Coase's article, 'The problem of social cost', and the view was later developed by Posner and others. Most judges would be surprised to hear that economics plays an important part in their decisions. They hardly ever talk about economics in their judgments and always try to rationalise their decisions by reference to precedent, logic and common sense. Coase, Posner and others in the L & E tradition think that judicial common sense is actually a form of economic thinking. In fact, Coase believed that common law judges are more aware than some economists of the 'reciprocal nature of the problem', and that 'they take economic implications into account, along with other factors, in arriving at their decisions' (1960, 19). The courts may not use economic language but the economic aspects of the judgment are revealed by the use of concepts such as 'reasonable use' or 'common or ordinary use' of land (Coase 1960, 22). As Coase demonstrated, this is particularly evident in nuisance cases where courts have taken into consideration the character of the locality. If a person takes up residence in an industrial neighbourhood and complains of disturbance by plant and machinery, the court is likely to be unsympathetic. Similarly, a court refused to stop a building operation to preserve the peace and quiet of a nearby hotel (*Andreae v Selfridge & Co* [1938] 1 CH 1). Conversely, in *Sturges v Bridgman* (1879) 11 Ch D 852, the court stopped a confectioner from disturbing a doctor's consultation room next door, although the confectioner had been using his machinery for 60 years before the doctor moved in. The court in that case seemed to think that the neighbourhood was residential rather than industrial, and judgment for the confectioner would have discouraged residential development.

Judge Posner, who has done more systematic study of the economics of common law than any other writer, has noted:

> Many areas of the law, especially but not only the great common law fields of property, torts, crimes and contracts, bear the stamp of economic reasoning. Granted, few judicial opinions contain explicit references to economic concepts. But often the true

> grounds of legal decision are concealed by the characteristic rhetoric of opinions. Indeed, legal education consists primarily of learning to dig beneath the rhetorical surface to find those grounds, many which may turn out to have an economic character. (1998, 27)

The economic undertones are also noticeable in the way lawyers argue their cases. Lawyers support their interpretations of established law on grounds of public policy and not private sympathy. They will say that their interpretation yields the best outcome for society generally, and will rarely appeal for sympathy for the client. Poverty does not release a person from legal obligations.

Why would common law judges consciously or subconsciously promote economic efficiency in making or modifying rules of law? An easy answer is that judges, who are drawn from a class of society that is naturally partial to commerce and industry, favour economically efficient solutions. In short, judges have a capitalist bias. There is almost certainly some historical truth in this. As Posner pointed out, the common law acquired much of its modern shape during the 19th century, when *laissez faire* thinking was ascendant in England (1998, 275). However, Posner argued that the common law system tends to promote efficiency, irrespective of judges' personal views.

Efficiency promoted by judicial neutrality

Posner and others have argued that the neutrality of the court tends to favour efficient rule making. Common law judges are limited by the scope of the cases and the claims presented to them. They cannot engage in redistributing wealth in the way that legislatures do. The common law judge's duty is to restore the parties to the position they would have been in had the breach of the law not occurred. In other words, a common law judge dispenses rectificatory justice and not distributive justice. This means that the courts can only grant compensatory damages. A drives his car negligently into B's car. B has to spend $1000 to restore the car to its pre-collision state. The court will award B only the sum that she spent, and perhaps other incidental costs. The court will not consider extraneous matters such as the personal character of A, the income levels of the two parties or the deservedness of A or B.

Common law as a general rule does not permit judges to award punitive or exemplary damages. Punitive damages are sums awarded to the plaintiff, in addition to the plaintiff's actual loss, as a way of punishing the defendant or deterring the defendant from future wrongdoing. This means that the court does not actually compel persons to observe the law, but only makes defendants pay the opportunity costs of plaintiffs if they choose to violate the plaintiffs' rights. In a contract for the sale of goods, the seller is not compelled to deliver the goods but only to pay damages if she does not. The seller may decide not to deliver the goods but to pay damages, if the damages are less than what she gains by retaining the goods. Posner argued: 'If that price is lower than the value the violator derives

from the unlawful act, efficiency is maximised if he commits it, and the legal system in effect encourages him to do so' (1998, 565). The point here is that in the usual case, the common law of contract and tort imitates the market. The contract, in essence, says: deliver the goods or compensate the buyer's loss. The court simply determines the fact of non-delivery and the amount of the buyer's loss. One may ask: if that is the case, why do sellers usually deliver their goods as promised, even when they are able to gain a better price elsewhere? The obvious reason is that a seller who acquires a reputation for unreliability will soon be without customers. This is a cost that the seller has to consider, but the court leaves that decision to the seller.

A court that engages in distributive justice makes political decisions, and hence will not be seen as impartial. Such a court will soon lose its credibility and public confidence. This is the basic reason why courts leave questions of redistribution to the legislature. The law in different ways secures the impersonality and impartiality of the judicial process. In many countries courts have constitutionally guaranteed independence. The rules of natural justice militate against bias and arbitrariness. Common law courts are further insulated from pressure group politics by the rules concerning standing and costs. Under common law rules of standing, a citizen can sue or intervene in an action only to vindicate a private right – that is, a right that the person has over and above the right that every member of the public has. (See, for example, *Australian Conservation Foundation v Commonwealth* (1979) 146 CLR 493, 526–7.) In common law countries such as the United Kingdom, Australia and New Zealand, the party that loses the case has to pay the litigation costs of the party that wins. This means that the person who brings an action thinks that they have more to lose by inaction than the potential cost of losing the action. It also means that the party who elects to defend an action calculates that they have more to lose by conceding the claim. The point that Posner and others make is that the exclusion of busybodies and political activists insulates the courts from distortions that interest group politics can introduce to the judicial process.

Posner believes that the adversarial nature of the common law procedure, which mimics market operations, also promotes impartiality. The case is essentially a private contest between self-interested combatants. The responsibility for presenting the two sides of the case with evidence and legal submissions rests with the parties and their lawyers. The 'invisible hand of the market has its counterpart in the aloof disinterest of the judge' (Posner 1998, 566). A party may be disappointed by a decision but has no reason for personal grievance against the judge. Posner likened this to a customer who fails to find what he is looking for in a shop. The customer may be disappointed but has no reason to be angry at the shopkeeper. This analogy is not exact. The customer in the marketplace can shop around and find what he wants, but the litigant cannot go forum shopping. The former has a choice, but not the latter.

Posner concluded that, since courts are inhibited from redistributing wealth, they focus on expanding wealth:

> If, therefore, common law courts do not have effective tools for redistributing wealth – in other words, reslicing the economic pie among contending interest groups – it is to the benefit of all interest groups that courts, when they are enforcing common law principles rather than statutes, should concentrate on making the pie larger. (1998, 571)

Evolutionary explanation of common law efficiency

In every law school introductory course, students are taught the way the common law develops through precedent setting by the appeal courts. They are trained to separate the *ratio decidendi* (the principle or rule that decides the case) from *obiter dicta* (incidental remarks). Most importantly, students are asked to distinguish present cases from established common law rules and to understand how the courts adapt or modify existing law to new conditions. In other words, students are introduced to the mechanics of the evolution of law.

A rule that is efficient may become inefficient under new conditions. It is natural that the people who have to bear the cost of this inefficiency will seek to persuade the court to change the rule. Here is a good example. The doctrine of privity of contract and the doctrine of consideration set out two fundamental rules of the English law of contract. The doctrine of privity states that a contract cannot confer rights or obligations on any person who is not a party to the contract. The doctrine also states that only a party to a contract can sue under the contract. This is common sense and works efficiently most of the time. If not for this doctrine, everybody would be at risk of having duties imposed upon them by the contracts of others. However, it is clearly unjust in some kinds of cases. If A agrees with B to pay B's mother C a sum of money in return for some service B provides, and A fails to pay, C cannot sue to recover the sum. B can sue, but only if she herself has suffered some loss by A's failure to pay C. The efficiency of the doctrine of consideration is even less clear. According to this doctrine, a contract is not valid if no value (consideration) is owed by each party to the other party. D's promise to E to pay a sum of money has no force unless E owes something to D under the contract. It is noteworthy that in civil law countries, the contract system works efficiently without the requirement of consideration.

It is the practice in the building industry for a building company to take out an insurance policy that covers not only the building company but also all its sub-contractors and suppliers who enter the building site. A worker employed by a sub-contractor was injured and the sub-contractor had to pay out a substantial personal injury claim. The insurer refused to indemnify the sub-contractor because he was not a party to the insurance contract and had not provided consideration. It was evident that these two rules were no longer consistent with the expectations of people in the building industry, and that if enforced they would impose major costs on the industry. In *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1987) 165 CLR 107, the High Court of Australia recognised the

economic reality and modified the doctrines to allow the sub-contractor to be indemnified. If the court had held for the insurer, the cost to the industry would have led to the precedent being challenged again and again or being overturned by statute.

The first modern writer to recognise the evolutionary efficiency of the common law was FA Hayek, who argued that common law is an adaptive system that gives effect to the expectations established within the community (1973, 96–7). Some economists, though, doubted the tendency of the common law to evolve towards efficiency. They reasoned that most parties settle their disputes outside court because of the high cost of litigation, so inefficient rules remain in the law (Landes 1971; Gould 1973; Tullock 1971). Paul Rubin argued that sufficient economic incentives remain for litigants to seek revision of inefficient rules. This would be the case especially when a rule imposes continuing costs on a particular segment of society, such as government agencies, firms, labour unions or insurance companies (Rubin 1977, 53). If, for example, a rule placed an unusually heavy burden of care on doctors, in excess of the normal practices and procedures of the profession, there would be a strong incentive for doctors and their insurers to have the rule changed by repeated litigation. Trade unions would have strong economic reasons to seek to change factory accident liability rules in their favour. A government that had a railway monopoly might wish to limit its liability for lost property. In Australia, the media had strong economic reasons to have the common law defence of qualified privilege (to an action for defamation) extended to cover political communications. They succeeded in *Theophanous v Herald & Weekly Times Ltd* (1994) 182 CLR 211. Rubin concluded that the evolutionary pressure towards efficiency comes from the behaviour of litigants rather than judges. (If people do not litigate judges have no cases to decide.) He drew the following conclusions from his cost-benefit analysis of accident liability cases (1977, 61):

1. When neither party is interested in precedent, there is no incentive to litigate and hence no pressure on the law to change.
2. When only one party is interested, that party will litigate until a favourable decision is obtained; the law in such cases favours parties with such an ongoing interest.
3. When both parties have an ongoing interest in a type of case, there will be pressure toward efficiency.

GL Priest, who generally agreed with Rubin, developed a stronger version of the evolutionary thesis. He argued that efficient legal rules are more likely to endure regardless of the attitudes of individual judges or the disinterest of litigants about the allocative effects of rules. Let us assume (falsely) that most judges are opposed to efficient rules. Yet more disputes arise under inefficient rules than under efficient rules, because inefficient rules place greater costs on those who must obey them. Therefore, inefficient rules are more likely than efficient rules to be relitigated. The courts hear more cases involving inefficient rules than

efficient rules. Thus, efficient rules are more likely to remain outside the reach of judges. Priest concluded that 'as a consequence, judges will be unable to influence the content of the law to fully reflect their attitude towards inefficiency' (1977, 65).

Public choice theory: the economics of legislation

The common law is not the sole source of law in modern society. The evolution of the law through common law adjudication is a slow process. A court cannot address a question of law until it arises in an appropriate case, and this may take a long time. The common law method is also unsuitable for the making of laws establishing and regulating government departments and agencies.

The common law method has another serious limitation. When a common law court makes a change to the law, it has retrospective effect. It changes the legal rights of the parties to the action, as well as the rights of other persons who are not before the court. The common law court cannot change the law to take effect only in the future. This is the reason that common law courts do not usually make radical changes, but only make changes that people have anticipated because of changed social conditions. The decision of the High Court of Australia in *Mabo v Queensland (No. 2)* (1992) 175 CLR 1 overturned a long standing precedent to recognise the validity of customary land rights of Australia's indigenous peoples. The decision corrected historic injustices on indigenous peoples, but it had far reaching effects on property rights of persons who were not before the courts. The High Court could not sort out the many consequences of its decision and it was left to the Australian Parliament to enact detailed legislation to settle the law in the field.

Legislation therefore has a major role in modern society. Legislatures, though, do not limit themselves to the making of general rules, but engage in reallocating or redistributing wealth in ways that courts cannot achieve. A branch of economics known as public choice theory is focused on studying legislative processes to understand the economics of democratic law making. Public choice theory is closely identified with a group of economists led by James Buchanan and Gordon Tullock of the George Mason University in Virginia, and Mancur Olson of the University of Maryland at College Park. Buchanan received the Nobel Prize in Economic Science in 1986 for his pioneering work in this field. Buchanan and Tullock's *The Calculus of Consent* and Olson's *The Logic of Collective Action* stand out as classics in the field.

If a decision affects only two parties, the parties can reach a mutually acceptable agreement. If the decision of two parties affects (has an externality on) third parties, ideally their agreement should also be obtained. In other words, unanimity is the best way to reach the best outcome for all concerned. However, unanimity is not possible when a society needs to take

collective decisions affecting the whole population or large sections of it. As we have seen, the cost of negotiation even within small groups can be prohibitive because of holdout and free rider problems, and even the problem of finding all the persons who are affected by the decision. Liberal-democratic societies therefore elect representative legislatures and governments to make decisions for the good of society. It is generally accepted that democratic processes are imperfect, and that elected representatives often act in their self-interest or the interest of their supporters as opposed to the interests of the general public. They are known to act on short-term political expediency rather than longer term public good. Yet most people also accept that representative government is better than the alternatives. Public choice theorists have confirmed these intuitive impressions of democratic institutions and provided new insights about the way collective decisions are made. Among their most interesting findings are those concerning the phenomena of *logrolling* and *rent seeking*.

Logrolling

The studies of public choice economists have cast doubts on the genuineness of democratic collective choices, through their exposure of the way in which majority coalitions are formed under simple majority voting systems. Public choice theorists argue that majority coalitions tend to grow out of distributional struggles for shares of the social pie, which often produce bargains among interest groups pursuing different ends. These 'distributional coalitions', as Olson called them, represent collective choice only in the limited sense of producing legislative majorities (Olson 1982, 44). The reality is that decisions are made through vote trading – or in American parlance, 'logrolling'.

According to Buchanan and Tullock, logrolling takes one of two forms. First, it occurs within legislative bodies, where legislators trade votes to achieve their separate purposes. Senator A will vote for Senator B's proposed farm subsidy scheme in exchange for Senator B's support for Senator A's proposal to limit textile imports. The second form of logrolling occurs in the electorate at large. Political parties present competing policy packages to the electorate, each calculated to secure a winning combination of different voter groups. They will typically offer benefits to critically important voting blocs such as pensioners or families with young children. Voters who stand to gain a large personal benefit (say from an increased pension or a special subsidy) may vote for a party whose program they oppose in other respects. Buchanan and Tullock put it this way:

> Logrolling may occur in a second way, which we shall call implicit logrolling. Large bodies of voters may be called on to decide on complex issues, such as which party will rule or which set of issues will be approved in a referendum vote. Here there is no formal trading of votes, but an analogous process takes place. Political 'entrepreneurs' who offer candidates or programs to voters make up a complex mixture of policies

> designed to attract support. In doing so they keep firmly in mind the fact that the single voter may be so interested in the outcome of a particular issue that he will vote for the one party that supports this issue, although he may be opposed to the party stand on all other issues. Institutions described by this implicit logrolling are characteristic of much of the modern democratic procedure. (1962, 134–5)

Olson's work on group behaviour also challenged the conventional theory that particular distributions made by legislatures are the results of genuine collective choice. In *The Logic of Collective Action* Olson argued that smaller, homogeneous groups tend to prevail in the distributional struggle. Even more significantly, Olson claimed that larger interest groups emerge because of the application of 'selective incentives', such as compulsion (negative), or the offer of private benefits (positive) as inducements for joining and sharing the cost of lobbying enterprises (1965, 133–4). Olson argued that in large groups (such as consumers), where an individual's contribution makes no perceptible difference to the group as a whole or to the burden or benefit of any single member, there will be no cooperative effort to pursue a common interest unless there is coercion or some outside inducement (1965, 44). In his later work, *The Rise and Decline of Nations* (1982, 37), Olson summarised the implications of this finding for democracy:

> [A] society that would achieve either efficiency or equity through comprehensive bargaining is out of the question. Some groups such as consumers, tax payers, the unemployed, and the poor do not have either the selective incentive or the small numbers needed to organize, so they would be left out of the bargaining. It would be in the interest of those groups that are organized to increase their own gains by whatever means possible. This would include choosing policies that, though inefficient for the society as a whole, were advantageous for the organized groups because the costs of the policies fell disproportionately on the unorganized. (In the language of the game theorist, the society would not achieve a 'core' or Pareto-efficient allocation because some of the groups were, by virtue of their lack of organization unable to block changes detrimental to them or to work out mutually advantageous bargains with others.) With some groups left out of the bargaining, there is also no reason to suppose that the results have any appeal on grounds of fairness.

The general findings of Buchanan, Tullock, Olson and others may be summarised in another way. Even if it is assumed that a legislative majority on a particular question represents a popular majority on a question of policy, such majority is likely to include large numbers who dislike the policy but nevertheless support it as the price for obtaining a majority on some other policy that they value more. Thus, in respect of measures aimed at producing collective goods or material outcomes, there is little likelihood of genuine majority agreement, except in the rare instances where individuals, or the community as a whole, receive a roughly equal gain without costs accruing disproportionately to particular classes.

Rent seeking

Economic rent refers to gains made without productive effort and not through mutually beneficial exchange. It is different from the rent that a house owner charges a tenant under a tenancy agreement. In a tenancy there are benefits to both parties. In its technical economic sense, rent seeking occurs when a person or group gains a benefit under the law while the cost is borne by other sections of society or the public at large. If a company gains a monopoly to supply a product, it makes monopoly profits while the consumers bear the rise in cost that results from the elimination of competition. The farm lobby that persuades the legislature to restrict imports gains the benefit of extra profit without extra effort. All kinds of regulations can impose social costs without social benefit.

Assume that product X can be legally manufactured only under a licence issued by a government authority. The authority grants a licence to A, subject to the condition that A's factory is located in a town some distance from the port from which A must transport imported raw materials. A may decide to take his plant to the town because his additional cost can be recovered by increasing the price of his product. The value of the licence is worth more than the added transport costs. The transport cost is a wasteful impost on the community unless there is a compensating benefit. Some benefit may flow to the townsfolk through increased employment, but its cost is borne by others. In all these cases there is a social cost. Resources that may be used for the greater benefit of society are expended on unproductive distribution.

The kinds of economic rents that regulations can create vary. They include unnecessary qualifications or assets stipulated by the regulator, and the expenses of lobbying regulators. In some countries, regulations lead to enormous corruption in the form of bribery. An authority can get rich simply by requiring a licence to do what is otherwise lawful.

Efficiency, wealth maximisation and justice

The economic approach of the L & E school has critics on both the left and the right of the ideological spectrum. On the right, scholars of the Austrian school of economics reject efficiency as a basis for judicial determination of property rights. They have several objections. First, judges have no competence to determine questions of costs. Second, if judges select rules on the basis of efficiency in different kinds of cases, as suggested by Coase, Calabresi and others, the law will become uncertain. Third, efficiency analysis is based on a misunderstanding of the market process. It assumes that the world is in a state of equilibrium, whereas it actually changes over time. Markets are a process of discovery, and the best means of facilitating discovery is to have firm property rules. Fourth, determining entitlements according to efficiency is simply immoral.

The last argument is noteworthy. The Coase theorem claims that in a zero transaction cost world it does not matter whether a factory owner has the right to damage her neighbour's crop or the neighbour has the right not to have his crop damaged. Walter Block asked the question: what would happen if the damage is not to a commercial crop but to the neighbour's garden that he treasures for sentimental reasons? The plants in the garden may be commercially valueless, so he cannot possibly raise a loan to pay the factory owner to stop the pollution (Block 1977, 111–12). A more telling example is Harold Demsetz's claim that it does not matter whether the state (taxpayers) hires volunteers into the military or the state (taxpayers) conscripts them and allows them to buy their way out of the military; the same persons will end up in the military (1967, 348). Wrong, said Block. There may be pacifists who simply do not want to fight but have no money to buy out of the military. Besides, the conscription alternative amounts to first enslaving or kidnapping a person and then demanding a ransom for release! (Block 1977, 112) One option is moral and the other immoral. Block wrote: 'It is evil and downright vicious to violate our most cherished and precious property rights in an ill conceived attempt to maximise the monetary value of production' (1977, 115).

Ronald Dworkin, a liberal in the social democratic sense, made a similar argument. Dworkin's essential point is this. A person against whom judgment is given should have done something wrong. 'So, decisions can be justified only by deploying some general scheme of moral responsibility the members of the community might properly be deemed to have, about not injuring others, or about taking financial responsibility for their acts' (Dworkin 1998, 285). In doing or not doing something we are guided by moral or legal rules. I have a right to play my trumpet and my neighbour has a right to study algebra in silence. In this situation, I would play the instrument softly or at times when my neighbour is not studying. I exercise restraint not because I calculate the relative costs of playing or not playing but because I respect the 'live and let live' morality that underlies nuisance law. This is not denied by L & E scholars. However, if the conflict has occurred and the court is asked to resolve it, how should it give judgment? The L & E view is that (assuming that neither the trumpet player nor the student has an inalienable right) it makes more sense for the court to make an efficient ruling. The 'efficiency of the common law hypothesis' predicts that in the long run the courts in fact gravitate to efficient rulings.

Many critics on the left present a different argument – that maximising wealth does not make society necessarily better off. In the example that we considered earlier, the carpenter who built the table made a profit, the rich customer who bought it gained value but the student who needed it most could not have it. The transaction made society wealthier by the economic calculus, but perhaps not better off in a moral sense. The argument against wealth maximisation is an argument for social justice in the sense of fairer distribution of wealth.

L & E scholars have two general answers. First, they concede that efficiency is an important consideration, but not the only consideration. Legislatures

commonly – and courts less commonly – make rules dictated by moral, ideological or partisan reasons. Efficiency analysis is still useful, as it informs judges and legislators of the economic trade-offs that are involved in doing so. Second, they give pragmatic reasons for embracing wealth maximisation as a guide to law making. They claim that societies whose laws are more conducive to wealth maximisation have done better economically. More importantly, as Posner suggested, 'wealth maximisation may be the most direct route to a variety of moral ends' (1990, 382).

10

Evolutionary Jurisprudence

> *Like the winds, that come we know not whence, and blow withersoever they list, the forms of society are derived from an obscure and distant origin; they arise, long before the date of philosophy, from the instincts, not from the speculations, of men. The croud of mankind, are directed in their establishments and measures, by the circumstances in which they are placed; and seldom are turned from their way, to follow the plan of any single projector.*
>
> Adam Ferguson (1966 (1767), 122)

Introduction

The second half of the 20th century witnessed a resurgence of evolutionary theory in both the natural sciences and the social sciences. The most significant feature of this movement has been the extension of the Darwinian theory of evolution – or, more accurately, the neo-Darwinian synthesis – to human culture in order to explain such phenomena as scientific and technological development, the emergence of formal and informal social institutions, language acquisition, and even mind and consciousness. Evolutionary accounts of legal emergence have figured prominently throughout the 20th century in cultural anthropology and within branches of economics, most notably the Austrian and the institutional economics traditions. Although American jurisprudence was quick to embrace evolution after Darwin, legal scholars in the 20th century have only paid sporadic attention to evolutionary accounts of law (Ruhl 1996a, 1412–13). The situation has changed somewhat with the persistent efforts in law and biology by scholars associated with the Gruter Institute for Law and Behavioral Research (Elliot 1997, 596) and the nascent complexity and law movement (Ruhl 1996a, 1996b). Outstanding work is also flowing from the efforts of Owen Jones and his colleagues at the Society for the Evolutionary Analysis of Law (SEAL) based in the Vanderbilt University (Jones 1999, Jones and Goldsmith 2005). However, this body of learning has yet to establish its presence in mainstream law school curricula.

It is not widely appreciated that the recent blossoming of the evolutionary theory of culture has a distinguished pedigree that pre-dated Darwin's breakthrough and, indeed, provided Darwin with the intellectual tools that helped him to uncover the idea of natural selection (Hayek 1982, 1, 152–3). The work of these pre-Darwin scholars is particularly significant in legal theory as they drew their greatest inspiration from the shining example of the common law, and proceeded to establish a solid foundation for an evolutionary jurisprudence. The recent developments in evolutionary scholarship allow us to build on this foundation a richer account of law in both its customary and statutory forms. Such a jurisprudence may be developed by drawing together the 18th century evolutionist thought, the neo-Darwinist synthesis, evolutionary epistemology, the emerging science of complexity and self-organisation and the central ideas developed in institutional economics. That task is beyond the scope of this chapter, but I hope to kindle interest in such a project by clarifying the central ideas of the 18th century evolutionists and assessing their relevance in the era of pervasive legislation in the light of recent developments in the aforementioned fields. In what follows, I will discuss the key ideas of the 18th century evolutionary viewpoint, consider the development of that viewpoint in the 20th century and draw some normative implications from the evolutionary approach.

The need for an evolutionary jurisprudence

The idea that all law stems from the will of an identifiable law maker remains influential, despite being contradicted by the natural history of the human race and by what we know of contemporary society. It would be a rare cultural anthropologist who would deny that law existed before there were legislators or courts. Although legislation and judicial precedents form the major sources of law today, it is evident that law formation is a complex and dynamic process grounded in social realities that are beyond the comprehensive control of any authority. Despite its best efforts, the state has failed to monopolise the enterprise of law. As the frontiers of human experience expand, rules become modified by practice to meet the coordination needs of the new field of experience. This phenomenon has been observed throughout history and is illustrated in our age by the continuing evolution of the common law and the emergence of new rules of behaviour in fields such as transnational commerce and new technologies.

Mainstream jurisprudence typically responds to the presence of such rules by ignoring them, by denying them the name 'law' or by treating them as the vicarious achievements of the official legal system. Jurisprudence that limits its concerns to the description of state law and consigns non-state law to other disciplines admits failure. Sophisticated analytical positivists such as Herbert Hart, Neil MacCormick and Joseph Raz abandoned the dogma that law is any command of a sovereign political authority that has capacity to enforce its commands, in favour of the idea of a legal system that establishes the ways in which

norms become laws that attract the coercive attention of the state. However, the concept of a legal system developed by these writers does not explain satisfactorily the nature of the legal system as part of the overall dynamic order of society. In particular, it leaves to other disciplines the following questions: (1) how do legal systems arise and change over time? (2) how do we account for the continuing emergence of rules that not only exist side by side with state law but also supply some of the normative content of new state law? It is proposed that these questions should be addressed within jurisprudence and that the evolutionary approach outlined in this chapter is appropriate to that task.

Argument from design versus the principle of the accumulation of design

The human intellect tends to divide the world into two categories, the natural and the artificial, with nothing in between. Structures like machines, buildings and organisations are identified as artificial because they are products of human intelligence and labour. Other physical and biological structures that were not created by human beings – such as rivers and mountains, planets and animals – are classed as natural things. The diversity, complexity and beauty of nature, particularly the way plants and animals fit their environments, have intrigued thinkers through the ages. Who or what brought about these amazing adaptations? The minds of our ancient ancestors could only come up with the anthropomorphic answer that they were the work of a supernatural Intelligent Artificer. Hume's Cleanthes, in the *Dialogues Concerning Natural Religion*, put it this way: 'The curious adapting of means to ends throughout all nature, resembles exactly, though it much exceeds, the productions of human contrivance; of human design, thought, wisdom, and intelligence . . . hence we are led to infer . . . that the Author of nature is somewhat similar to the mind of man' (1947 (1779), 143).

This argument from design would not have mattered much in legal theory had there not been three different types of law: (1) legislation, (2) customary law, and (3) higher natural law. Legal enactments of human agencies were considered artificial, and later came to be known as positive law. There was another kind of law that had existed from time immemorial with no evidence of human authorship. Every society, including the oldest, has its inheritance of laws that cannot be attributed to human legislators. The ancients had little choice but to assign these to the natural category. Hayek thought that the Greeks recognised a separate category of structures established by convention, which included things such as custom, law, language, morals and money, only to lose it in terminological confusion. This category comprised things that were neither natural nor artificial but were, as Ferguson described, 'indeed the result of human action, but not the execution of any human design' (1966 (1767), 122). There was certainly another close encounter with this third kind

of law by the later medieval schoolmen, but they, like the Greeks before them, eventually classed it as natural (Hayek 1982, 1, 20–1). Whichever way the law was classified, it was thought to have been designed, like everything else.

The classification of the inherited customary law with things natural created two major problems for legal theory. As mentioned, there was a third type of law with a long standing claim to the name 'natural law'. This natural law comprised the fundamental, universal, and immutable principles of justice and morality, the violation of which was said to deprive human (positive) laws of their validity – on the principle that unjust law is not law (*lex injusta non est lex*) or, alternatively, that it is the corruption of law (*non lex sed legis corruptio*). The first problem was that the equation of the inherited customary law with this higher unchanging natural law further obscured the evolutionary nature of customary law. Custom was adaptive, not immutable like the higher natural law. The second problem was that this classification suggested that customary law, being natural law, was inviolable by human legislators. This was incompatible with the legislative power of sovereign rulers, who could set aside customary law by legislative acts. In societies where legislation is uncommon and customary morality and customary law are hard to separate, the problem is not serious. It is very different where the ruler's power to make and unmake the law co-exists with a substantial body of inherited customary law (common law), as was the case in England. Hobbes and Locke, the 17th century social contract theorists, recognised this problem. Their response was to move customary law from the category of the natural to the artificial. Earlier custom was regarded as the work of a supernatural mind, but now it was the work of human law makers. Though the classification had changed, the argument from design remained.

Both Hobbes and Locke thought that law began only with the establishment of sovereign political authority by the social contract that brought society itself into existence. Indeed, the very purpose of the social contract, they said, was to escape the condition of lawlessness, which according to Hobbes made life 'solitary, poor, nasty, brutish and short' (Hobbes 1946, 82). Locke's state of nature was a little more benign, but still 'full of fears and continual dangers' (1960, 368) because, in the absence of established and known laws and organised executive power, each individual was their own law maker, judge and executioner (1960, 369). According to both theorists, the social contract established a supreme legislature to which was entrusted the exclusive power to make law. Though both believed in the existence of a higher natural law, they insisted that the only source of human law was the sovereign person or assembly. Locke denied custom any legal force, treating the legislature as antecedent to all positive law (1960, 373–4). According to Hobbes, customs were 'antiently Lawes written, or otherwise made known, for the Constitutions, and Statutes of their Soveraigns; and are now Lawes, not by vertue of the Praescription of time, but by the Constitutions of their present Soveraigns' (1946, 175). Hobbes insisted that law should not only be designed but, to be valid, its designer or Author should be sufficiently known

(1946, 178). Thus, with respect to law, social contract theory further entrenched the argument from design.

It is generally thought that until Charles Darwin and Alfred Russell Wallace stumbled upon the idea of the evolution of species by natural selection, there was no alternative to the argument from design. The basic idea of natural selection is very simple, though its implications are endless. Animals give birth to offspring who have varying qualities. Offspring who are better adapted to their environment tend to survive to produce more offspring like themselves, while those who are ill adapted tend not to survive to a reproducing age. Over very long periods of time, this statistical game leads to the gradual evolution of some species and the extinction of others. One of the principal insights from this idea is that the incredibly complex life forms that we observe and their remarkable adaptation of means to ends can result from this simple algorithmic process without the intervention of an Intelligent Artificer. This insight discloses what is known as the principle of accumulation of design, according to which the R & D that complex and adaptive structures require are attained through the slow build up of their design features in the course of natural selection (Dennett 1995, 68). It was certainly Darwin and Wallace who demonstrated this principle in relation to biological evolution. However, as shown in the next section, the principle of accumulation of design was discovered in relation to social evolution more than 100 years before the publication of Darwin's *The Origin of Species,* by 18th century scholars in England and Scotland.

The common law beginnings and the Darwinians before Darwin

The fact that the first understandings of the principle of accumulation of design occurred in 18th century England is, perhaps, not surprising. The English common law provided one of the most unambiguous illustrations of the principle in action. Statutes (*lex scripta*) were a major source of law in the nations of continental Europe even before the Napoleonic Codification. The laws of these nations combined the written Roman law, local statutes and local custom. The dominance of the *lex scripta* obscured the evolutionary character of the law. In England, by contrast, the common law reigned in its classical form without serious challenge from the Roman law or legislation. The evolutionary nature of the common law was noticed by the great Chief Justice Sir Matthew Hale, who wrote that law is 'accommodate to the Conditions, Exigencies and Conveniences of the People [and] as those Exigencies and Conveniences do insensibly grow upon the People, so many Times there grows insensibly a Variation of Laws, especially in a long Tract of Time' (1971 (1713), 39). Hale was speaking of the self-ordering nature of the common law, which enabled it to maintain itself as a system while undergoing change. He identified the two properties of the common law that show its evolutionary character. The first is that the common law has no author

or designer but grows endogenously (arises from within) over long periods of time through the build up of precedents. The second is that the common law is part of the process by which society adapts to changing conditions.

Mandeville's *Fable of the Bees*

The first of the 18th century evolutionary thinkers was Bernard Mandeville, a Dutch physician and satirist practising in London, to whom Hayek paid the extraordinary compliment that he made Hume possible (Hayek 1978, 264). In 1705 Mandeville published a parody titled *The Grumbling Hive; or Knaves turn'd Honest*. In a series of 200 doggerels, Mandeville mocked the moralists of high society who viewed all selfish acts as vices. He suggested that if that was true society's good must be the result of vice because people always act in their self-interest. How else does one explain the success of the vibrant English commercial society of his time? The following typical verse captures his message:

> Thus every Part was full of Vice,
> Yet the whole Mass a Paradice;
> Flatter'd in Peace, and fear'd in Wars
> They were th'Esteem of Foreigners,
> And lavish of their Wealth and Lives,
> The Ballance of all other Hives.
> Such were the Blessings of that State;
> Their Crimes conspired to make 'em Great;
> And Vertue, who from Politicks
> Had learn'd a Thousand cunning Tricks,
> Was, by their happy Influence,
> Made Friends with Vice: And ever since
> The worst of all the Multitude
> Did something for the common Good.

Philosophers, politician and churchmen were outraged, but that only made the pamphlet more popular. In 1714, Mandeville republished it with a commentary and a serious essay under the title *The Fable of the Bees: or Private Vices, Publick Benefits*. In 1728 he wrote a second part consisting of six dialogues, and the two parts were published together in 1733. Mandeville's message was that if people were acting in their own interests, culture must be the unintended cumulative result of individual strivings (1924 (1733), vol. 1, 44). He identified the principle of the accumulation of design. In the third dialogue, Cleomenes says, 'That we often ascribe to the Excellency of Man's Genious, and the Depth of his Penetration, what is in reality owing to length of Time, and the Experience of many Generations, all of them very little differing from one another in natural Parts and Sagacity' (1924, vol. 2, 142). In the sixth dialogue, Cleomenes compares the process by which the law attains its sophistication to the mechanical process of weaving stockings (1924, vol. 2, 32). Compare these with Dennett's comment: 'What Darwin saw was that in principle the same work [previously

attributed to a designing agent] could be done by a different sort of process that *distributed* that work over huge amounts of time, by thriftily conserving the design work that had been accomplished at each stage, so that it didn't have to be done over again' (1995, 68).

Hume's evolutionary view of society and law

In Chapter 3, I discussed Hume's epistemology (theory of knowledge) briefly, in comparing his empiricism with Kant's transcendental idealism. Here we take another look at his view of human knowledge, to see how it leads to an evolutionary explanation of the emergence of social systems and law. In *A Treatise of Human Nature* Hume argued that reason alone can never give rise to any original idea, and that the basis of our knowledge is nothing more than custom or accumulated experience (1978 (1739–40), 157). As discussed in Chapter 3, Hume observed that there are only perceptions present to the mind. The objects that cause our perceptions are not knowable directly. What we do not perceive directly, we infer on the principle of cause and effect. Causation is a relation and not a thing. Wherever there is fire, we feel heat. Hence we infer that fire causes heat. Yet, however hard we try, we cannot show the essence that connects the two. We cannot infer that one object causes another on the first occasion that we perceive them. (A child will fearlessly go near a fire the first time.) It is only our past experience of the repeated conjunction of one event with another that gives rise to the expectation that where one is found the other will also be found. Hence, our expectation that the future will resemble the past is based on nothing better than custom (Hume 1978, 104–6). Hume rejected the notion of innate ideas. We can construct theories and test them by laboratory experiments, but this process too is based on the 'general habit, by which we transfer the known to the unknown, and conceive the latter to resemble the former' (Hume 1975 (1748), 107). Scientific theorising depends in part on experience, and in part on blind speculation. Hume declared that 'experimental reasoning itself, which we possess in common with beasts, and on which the whole conduct of life depends, is nothing but a species of instinct or mechanical power, that acts in us unknown to ourselves' (1975, 108).

This theory of knowledge led Hume to his view that social institutions grew out of convention or custom and were not the result of design or agreement. Conventions were formed not by reason but by the accumulation of experience. Hume rejected the social contract theory concerning the establishment of law and society. He argued that law and society could not have been established by a promise, as the institution of the promise was itself based on convention. In short, the social contract theorists were guilty of putting the cart before the horse!

Hume retained the natural–artificial dichotomy, and placed justice in the artificial category. However, he was at pains to explain that justice belonged to a subset of artificial things that arose from convention as opposed to reason. He

wrote: 'Tho' the rules of justice be *artificial*, they are not *arbitrary*. Nor is the expression improper to call the *Law of Nature*; if by natural we understand what is common to any species, or even if we confine it to mean what is inseparable from the species' (1975, 484). The rules of justice arise out of a sense of mutual need. This shared sense does not result from verbal exchanges but through the coincidence of behaviour, as when 'two men, who pull the oars of a boat, do it by an agreement or convention, tho' they have never given promises to each other'. Thus, rules of justice, like other conventional things such as language and currency, 'arise gradually, and acquire force by a slow progression, and by our repeated experience of the inconvenience of transgressing it' (1975, 490). Hume struck upon the evolutionary idea that rule formation is a process of habit meshing that occurs through the tendency of punishing encounters to extinguish and rewarding encounters to reinforce behavioural patterns. (Compare Campbell 1965, 32–3.)

Hume regarded law as antecedent to government for, though men can maintain 'a small uncultivated society without government, 'tis impossible they shou'd maintain a society of any kind without justice and the observance of the three fundamental laws concerning the stability of possession, its translation by consent and the performance of promises' (1975, 541). Government was needed not to make law, but to administer the law impartially (1975, 537).

Adam Smith and original passions

Like Hume, Adam Smith rejected social contract theory and treated social order, law and government as the outcomes of 'the natural progress which men make in society' (1981 (1776), vol. 2, 710). The starting point of Smith's philosophy is the concept of the 'original passions of human nature'. One of these passions is fellow feeling or sympathy. Though man is selfish by nature 'there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it' (Smith 1976 (1759), 9). Sympathy is the origin of the ideas of beneficence and of justice. The absence of beneficence or sense of justice in a person evokes disapprobation. However it is only unjust conduct that inspires the stronger feeling of resentment and leads to the demand for retribution.

How does the sense of justice give rise to the rules of justice? Rules arise because our sense of justice fails us when we most need it. We cannot make reasoned judgments before every action, not only because of the lack of time but also because we are driven by our passions. Afterwards, if we have acted unjustly, we are prone to forgive ourselves (Smith 1976, 157). This flaw in our nature is overcome by other instincts which, through the observation of the conduct of others, 'insensibly lead us to form to ourselves certain general rules concerning what is fit and proper either to be done or to be avoided' (1976, 159). We avoid self-deception through rule following, and rule formation occurs

insensibly by the coincidence of individual behaviour. Smith could have been more reductionist in his search for the origins of rules, in the manner of later game theorists who attributed the evolution of cooperation to the dominance of the 'tit for tat' or 'eye for an eye' strategy (Axelrod 1990). However, he deserves credit for noticing that cooperation is the outgrowth of not only the instinct of retribution but also the instinct of sympathy.

Smith's theory is strikingly Darwinian and, in fact, avoids a mistake commonly made even by modern Darwinists. Smith argued that although social life is impossible without the rules of justice, it is not this consideration that animates the rules of justice initially, but our natural passions (1976, 89). The human species did not acquire its sense of justice and make itself social rules because these rules helped the species to prosper; rather, the race prospered because its members inherited a sense of justice and the instinct for rule following. Smith also brought out the underlying unity of the social, economic and legal evolution throughout his work. A clear demonstration of this unity is offered in his speculation concerning the emergence of the division of labour and money. The division of labour, Smith maintained, is not the product of human wisdom that foresees its great advantages, but 'is the necessary, though very slow and gradual consequence of a certain propensity in human nature which has in view no such utility; the propensity to truck, barter, and exchange one thing for another' (1981, vol. 1, 25). This propensity to exchange brings about the practice of contracting. The initial form of contract, barter, is a severely limited form of exchange. A person must have a stock of things that others commonly want (oxen, salt, pelts etc) in order to obtain what they themselves want through exchange. No exchange will take place where people have no need of what is offered. This problem activates a Darwinian type selection, whereby certain kinds of metals serve as substitutes and by a process of elimination become standard currency for exchange. The emergence of this practice accelerates the development of both commerce and commercial law. The need to certify the weight or value of the metals leads to the practice of official coinage, and hence, we might add, to the law of financial institutions (Smith 1981, vol. 1, 41–6).

Ferguson's theory of unconscious rule following

The idea that social patterns emerge through the cumulative effects of adaptive behaviour of individuals responding instinctively to local conditions was systematically developed by Adam Ferguson in *An Essay on the History of Civil Society*, published in 1767. Ferguson clearly perceived that human beings are able to do the right thing without knowing the reason why it is right. We derive general rules of morality, law, language and so forth by observing the repeated occurrence of particular actions. How does a child or an illiterate peasant gain the capacity to reason or even to speak their language? It is not by memorising bits of information, but by subconsciously grasping the relevant underlying principles of reasoning and of language (Ferguson 1966 (1767), 34).

Ferguson argued that the sense of legal right inheres in human nature: 'Every peasant will tell us, that a man hath his rights; and that to trespass on those rights is injustice.' If we ask him what he means by 'right' we force him 'to substitute a less significant, or less proper term, in place of this; or require him to account for what is an original mode of his mind, and a sentiment to which he refers, when he would explain himself upon any particular application of his language' (1966, 34).

Ferguson was conscious that human learning was radically different from other animal learning, as the human race can accumulate knowledge from generation to generation (1966, 5). Yet, like Hume and Smith, he anticipated the Darwinian insight that all human knowledge gains are achieved without prescience: 'Every step and every movement of the multitude, even in what are termed enlightened ages, are made with equal blindness to the future; and nations stumble upon establishments, which are indeed the result of human action, but not the execution of any human design' (1966, 122). With Hume and Smith, he rejected patriarchal and contractarian theories of the state, observing that they 'ascribe to a previous design, what came to be known only by experience, what no human wisdom could foresee, and what, without the concurring humor and disposition of his age, no authority could enable an individual to execute' (1966, 123).

Summary

In summary, the pre-Darwin evolutionists developed in relation to social phenomena the following key ideas:

1. Human beings inherit certain instincts, dispositions and passions as part of the natural characteristics of their species. These would be identified today as genetically transmitted qualities that have been selectively retained, but this knowledge was unavailable to 18th century thinkers.
2. Human beings also inherit, through cultural means, a fund of knowledge. This knowledge is embodied in the form of convention or custom that results from a process of insensible accumulation of the experience of successive generations.
3. New knowledge (that is, knowledge not acquired through deductive inference from conventional knowledge) is acquired without prescience, through blind theorising. This type of knowledge becomes conventional knowledge if not falsified by experience.
4. Social and legal rules are formed through the blind process of habit meshing, involving the selective retention of rewarding behavioural tendencies. Initially, as we have no prescience, we do not possess the knowledge of the general rules of social life, but only know how to act in specific situations guided by instincts. We gain knowledge of the general rules when regularities of behaviour are observed.
5. Initially, state authority is not the source of law; rather, authority becomes necessary because there is law to enforce.

Eighteenth century evolutionism compared with the German historical approach

The German historical school was founded by Gustav Hugo, but its most influential figure was Friedrich Carl von Savigny (1779–1861), one of the prominent jurists of the 19th century. The historical school was part of the Romantic movement in art and philosophy, which was a revolt against empiricist rationalism. In jurisprudence it took the form of the rejection of legal positivism in favour of law as folkways. The German historical school identified the law not with the state but with the character of the people. There are important similarities between the historical school and the evolutionary approach that we discussed. There are also critical differences.

According to the evolutionists, law is not derived from organised society but, rather, the emergence of law brings about social order. Savigny and his followers completely reversed this order of cause and effect. According to them, law was derived from the common consciousness of a people (*Volksgeist*) who already exist as an 'active personal subject' (Savigny 1867, 15). In other words, law is the product of a society that already exists. Savigny rejected the idea that law emerges insensibly as custom, and claimed that the opposite is true. The law lives in the common consciousness, which is 'diametrically opposite to bare chance'. Moreover, the law lives in this consciousness not as rules but as 'the living intuition of law in their organic connection'. When the need arises for a rule to be conceived in a logical form, 'it must be formed by a scientific procedure from that total intuition' (Savigny 1867, 13). What Savigny meant by 'scientific procedure' is a process whereby the specific rules of law reveal themselves through symbolic acts. Initially, we recognise the law 'when it steps forth in usage, manners, custom' (1867, 28). Later, two other 'organs' of the people's law appear in the form of legal science and legislation. Savigny thought that at some point in the history of the community, 'the law forming energy departs from the people as a whole', so that the law will live only in these two organs (1867, 40). In other words, once the legal experts and law makers take over the law, popular consciousness ceases to be a significant source of law.

The major difference between the German historical school and the evolutionary theory is this. The *Volksgeist* as the source of law eventually runs out of steam. In evolutionary theory, law continues to be shaped by endogenous bottom-up pressures even after the arrival of the jurists and legislators. In fact, as I explain in the following pages, deliberate law making by legislators is not free from evolutionary pressures and the algorithmic process of design accumulation works incessantly at all levels, influencing legislative and juristic activity.

The Austrian school and spontaneous order

The independent discovery of the process of evolution of species through natural selection by Charles Darwin and Alfred Wallace occurred in the middle of the

19th century. The excitement and controversy that ensued, if anything, distracted scholarly attention from the older evolutionary tradition in the social sciences. The carriage of that tradition into the 20th century owes much to the work of the Austrian school of economics, which sprang chiefly from the work of Carl Menger (1840–1921). Although the English and Scottish scholars are hardly mentioned in Menger's work, his view of the emergence of social order is remarkably similar. In his critique of the historical school, Menger wrote:

> National law in its most original form is thus, to be sure, not the result of a contract or of reflection aiming at the assurance of common welfare. Nor is it, indeed, given with the nation, as the historical school asserts. Rather, it is older than the appearance of the latter. Indeed, it is one of the strongest ties by which the population of a territory becomes a nation and achieves state organisation. (1963, 227)

The initial impetus for the revival of evolutionary thinking in the 19th century was the realisation by the economists Jevons, Walras and Menger that the search for inherent value of goods and services was doomed. Menger went furthest in grasping that the price of a good or service was the unintended result of the actions of millions of interacting persons pursuing their own disparate ends (1963, 146). So, too, are many other social structures. Menger realised that the formation of economic arrangements is part and parcel of the spontaneous emergence of social structures. Structures such as law, language, the state, money and markets result from the same process of social development (Menger 1963, 147). They are inter-dependent parts of an overall self-ordering complex system similar to a living organism (1963, 129–30). Menger appreciated that not all social structures are unintended outcomes and that the analogy between social and organic phenomena is incomplete. The social order has many deliberately designed aspects. There is a vast volume of enacted statute law in the modern states. There are also many deliberately made organisations, such as corporations and government agencies. Menger argued that the organic comparison, incomplete as it is, has profound implications for the method of the social sciences. It demonstrates that we cannot make precise predictions about social phenomena, but can only determine their general features and the processes by which they emerge. It also demonstrates that the capacity of a government to produce specific outcomes by deliberate intervention in the workings of society is severely limited, because it cannot precisely predict or control the behaviour of its innumerable members.

The theory of complex orders blossomed in the 20th century through the work of the Austrians Ludwig von Mises and Friedrich Hayek and their followers, who continued to investigate the epistemological problem neglected in classical theory – namely, the disequilibrium of the market and imperfect information of actors. The idea of complex systems or spontaneous order was systematically developed by Hayek, who worked out most of its implications for economics and jurisprudence. Hayek distinguished spontaneous order (*cosmoi*) from made order or organisations (*taxeis*). Spontaneous order was found in complex

systems, in which constituent members have freedom of action but are coordinated in their interactions by the observance of general rules. These general rules are themselves the unintended results of the coincidence and meshing of behaviour on the part of members responding to local stimuli in the pursuit of disparate ends.

In Israel Kirzner's work on the equilibrating process of markets, we find further refinements of the theory of spontaneous order. Although Kirzner did not use evolutionist language, the evolutionary implications of his work are clear. Following von Mises and Hayek, Kirzner criticised the neo-classical equilibrium model as failing to show how markets actually work. In a universe of perfectly informed wealth maximisers there would be no scope for entrepreneurship or discovery. The consequences of market events are foreordained within a given set of market data, and genuine unprogrammed change can only result from exogenous (external) shocks to the system (Kirzner 1997, 35). In short, in the equilibrium scenario of mainstream economic theory, there cannot be evolution in the adaptive sense but only change in the computational sense. Kirzner recognised that actors in the market are imperfectly informed and lack prescience. Hence, their entrepreneurial activity has less to do with search than with discovery. Search presupposes existing knowledge of the value of information sought and the cost of acquiring it, whereas discovery consists of noticing information that is costless, but which has been previously overlooked (Kirzner 1997, 32). What is previously overlooked represents an opportunity for pure profit. The human propensity to sense such opportunities leads to the systematic correction of errors that is the feature of the market process. Paradoxically, markets tend to equilibrate not because choices are clear to individual decision makers, but because 'of the unsystematic human efforts to cope with open-ended uncertainties of the great unknown' (Kirzner 1997, 27).

Scientific explanations

Understandings concerning spontaneous order developed by the 18th century evolutionists and the Austrian school have been deepened by research programs in many scientific disciplines that focus on the study of complexity and self-organisation. Complexity theory seeks to explain how order found in dynamical systems emerges without design. Living systems, whether they are single cells in our body, whole organisms or societies, need to be both dynamic and stable because life is not sustainable in static or chaotic states. (A static man is a corpse or a statue.) Complex systems allow flexible behaviour of their parts while withstanding the resulting perturbations (Kauffman 1995, 89; Levy 1992, 1, 27). They occur, in the words of Kauffman, 'at the edge of chaos'.

As observed previously, complex systems, of which societies are prime examples, result from the regularities that arise in the course of interaction among individual agents pursuing their disparate ends. These regularities themselves

come under selection pressures, and survive to the extent that they are retained by surviving groups. The evolutionary process is further complicated by the fact that selective retention of living systems occurs simultaneously at different levels in nested hierarchies. The environment that selects the genotype (genetic structure) of an organism includes its phenotype (the observable physical structure), the physical surroundings and the cultural environment. Each of these levels has levels within them. Simpler lower level systems coagulate to form complex upper level systems, which in turn provide the ecologies for future selection at the lower levels, causing systems at the lower levels to change further (Campbell 1987a, 54–73; Hahlweg 1989, 58–62). The survival of the system depends on its capacity to maintain stability through this two-way feedback. This makes the task of controlling living systems to produce desired results that much harder. These observations apply equally to the complex order of society.

Role of purposive action in legal evolution: the contribution of institutional theory

Scottish and Austrian schools highlighted the emergence of social structures as the unintended results of human action. Twentieth century scholars concerned with law and economics focused their efforts on the role of purposive human action in legal evolution. The idea that law is the creation of human agencies is deeply ingrained in the popular mind and is hardly novel. Legal obligations may arise under contract or under customary law, such as the law of tort and common law crime. Rights concerning person and property are directly or indirectly delineated by these two kinds of law. Institutionalists have been interested in the study of the evolution of both these forms of legal obligations. In relation to contract, institutionalists started with the rudimentary form of contract and examined the ways in which contract forms have changed over time (Macneil 1980), and how contract leads to the emergence of firms (Coase 1937; Williamson 1979; *et al.*).

The significance of the work of the institutional economists lies in their integration of purposeful action in the evolutionary process in a way that highlights human design and effort in legal evolution. Yet the differences between the spontaneous order tradition and the institutionalists should not be exaggerated. There is no fundamental inconsistency to be found between the two approaches. Many institutionalists consider the abstract principles of spontaneous order to be equally applicable to designed social organisations. The spontaneous order tradition does not deny the role of human actions in legal evolution. What it denies is that human beings act with prescience, not that they act with intent. Human designs, its theorists maintain, are but hypotheses that stand the test of history or are edited by it. Conversely, there is no denial in the work of the institutionalists of the fallibility of human design and the unpredictability that attends all human action. What they seek to demonstrate is that purposive human action has a great

deal to do with legal evolution, a fact not denied by spontaneous order scholars. The key differences between the approaches concerns focus. While the spontaneous order tradition looks at the abstract nature of the process of legal change, the institutionalists study the actual actions that cause such change. We need to be careful not to extrapolate from the work of the institutionalists a theory that human beings are in command of their destiny. Provided we do not do this, their work helps us anchor the evolutionary thinking developed by the Scots and Austrians to concrete developments in modern market based economies and to gain a deeper appreciation of the type of pressures that influence the directions of legal evolution.

There are three branches of institutional theory that are particularly relevant to the study of legal evolution. The first is associated with the 'old institutionalist' scholars who highlight the role of purposive human action in legal evolution. The second represents evolutionary game theory, and the third focuses on the role of history in determining the choices available to human agents seeking legal change. The central concern of the latter school, known also as the new institutional economists (NIE), is the problem of path dependency in institutional change.

The start of institutionalism has been identified with Thorstein Veblen's 1898 essay 'Why is economics not an evolutionary science?' (Seckler 1975, 11). Veblen argued that the idea of the economic person as a free choosing agent should be abandoned. An economic actor is one caught in an institutional web handed down inter-generationally and subject to change through exogenous shocks such as war, famine, disease and technological change (Seckler 1975, 8). The institutions themselves are transformed in response to changing conditions in industrial society, but there is always a time lag in adaptation that leaves some institutions maladapted to modern life. According to Veblen, deliberate law making is a game of 'catch up'. In contrast, Commons took a more optimistic view of the human capacity to direct the course of institutional evolution.

JR Commons and artificial selection in legal evolution

The starting point for JR Commons was the individual transactions between persons. These discrete transactions cumulatively lead to the emergence of legal structures. In *Legal Foundations of Capitalism* (1924), Commons argued that economic and legal evolution involves artificial selection 'like that of a steam engine or a breed of cattle, rather than like that of a continent, monkey or tiger' (1924, 376). What he meant was that law-making authorities (legislators and judges) are continually selecting those laws that serve known purposes, and eliminating those that are detrimental to them. Unlike Hayek, who regarded the cultural universe as comprising made orders (*taxeis*) that are created for known purposes and spontaneous orders (*cosmoi*) that have no purpose, Commons saw that universe in terms of *going concerns*. Going concerns consist of a series of transactions of individuals interacting for particular purposes. They include

the corporation, the church, the club, the family, the government and the state. A going concern exists before it is legally recognised in the form of the intentions and transactions of its members. Its internal rules have built up through customs, practices, habits, precedents, methods of work and such like. Law is born when functionaries of the state find a going concern 'already in a trembling existence and then proceed "artificially" to guide the individuals concerned and give it a safer existence' (Commons 1924, 145). The law evolves as courts and legislators seek to fix problems and to eliminate impediments that prevent going concerns from achieving their purposes. The law maker's task is thus similar to that of a mechanic fixing a car. They determine the organisation's purpose, find out the problem and then modify the applicable working rules (Commons 1924, 145).

The analogy of law making with animal breeding and manufacture is misleading, as Vanberg (1997) pointed out. Legal evolution could be said to be artificial only in the sense that it results from actions of human agents, as Ferguson stated. It is not artificial in the sense that law makers can have requisite knowledge, resources and command of process to engineer the law to attain precise ends (Vanberg 1997, 112). Commons' view that laws evolve through purposive human acts of selection is highly contestable. Human acts are elements in a complex selecting environment. One person's act by itself can never be a selector in relation to the law. Indeed, the selecting environment will usually be made up of countless acts, many of which express no preference at all for the selected law. This is obviously the case with customary law but, on examination, is equally true of legislation. Deliberate enactments, whether made by legislators or by judges, undoubtedly change the law, but they too are ultimately selectively retained (or eliminated) by an environment that consists only partly of purposive human actions – many of which say nothing about the laws in question. Thus, judicial precedents are revised from time to time, and so are legislative enactments that do not stand the test of time.

In Common's theory, the working rules of a going concern result from the problem of scarcity. Law makers, whether they be judges, executives or legislators, are engaged in 'proportioning the inducements which collective power creates' (Commons 1974, 365). Commons was unclear on the principle that guides this proportioning. He suggested that officials are guided by 'the sense of fitness and unfitness arising out of habit and custom, which is but the sense of the proper and the improper proportioning of limiting and complementary factors needed to bring about what is deemed to be the best proportioning of all' (1974, 366). As to the sense of fitness, he stated that it is 'that feeling of harmony and unity attained by fitting the immediate transactions under discussion to the whole scheme of life as perceived and habitually accepted' (1974, 366). Though unclear, this explanation of law making draws Commons closer to the spontaneous order paradigm. Compare, in this respect, Hayek's view that the effort of the judge who decides the hard case is part of the process of adaptation of society to circumstances by which the spontaneous order grows. This is because the

judge's function is not to create new order but to 'maintain and improve a going order' (Hayek 1982, 1, 119). The judge performs this function by 'piecemeal tinkering' or 'immanent criticism' (Hayek 1982, 118). A dispute comes before a judge when a person's expectations are defeated or when contending parties hold conflicting expectations. Where an existing rule provides no clear answer the judge must supply a rule that will tend to match expectations and not promote conflict. Hayek's judge is directed back to the abstract rules of the spontaneous order upon which expectations were initially founded, in order to devise a rule that is in harmony with that order. Thus, for both Hayek and Commons, the duty of the magistrate is to supply a rule that fits the ongoing order.

Vanberg argued that the value of Commons' work lies in its demonstration that we are not passive sufferers of a given evolutionary destiny, but that we can and should assert a positive influence on the direction of legal evolution, as the German school of ordo-liberalism proposes (Vanberg 1997, 114). Vanberg acknowledged that neither the Scots nor the Austrians had a wholly agnostic view of evolution (1994, 465–6).

Evolution of organisations

The spontaneous order tradition does not deny that there are organisations based on deliberately created rules. What it maintains is that, ultimately, these organisations are subject to the same principle of unforeseeable and unintended consequences as grown orders. Organisations are themselves elements that interact in the overall spontaneous order that no authority can control. What about the government? There are many selectionist explanations of the emergence and ubiquity of headship institutions or governments. H Guetzkow, Harold Leavitt, Alex Bavelas, DT Campbell and others thought that most societies, through selection pressure, tend to produce a single coordinator or communications clearing house (Guetzkow 1961, 187–200; Campbell 1965, 29). Campbell identified the selective advantages of the economy of cognition (information sharing), the economy of specialisation (division of labour) and the economy of mutual defence (1965, 44–5). Whatever may have been the causes, it is evident that government, having legislative power and near monopoly of coercive power, is a common occurrence in social evolution.

Governments are not the only kinds of organisations found in a large society. There is a wide range of private voluntary organisations directed to all manner of purposes. Until Ronald Coase's 1937 essay on 'The nature of the firm', the question of why individuals form organisations and surrender their market power in exchange for central planning had received little attention. (Coase's theory is discussed in more detail in Chapter 9.) Coase's investigation of this puzzle led to new insights concerning the role of purposive action in legal evolution. Coase argued that the firm was a long-term contract among previously independent owners of labour, capital and raw materials who agreed to place themselves under the management of an entrepreneur in preference to engaging in free

exchange to produce goods or services. Whether a firm would arise in this manner depends on the marginal cost of using the price mechanism (Coase 1937, 390). Where production reaches a certain scale and complexity normal contracting becomes impractical, as too many contracts are needed to marshal labour, capital and raw materials in a highly competitive and volatile market. At this point it makes economic sense for persons to organise themselves into a firm and become employees of the firm. A firm thus formed will not expand indefinitely, because at some point the capacity of management to efficiently deploy factors of production suffers. Coase concluded that 'a firm will tend to expand until the costs of organising an extra transaction within the firm become equal to the costs of carrying out the same transaction by an exchange on the open market' (1937, 394–5).

Coase's theory was neglected for more than 30 years, until Williamson elaborated it by aligning changes in organisational structure to changes in the transactional environment. Williamson explored the conditions under which firms resort to markets to secure services or make long-term employment contracts. Factors that influence the formation of a firm include uncertainties caused by opportunistic behaviour of others, the recurrence of similar transactions in a business (a furniture business needs a carpenter full time) and the specificity of human and physical capital (Adelstein 1998, 63). Williamson used Macneil's taxonomy of contractual forms to argue that firms oscillate between classical, neo-classical and relational contracts along the chain of production as they seek to maximise profits (Williamson 1979, 248). The classical contract is the discrete contract, where two strangers come together just for the purpose of the contract and can reasonably foresee the consequences of their bargain. In these cases, the courts usually hold parties strictly to the terms. The neo-classical contract occurs where parties have ongoing concerns but may not be able to predict accurately the consequences of particular bargains. Thus, the importer and the exporter of an agricultural product on a long-term contract may leave room for future adjustments of prices. Relational contracts are observed where economic factors create strong ongoing interdependencies within a wider community (Macneil 1980).

The selectionist nature of organisational evolution, even when it is the consequence of purposive actions, was emphasised by Alchian (1950), Friedman (1953) and Becker (1962). They argued that even if entrepreneurs in real life do not engage in profit maximisation through marginal analysis, as assumed in the neoclassical theory, the model holds good when it is viewed in relation to industries as opposed to single firms. All three theorists took the Humean view that a theory may hold good even if its assumptions are unproved (Friedman 1953, 9, 14; Becker 1962, 12). Even if individual entrepreneurs are not driven by profit maximisation, within an industry firms that survive are those whose conduct approximates to the model of profit maximisation. As Alchian contended, we cannot know in advance what subjective preference in relation to risk will yield the better results; we only know with hindsight what actions have yielded the