The Logic of Social Action: Austrian Law-and-Economics

Josef Šíma
Prague University of Economics
sima@vse.cz

The collapse of communism clearly demonstrated that private property matters. This simple truth has often been denied though by economic theoreticians especially with the "success" of formalist revolution in economics in the second half of the 20th century. Coasean and Posnerian version of law-and-economics described in textbooks as the school of thought that brought property back into economics however does not offer much improvement. A growing number of authors has shown that Chicago *efficiency theory of rights* is contradictory. It is a goal of this paper to present a case for more fundamental defense of property in economics.

In the summary on the evolution of the institution of private property, Harvard professor Richard Pipes concludes his recent comprehensive work stating that "[a]nthropology has no knowledge of societies ignorant of property rights... which means... that it is not merely a "legal" or "conventional" but a "natural" institution"[1]. It is, according to him, a basic fabric of all society.

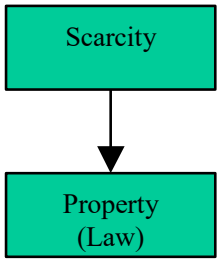
Such an empirical "proof" of the natural character of the institution of property seems to be a very useful hint that shows us a direction where to look for justification of property. If it is really true that *all* societies developed some sort of property rights structure and if we take seriously the claims of earlier political economists that the more property was respected, the more prosperous societies were, one is perhaps justified in looking for more than just an empirical regularity – for some sort of *a priori* argument for property.

Indeed, we know from history that the whole group of well-known European scholars – natural rights theorists – has argued for centuries that property is a phenomenon inexorably linked to human nature. One problem with making these arguments a starting point of the whole analysis of law and economics is that the concept of natural rights is considered to be completely outdated, bankrupted and linked to a specific philosophy – namely Aristotelian metaphysics –

[1] Pipes, Richard: *Property and Freedom*, Alfred A. Knopf, 1999, p. 116.

rooted in the classic exposition of God.[2] Without trying to restate the case for God, our aim is much more modest but likely more relevant for policy implications. We will investigate whether these earlier authors did not discover a non-divine, though natural, justification of property. The same fundamental insight keeps popping up in many works[3] and is summarized nicely by Hugo Grotius as follows:

> Almighty God has created all visible and sensible things for the good of the human race in general... But of created things some are of such a nature that they are sufficient for the use of all men, as sun, moon, stars and sky, and to some extent also air and sea; others are not sufficient, namely such things as cannot be enjoyed equally by all. Of these ...some are such that they are immediately or in process of time consumed by use; immediately, as meat and drink; the very nature of these things does not admit of their continuing to be enjoyed in common; for as soon as any one consumes for his own account any part of the common provision, this is applied to the sustenance of that person and no one else; and here we see already something like ownership, springing from an act which accords with the law of nature.[4]



Without speculating about God[5] in this story, one thing must capture the attention especially of a student of economics. Grotius shows how crucial is the role played by the concept of *scarcity* – a concept at the root of modern economics – in law. Property being a cornerstone of law has thus the same origin. Some things are "sufficient for the use of all men, as sun, moon, stars and sky", therefore not scarce and thus no economizing takes place – there are not goods or so called "free goods"; some goods are scarce "to some extent" such as "air and sea", therefore some problems and conflict may arise – there is a potential for becoming a property – here we have the problem of pollution and the "tragedy of the commons"; or things "are not sufficient, namely such things as cannot be enjoyed equally by all" and therefore property must necessarily and *naturally* arise.[6]

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[2] See e.g. Pavlík, Ján: "Hayekův liberalismus: věda či ideologie?" in Schwarz, Jiří (ed.): *Hayek semper vivus*, Liberální institut, 2000, p. 23.
[3] For a nice introduction to this topic see Barnett, Randy: *The Structure of Liberty*, Clarendon Press, 1998, ch. 1, pp. 1–26.
[4] Grotius: *Jurisprudence of Holland*, I, p. 79, cited in Pipes 29
[5] Even Grotius seems to be more than aware of the non-divine universal validity of his teaching:

> What we have been saying [about natural law] would have a degree of validity even if we should concede that which cannot be conceded without the utmost wickedness, that there is no God, or that the affairs of men are of no concern to Him.

Grotius, Hugo: *De Jure Belli ac Pacis Libri*, Prol. 11, Clarendon Press, 1925, p. 13.
Randy Barnett summarizes:

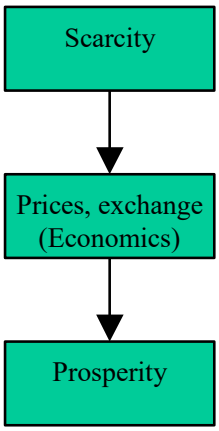
> Thus today one can no more disparage the idea of natural law (or natural rights) because eighteenth-century thinkers attributed their origin to a divine power than one can disparage the laws of physics because eighteenth-century scientists believed that such laws were also established by God.

Barnett, Randy E.: *The Structure of Liberty*, Clarendon Press, 1998, p. 6.
[6] Or as put by French political economist J. B. Say:

This is *not* to say that if nature gives us conditions in which certain things must necessarily be controlled or owned by someone (because there are scarce) and – as classical political economists observed – respect for property brings about prosperity, then all societies will automatically and *naturally* become rich.[7]

> ...while nature makes things appropriable, mankind determines and carries out the appropriation...[8]

There is plenty of occasions for people's activities to respond properly to natural conditions or to mess things up. The argument merely parallels a standard economic insight which says that prices and exchange arise due to scarcity and – as economists also claim – prices may be a very useful means in the hands of entrepreneurs to bring about prosperity as a result of coordination and the reduction of waste. Yet, it of course does not follow in any way that prosperity automatically arises out of the underlying scarcity. In order to achieve prosperity, only some prices count as real prices. The price structure under socialism with "prices" set by central planning agency was not what economists have in mind when they talk about coordinating properties of markets. Prices must reflect underlying scarcity and consumers preferences as closely as possible to be an important input into entrepreneurial calculations. And only activities of those entrepreneurs are able to help to overcome the *natural* trouble that scarcity causes.



Where then leads us a parallel between law and economics? What can we analogically derive from the concept of scarcity in the sphere of property and law? Primarily, scarcity implies not merely the inevitability of choice on which economics starts building its edifice, but also the inevitability of conflict and a need to solve it. Economics then looks for ways to alleviate scarcity constrains and thereby improve people's life, i.e. to achieve prosperity.[9] Law's task is to

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> If the state of nature is for man the one in which he obtains his greatest development, if he attains this development only in the state of society, and if the state of society can survive only with property, then the right of property is therefore a natural one: it derives therefore from the very nature of man.

Say, Jean-Baptiste: *Cours complet d'economie politique*, 2nd edition, Société Belge de Libraire, 1840 [1828–29] cited in Pearson, p. 8, n. 6.

[7] That would be a similarly silly argument as the Chicago strong version of political efficiency.

[8] Walras, Léon: *Éléments d'économie plitique pure*, translated Elements of Pure Economics, Allen and Unwin, [1874]1954, p. 35–36 cited in Pearson, p. 32.

[9] Prosperity defined as a product of development which means "widening the possibilities of choice" as Peter Bauer explained, when the choice is left on everybody's discretion. Bauer, Peter and Yamey, Basil: *The Economics of Underdeveloped Countries*, Cambridge University Press, 1957, p. 151.

prevent the necessary emergence of conflict and develop such rules that would enable people in society to co-exist peacefully.

We shall be able to see now two pictures in front of us, both derived from the same feature of our world – scarcity. However, when we tried to explain independently the logic of both systems – law and economics – we faced, as an attentive reader must have figured out, several situations when it was impossible to make independent claims for each system: socialist "prices" are not "what economists have in mind when they talk about coordinating properties of markets" only because they understand *markets* as a place where preferences of people who are not oppressed get demonstrated (the same way Adam Smith speaks in his *Wealth of Nations* about invisible hand guiding the butcher who is selling unstolen meat).[10] To speak meaningfully and generally about (economic) exchange, prices and prosperity means at the same time to presuppose peace. And peaceful, non-coercive relations define *society*.[11] To speak about "society of murderers" is as meaningless as to speak about "socialist economics".

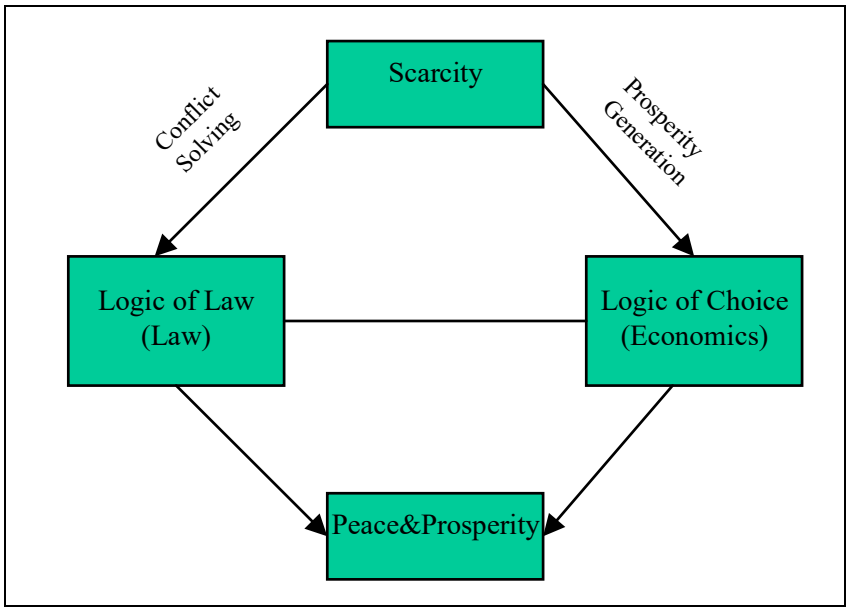
Though we have not yet given the final answer to the problem in question – there is still a law and economics vicious circle of what exactly notions of peace, coercion and the like mean – we may be closer now to better understanding of the interconnections between law and economics: "socialist economics" and "society of murderers" give us an intuitive grasp of the matter. We can even now already see that from the very beginning we were not drawing two distinct pictures – one for economics and one for law – but one. In reality we start from the same point[12] – the unavoidable phenomenon of scarcity – and end up ultimately again together in the realm of the twins: peace and prosperity. Thus, we have come to the conclusion not very different from what J. S. Mill observed more than 150 years ago:

> Political economy and law are interpenetrated. He who is ignorant of law will not fathom political economy, and he who is ignorant of political economy will be unable to trace the rationale of law.[13]

[10] It does not mean that economics has nothing to say about the logic of economic activities under socialism, under slavery or in the concentration camp. We will discuss those issues bellow.
[11] Economist typically, as we have already demonstrated, emphasized this necessary condition for social and economic development. Leading positions among them was occupied by French harmonist – Bastiat and Molinari.
[12] Though both disciplines might have also other roots.
[13] Mill, John Stuart: *Principles of Political Economy*, Little, Brown, 1848, book II, ch. 1, § 1 in Pearson, *op. cit.,* p. 34.

A graphical illustration will help us to depict this interpenetration – the *legal-economic nexus*,[14] define the field of law and economics and sequence the exploration of the long way from the implication of the concept of scarcity to its transformation into general well-being.

Logic of Social Action



We can now see from the picture that, rather than viewing law&economics as "the application of economic theory and econometric methods to examine the formation, structure, processes and impact of law and legal institutions"[15], we may speak of the interconnection between *Logic of Law* and *Logic of Choice*, or in short of the *Logic of (Social) Action*. Its goal would be to develop *necessary logical implications of the existence of scarcity for human society*.

There is no doubt about the fact that many people over centuries contributed pieces of knowledge to the edifice of this discipline. It was surely *not* developed in Chicago half a century ago.[16] Smith and classical political economists, as we have shown, did not discriminate against the law and neither did some other schools of thought – namely historical schools in Germany[17]

[14] Samuels, Warren J.: "The Legal-Economic Nexus", *George Washington Law Review*, vol. 57, no. 6, August 1989; Moss, Laurence S.: "Government, Civil Society, and Property: Restraining the Legal-Economic Nexus" in Samuels, Warren J. and Mercuro, Nicholas (eds.): *The Fundamental Interrelationships Between Government and Property*, JAI Press, 1999; Medema, Steven G.: "Is there life beyond efficiency? Elements of a social law and economics", *Review of Social Economy*, vol. 51, no. 2, Summer 1993.

[15] Rowley, Charles K.: Public Choice and the Economic Analysis of Law" in Mercuro, Nicholas (ed.): *Law and Economics*, Kluwer Academic Publishers, 1989, p. 125

[16] Such claim is sometimes promulgated by Chicago law&economists but even they do not really claim originality. Rochard Posner lists e.g. J. Bentham as "the first economist of nonmarket behavior", and therefore he qualifies as an antecedent of law and economics; Armen Alchian, one of the leading authors, acknowledges that "[o]ne can't help to see the whole issue [of his famous article *The Theory of Property Rights* – more about it later] in Adam Smith's famous section on the university." In Kitch, *op. cit.*, p. 228

[17] Chicago economist and a Nobel Prize winner from 1982 Stigler comments on this point:

> When Adam Smith discussed the economics of the primogeniture system, that seems to me like a traditional analysis by a competent economist. And when John S. Mill and Marshall discussed land tenancy systems... they were addressing some economics to what were institutional and legal questions. ...The German historical school had big names in it... All had treatises in which there were books devoted to legal institutions... If you look at them – I haven't gone through all of them – it is my impression that you will be dissatisfied with them on the ground that they were largely descriptive rather than analytical. But they weren't discriminating against law and institutions." Kitch, *op. cit.*, p. 169.

or elsewhere[18] and institutionalists[19]. Can we therefore meaningfully claim that law and economics understood as the logic of social action is as old as economics or perhaps even older? Such definition would be too broad. We will be of course able to trace scholarly works back to the past and make cases for different scholar to be founding fathers of the discipline.[20] Recent scholarship brought again the attention especially to the period of 1830–1930[21] or German tradition of *Staatswissenschaften*[22] and challenges reasons for harsh rebuttal. It is clear that the more modern era we study the more candidates for founding fathers we have and that the view that the real law and economics movement originated in 1950s "may overstate the originality of the movement"[23].

We need to draw a line somewhere, or in other words, to have a criterion of direct usefulness of some body of thought we can fully built upon. We propose this criterion to be an introduction of marginalist ideas to economic theory. It is because it was this insight that finally enabled to explain principal mechanism guiding people's behavior. It delivered the missing piece to the Logic of Choice and since law and economics strives to bring insights about how this mixes with the Logic of Law, it is useful to permit this mixing only after economics is ready for it. Only after we understand how values transform into market prices which guide people's market

[18] Stigler's judgment in this case is similar to the previous one:

> There was an English version of it [German Historical School]... There were people like Cliffe Leslie and Cunningham... and Bagehot, in a way became the English historical school. While they talked a lot about the importance of studying environmental conditions and the like, they paid no real attention to the institutions and the law.

Kitch, *op. cit.*, p. 216.

[19] All who believe in usefulness of (old) institutionalists' exercise should read their classics such as Veblen's *The Theory of the Leisure Class* and try to derive any theoretical lesson from it. We might then tend to agree with Mark Blaug that "[a] much better description of the working methodology of institutionalists is *storytelling*". Blaug, Mark: *The Methodology of Economics – or How Economists Explain,* Cambridge University Press, 1980, p. 126.

An interesting point about a link between anti-theoretical institutionalism and theoretical interventionist Keynesianism is made by Wallis who claims that:

> All of a sudden the very same people who opposed all abstract reasoning were seizing upon it [Keynesianism] because it supported the conclusions for which they had previously thought there was no theoretical basis, and the very same individuals (I suppose Alvin Hansen is the most striking case) jumped from being institutionalists to being abstract theorists.

Kitch, *op. cit.*, p. 173.

[20] See e.g. Drechsler, Wolfgang: "Etienne Laspeyres' *History of the Economic Thought of the Netherlanders*: A Law & Economics Classic?", *European Journal of Law and Economics*, vol. 10, no. 3, 2000; or entries on history of law&economics scholarship across countries denoted as *0300 Survey of Non-English Publications* in Bouckaert, Boudewijn and De Geest, Gerrit (eds.): *Encyclopedia of Law and Economics*, vol. I–V, Edward Elgar, 2000.

[21] Pearson Heath: *Origins of Law and Economics, The Economists' New Science of Law, 1830–1930*, Cambridge University Press, 1997. In a review of this book Juergen Backhaus of Maastricht University states: "There is a consensus on the American side of the economics profession that law and economics... is a phenomenon which originated at the law schools of the University of Chicago and Yale University after WWII... this consensus is laughable." Backhaus, Juergen: "Book Review: *Origins of Law and Economics: The Economist's New Science of Law, 1830–1930*", *European Journal of Law and Economics*, vol. 5, 1998.

[22] Drechsler, Wolfgang: "On the Viability of the Concept of *Staatswissenschaften*", *European Journal of Law and Economics*", vol. 12, 2001.

[23] Mackaay, Ejan: "History of Law and Economics" in Bouckaert, Boudewijn and De Geest, Gerrit (eds.): *Encyclopedia of Law and Economics*, vol. I, Edward Elgar, 2000, p. 66.

behavior we may be able to understand how "mankind determines and carries out the appropriation"[24].

Though we will from time to time illustrate some of our points by letting earlier authors speak – since we by no means claim futility of wisdom of pre-mid-19th century authors[25]. For the study of the legal-economic nexus we will use the knowledge of modern economics – based on marginalism, subjectivism and individualism and emphasizing both purposeful human action and complexity.

It is quite fitting that Carl Menger, who memorably played a part in the emergence of new science of marginalist economics, was primarily a lawyer who also contributed substantially to the development of law. In his *Principles* he was describing exactly the same thing that is depicted in our scheme.

> Thus human economy and property have a joint economic origin since both have, as the ultimate reason for their existence, the fact that goods exist whose available quantities are smaller than the requirements of men. Property, therefore, like human economy, is not an arbitrary invention but rather the only practically possible solution of the problem that is, in the nature of things, imposed upon us by the disparity between requirements for, and available quantities of, all economic goods.[26]

In the appendix to his Investigations[27] he also develops his concept of *Organic Origin of Law*, which – as we shall explain soon – is a crucial part of the study of law&economics. Thanks to these insights he qualifies as "a leader in both the marginalist revolution and in the new science of law".[28] We will show in the following text that a rigorous theory of law and economics can be built using pre-Chicago "Mengerian" insights; a theory that will not be time- and place-contingent and will keep strict logical status – in short, a Logic of Social Action; a theory that is eternal in a sense but at the same time has a strong real-life relevance.

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[24] Walras, Léon: *Éléments d'économie plitique pure*, translated Elements of Pure Economics, Allen and Unwin, [1874]1954, p. 35–36 cited in Pearson, p. 32.

[25] Though it may well be true that some attempts to explain social relations can be completely wasteful. There might be something to Coase's dissmisal of institutionalists:

> Without a theory they had nothing to pass on except a mass of descriptive material waiting for a theory, or a fire.

Coase, Ronald: "The New Institutional Economics", *Journal of Institutional and Theoretical Economics*, vol. 140, 1984, p. 230.

[26] Menger, Carl: *Principles of Economics,* New York University Press, 1976, p. 97.

[27] Menger, Carl : *Investigations into the Method of the Social Sciences*, Libertarian Press, 1990.

[28] Pearson, *op. cit.*, p. 151.

Property in Humans Themselves: The first test of the scheme

Our first attempt to test the scheme we have developed will not be an incomprehensibly complex one. We will limit the scope of our first inquiry into the logic of social action only to the most basic item – humans themselves. This easy subject of our attention will enable us to understand better the relations within and logic of our argument.

Given the nature of our world, human beings are subject to scarcity. Every man has only (indeed is defined as) one body, not more. As one lives, one must make choices – that is, one must *act* (concept of individualism). The aim of such action is to make one's life better. Men respond to the underlying fact of scarcity by economizing – by their effort to generate prosperity. This is reflected in their activities – they prefer less painstaking work over more, current satisfaction over future satisfaction, etc. as basic laws of economics teach us, which can be dubbed *Logic of Choice*.[29] Men know that co-operation with other people – division of labor and trade – may help them to speed-up the wealth creation, though one's concept of wealth is likely to be very different from what other people consider wealth (hence the concept of subjectivity of preferences is entering the picture). This is the prosperity part of the scheme.

On the other hand the concept of scarcity implies the necessity of conflict. Suddenly, somebody may want to use somebody else (somebody else's body) as one pleases. Who is to have the final say in this dispute? Who is to be the owner? Is there any principle of ownership or shall we resort to cost-benefit efficiency calculus to assign ownership?

A critical problem for giving an answer to these questions is *whose* rights count (whose preferences will be allowed to get demonstrated). Of course, as some scholars argue, in different "societies" different approaches were used – sometimes blacks were not treated as having rights, sometimes Jews, sometimes women. Pointing at those historical episodes does not however invalidate a possibility to investigate the logic of law and formulate the laws of social action in the same way as socialist experiments did not invalidate the possibility to formulate economic laws. If the logic of law exists in order to give us rules preventing conflict and bring about peace among people, then *all* people must be counted.[30] Otherwise we will end up in creating not *social* science of law but oxymoronic "racist social science of law", "Aryan social science of law" or

[29] Mises, Ludwig: *Human Action*, Fox & Wilkes, 1966; Rothbard, Murray: *Man Economy, and State*, Mises Institute, 1993.
[30] Including all beings with human cognitive capacities capable of social interaction. Even Barry Smith's extraterrestrial being (who is allegedly capable to invalidate the axiom that people act) would be considered human. See Smith, Barry: "The Question of Apriorism", http://www.mises.org/apriorism.asp [October 30, 2003]

"male social science of law". It follows then that if a conflict over scarce bodies emerges, the social science of law must give us necessarily and unavoidably a clear answer: every single individual must have a final say to what will happen with his body, i.e. every individual owns his body. The logic of law thus claims that if there is to be peace among all people, they must respect physical integrity of other people's bodies (bodily integrity). If people will not stick to this law, conflict will necessarily emerge – someone will be killed, kidnapped, raped or enslaved. Peace within human society is conceivable only if the *principle* of "self-ownership" is upheld.

Thus we can see that our scheme depicting the logic of social action encompassing the logic of choice and the logic of law is workable and describes clearly two aspects of one path from the problem – scarcity, to its solution – peace and prosperity.

On the concept of efficiency. Part I

Let us now have a look at whether or how the modern view of efficiency relates to the principle of self-ownership which we have just developed. We have to remember that the starting point of the efficiency theory of rights is the Coase Theorem which challenges the traditional concept of causation and guilt. Maximizing the value of production (or minimizing the loss thereof), not any notion of *natural right*, is to lead policy experts.

> Economic policy consists of choosing those legal rules, procedures, and administrative structures which will maximize the value of production.[31]

Richard Posner then has built on those Coase's ideas and elaborated his vision of the theory of rights. He claimed, as we have explained, that rights are to be assigned to those, who value them more, while value is measured in their willingness to pay. "Wealth maximization as an ethical concept" – "Wealth is the value in dollars or dollar equivalents... of everything in society."[32] If *everything*, then – one can infer – also human bodies. Posner emphasizes that his theory has really ambitions to be a general theory of rights.

> The most ambitious *theoretical* aspect of the economic approach to law has been the proposal of a unified economic theory of law in which law's function is understood to be to facilitate the operation of free markets and, in areas where the costs of market transactions are prohibitive, to

[31] Coase, Ronald H.: *The Firm, the Market and the Law*, University of Chicago Press, 1990, p. 28.
[32] Posner, Richard A.: "Utilitarism, Economics, and Legal Theory", *Journal of Legal Studies*, vol. VIII, no. 1, 1979, p. 119.

> "mimic the market" by decreeing the outcome that the market could be expected to produce if market transactions were feasible.[33]

General and unified theory of rights must give us mechanism of assigning rights not only in case of cows destroying the crop of a farmer, but must also – and primarily – give us an answer whether the law is to allow a released criminal to violate a prostitute[34] or one part of population to enslave another part of population.

One of the implications is that if "dollar value" is to decide who has the right, then it is conceivable that "murder" be justified. We put "murder" in quotes because in a world of mutual causation a victim may be "responsible" for his own murder because the case might be seen as follows: the victim might have been "just" standing in the way of the bullet and it might have been cheaper for him to avoid the murderer. Posner himself partly acknowledges this implication.

> A less welcome implication of the wealth-maximization approach is that people who are very poor... count only if they are part of the utility function of somebody who has wealth.[35]

Then the efficiency theory seems to imply that poor people do not count as being the right owners of their bodies (labor, etc.).[36] That is why efficiency theory can never serve as a cornerstone of any theory of social action. Even if we make the unrealistic assumption that "the data" for making efficiency calculus are "knowable" and "known", we cannot get the universal efficiency justification of self-ownership. This result may well be reversed as the circumstances change and the efficiency calculus may then "justify" slavery,[37] "class justice" and similar anti-social theories. The theory of social action, as we have developed it, must be therefore rooted in the *principle* of self-ownership as a necessary implication of the fact that all people must count.

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[33] Posner, Richard A.: *Frontiers of Legal Theory*, Harvard University Press, 2001, p. 5.

[34] We borrow this extreme example from professor Walter Block's application of Coasian logic as a way to justify the murder of O. J. Simpson's wife. See Block, Walter: "O. J.'s Defense: A Reductio Ad Absurdum of the Economics of Coase and Posner", *European Journal of Law and Economics*, vol. 3, 1996.

[35] Posner, Richard A.: "Utilitarism, Economics, and Legal Theory", *Journal of Legal Studies*, vol. VIII, no. 1, 1979, p. 119.

[36] Posner's conclusion avoids this dramatic implication and only mentions that there is therefore "no *public* duty to support the indigent" (ibid.). Posner smuggles into his efficiency theory some sort of quasi natural theory (he uses *natural* in quotes) and actually shifts the applicability of his theory only to other things than human bodies, where the logical implication is not as seditious. His argument is as follows:

> This is the economic reason for giving a worker the right to sell his labor and a woman the right to determine her sexual partners. If assigned randomly to strangers these rights would generally (not invariably) be repurchased by the worker and the woman respectively. Nor is there any mechanism for initially identifying, and vesting the right in, someone who in fact values it so highly that he might not resell it to the "natural" owner. No doubt the inherent difficulties of borrowing against human capital would defeat some efforts by the natural owner to buy back the right of his labor or body even from someone who did not really value it more highly than he did – but that is simply a further reason for initially vesting the right in the natural owner. *Ibid*. p. 125. (inner citations omitted)

[37] Prominent economic historians supply us with analyses leading to the conclusion about efficiency of slave economy putting aside the fact of enslavement as such. See Fogel, Robet and Engerman, Stanley L: *Time on the Cross: The Economics of American Negro Slavery*, W. W. Norton & Company, 1995.

This is not to discard the concept of efficiency altogether or deny its usefulness. We will devote a considerable attention to the implication of the concept of efficiency in the following chapter. At this point we only have to realize that within the theory of social action the concept of efficiency must be brought into the picture only *after* the principle of self-ownership is acknowledged – the respect for self-ownership is a natural necessity for any meaningful social theory.

On the problem of achieving the necessary: The concept of entrepreneurial margins

This chapter, where our goal is to discover basic proprieties of the general scheme of law&economics in the intuitively understandable context of ownership of human bodies, will introduce us to another crucial concept – the concept of *entrepreneurial margins*. It will show us the way in which we get ultimately to the society where self-ownership is respected, so that peace and prosperity can follow. We have so far often explained that something *must be* so and so, that something is *natural* as the theorist of natural rights claimed and we *necessarily* have to stick to such a principle. Things do not, however, happen out of the blue. We do not want to assume, as many economists do, that some sort of semi-divine body – or "economic aristocracy" to recall Keynes's vision – automatically solves human problems. To get things done, there must be someone who does the job, and does it right – a successful entrepreneur.[38]

Our current effort to formulate the principles of social action amounts to entrepreneurial activity at the first margin – intellectual entrepreneurship aiming at discovering correct principles capable of guiding human action in society. Grotius, Smith, Say, Bastiat, Menger, Mises and many others, all these great thinkers in their roles of intellectual entrepreneurs invested their time and effort to give us a product that would not be here without them. Their ideas have been competing with the ideas of Marx, Rousseau, Galbraith and many more who came up with opposing principles. The result is not pre-determined. Everybody must himself scrutinize critically what these entrepreneurs offer and make his choice.

Yet this does not exhaust the room for entrepreneurs in our picture. Even if the correct principles are discovered such as the principle of self-ownership, they will not be automatically respected by all the people. As long as people will not turn into angels there opens a room for the existence

[38] One of the few modern economists who did not ignore the role of entrepreneurs and focused his research interest on the study of the *process* of social change was Israel Kirzner. From his entrepreneurial perspective he frequently attacked a static, pre-tied world of Chicago economics including the mainstream law&economics movement (Coase, Demsetz, Calabresi, etc.). See Kirzner, Israel M.: *Competition and Entrepreneurship*, University of Chicago Press, 1973, pp. 225–234.

of the second entrepreneurial margin. Again, no semi-divine body will do the job. There must be people investing resources to make sure, that the correct principles are put into practice, so that those who do not respect other people's bodily integrity are caught and prevented from doing harm.

Not only that both entrepreneurial tasks are extremely complicated and costly, but both activities must be coordinated – they must go hand in hand. It should be clear now that our legal-economic nexus gained an additional dimension. Economic understanding of activities on those margins is crucial for the quality of law governing societies. To have a real theory of social action, i.e. a recipe for peaceful and prosperous life, we have to make sure that our theory is meaningful on those margins – that there is a meaningful mechanism enabling generation of quality products by these entrepreneurs who take into account their knowledge and motivation and their actions are mutually coordinated. If only one part of those entrepreneurial activities is missing neither peace nor prosperity is attainable and social structure breaks down. Poverty and violence replace social relations.

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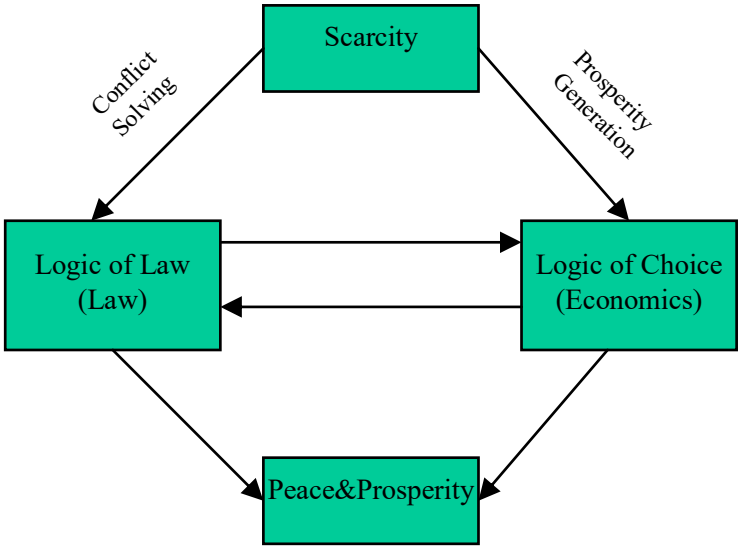
We can now conclude our chapter. We have tested our scheme of legal and economic nexus and explained its basic characteristics for the case of ownership of human bodies only. This simplification enabled us to start our treatment of the role of the concepts of efficiency and entrepreneurial margins. An introduction of these problems completed our analytical apparatus. In the following chapters we will study these concepts in more detail as part of a more complex scheme of social interactions.

Property in Other Stuff:The scheme completed

Equipped with the understanding of basic concepts and their place in our scheme of legal and economic nexus, we will in this chapter pitch into a more complicated analysis. We will quit the world where only human bodies (and time and space) are subject to scarcity and enter the real world where there is a variety of other scarce resources. We will explore how this phenomenon fits into our scheme of peace&prosperity generation and how it gives rise to new entrepreneurial margins. At the same time new light can be shed on the feasibility of cost-benefit calculus.

Our analysis can start completely the same way as in the previous chapter: Given the nature of our world, not only human beings but *also* many other things people are eager to get control over and use, are subject to scarcity. Economists call such scarce stuff *goods*.[39] Now we can reproduce our scheme again (with some modifications whose importance will appear soon) to explain the story about peace and prosperity generation in case of scarce goods.



As in our "body story", the economic part of the story is easy. Since it is not possible to use every scarce stuff for every purpose, one must make choices – one acts (concept of individualism). One's actions aim at making one's life better. Men respond to the underlying fact of scarcity by economizing – by their effort to generate prosperity. Logic of Choice leads their activities. Hence the importance of division of labor, now newly also division of capital and trade – concept of subjectivism as what one considers wealth is in full play here as in the previous chapter. The prosperity part of the scheme does not differ much.

What about the peace part of the picture? The concept of scarcity implies the necessity of conflict. Here the problem seems to be different though. When speaking about bodies we could easily say that every man has only (is defined as) one body, not more. So if conflict over (scarce) bodies arose we could relatively easily say that if the science we are developing is to be *social*,

[39] More on the nature of goods can be found in Menger, Carl: *Principles of Economics*, New York University Press, 1976, p. 52, who identifies four prerequisites that must be simultaneously present for a thing to become a good: 1. Human need; 2. Such properties that render the thing capable of being brought into a causal connection with the satisfaction of this need; 3. Human knowledge of this causal connection; 4. Command of the thing sufficient to direct it to the satisfaction of the need. (Sometimes, such as in the case of amulets, even things without any objective causal connection mentioned in point 2 are treated by people as goods.)

i.e. general for all people (and not racist, class, etc.), the body must be the property of the man, because it *is* actually him. Yet, can we make the same claim in case of goods? Can we say that a man is *defined* as having under his control some of these goods? Can property be a part of a man? And if so, which goods qualify as being *his*?

The case seems to be completely lost. Even if we succeeded in explaining the idea that peace is compatible only with self-ownership, in case of ownership of goods there seems to be so many possible ways of who ought to own what. Can anyone really dare to seriously claim that only one way is possible, i.e. compatible with peace, while any other way is not? It may surprise many, but there have been numerous people – respected philosophers and economists in the past and now who endeavored just that. If we do not go back to early Natural Right philosophers who lacked the modern grasp of law *and* economics, we may mention 19th century economist Frédéric Bastiat who definitely *can* be counted – as we will yet show – as a predecessor of modern law&economics. In Bastiat's discussion about property, the link from ownership to person is clear.

> In the full sense of the word, man is *born a proprietor*, because he is born with wants whose satisfaction is necessary to life, and with organs and faculties whose exercise is indispensable to the satisfaction of these wants. Faculties are only an extension of the person; and property is nothing but an extension of the faculties. To separate a man from his faculties is to cause him to die; to separate a man from the product of his faculties is likewise to cause him to die.[40]

Some contemporary philosophers, such as Samuel Wheeler, present a logical argument that property rights are actually body rights. This claim is derived from the fact that in order to be a body part, neither organic attachment nor sensation nor control of a thing is essential. As he concludes:

> ...things seem to group themselves into body parts and things that are not body parts. This grouping, though, is accidental and doesn't reflect any real difference in moral or metaphysical kind. ...Your property *is* your body.[41]

A case for property and body rights is also made on the ground that these rights are necessary as a fundamental requirement of morality[42] or a logical extension of people's argumentation

[40] Bastiat, Frédéric: *Selected Essays on Political Economy*, Foundation for Economic Education, 2001, chap. Property and Law, p. 99.
[41] Wheeler, Samuel C. III: "Natural Property Rights as Body Rights" in Machan, Tibor (ed.): *The Main Debate*, Random House, 1987, p. 280–282. Author's application is straightforward: "Theft, taxation, and disembowelment are different forms of the same kind of violation of rights." p. 286.

capacities.[43] It follows therefore, that this intellectual endeavor is by no means hopeless and certainly not prehistoric. It only proves that our legal-economic nexus is not all-encompassing approach and that a powerful argument can be made for developing a still broader discipline of social action – a logical discipline of law&economics&philosophy.

Our reader should not, however, expect that comprehensive theory of this sort will be now presented. The current author is after all an economist who understands the meaning of division of labor. Are we then facing the choice between simply adopting the concept of property as body part without qualification or finishing our project of deriving the logical implication of the phenomenon of scarcity on our own? We should try to find a trick that would enable us to go on in making logical arguments without making this primer a treatise in philosophy. How could it be done?

In discussing the role of property in an effort to present the logic of social choice, we will modify the implications of social action we derived in the preceding chapter. When we spoke about bodies, the important implication of *social* action was that it includes everybody – that all people have to have their say. Only then peace was attainable. When it comes to property, i.e. control over things from the outside world, it is conceivable that people live as animals and utilize outside world as a common pasture. However, we do not want to develop a theory for people living like animals. We have been developing a theory of *social* action having now the implication of looking to the distant future when making current choices. What makes a set of people a *society* of people as opposed to "society of savage" or "animal society" is their civilization – forward-lookingness.[44] To behave this way, people must be sure that whenever they use their bodies in a creative peaceful way (the first *social* requirement), they will not be deprived of the results of this activity – (scarce) new goods.[45] Only then the process of civilization can bring its fruits in full. Hence, what people produce must become their property (the second *social* requirement).[46] That will lead them out of the animal-like use of common pasture to creative production.

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[42] See e.g. Hasnas, John: "Are There Derivative Natural Rights?", *Public Affairs Quarterly*, vol. 9, 1995 summarizing the argument of Rasmussen, Douglas B. and Uyl, Douglas J. Den: *Liberty and Nature: An Aristotelian Defense of Liberal Order*, Open Court Publishing, 1991.
[43] Hoppe, Hans-Hermann: *The Economics and Ethics of Private Property*, Kluwer Academic Publishers, 1993.
[44] See Hoppe, Hans-Hermann: "Time Preference, Government, and the Process of Decivilization" in Denson, John (ed.): *The Costs of War*, Transaction Publishers, 1999.
[45] Not only goods produced in a strict sense but also discovered goods. Discovery or finding of something that was not spotted by anyone before entails a creative process of production. Collecting existing things was after all historically the first kind of production.
[46] This process that may be a preconditon for mere survival is not an automatic one, but a costly and laborious effort.

Property and the Tragedy of the Commons

Holding property in common was suggested and practiced as the main alternative to (private) property principle.[47] This alternative has however been shown to trigger substantial shortening of the time horizon of people's plans. This may render any care about durable property – capital goods – useless and cause its gradual destruction. That is accompanied by lower (ultimately no) stock of capital and reduced wealth. It comes without saying that this can hardly be compatible with *social* action and it is quite obvious that this process amounts to the process of decivilization. Economists came to know this process as the *tragedy of the commons*. The pattern of incentives guiding in this way people's behavior has been explained by many authors over the centuries starting with Aristotle, through Hobbes and going to 20th century authors.[48] Though the authorship of the concept is attributed to Garret Hardin and his 1968 article "The Tragedy of the Commons" in *Science*[49], more than 10 years before him Scott Gordon trenchantly explained the mechanism in question.

> Perhaps the most interesting... case is the use of common pasture in the medieval manorial economy. Where the ownership of animals was private but the resource on which they fed was common (and limited), it was necessary to regulate the use of common pasture in order to prevent each man from competing and conflicting with his neighbors in an effort to utilize more of the pasture for his own animals. ...Wealth that is free for all is valued by none because he who is foolhardy enough to wait for its proper time of use will only find that it has been taken by another. ...Common-property natural resources are free goods for the individual and scarce goods for society.[50]

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[47] Nobody, for example, seriously advocated that the property claim of the person who discovered a good should be invalidated in favor of the second or third "discoverer". Such an argument is internally contradictory. As a philosopher James Sadowsky put it:

> Now let us suppose that in various manners I deploy my activity upon material non-human goods that are previously unowned. By what right does anyone stop me? There are but two possible justifications: either he has the right to direct my activities by using violence (in other words he owns me) or else he owns the material goods in question. But this contradicts the assumptions we have already made: that each human being is self-owned and that the material goods in question are not previously owned. This man is claiming either to own me or the property I think I have acquired. The only factor open to question is whether the other man had peacefully acquired the land before me. But to raise this question is to concede the right of private property which is the thing we are trying to establish. Now, if no one man has the right to do this, it follows that no greater number may do so, for the same question that was asked of A may be asked concerning C, and so of all the others. Surely, if this is true of any of them taken singly, there is no reason to suppose that they could properly do this if they banded together.

Sadowsky, James: "Private Property and Collective Ownership" in Machan, Tibor (ed.): *The Libertarian Alternative. Essays in social and political philosophy*, Nelson-Hall Company, 1974, pp. 121–122.
See also Jasay, Anthony de: *Against Politics: on government, anarchy, and order*, Routletge, 1998, pp. 172–179.

[48] Urbanová, Tereza: *Tržní přístup k ochraně životního prostředí*, www.libinst.cz, Appendix II.

[49] Hardin, Garett.: "The Tragedy of the Commons", *Science* , no. 162, 1968, p. 1244.

[50] Gordon, Scott H.: "The Economic Theory of a Common-Property Resource: The Fishery", *The Journal of Political Economy*, vol. 62, no. 2, April 1954, p. 135.

While these Gordon's arguments published in a specialized journal article are sometimes mentioned in the literature, Ludwig von Mises's explanation of the same phenomenon incorporated (unlike Hardin's[51]) in his comprehensive treatise on economics published more than a decade before Gordon are routinely ignored.[52] Mises states:

> Wenn der Unternehmer gewisse Kosten seines Handelns nicht in Rechnung stellen muss, weil sie für ihn angesichts der Rechtslage external costs sind, dann wird er manches unternehmen, was er sonst unterlassen hätte. Es wird dann Personen geben, die unter seinem Vorgehen leiden, ohne dass ihnen die Möglichkeit geboten wäre, den Ersatz des von ihnen erlittenen Schadens zu begehren.
>
> Ein anderes Beispiel bieten die schon erwähnten Fälle, in denen Boden außerhalb des Sondereigentums steht und jedermann sich Bodenträgnisse wie herrenloses Gut aneignen darf. Wenn irgendwo Naturschätze – Holz und Wild in den Waldungen, Mineralschätze des Bodens, Fische in Gewässern – von jedermann erworben werden dürfen, dann wird jenes Verfahren Platzgreifen, das man als Raubbau bezeichnet. Niemand ist für die Nachteile verantwortlich, die durch Vernichtung der Bestände entstehen mögen. Dann werden die Wälder abgestockt, ohne dass für die Wiederaufforstung gesorgt wird, dann werden Wild und Fische so gejagt und gefischt, dass der Nachwuchs gefährdet oder vernichtet wird.[53]

Society engaging in "common pasture" experiment – property held in common – thus loses its social qualities.[54] To prevent a breakdown into barbarism, some sort of different rules must be developed in order to keep the social structure standing. Those rules had the form of regulations, prohibitions, limitations, etc. As Gordon states:

> Thus the manor developed its elaborate rules regulating the use of the common pasture, or "stinting" the common: limitations on the number of animals, hours of pasturing, etc., designed to prevent the abuses of excessive individualistic competition.[55]

It is not to say that society in which some property is held in common cannot exist – a hindsight gives us evidence that it was of course the case. We merely claim that it is theoretically

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[51] Hardin, a biologist by education, was more of a popularizer of Malthusian overpopulation myth than a scientist who understands the working of social processes, though his suggestion to create a market in *baby vouchers* may have pleased some Chicago "free-market reformers". More on Hardin can be found in Rubin, Charles T.: *The Green Crusade*, Rowman&Littlefield Publishers, 1998, pp.101–127.

[52] One of very few people, who mention Mises's contribution, is de Soto, Jesús Huerta: *Dinero, Crédito Bancario y Ciclos Económicos*, Unión Editorial, 1998. English edition *Money, Bank Credit, and Economic Cycles*, Ludwig von Mises Institute, forthcoming 2003.

[53] Mises, Ludwig von: *Nationaloekonomie*, Philosophia Verlag, 1940.

[54] As Thomas Sowell in his famous book *Knowledge and Decisions* aptly notes:

> No owned creatures are in danger of extinction. No owned forests are in danger of being leveled. No one kills the goose that lays the golden egg when it is his goose.

Sowell, Thomas: *Knowledge and Decisions*, Basic Books, 1982, p. 124.

The lack of social qualities under the commons setting we are talking about manifests itself by the fact that people have incentives to kill the goose in Sowell's example.

[55] Gordon, *ibid*.

unjustifiable and practically relatively unworkable system. If you reject a *principle* of property in the field of theory of social action you do not have a feasible theoretical alternative. This is a clear parallel with the famous socialist calculation debate. One may adopt a socialist theory of elimination of property (of the means of production) and see socialist economy in existence. However, as Ludwig von Mises explained, the theory is unattainable because there is no way that the means chosen could bring about the declared ends.[56] Socialist economies may then exist only if they look for alternative ways to get the results which the denied principle would bring about. Socialists had to mimic the black market, use foreign prices, etc.

The same is true for historical ways of practicing common pasture. The actual practice of villagers' shows that "common property" was not really common. It was not open to outsiders and even insiders were limited in their activities. A mechanism of devising the actual limitations on the "common property" was based on habits and partly on voting.[57]

The reform of the common pasture system through enclosure – land being a crucial part of property in this period – that led subsequently to the industrial revolution is too well known to require repetition. The relatively unworkable system of common property evolved into private property system giving a huge impulse to the process of prolonging people's time horizon and prosperity creation[58] – fuelling the process of civilization as described above.

> The understanding that good fences make good neighbors, that is, that men can use their own knowledge in the pursuit of their own ends without colliding with each other only if clear boundaries can be drawn between their respective domains of free action, is the basis on which all known civilization has grown. ...Property... is the only solution men have yet discovered to the problem of reconciling individual freedom with the absence of conflict.[59]

Or

> In essence the first possession rule has been the organizing principle of most social institutions, and the heavy burden of persuasion lies upon those who wish to displace it.[60]

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[56] Mises, Ludwig: *Economic Calculation in the Socialist Commonwealth*, Ludwig von Mises Institute, 1990 [1920]. See also Rothbard, Murray: "The End of Socialism and the Calculation Debate Revisited", *The Logic of Action I*, Edward Elgar, 1997; Salerno, Joseph: "Why Socialist Economy is *Impossible*", postscript to Mises, Ludwig: *Economic Calculation in the Socialist Commonwealth*, Ludwig von Mises Institute, 1990.

[57] More in Barzel, *op. cit.*, p. 71 and Dahlman, *op. cit.*

[58] As explained by Barnett, primarily because of its supremacy in spreading of knowledge needed for social cooperation:

> [T]he right of first possession performs the same general function as the right of consensual transfers – that is, it assures that the knowledge of others will be taken into account when one acts on the basis of one's own knowledge.

Barnett, Randy E.: *The Structure of Liberty*, Clarendon Press, 1998, p. 70.

[59] Hayek, F. A.: *Law, Legislation and Liberty*, p. 98–99 (in Czech translation)

[60] Epstein, Richard A.: "Possession as the Root of Title", *Georgia Law Review*, vol. 13, no. 4, Summer 1979, p. 1241. Note also the wide range of applicability of the rule emphasized by Lueck:

However, even if it may come as a surprise after what has been said so far, the existence of some common property in the real world does not necessarily imply poverty or backwardness. There may still be good reasons for common property to be the best available alternative. Let us see now why.

Entrepreneurial margin no. 3

When we analyzed a link between theory and the real world in the previous chapter we made our first insights into the problem in question. We stressed a crucial role of entrepreneurial activity on two margins – first, the intellectual discovery of rights themselves and second, protection and enforcement of these rights. Both activities involve use of resources and have to deal with inexorable lack of information (risk and uncertainty). The common denominator of both is scarcity that entrepreneurs try to overcome to the greatest degree possible. Costs of discovery and enforcement of discovered principles with people's willingness or ability to pay will then decide which rights and to what extent will be ultimately protected in a given society. If rights only from this *limited* scheme of legal-economic nexus from the previous chapter are to be discovered and well protected – no one killed, raped, enslaved, etc. – the cost would be enormous and, as we can see from experience, even the richest societies could not afford it. In every society, people are being occasionally killed. In this chapter we argue that there are even *more* rights creating the fabric of society. Hence there is a need for extra costly activities.

In case of humans, no one needed to spend resources on appropriating people's bodies. People possess their bodies naturally by birth. Things, on the other hand, must be *made* property by men's activities. Property in things may well be natural, i.e. necessary condition for peace in a society, as we argued above, but it does not come about without costs. Things exist *naturally* "out-there" in the form of commons and they stay there as long as there is plenty of it for all. Once this point of abundance is passed, conflict arises and must be solved. Property rights typically emerge as a result of entrepreneurial activity on this margin – represented by the arrows

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> [First possession rules] ...have been applied widely in both common and statute law, in such varied settings as abandoned property, adverse possession, bona fide purchasing, the electromagnetic spectrum, emissions rights, fisheries and wildlife, groundwater, hardrock minerals, intellectual property, oil and gas, land, nonbankruptcy debt collection, satellite orbits, spoils of war, treasure trove, and water rights. First possession rules also have been a fundamental component of civil law, traditional African and Islamic legal systems, as well as informal and customary rule making.

Lueck, Dean: "The Rule of First Possession and the Design of the Law", *Journal of Law and Economics*, vol. XXXVIII, no. 2, 1995, p. 394 (inner citations omitted).

in our graphical scheme (as opposed to a mere "automatic" link – no arrows – in the previous chapter).

> ...recognition of new values is only half of the equation; to capture those newly recognized values, property rights entrepreneurs must establish ownership over the relevant assets.[61]

A famous illustration of this is presented in a pioneering article by Harold Demsetz.[62] He describes the life of Montagnais, American Indians living on the Labrador Peninsula, and studies incentives behind a change in their behavior. Montagnais engaged collectively in catching beavers and then sold their furs. It worked well until white traders arrived and increased the demand for and the price of beaver's furs. A declining population of beavers (increased scarcity as a result of the tragedy of the commons) led to a change in Indians' behavior. To prevent the tragedy of the commons, they developed a concept of private ownership in the resource (beavers). A crucial point of this story is that the transition between the system of commons to the system of property took place only after it paid off (after the benefits of the arrangement exceeded its transaction cost).[63] Since the existence of the system of property is costly, economic considerations influence the laws governing societies. Shortly, the ideal of property in things guaranteeing peace within society may not be attainable at all times. As a result, only an entrepreneurial success or failure (profit or loss) in testing the profitability of "superior" legal system and not strict logical deduction will determine what is the best attainable system societies will live under.

The necessity of entrepreneurial activities to decide on the best system of legal arrangements provide us also with an explanation of the seeming paradox with which we started this part – a successful existence of systems of property held in common. In many areas it may be perfectly profitable (the least costly) not to have individual private property.[64, 65] This is not however by

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[61] Anderson, Terry L. and Huggins, Laura E.: *Property Rights: A Practical guide to Freedom and Prosperity*, Hoover Institutions Press Publications, 2003, p. 37.

[62] Demsetz, Harold: "Towards a Theory of Property Rights," *American Economic Review*, May 1967.

[63] This Demsetz's story about reasons for transition toward the property system is certainly possible, though it does not represent the only feasible explanation. It is still a nice and optimistic parable.

> One could tell this kind of [non-optimistic] story about the Montagnais as well, given how little we know about them. It is conceivable that colonial settlement altered power relations within the tribe, for instance, by conferring more power to tribe members who had closer contact with the settlers, and allowed one set of tribe members to squeeze out the rest by dividing the tribe's hunting territory among themselves. ...This is a darker story than the one offered by Demsetz, because it has no efficiency implications one way or the other.

Banner, Stuart: "Transition Between Property Regimes", *Journal of Legal Studies*, vol. XXXI, June 2002, p. 360.

[64] Many examples of administration and functioning of common pool resources (CPR) can be found in Ostrom, Elinor: *Governing the Commons*, Cambridge University Press, 1990.

Among reasons for holding some resources as commons may belong also the fact that owners are then not as easily identifiable, which may in some instances be a advantage.

any means an argument against (private) property in the same way as the existence (and profitability) of a firm – as Ronald Coase has shown[66] – does not deny the necessity of market setting.[67] It merely acknowledges the realities of our world, namely inexorable and omnipresent scarcity and therefore costs of any human actions, and further highlights the need for quality property entrepreneurs on this margin.

On the concept of efficiency. Part II

We have pushed the logical implications of scarcity of things for the theory of social action as far as possible until we hit the limit of logical deduction. This limit means a discovery of an entrepreneurial margin. Our developed principle (i.e. logical exercise of intellectual entrepreneur) gets into the hands of property entrepreneurs who seek to carry the principle as far as the profitability allows. And as for all entrepreneurs, efficiency of their activity will determinate their success or failure.[68] Though as we have shown in Part I of our investigation into the problems of efficiency within legal-economic nexus, this is *not* what the defenders of efficiency theory of right have in mind. They do not accept the natural fact of scarcity as a defining characteristic of the market (a framework in which peace&prosperity generating activities take place). They do not find property entrepreneurs as those whose activities belong to that framework and are indispensable to cope with "transaction costs". What they want is to

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> The users of the commons are harder to identify and very hard to tax. In contrast, atomistic farmers or other private property holders are quite identifiable.

Levmore, Saul: "Two Stories about the Evolution of Property Rights", *Journal of Legal Studies*, vol. XXXI, June 2002, p. 430.

[65] Recently, there appeared a new concept showing that there may exist a symmetrical problem to the tragedy of the commons reminding us that once natural social evolution is violently disconnected, there is not an easy way back on the right track. As a reaction to the development in Moscow in 1990s, Michael Heller developed a concept of The Tragedy of the Anticommons. (Heller, Michael A.: "The Tragedy of the Anticommons: Property in the Transition from Marx to Markets", *Harvard Law Review*, vol. 111, no. 3, January 1998). He found "a paradox". Despite the shortage of facilities for small entrepreneurs, many building remained empty while numerous kiosks occupied the streets. It was because property was assigned to a big number of owners who then needed an approval of all others when for example the premises was rented out. Due to high transaction costs they were often not able to agree on what to do with the place. As James Buchanan summarizes in the follow-up:

> The anticommons tragedy, as measured in nonrealized economic value, takes the form of underusage rather than overusage of the resource.

Buchanan, James M.: "Symmetric Tragedies: Commons and Anticommons", *The Journal of Law and Economics*, vol. 43, no. 1, 2000.

[66] Coase, Ronald: "The Nature of the Firm", *Economica*, vol. IV, 1937, see also chapter 3.

[67] This analogy is widely recognized by economists. As Bruce Yandle put it:

> [M]ost institutions that organize production within the envelope of a firm, club or any other economic unit can be described as working to avoid a tragedy of the commons. Indeed, all contracts defining exclusive arrangements can be seen as tragedy-avoiding devices of some sort; in each case, parties have colluded and restrained trade.

Yandle, Bruce: "Antitrust and the Commons: Cooperation or Collusion?, *Independent Review*, 3, 37, p. 43.

[68] Entrepreneurs ought to seek efficiency, though in reality they will do it only under certain institutional structure. More about it bellow in chapter 8.

protect the "market" from these alleged deficiencies, to use judicial power to speed-up the market and redesign society as if some costs of transacting never existed.[69]

> Prefixing "trans-" to "action" does not and cannot create a special kind of cost with exceptional properties.[70]

Instead of taking advantage of entrepreneurial alertness to profit opportunities on top of general principles of social actions, they call for judicial activism. As we have already touched upon, the efficiency theory of rights builds on the axiom that "dollar value of production" must be maximized.

> ...the wealth-maximization principle implies... legal rules that simulate the operations of the market when the costs of market transactions are prohibitive.[71]

Here we can see clearly the implication of the fact that one part of the cost (transaction costs) is excluded from being a part of free-market. Anytime a problem arises over something, judges are advised to try to imagine a counterfactual unreal world without cost of transacting and place their final judgments about who is to own something on the calculation of wealth changes in such a world. Though Richard Posner, a leading exponent of such a view, was at times criticized by a founding father of Chicago law&economics movement Ronald Coase, Coase himself went much further in his pioneering article.

> Even when it is possible to change the legal delimitation of rights through market transactions, it is obviously desirable to reduce the need for such transactions and thus reduce the employment of resources in carrying them out.[72]

In other words, even if it is mutually beneficial for people to engage in exchange of property, the judge should step in and assign the property without waiting for real people to come up with agreeable terms of exchange. At this point it must be clear how much is this view irreconcilable with the principles of property (and self-ownership!) derived above. It becomes obvious that – as opposed to our approach rooted in the entrepreneurial discovery of cost-saving methods of

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[69] As aptly pointed out in the discussion about real-world pricing as opposed to perfectly competitive view on this process by a leading public choice economist:

> It may be cause for lament that those gains [such as in case of monopolistic pricing above the MC] could not be exploited, just as it may be cause for lament that there are not fewer children born with birth defects or that so many resources are devoted to the supply of anti/theft devices and dog food. But, lamentation is no vehicle for amelioration, and we may be either unable or unwilling to achieve amelioration, regardless of the intensity of our lamentation. ...Transaction costs are as much a cost as any other type of cost.

Wagner, Richard E.: "Economic Efficiency, Rent Seeking, and Democracy: Zenoistic Variations on Coasian Themes" in Boettke, Peter J.; Kirzner, Israel M.; Rizzo, Mario J. (eds.): *Advances in Austrian Economics*, vol. 1, 1994, pp. 132–133.

[70] Stromberg, Joseph R.: "Douglass C. North and Non-Marxist Institutional Determinism", *Journal of Libertarian Studies*, vol. 16, no. 4, Fall 2002, p. 127.

[71] Posner, Richard A.: "Utilitarism, Economics, and Legal Theory", *Journal of Legal Studies*, vol. VIII, no. 1, 1979, p. 127.

[72] Coase, Ronald H.: "The Problem of Social Cost", *Journal of Law and Economics*, vol. III, October 1960, p. 19.

solving problems and transacting – efficiency approach to rights is based on discretion of judicial authority to "outlaw" cost by decree. Chicago approach ultimately suggests outlawing peaceful activities of people in order to have a "perfect" market as a tool for wealth generation. We can see that this tears apart our legal-economic nexus: peace and prosperity do not coincide in their view – peace (a possibility to conduct transactions with owned property) must be sacrificed for the sake of wealth maximization of dollar values.[73] One is tempted to paraphrase a famous book title and conclude that Chicagoits for their love of market pursue the strategy of *Perpetual Coercion for Perpetual Free Market*.[74]

Let us go, however, behind the first stage of the battle between natural rights (the principle of self-ownership and its off-spring – property) and the efficiency theory of rights. The dispute might not be ultimately so intense at the level of *principle* for even Richard Posner over time softened his claim about the feasibility to structure the *whole* system of rights according to wealth-maximization principle,[75] however they can make marginal changes, which is what is relevant in everyday life. Hence, we will have a look at the possibility for a judge to use cost-benefit analysis.

Let us take a classical Coasian example. Rancher's cows stray into farmer's crop. Then a basic question arises: Who owns the crop? Is it the farmer or the rancher? How should the judge who assigns ownership by looking at the dollar value of production decide? We know already that the argument that the farmer produced the crop on his own land seems irrelevant. An argument relevant to him is who is the least-cost avoider. Once this is identified, the problem is solved – the party (say the rancher) for which it is costly to change its behavior can continue in his activity.

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[73] This approach to law finds its far-reaching application in the sphere of monetary policy. An early contributor to the *Journal of Law and Economics* and economist who as no one else is considered to be a defender of free-markets, Milton Friedman, came to his famous attack on the gold standard. Along the Coasean/Posnerian lines, he suggested that it is "obviously" desirable to reduce the cost of digging out the gold and hence when law introduces fiat money instead of gold money, society will be better off.

> The fundamental defect of a commodity standard, from the point of view of the society as a whole, is that it requires the use of real resources... People must work hard to dig gold out of the ground in South Africa – in order to rebury it in Fort Knox or some similar place.

Friedman, Milton: Capitalism and Freedom, The University of Chicago Press, 1982, p. 40.

[74] Compare to Barnes, Harry Elmer (ed.): *Perpetual War for Perpetual Peace: A Critical Examination of the Foreign Policy of Franklin Delano Roosevelt and Its Aftermath*, Greenwood Publishing Group, 1969.

[75] More and more critics of Chicago law&economics based on the efficiency theory of rights point out the futility to derive a comprehensive system of rights from cost-benefit calculus.

> ...a cost benefit analysis of the facts of a particular dispute will generate no general rule... But law has to operate through generalization... How one can compare two *systems* in terms of their contribution to wealth creation is nowhere explained, and the idea seems again to be wholly fanciful, the complexity being quite limitless. ...Cost benefit analysis is no doubt a valuable activity, but cost benefit analysis in the air is the stuff of dreams or nightmares, not of practical government and law.

Simpson, A. W. Brian: "*Coase v. Pigou* Reexamined", *Journal of Legal Studies*, vol. XXV, no. 1, January 1996, 97–8.

Let us suppose that the judge really wants to do his job well and find the respective costs in order to practice "judicial fine tuning" – marginally change the property structure.[76] His first obstacle will be the fact economists know too well that cost is forgone utility and is therefore inherently subjective. Some preferences get demonstrated in people's real-life actions so that an economist can get a glimpse of actors' preference rankings of some activities, but it is far from knowing costs of alternative property arrangements. Posner's suggestion to our judge is basically to ignore this economic insight.

> The purist would insist that the relevant values are unknowable since they have not been revealed in an actual market transaction, but I assume that (in many cases anyway) a court can make a reasonably accurate guess as to the allocation of resources that would maximize wealth.[77]

Even if we grant some sort of scientific validity of this Posner's argument and we really allow the judge try to "make reasonably accurate guess", we soon discover that our judge is lacking inputs for his guess. For if he is to succeed in attaining his goal of maximization of wealth, he must possess some means for such calculation. Yet the only information he has are existing market prices. He knows for example the price of wheat the farmer got (or, at best, can get) for his crop, or the price of meat and milk the rancher got for his cows. One may reply that it is all well and fine because this is exactly what the judge needs to know – prices are eventually said to reflect how much society values different goods and services. Many theorists consequently just took these "data" and started to compute who should own what.

There is, however, a deep flaw in this argument. To say that prices reflect social value of goods and services, you have to *assume* these prices to be equilibrium prices of the model of perfect competition.[78] Once we leave this artificial model and realistically allow for imperfect knowledge, uncertainty and disequilibrium, we finally appreciate the importance of entrepreneurial activity that keeps reappearing throughout this book.[79] Once the static model of

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[76] Such an effort cannot be simply taken for granted. Judge's activities take place at the entrepreneurial margin. We will return to this discussion in a separate chapter below.

[77] Posner, Richard A.: "Utilitarism, Economics, and Legal Theory", *Journal of Legal Studies*, vol. VIII, no. 1, 1979, p. 120.

[78] Chicago economics (and its application law&economics) is of course deeply rooted in the equilibrium model. As one of their own explained, Chicago approach *means* an assumption that the economy is tied prior equilibrium as opposed to diffused prior equilibrium. This assumption is then supplemented by others – all relevant to our analysis. When extending strict economic model to other fields – politics, law, etc. "In essence, individuals are assumed to be rational and to have means of obtaining goods and services through the political system – political wealth – as well as by exchange through the market." Reder, Melvin W.: "Chicago Economics: Permanence and Change", *Journal of Economic Literature*, vol. 20, no. 1, March 1982, p. 27. See this article also for an insider view about means used to keep the doctrinal purity of the Chicago approach.

[79] As a scholar investigating features of a dynamic economy observed:

> Once the focus moves away from narrow technical question of ideal allocative efficiency and settles instead on broad institutional issues and the possibility of changing a system's constraints, analysis takes on a somewhat Austrian coloration. Emphasis is on the productive sector and the operations of entrepreneurs who seek profits in an environment characterized by pervasive uncertainty.

Furubotn, Eirik G.: "Economic Efficiency in a World of Frictions", *European Journal of Law and Economics*, vol. 8, 1999, p. 191.

general equilibrium is abandoned, the world becomes what it really is – a continual flux: prices change, preferences evolve, knowledge spreads, people make mistakes, governments regulate, firms go bankrupt, etc. The judge cannot simply pick up certain prices, make the calculus and say that, based on high prices of milk, the rancher's cows should be allowed to stray into the farmer's field. The price of milk may be artificially high due to high tariffs or may be on its way down to reflect the true social value milk after the market "bubble". If the judge opts for redesigning the property after using current prices of this sort, he may easily in the name of efficiency produce much more *inefficient* result and *destroy* wealth. As Mario Rizzo in his lengthy discussion of these inexorable obstacles pointed out.

> Subjectivity of costs in the framework of disequilibrium brings about two consequences: (1) judicial cost-benefit analysis cannot duplicate what the market result would have been merely by following objective market prices, and (2) if these market prices are not "correct" GE [general equilibrium] prices then the courts may push us *farther away* from optimality by imposing liability on the party which only appears to be the cheaper-cost avoider.[80]

Unfortunately, this in not the end of problems for our judge. He is also facing an unanswerable question about the relevant time frame he has to take into account. Even if we could "trust" current prices for assigning the right to somebody (finding who is the least-cost avoider) it would still matter where in time we start measuring the cost and when we stop doing it. The farmer may *now* really be the least-cost avoider (and so the judge might correctly decide in favor of the rancher) but within couple of months the price of milk may go down and the rancher will become the least-cost avoider. Is the judge supposed to see in the future or would the solution be to change property rights every time the price of milk changes? Posner himself admits in the 1st edition of his textbook (p. 139) that to determine who has the greater long-run accident-avoidance potential is "an intractable question, in most cases".[81]

It should be clear by now that even in "trivial" disputes there is no way for the judge to know how he ought to decide cases in order to follow his doctrine of wealth maximization. For knowing what decision will increase wealth and what will reduce it, he needs to possess the knowledge that a single mind cannot possess.[82]

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[80] Rizzo, Mario J.: "Law Amid Flux: The Economics of Negligence and Strict Liability in Tort", *Journal of Legal Studies*, vol. IX, no. 2, March 1980, p. 310.
[81] Quoted by Rizzo. He also reminds us that Posner omits this phrase in subsequent editions of his book. Rizzo, Mario J.: "Law Amid Flux: The Economics of Negligence and Strict Liability in Tort", *Journal of Legal Studies*, vol. IX, no. 2, March 1980, p. 308.
[82] In more difficult cases the complications multiply. As Rizzo explains:

This assessment of the very *impossibility* of a man to *know* leads correctly some law&economics scholars to call for the necessity to make F. A. Hayek's basic insight about dispersed character of knowledge the "building block of law and economics"[83]. To claim otherwise would amount to requiring the judge to transform himself into a "cognitive superman".[84]

Not for the first time in this book we will evoke the parallel to the unavoidable problems faced by socialist central planners.[85] What is to be understood is the similarity and impossibility of tasks that both judges and socialist planners stand before. The analogy is apt and fits well into our legal-economic nexus. In both cases someone aspires to engage in non-price (non-market) allocation of resources. It is believed in both situations that more of peace and prosperity can be attained by the trick; that someone saves some resources by knowing in advance what the result of complex social phenomena will be; that one can *think* markets without people really *having* and *making* markets. This aspiration is however completely fallacious. Under socialism, as the bigger part of the economy got closer the "socialist ideal" of non-market allocation, the less socialist planners knew about real needs of the economy (the people) and the more pervasive chaos ensued.[86] The same will be true for the emergence of chaos and spread of pure arbitrariness in law once we got closer to the "ideal".

> The efficiency approach requires not only the testing of hypotheses about the defendant's negligence, but also investigation into the (contributory) negligence of the plaintiff. If, however, the doctrine of contributory negligence is to be interpreted as a lesser-cost avoider defense [as in Posner, p. 123–124, 2nd edition], our task is still not complete. If we find that both defendant and plaintiff have been negligent, we must still determine which party could have avoided the accident at less cost. Therefore, we are driven to compare two counterfactual hypotheses... The issue is not to compare or evaluate what *has* happened but, rather to speculate about what *might* have happened in two alternate worlds and then to compare the outcomes.

Rizzo, Mario J.: "Law Amid Flux: The Economics of Negligence and Strict Liability in Tort", *Journal of Legal Studies*, vol. IX, no. 2, March 1980, p. 292.

[83] Parker, Jeffrey S.: *Fundamentals of Law and Economics*, Edward Elgar, forthcoming.

As a European author writing on law and economics reminds us.

> From a Law-and-Economics standpoint however, Hayek's philosophy delivers an important insight: if we want to generate in society any particular order of a certain degree of complexity, we should look for general rules of conduct which, if followed by individuals, would tend to induce that order to form spontaneously, i.e. we should rely on spontaneous ordering forces. The reason is that in the case of complex spontaneous orders we will never be able to determine more than the general principles on which they operate.

Houwe, Van Den L.: "Evolution and the Production of Rules – Some Preliminary Remarks", *European Journal of Law and Economics*, vol. 5, 1998, p. 112.

[84] Schmidtchen, Dieter: "Time, Uncertainty, and Subjectivism: Giving More Body to Law and Economics", *International Review of Law and Economics*, vol. 13, no. 1, March 1993, p. 78 quoting Ackerman, B.: "Law, Economics, and the Problem of Legal Culture", *Duke Law Journal*, vol. 1986, no. 6, December 1986.

[85] Several lawyers familiar with the nature of economic problem in a socialist commonwealth pointed to this analogy. As Peter Aranson explained:

> The Austrian and L.S.E. critiques offer four reasons to believe that courts, like central economic planners, cannot adequately perform the necessary calculations to get matters right. I call these reasons: (1) the computation problem; (2) the dynamic prediction problem; (3) the decentralized information problem; and (4) the subjective cost problem."

Aranson, Peter. H.: "The Common Law as Central Economic Planning", *Constitutional Political Economy*, vol. 3, no. 3, 1992, p. 299.

[86] An interesting example among practitioners of central planning is Poland in 1950s and 1960s. The way planning was shaped by the most prominent advocate of central planning, Oscar Lange of the University of Chicago. During his long carrier of "doing" the planning, he did not come up with any practical solution to the problem of how the prices should be set. Socialist planners had no idea what the prices should be. To avoid complete economic chaos, world (i.e. capitalist) prices were used in socialist economies. One British economist reports an interesting response when he asked how the socialist planners would set the prices if there was no capitalist world. A Polish economist working under the alleged winner of the socialist calculation debate – super brain of the University of Chicago, Oscar Lange – responded: "We'll cross that bridge

> The greater the lack of market data, the more urgent that the judge, in the economic analysis of law, mimic the market. But the more urgent it is, the less able he is to do so.[87]

It should be also clear that the lack of knowledge cannot be alleviated by better computing procedures, better computers or better training. The problem of complex social phenomena and unknowable future is inherent in the nature of our world.

> It is all too easy to show that efficiency leads to desirable results within simplified constructs; it is quite another thing to show what this has to do with the world in which we live.[88]

Every system of rights that will be derived from calculus based on expectation about future development of constantly changing variables will not therefore give us any *rule* telling us what inoffensive (i.e. social) activities are permissible.

> Precisely because we live outside of general competitive equilibrium and in a world of unpredictable flux, the efficiency case for negligence must fail...[89]

We can sum up this chapter: an introduction of property in other stuff does not change the general conclusion presented in the previous chapter. We have discovered a new entrepreneurial margin (i.e. that someone has to do the appropriation) with interesting legal-economic issues around the "tragedy of the commons" problem, and a new implication of the concept of social action (i.e. that time-preference plays a crucial role). Those insights extended our understanding of the logic of social action, yet they did not contradict our crucial insights reached before. The reverse is true. We should now understand even *more* the critical importance of entrepreneurial activity for the quality of law and should be equipped with *more* arguments about the impossibility of developing an efficiency theory of rights and of practicing such a theory. Our argument for property based on principle should now be strengthened. We should now see that self-ownership and property in other stuff (found or produced) are indispensable cornerstones of the theory of social action.

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when we come to it." The story is told by Rothbard, Murray: "The End of Socialism and the Calculation Debate Revisited", *The Logic of Action I*, Edward Elgar, 1997, p. 428–435.

[87] O'Driscoll, Gerald P. Jr.: "Justice, Efficiency, and the Economic Analysis of Law: A Comment on Fried, *Journal of Legal Studies*, vol. IX, no. 2, March 1980, p. 360.

[88] Rizzo, Mario: "The Mirage of Efficiency", *Hofstra Law Review*, vol. 8, no. 3, Spring 1980, p. 658.

[89] Rizzo, Mario J.: "Law Amid Flux: The Economics of Negligence and Strict Liability in Tort", *Journal of Legal Studies*, vol. IX, no. 2, March 1980, p. 291.

Property Violation and Reintroduction of Efficiency: On the normativness, value-freedom and efficiency

We have now reached the point at which we have our scheme of legal-economic nexus complete, but we seem to completely have lost the concept of efficiency. Such outcome would be very suspicious for at the beginning of this book we set up a goal to combine the knowledge of two disciplines – law and economics – and it is hard to imagine this semi-economic approach without a notion of efficiency. A careful reading of the preceding chapters however does not support this claim. All the arguments against efficiency were targeted at the unjustifiable *use* of this concept. In this and the following chapter we will elaborate on the correct meaning and use of efficiency and show how useful and crucial this concept is for our theory of social action.

We must start with identifying the meaning of efficiency. Though used very often, the term is not understood, the same way by different people.

> The closest it comes to being meaningful is to identify actions in which the perceived benefits exceed the perceived costs – such an action is efficient – but, of course, to the radical subjectivist who allows the actor to demonstrate his own perceived costs and benefits *every action is of this nature*. Unless we impose some outside, exogenous constraint that allows us to differentiate efficient from inefficient the term "efficiency" is indeed superfluous.[90]

Without closer specification this definition of efficiency is not very helpful and the same is true when the term is used by most economists. As Murray Rothbard describes the consequences of using the term in its "mainstream" meaning:

> ...since no one can ever have perfect knowledge of the future, no one's action can be called "efficient". We live in a world of uncertainty. Efficiency is therefore a chimera.[91]

Once the concept is perceived so differently – as "all" or "nothing" – it is no wonder that people, who wanted to explore law and economics without always wasting time to explain first what concept of efficiency is used, suggested a radical step – to rid their theory of the concept altogether.

> The idea of efficiency is hopelessly clouded in ambiguity, and clear thinking might better be served by complete elimination of the notion.[92]

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[90] Egger, John B.: "Comment: Efficiency Is Not a Substitute for Ethics" in Rizzo, Mario J. (ed.): *Time, Uncertainty, and Disequilibrium*, LexingtonBooks, 1979, p. 121.
[91] Rothbard, Murray N.: "Comment: The Myth of Efficiency" in Rizzo, Mario J. (ed.): *Time, Uncertainty, and Disequilibrium*, LexingtonBooks, 1979, p. 90.

Though this suggestion has some merit, the term is still used all too frequently to warrant its complete elimination on the part of authors who wish to do so. Moreover, we believe strongly that it is possible to give efficiency a reasonable meaning. We will present an extension of our model of social action which will supply the criterion – the one that John Egger calls for – for distinguishing "efficient" from "inefficient". We will not, however, leave the realism of our analysis and will continue building upon the same basic insights about the world as we know it – existence of uncertainty, subjectivity of crucial economic concepts such as costs or utility, existence of disequilibria, etc.

Several authors who did not want to discard the notion of efficiency understood well that the "always efficient" approach of the Chicago is untenable. Neoinstitutionalists, who made it into the respected economic mainstream claim,[93] that

> it seems feasible to say that efficient arrangements can be differentiated from inefficient arrangements on the basis of whether firms are making positive economic profits or not.[94]

Yet, one of their own the Nobel Prize winner Douglass North, draws an important conclusion from his historical research giving a fatal blow to all other theories arguing that *time* is the final judge deciding on the efficiency of institutions – it is *not*. North tells us that he abandoned the efficiency view of institutions and gives us a good reason. It is because

> [r]ulers devised property rights in their own interests and transaction costs resulted in typically inefficient property rights prevailing [for millennia].[95]

He consequently comes up with a suggestion that if such an "inefficient" rule is discarded, society moves toward more efficiency – a concept of *adaptive efficiency*.

Another attempt to rehabilitate the concept of efficiency has been made by James Buchanan, another Nobel Prize winner. His arguments for an alternative concept of efficiency (and against Chicago-Posnerian law and economics) are rooted in subjectivist-contractarian (Austrian-

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[92] Rizzo, Mario J.: "Uncertainty, Subjectivity, and the Economic Analysis of Law" in Rizzo, Mario J. (ed.): *Time, Uncertainty, and Disequilibrium*, LexingtonBooks, 1979, p. 86.

[93] Building on Alchian who in his pioneering article stated:

> The pertinent requirement – positive profits through relative efficiency – is weaker than "maximized profit". ...Positive profits accrue to those who are better than their actual competitors, even if the participants are ignorant, intelligent, skillful, etc. The crucial element is one's aggregate position relative to actual competitors, not some hypothetically perfect competitors. As in a race, the award goes to the relatively fastest, even if all the competitors loaf. Even in a world of stupid men there would still be profits.

Alchian, Armen: "Uncertainty, Evolution, and Economic Theory", *Journal of Political Economy*, vol. 58, 1950, p. 20.

[94] Furubotn, Eirik G.: "Economic Efficiency in a World of Frictions", *European Journal of Law and Economics*, vol. 8, 1999, p. 189.

[95] North, Douglas: *Institutions, Institutional Change, and Economic Performance*, Cambridge University Press, 1996, p. 7.

Wicksellian) tradition.[96] Thus, his focus is on the process through which changes take place, and on identification of obstacles to this process.

> To the extent that the constraints that exist are *artificially* imposed, via the auspices of political-governmental agency, the activities of entrepreneurial traders that might otherwise generate an optimal breakdown of barriers may be prevented or inhibited. In the presence of observed artificial constraints, the allocative patterns can be labeled as "presumably inefficient", since trade is not allowed to take place.[97]

As we can see, Buchanan is able to build on the insight that there are always costs of human action – subjectively perceived barriers that are constantly challenged by entrepreneurs. What is important, however, is that some of these barriers are artificially erected by political-governmental agencies and the efficiency of the system (ability of entrepreneurs to overcome barriers) may be limited.

Notwithstanding an undeniable success of both approaches to detach the concept of efficiency from its perfect-knowledge-Chicago-Posnerian connotations, there is much to add to this discussion. We will use our model of legal-economic nexus to show where and how the notion of efficiency relates to it. But let us first highlight the problematic points in North's and Buchanan's analysis.

The problem with North and Northians is that they are not really clear about what they mean by property rights and what benchmark they use to conclude that some inefficient rights seem to persist.[98] Buchanan and Buchananians are on the other hand forced by the logic of their argument to declare as efficient many of the rules devised in the rulers' interest (rules, that will be denounced by the Northian). Buchanan claims that

> [i]t becomes illegitimate to assign intrinsic value to efficiency as such, in the absence of agreement on the part of participant.[99]

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[96] "If, however, the whole Coase analysis is interpreted in subjectivist-contractarian (or, if preferred, Austrian-Wicksellian) terms, the critique [based on the idea that "efficient" resource allocation exists independently of the process of its generation and cannot be always attained only through bargaining] can be shown to be without substance". Buchanan, James M.: "Rights, Efficiency, and Exchange: "The Irrelevance of Transaction Cost" in *idem., Liberty, Market and State*, New York University Press, 1986, p. 94.
[97] *Ibid*., p. 98.
[98] Douglass North for example suggests that the monopoly of Bank of England and her monetization of debt were necessary instruments of economic progress and recently he also, e. g. signed the petition to support Bill Clinton's plan for socializing health care. More on North and his roots in Chicago–Coase tradition can be found in Stromberg, Joseph R.: "Douglass C. North and Non-Marxist Institutional Determinism", *Journal of Libertarian Studies*, vol. 16, no. 4, Fall 2002.
[99] Buchanan, James M.: "The Status of the *Status Quo*", manuscript, 2003

In other words, he believes as a true contractarian and subjectivist economist that without an agreement of parties involved, an economist cannot say anything about efficiency without getting engaged in interpersonal comparison of utility, which would discredit him as an economist.

> And how can their predicted losses be set off against the gains of those who secure the benefits? Without some means of measuring and comparing utility gains and losses, the efficiency-reducing claim is not testable.[100]

But then an economist such as Buchanan has to acknowledge that he has no efficiency argument against such an obviously inefficient regulation *artificially* imposed, such as rent-control.

> If no such arrangement [compensation arrangement] seems to be within the possible, ...the hypothesis that rent control... is efficiency reducing is falsified.[101]

Buchanan therefore ultimately suggests that until the impoverished population is not be able to bribe communist party elite to sell them back the stolen property, socialism cannot be declared inefficient. If an economist dared to make such a claim, he would allegedly become a practitioner of "bad economics".[102] The same would apply to the claim about inefficiency of slavery, Nazi labor camps, etc. Buchanan's approach to economics then parallels Calabresi approach to law and economics in the sense that both scholars found their disciplines incapable of providing a fundamental evaluation of different social institutions. As Calabresi said:

> ...some institutions are pretty good at finding road signs while others are better at defining the end point and suggesting when the road signs are apt to head away rather than towards the goal, it would be silly to ask both sets of institutions to be concerned either with the end point or with the road signs. ...I believe that law-and-economics is concerned with the road signs.[103]

We have to disagree with this approach. We believe that it is not useless to do both – define the end point and evaluate the quality of the road signs. Our framework of social action is predestined to do just this. One has to realize that we are not designing a free-floating system where logic of law and economics is applied. We deal with human society. Our end point is therefore given. It is by no means as Posner claims an "improvement that the observer thinks

[100] *Ibid*.
[101] *Ibid.*
[102] See Buchanan, James M.: "Good Economics–Bad Law", *Virginia Law Review*, vol. 60. no. 3, March 1974.
[103] Calabresi, Guido: "About Law and Economics: A Letter to Ronald Dworkin", *Hofstra Law Review*, vol. 8, no. 3, Spring 1980, p. 560.

appropriate" or a quality service pursuing "whatever goals we have"[104] or any goal which is "the best approach for the contemporary American legal system to follow"[105]. A universal general goal, i.e. the end point, of any human society must be, as we have shown, the inseparable twins – peace&prosperity. The road signs are rules accompanying societies on their way from omnipresent scarcity toward this goal – some of these road signs are derivable by pure logic given the qualities of our world, some are produced by entrepreneurs and offered to the rest of people to be followed. To function well, the entrepreneurial margins must be open for "adaptive efficiency" improvement, as North suggests and as will be explained in more detail in the following chapter. It must be also emphasized that the very goal of social activities is not a firm point in the universe. As we explained above, our world is in continual flux, so the goal (having peace&prosperity) actually means having the whole structure of legal-economic nexus as we described it with all the entrepreneurial margins in place. It is a necessary pre-condition for our ultimate goal.

Now, we are ready to define the concept of efficiency within our framework of social action. To call an activity efficiency *improving*, the activity must remove either a) a (artificial) barrier preventing a society to *get into* the framework of social actions within the legal-economic nexus;[106] or b) a (natural) barrier on an entrepreneurial margin *within* that framework through a successful entrepreneurial activity.

This concept of efficiency – rooted in subjectivism and sound economics and in sound legal theory as well – allows us to make a clear judgment about efficiency of rent control, slavery and labor camps. Rent control, slavery and labor camps embody arrangements of artificial barriers for (all) people to achieve peace and prosperity, they violate laws of social action (as defined in previous chapters), and call therefore for removal. If any of those barriers is torn down, we get closer to the ideal arrangement of legal-economic nexus. Abolishing of rent-control is hence efficient as well as abolishing of slavery and release of prisoners from labor camps.

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[104] Posner, Richard A.: "Cost-Benefit Analysis: Definition, Justification, and Comment on Conference Papers", *Journal of Legal Studies*, vol. XXIX, June 2000, pp. 1155–56.

[105] Posner, Richard A.: *Overcoming Law*, Harvard University Press, 1995, pp. 403–404.

[106] As Dominick Armentano noted:

> ...the only efficiency-relevant entry barriers would be those associated with legal restrictions that prevent opportunities for additional seller/consumer coordination.

Armentano, Dominick T.: "Property Rights, Efficiency, and Social Welfare", Introduction to Cordato, Roy E.: *Welfare Economics and Externalities In An Open Ended Universe: A Modern Austrian View*, Kluwer Academic Publishers, 1992, p. xii.

This conclusion might seem intuitively correct. But did not we violate the cornerstone of economic science – the *value neutrality*? As James Buchanan believes, if both costs and benefits are involved, such as when rent-control gets abolished without mutually agreed-upon compensation, then an economist behind such a policy "injects her [political economist] own value standard".[107]

Such verdict is not correct though. The status of our claim that abolition of rent-control is efficient corresponds to Mises's claim – we evoke again – that socialism is impossible. It might be argued that the goal that socialism will produce prosperity was explicitly stated by socialists themselves and it was therefore "easy" for Mises to show the incompatibility of explicitly stated means (abolishment of private property in the means of production) and an explicitly stated end (prosperity). Our situation is not different in principle. Our goal is not explicitly stated but is implied in the concept of society. It is therefore not *our* value standard that exists in opposition to other people value standard. It is not *our* belief that scarcity exists and only if people follow certain rule all may then enjoy peace and prosperity. We have here something to do with

> necessary conditions of human action, i.e., those conditions that must be fulfilled if human action is to be possible either at all or with general chances of success in achieving the purposes for which humans act[108]

or a *Principle of Generic Consistency* as James Gewirth, a philosophy professor at the *University of Chicago* and a past president of the *American Philosophical Association*, calls it. Our statement about efficiency of abolition of rent-control is good economics – it does not impose *our* values upon others nor is it based upon the interpersonal comparison of utility.

To say that our broad vision of economic science within the legal-economic nexus is good economics does not in any say imply that the use of economic logic outside the sphere of social action would mean bad economics. It is perfectly possible to use good economics in the P.O.W. camp and explain how the trade in food using cigarettes as money will alleviate hunger[109] or that

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[107] Buchanan, James M.: "The Status of the *Status Quo*", manuscript, 2003.

[108] Gewirth, Alan: *Human Rights*, University of Chicago Press, 1982, p. 3. Or as he stated in his article "The Is-Ought Problem Resolved", *Proceedings and Addresses of the American Philosophical Association*, vol. 47, 1974,

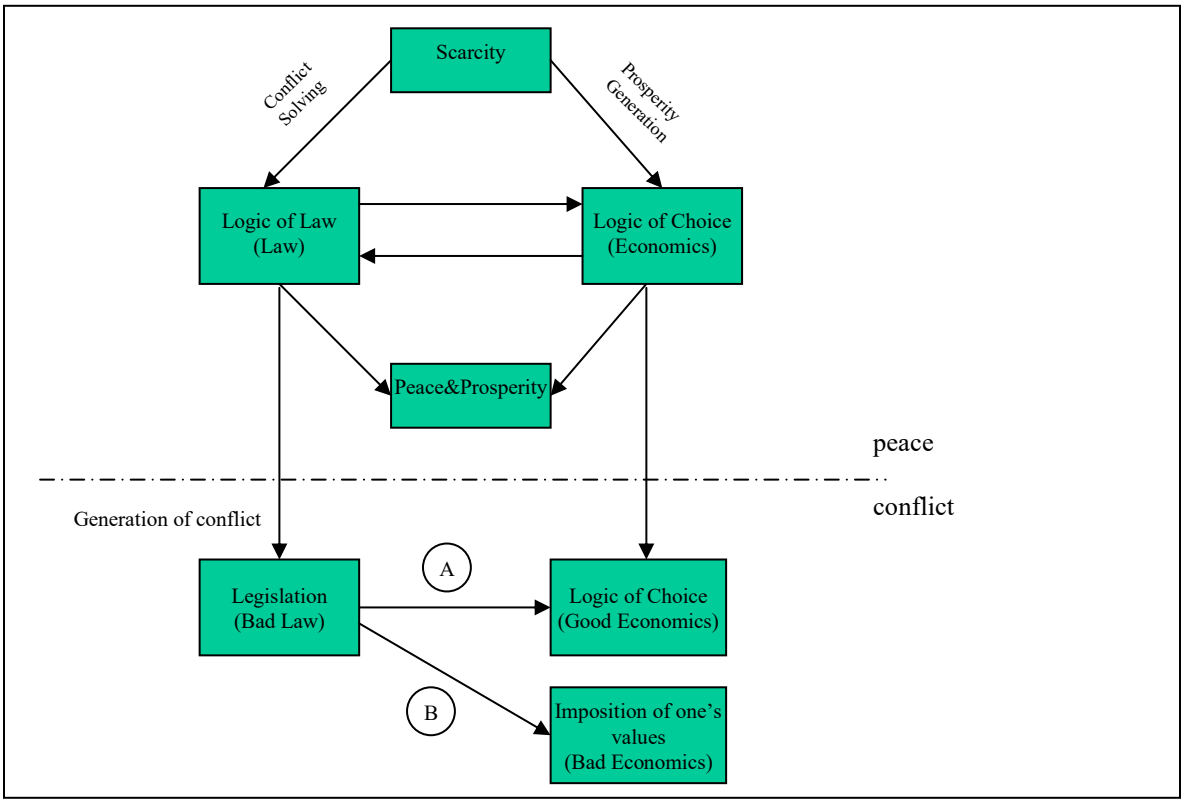
> the "is" of the performance of actions having the generic features logically generates the "ought" of categorical moral judgments; or, in other words, that the fact of being a purposive agent logically requires, on pain of self-contradiction, an acknowledgment that one ought to act in certain basic moral ways.

Reprinted in Gewirth, Alan: *Human Rights*, University of Chicago Press, 1982, p. 127.

[109] See an interesting article about economic organization and evolution of economic cooperation under these special circumstances: Radford, R. W.: "The Economic Organization of a P. O. W. Camp", *Economica*, November 1945.

investing into a slave may increase his productivity – this is denoted in the picture as (A). Bad economics would be to claim that prisoners' trade with cigarettes *should be* prohibited – a link denoted as (B).

It should be clear, however, that there is a difference between these two sorts of good economics. The latter sort is a limited economics that accepts "artificial" frontiers of its investigation. An economist with this approach is basically saying: "O.K. I know that the slave holder holds slaves against their will by the use of force, but I ignore it. That is not my problem now. It is just the data. What I am trying to do is to solve the partial problem of whether to feed the slaves or let them have babies in order to maximize their production." A lot of economic skills is needed to give a "right" answer. Undeniably, this is economics, too.



However, economics as a part of the theory of social action – *economics proper* – must go much further. It must challenge the assumption of limited horizon and apply its insights in all places to

qualify as a social (and not slave-holders') science – it has to explain that both slavery and rent-control are barriers to achieve universal peace and prosperity.

It should be clear that both sorts of economics can bring us pieces of understanding about the world we live in. Both will use the same techniques to reach the conclusions. But it is also evident that one is more general and the only one allowing us to draw conclusions about efficiency – social science of economics as an integral part of legal-economic nexus.

Efficiency and Coordination: On the implications of efficiency

Once we understand that efficiency moves are of two kinds – one based on removing an artificial barrier preventing us from becoming part of peaceful activities of legal-economic nexus and one on successful activity at the entrepreneurial margin within this nexus – an interesting implication emerges for the meaning of the concept of coordination. In this chapter we will explain the meaning of coordination and elaborate on the prerequisites for efficiency and coordination.

Removing artificial barriers

Economists have always understood that the major goal of their science is to provide an explanation about how societies can prevent waste of resources. In response to that, they came up with a story about the importance of decentralized decision-making giving rise to prices that help entrepreneurs design their activities so that ultimately those who find best ways of avoiding waste are awarded by profit. This story was a dynamic one for the target (coordinated activities and hence no waste) has continually moved as preferences, knowledge, etc. evolved over time. A parallel of dogs chasing a rabbit was evoked to capture the logic of processes in question.[110]

The understanding of coordinating properties of markets cannot be overemphasized. As Leonard Read in his famous essay *I, Pencil*[111] made clear in unparallel clarity, whenever a single price is fixed by the regulators, a grain of sand is put into the machinery of market and the "miracle" of market coordination is to that degree crippled. If this artificial barrier to coordination is removed, the mechanism of coordination (i.e. reduction of waste) is back in place.

[110] Rothbard, Murray: *Man, Economy, and State,* p. 276.
[111] Read, Leonard: *I, Pencil*, Foundation for Economic Education, 1999.

An interesting problem, however, pops up once our starting point is not the miraculous world of existing coordination, but our real world – world of uncertainty and disequilibrium. The world in which, as Mario Rizzo pointed out, a Posnerian judge trying to improve efficiency by his verdict "may push us *farther away* from optimality by imposing liability on the party which only appears to be the cheaper-cost avoider".[112] This would however apply also to the situation when in a real world – a world of many regulations – a rule, such as rent-control, is to be abolished. As Paul Rubin in his response to Rizzo states:

> But these objections are not merely objections to the view that the law is efficient, but objections to the view that *any* economic transaction is efficient. Should we have rent control laws? If we accept Rizzo's viewpoint, it is hard to say.[113]

Well, it is indeed highly problematic to claim that we know where is the counter-factual economic optimum. If we knew without markets what markets would produce, we will be the "cognitive supermen" and Chicago law and economics (and socialism) would be much easier to practice. Let's use an example to illustrate the sort of problem Rubin mentions.

Imagine we live in a world where central banks produce inflation and inject new money into the economy via the loan market (it is not very hard to imagine!). As a result of this activity of a state monopolist (regulation, artificial barrier to peace and prosperity) new housing construction is launched. Hence, *more* apartments are being built than would have existed without this regulation.[114] However, suppose that at the same time another branch of government imposes rent-control (also a regulation and an artificial barrier to peace and prosperity). Results of rent-control are too well known. Among other effects, *less* apartments are built than without this regulation. The problem in question should be clear now. Those two regulations may to some extent – we will never be able to quantify – counter-balance themselves.

In this situation, imagine that the government contemplates abolition of rent-control[115] and asks an economist to evaluate the impacts on coordination and efficiency. It must be clear that without rent-control (and with the existence of inflationary boom) more apartments are likely to be built.

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[112] Rizzo, Mario J.: "Law Amid Flux: The Economics of Negligence and Strict Liability in Tort", *Journal of Legal Studies*, vol. IX, no. 2, March 1980, p. 310.
[113] Rubin, Paul H.: "Predictability and the Economic Approach to Law: A Comment on Rizzo", *Journal of Legal Studies*, vol. IX, no. 2, March 1980, p. 320.
[114] This amounts to the claim that more resources were devoted to this use and correspondingly less resources to other (more valued) uses. Resources were therefore wasted.
[115] As hard to imagine as this is, it is still easier then imagining the government contemplating the abolition of central bank. Using the latter example would mean to run the risk of turning this book into a science-fiction.

The existing quantity of apartments might be therefore pushed *further away* from the free-market number in the counter-factual world of no governmentally initiated violence. It means that more resources might be wasted as compared to the counterfactual "perfect" world of peace and prosperity, but *also* as compared to the world in which rent-control was in existence. It might or might not be the case. In a world of uncertainty and disequilibrium we simply do not and cannot know.

Yet, even if we could somehow figure out in our example that there will be more waste after rent-control is abolished – and, even more so, if we have, as it is the case, no way of knowing – we feel to have good reasons to claim that abolition of rent-control is indeed an *efficient* move – a step toward *more* efficiency. Abolition of *any* artificial barrier to social action is efficient.[116] What is decisive is not any sophisticated speculation about what amount of waste is produced under an alternative non-existent social arrangement as opposed to the existing world. A crucial quality of a new legal arrangement is that it removes an artificial barrier for people to engage in social activities, i.e. that people will be closer to the possibility to live by laws of social action as we defined them in previous chapters.

This discussion provides further understanding of the importance of the link between law and economics and – at the same time – a question how good economics and bad law fit together. Economists should always carefully distinguish whether they speak within the framework of social action (good economics–good law) or whether they speak about the situation outside the sphere of social action – i.e. where violence is part of the picture (good economics–bad law).[117] Efficiency and coordination (i.e. waste reduction) go always hand in hand in the former. In the latter we simply do not know, though it is conceivable that efficiency is accompanied with more waste. Coordination as a Criterion for Economic "Goodness" must then be re-evaluated.[118]

[116] A curious policy conclusion was suggested by some German Ordo-Liberals such as Walter Eucken. In the name of efficiency, he wanted to keep the markets isolated from any artificial barrier and shocks such as goods produced by socialist economies by *erecting* prohibitive barriers – tariffs – and auction off the socialist goods to give them somehow "true" market prices. See Eucken, Walter: *Zásady hospodářského řádu*, Liberální institut, 2004 (in print)

[117] See both *Human Action* and *Man, Economy, and State* as examples of textbooks that carefully distinguish economics within the framework of peaceful relations where all the economic logic is explained, and economics of violent interventions to the market and the analysis of subsequent problems for coordination and prosperity. Mises, Ludwig, *op. cit.;* Rothbard, Murray, *op. cit.*

[118] Cf. Kirzner, Israel M.: "Coordination as a Criterion for Economic "Goodness"", *Constitutional Political Economy*, vol. 9, no. 4, 1998.

Efficiency at the entrepreneurial margins

As opposed to our previous discussion about violence and regulations, our second kind of efficiency improvement is happening within the sphere of social action. It is a product of a peaceful entrepreneurial activity which results in finding a better way to define or protect our legal-economic nexus. Since we are speaking about entrepreneurial activity – a discovery procedure – our objective cannot be to give a recipe to entrepreneurs how to do their business. There is no such thing as business-doing in theory. Our task must be therefore limited. We will only cast some light on the question of what arrangement can allow this procedure to exist.

Once the idea of a good system of law imposed upon people and enforced by a semi-divine body is rejected and we fully realize that the law must be first (costly) developed and then (costly) enforced and continually (costly) improved and adjusted by people, the relevance of economics for law must be clear. If economics has to deliver one message to law it must be the one long ago formulated by Gustave de Molinari:

> If there is one well-established truth in political economy, it is this:
>
> *That in all cases, for all commodities that serve to provide for the tangible or intangible needs of the consumer, it is in the consumer's best interest that labor and trade remain free, because the freedom of labor and of trade have as their necessary and permanent result the maximum reduction of price.*[119]

The rejection of any sort of monopoly – concept of free competition – is not only a well-established truth as pointed out by Molinari, but it is a direct implication of our conception of social action. Entrepreneurial activities not only help to define social action – they develop the principles and turn them into practicable activities – but they are themselves social actions. To qualify for that purpose, they themselves must be peaceful human activities. Yet being a monopoly means being privileged over others – being allowed to do what others are prevented from doing by force. As Murray Rothbard states:

> The only viable definition of monopoly is a grant of privilege from the government.[120]

Absence of monopoly does not guarantee success in entrepreneurial activity but opens a room for competition,

[119] Molinari, Gustave de: *The Production of Security*, The Center for Libertarian Studies, 1977 [1849], p. 3.
[120] Rothbard, Murray: *Power and Market*, Sheed Andrews and McMeel, 1977, p. 60.

> ...a procedure for discovering facts which, if the procedure did not exist, would remain unknown...[121]

– a social mechanism that provides a feasible means toward attainment of social goals.[122] Let us now have a look at what are the implications of our requirement of competition for all margins we have discovered so far.

Margin #1 – discovery of rules

This margin amounts to intellectual entrepreneurial activity (something we were engaging in) aiming at the discovery of principles of social action – such as the concept of property and self-ownership. Competition requirement at this margin would ask for the absence of monopoly privileges, i.e. artificial barriers to enter this business. Although everyone today can in some way present his own idea about the logic of social action, an enormous obstacle to competition in the discovery of rules is a monopoly situation in the field dealing with ideas. There are major barriers to entry both in production of ideas – state control over the *system of schools*[123] – and in their dissemination – state control (licensing) over the *media and electro-magnetic spectrum*.[124] Though critically important for the quality of products offered at this margin, further discussion of this issue would go beyond what is required for understanding the legal-economic nexus.[125]

Students of society have traditionally placed their emphasis on another aspect of competition – competition generation and application of rules governing societies. Such a competition is

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[121] Hayek, F. A.: "Competition as a Discovery Procedure", *Quarterly Journal of Austrian Economics*, vol. 5, no. 3, Fall 2002, p. 9.

[122] It is an analogy to the claim that absence of socialism does not guarantee prosperity but opens room for the existence of price mechanism – a social mechanism that provides a feasible means toward attainment of this goal.

[123] As Frédéric Bastiat aptly pointed out in another context:

> The most urgent necessity is, not that the State should teach, but that it should *allow* education. All monopolies are detestable, but the worst of all is the monopoly of education.

Bastiat, Frédéric: "What is Money?", *Quarterly Journal of Austrian Economics*, vol. 5, no. 3, Fall 2002, p.105.

[124] Both these fields provide us with a link back to the work of the founder of Chicago law and economics, Ronald Coase. His suggestion to privatize (or rather auction-off) the spectrum gave rise, as we have shown above, to his famous article "The Problem of Social Cost". Market in ideas attracted his attention in one of his less famous articles "The Market for Goods and the Market for Ideas" where he identified an asymmetry in political treatment of goods and ideas. If it is believed that people themselves cannot, without state regulation, produce quality goods (the reason why we have so much regulation) then the same must be true for the market of ideas. If, however, freedom to spread ideas is declared so important and beneficial that the freedom must be guaranteed in the Constitution, so must be the freedom to sell goods. It makes no sense according to Coase to regulate one and not the other. If the principle of people's incapability to choose good stuff is true, the market for ideas must be regulated as well. If it is not, the market for goods must be freed. See Coase, Ronald: "The Market for Goods and the Market for Ideas", *American Economic Review*, vol. 64, no. 2, 1974.

[125] For more detailed studies about the evolution and consequences of monopolization in education see Rothbard, Murray: *Education: Free and Compulsory*, Mises Institute, 1999; or in Czech a special issue of Terra Libera featuring two articles by Tooley, James: "Vzdělání bez státu: Historie a současnost" and Rothbard, Murray: "Veřejné školství: dělání "vzdělání"", Terra Libera 7–8/2003. For the same process in electromagnetic spectrum see Šťastný, Dan: "Telekomunikační trh", *Studie Národohospodářského ústavu Josefa Hlávky*, 2/2003, pp. 9–10.

possible only under conditions of decentralization, which is the general conclusion of those who explicitly studied social institutional structure.

> ...the development of decentralized decision-making processes that will allow societies to maximize the efforts required to explore alternative ways of solving problems.[126]

In such an environment there is a room for a special kind of entrepreneur – "norm entrepreneur".[127] Norms are indeed, along with laws, important sources of rules guiding people's behavior. Living in a certain "norm community"[128] based on religion, belief or nationality may imply reduction of costs of having an efficient legal-economic nexus and hence be the way society can save some resources and invest them into other projects not available in other societies.[129]

Competition and experimentation giving rise to a decentralized process of entrepreneurial discovery is responsible, as legal scholars argue, for the evolution of quality Western legal order.

> The very complexity of a common legal *order* containing diverse legal *systems* contributed to legal sophistication. Which court has jurisdiction? Which law is applicable? How are legal differences to be reconciled?[130]

This sort of discovery of rules in the process of their practicing under different systems was, however, heavily hindered as the state over time nationalized and *monopolized legal systems*.[131] A powerful monopoly was put in the way of entrepreneurial discovery and this monopoly was even declared the source of order, despite the fact that – as a leading legal theorist Lon Fuller argues – "[multiple legal systems governing the same population] have in the history been more common than unitary systems".[132] Oddly enough, the same scholars who as historians well acknowledge such an importance of decentralization and competition for general social progress become – when it comes to law – advocates of monopolies claiming that "it is unclear how the requisite standardization of commonality could be achieved in the [law] without a single source for [law] – without, that is to say, a monopoly".[133] This position is untenable: one cannot be

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[126] North, Douglass: *Institutions, Institutional Change, and Economic Performance*, Cambridge University Press, 1990, p. 81.
[127] Sunstein, Cass R.: "Social Norms and Social Roles", *Columbia Law Review*, 1996, p. 909.
[128] Ibid., pp. 919–20.
[129] In addition to it there may be an extra benefit of this arrangement.
> To the extent that people can freely enter and exit norm communities, such communities offer important protection against oppressive norms.

Ibid., p. 920.
[130] Berman, Harold J.: *Law and Revolution*, Harvard University Press, 1983, p. 10.
[131] More about it in the following chapter.
[132] Fuller, Lon L.: *The Morality of Law*, Yale University Press, 1977, p. 106.
[133] Landes, William M. and Posner, Richard A.: "Adjudication as a Private Good", *Journal of Legal Studies*, vol. 8, March 1979, p. 239.

aware of the historical absence of monopoly and, at the same time, claim, it is "unclear" how it could work.

Margin #2 – protection of rules

Let us now investigate how the efficiency requirement of free competition (absence of monopoly) reflects in the institutional arrangement of the second entrepreneurial margin. Protection of rules developed at the first margin is a necessary logical step toward an ordered society. Free competition at this margin is, however, almost never discussed in law&economics literature. While some sort of multiplicity of rules generation processes (margin #1) such as laws, social norms or habits is usually acknowledged, monopoly in enforcing these rules is taken for granted. It is claimed that only a monopolistic judge together with a monopolistic policeman can and simply will perform the role of a guarantor of peace.[134] Molinari's questions asked a century and a half ago remain largely ignored.

> But why should there be an exception relative to security? What special reason is there that the production of security cannot be relegated to free competition? Why should it be subjected to a different principle and organized according to a different system?
>
> On this point, the masters of the science are silent...[135]

There is nothing smaller here at stake than the fate of economics and law&economics as coherent sciences. As Molinari correctly deduces:

> I believe that while these principles [of free competition] can be *disturbed*, they admit no exception.
>
> But, if this is the case, the production of security should not be removed from the jurisdiction of free competition...
>
> Either this is logical and true, or else the principles on which economic science is based are invalid. [136]

[134] This is, for example, a reason for governmental "protection" by a leading law&economics scholar Harold Demsetz. In his famous article "Some Aspects of Property Rights", he first speculates how the Coasian setting makes the initial assignment of rights irrelevant such as the right to produce a new product – the product will end up being owned by that party which will find it more valuable. The same is true for other goods, e.g. protection which is a notorical example of high transaction costs. Demsetz claims that "it is conceptually possible for the government to acquire information [about who is harmed by a government program] of greater accuracy". Government can thus, according the Demsetz, play the middleman role and collect the necessary information. "But if the government can be a better innovator in this marketing function it is clear that compensation may be desirable to improve the accuracy of information, that is, for efficiency reasons." So the case is made for taxation compensating government for giving us the best information about how to provide protection.
Demsetz. Demsetz, Harold: "Some Aspects of Property Rights", *Journal of Law and Economics*, vol. IX, October 1966, p. 69.
[135] Molinari, Gustave de: *The Production of Security*, The Center for Libertarian Studies, 1977 [1849], p. 4.
[136] *Ibid.*

There is however no reason to discard the whole edifice of economics and our theory of social action because of a prejudice of majority of social scientists regarding the nature of policing and protection of rights. This activity justly forms an entrepreneurial margin for it entails – as *any other* provision of service – a costly production (by an entrepreneur) of a valuable thing desired in different quality and quantity by different people. As shown by a growing body of literature, state monopolization of these services is far from being a recipe for peace and order. Theoretical arguments elaborating on Molinari's pioneering work and historical studies have been repeatedly proving not only the possibility of private – non-monopolized – provision of these services, but their successful existence and viability as well.[137] Many of these activities were, however, over time crowded-out by subsidized monopolistic state "services". No wonder then that we lost not only entrepreneurs who would put our principle of social action into reality in a cheap and quality way, and any practical benchmark for evaluating the quality and price people are forced to pay to the state monopolist, but often also imagination about capabilities of free competition.[138]

Margin #3 – appropriative activities

Our third margin where a monopoly can erect a barrier to efficiency depicts the activities through which people appropriate unowned things found in nature. As we have explained, the commons represent rather than a problem or a failure of market forces an *entrepreneurial challenge*. Entrepreneurs are aware of the destruction of values associated with the tragedy of the commons, as we have explained above. If they want to stop this rent dissipation they have to invest resources into the costly process of appropriation.

> Because assets are a collection of valued attributes, the successful property rights entrepreneur perceives an attribute for which the property rights are incomplete and takes action to define and enforce rights to that attribute.[139] (inner citation omitted)

If there is an open room for appropriative activities, market forces do their job to reward successful and farsighted property rights entrepreneurs. These people put property into existence

[137] See e.g. Šíma, Josef (ed.): *Právo a obrana jako zboží na trhu*, Liberální institut, 1999; Benson, Bruce: "The Legal Monopoly on Coercion" in *idem.*, *The Enterprise of Law*, Pacific Research Institute for Public Policy, 1990, chap. 12.; See also references in chapters 9 and 11.
[138] A claim that markets cannot provide security by advocates of state monopolization of this sector parallels the claim of Samuelsonian economists (and one allegedly free-market former Czech member of Constitutional Court for that matter) that "a businessman could not build it [a lighthouse] for a profit, since he cannot claim a price from each user". (Samuelson, Paul: *Economics*, 6th edition, McGraw-Hill, 1964, p. 159). To this claim Kenneth Goldin trenchantly remarked: "All this proves is that economists are less imaginative than lighthouse keepers." (Goldin, Kenneth D.: "Equal Access vs. Selective Access: A Critique of Public Goods Theory", *Public Choice*, vol. 29, Spring 1977, p. 62.
[139] Anderson, Terry L. and Hill, Peter J.: "Cowboys and Contracts", *Journal of Legal Studies*, vol. XXXI, June 2002, p. 493.

and capture the previously lost value – the rent. Efficiency thereby naturally increases. What happens, however, if this smooth process of discovery of new property is blocked by the monopolistic behavior (typically by the state)?

Property rights will not emerge out of the commons by a social activity at the most economic time but there will be some sort of violence behind the way in which someone got the ultimate control over a scarce resource – and that will happen "too soon". Governmental monopoly cannot simply *declare* itself an "owner" of the resource (such as land) and prohibit property rights entrepreneurs to do the appropriation. If the monopoly has to be effective and not only verbal, some sort of appropriation – at least to banish property rights entrepreneurs who are ready to do a *de facto* appropriation – must be always conducted. Since it is not yet profitable (no private entrepreneur invested yet his own sources into it) it must be subsidized by a monopolist at the expense of other profitable projects. Waste necessarily results.

The monopolist cannot save the situation even if he decides later on to allow the property rights entrepreneurs to do "private" appropriation. It is because we do not deal anymore with a number of alert heterogeneous entrepreneurs, but the whole group of "homogenized" people ready to rush and get a profit in the race with others. Consequences are not surprising:

> Without entrepreneurial alertness [both for the heterogeneity it brings to discovery of rents and for the role that it plays in developing contracts to limit access to scarce resources] and entrepreneurial contracting, the rent dissipation inherent in the tragedy of the commons continues, but in a different arena – the production of property rights.[140]

A real life example of such a rent dissipation is provided by "Oklahoma land rush" of 1893 when the American government decided *to allow* people appropriate the land by decree. The area was made available at noon on September 16.

> Hence on the morning of September 16, between 100,000 and 150,000 racers gathered along the borders of the outlet. Soldiers with rifles were stationed every 600 yards to stop anyone taking off before the signal. A deaf person thought the signal had occured and was shot from his saddle as he started early. When the signal was given, at 12:00 noon, the racers surged forward... "Horses broke their legs stepping into holes, some men broke their legs jumping from trains. ...Now and then a shout echoed, "Sooner! Sooner! Shoot the S.O.B." And shots rang out." ..."Horsemen were unseated, wagons overturned, spilling contents and people. Pedestrians were trampled in the mad rush to be off. Cries of angry men mingled with the neighing of panic-stricken horses. Their

[140] *Ibid.*, p. 513.

> shouts and curses, the thud and clatter of hooves, the rattling of wagons, the shriek of locomotive whistles, all combined to make a scene of pandemonium."[141] (inner citations omitted)

It must be clear by now that even at this margin, open competition will create an institutional framework amiable to ever-increasing efficiency and, on the other hand, that monopoly will cripple the efficiency properties of the third entrepreneurial margin of the legal-economic nexus.

Conclusion

In this paper we have challenged the mainstream view that only legal centralism can bring about order by extending the fundamental argument of economic science against monopolistic structures. Once these economic insights enrich our understanding of law and law delivers a building block of property into economics, we can then understand the social processes in a much better light. And once we are able to identify problems for smooth functioning of social forces, we can start working on overcoming the barriers preventing societies to reap the full fruits of civilization. The science of law&economics provides us with a powerful argument that complements a strict economic argument against socialism: Societies can do better without state monopolization of one crucially important sector – production and enforcement of law. Legal centralism must be declared a relict of socialism as any other theory of state monopoly. "[L]awmakers who are unappreciative of the social conditions that foster informal cooperation are likely to create a world in which there is both more law and less order."[142] The sector of production and enforcement of law must be set free, it must be opened for legal-entrepreneurs who will ensure the best possible quality of the law. We might expect that competition will – as in any other sector – make use of human genius, creativity and knowledge and bring into being such methods of crime prevention, law enforcement and problem solving we can hardly think of today.

[141] *Ibid.*, pp. 511–512.
[142] Ellickson, Robert C.: *Order without Law*, Harvard University Press, 1991, p. 286.

Appendix: Austrian Praxeology as Law&Economics Proper

It should be of no surprise that many insights about law-economic nexus, as we have already indicated, can be found in the works of earlier economists. Adam Smith and his work on both law and economics is generally known[143], though he never wrote his promised treatise on "a system of those principles which ought to run through, and be the foundation of the laws of all nations"[144]. Much less known and appreciated insights are those of the French tradition whose authors had a broad grasp of social processes to accommodate much more than narrow economics. Almost completely forgotten is a very systematic work of Abbé de Condillac, *Commerce and Government considered in their mutual relationship*[145] presenting a theory of state interventionism (legal regulation of economic system) and subsequently classified these interventions and describing their consequences. The works of Bastiat and Molinari were already mentioned in this volume. They understood well that law effects economic performance and also that economics is important in law, i.e. that scarcity shapes and limits the sphere of law. They pleaded for making all spheres of social life open to competition and they were well aware that the quality of law will not come out of the blue but must be costly created and protected. So writes Bastiat about the scarcity at the second entrepreneurial margin, giving a lesson that is yet to be learned:

> ...[E]xact justice is something so definite that legislation which had only justice in view would be virtually immutable. It could vary only as to the means of approaching ever more closely to this single end: protection of men's persons and their rights. ...Moreover, the forces of government would attain this goal all the better because they would all be applied to preventing and repressing misrepresentation, fraud, delinquency, crime, and acts of violence, instead of being dissipated, as at present, among a host of matters alien to their essential function.[146]

The search of the French economists for *economic harmonies* entails an effort to find general principles of social organization that can lead toward peace and prosperity – exactly the same thing as what is the ultimate objective of law&economics. This effort also enabled the French economists to identify the problem with the monopoly of legal provision – the state. Hence Bastiat wrote in an unsurpassable style about "legal plunder" in his *The Law*[147] and Molinari became the champion in his revolutionary discussion of private production of security.[148] Though French harmonists made many contributions to the science of law&economics, their influence vanished paradoxically with a process of spreading economic education in law schools. As Joseph Salerno in his historical study explains, instead of using "good economics" to make "good law", the government by decreeing to increase the number of economic departments managed to outnumber good economists by the bad ones and then use their "bad economics" to make "bad law".[149]

In any case, by the end of the 19th century the school of French harmonists was literally dead. At about the same time economics undertook a dramatic turn – marginalist revolution – and Carl Menger, "a leader in both the marginalist revolution and in the new science of law"[150], started a new economic school with a broad enough grasp to include as an integral part of its study the analyses of legal processes. The Austrian School was born together with its "general theory of human action" – *praxeology*, worked through later on first by Ludwig von Mises.[151] Though this Mengerian-Misesian tradition was for many years forming the mainstream of economic science (e.g. two battles over economic method first with German Historical School and later with socialists over economic calculation, explanation of ordinal nature of utility, evolution of money or the business cycle theory), after WWII with narrowing economic science it lost its impact. It was too much of a *social* science for technical economics to be part of it. Over time, however, post-WWII formalized economic mainstream – "propertyless economics" – became more and more irrelevant so that the room opened for new economic schools to bring pieces of relevant social dimension back to economics.

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[143] Smith, Adam: *Wealth of Nations*, *op. cit.*
[144] Smith, Adam: *The Theory of Moral Sentiments*, Liberty Fund, 1982, p. 342.
[145] Condillac, Étienne Bonnot, Abbé de: *Commerce and Government considered in their mutual relationship*, Edward Elgar, 1997 [1776].
[146] Bastiat, Frédéric: *Selected Essays on Political Economy*, Foundation for Economic Education, 2001, p. 122.
[147] Bastiat, Frédéric: *The Law*, Foundation for Econmic Education, 1996.
[148] Molinari, Gustave de: *The Production of Security*, The Center for Libertarian Studies, 1977 [1849].
[149] See Salerno, Joseph: "The Neglect of Bastiat's School by English-speaking Economists: the Puzzle Resolved", *Journal des Economistes*, vol. 11, no. 2/3, 2001.
[150] Pearson, *op. cit* , p. 151.
[151] Mises, Ludwig: *Human Action*, *op. cit.,* p. 3.

Chicago Law&Economics, New Institutional Economics, Public Choice Theory or Property Rights Economics were among the first ones that challenged successfully the mainstream. Throughout this book we have attempted to demonstrate a crucial link between economics and law. Many insights from these schools served that purpose. We have deliberately partly ignored the Austrians and supported our arguments by as many references to authors from these schools as possible. This was not, however, to express agreement with the whole teaching of these theories as must be clear from the criticism of many of their arguments. The purpose was to show that some schools – respected by the mainstream – have *some* interesting pieces to contribute toward understanding of legal-economic nexus, but Austrians – such as Menger, Mises, Hayek, Kirzner, Rothbard – with their broad praxeological approach understand much more. Not only they did predate the discovery of the very pieces of knowledge other schools claim to be of their origin, but, more importantly, they did it being aware of the *whole picture* of the legal-economic nexus.

Mises's Part Six of *Human Action* (The Hampered Market Economy) and especially Murray Rothbard's third volume of *Man, Economy, and State* that was in full published as *Power and Market: Government & the Economy* qualify as the best works in "Coasian" law&economics (New Institutional Economics) systematically exploring consequences of legal barriers to efficient functioning of economic system.

Despite the existence of these great systematic works, Armen Alchian and Harold Demsetz in their 1973 celebrated article "The Property Right *Paradigm*" claim that

> [e]conomics textbooks invariably [sic!] describe the important economic choices that all societies must make by the following three questions: What goods are to be produced? How are these goods to be produced? Who is to get what is produced? This way of stating social choice problems is misleading. ...It is more useful and nearer to the truth to view a social system as relying on techniques, rules, or customs to resolve conflicts that arise in the use of scarce resources rather than imagining that societies specify the particular uses to which resources will be put. The arrangement for doing this [solving conflicts] run the full gamut of human experience and include war, strikes, elections, religious authority, legal arbitration, exchange, and gambling.[152]

No economist familiar with Austrian scholarship can consider such claim legitimate and article pioneering. As we have shown above, it was Carl Menger who a century before envisaged the common nexus of law and economics and his followers published works developing both economic and legal (property) part of the picture. Ludwig von Mises in his *Liberalism* (1927) defined the latter by explaining why property-based social system is "the only workable system of human cooperation in a society based on the division of labor"[153] and, building on this, worked out the former in his *Human Action* (1944). A decade later Murray Rothbard started to integrate these two in his works culminating in *Man, Economy, and State* and *Power and Market*. In all these works, the approach suggested by Demsetz and Alchian is practiced – the nature of violence and peace is identified and human activities analyzed using this dichotomy – and phenomena like socialism, war, slavery, strikes, customs and problem solving are discussed.

Especially in Murray Rothbard's works, one can find several insights that are generally attributed to other authors. Above we introduced the 3rd entrepreneurial margin by mentioning Demsetz's Indian story from his famous 1967 article "Towards a Theory of Property Rights". His point that costs determine whether or when property rights will be established is considered truly pioneering. Murray Rothbard, however, made the same point more than a decade sooner. Not only did he talk about scarcity as a pre-requisite for ownership (this has been pointed out for centuries) but explicitly spoke about profitability of appropriative activities, i.e. costs as determinants of ownership. In his criticism of single tax, he explained in 1957 that "the site owner must decide whether or not to work a plot of land or keep it idle"[154] and it may happen that as a result of higher costs and "locational chaos", ownership may be discontinued and some sites may be "abandoned altogether"[155] by their former owners. What we called the 3rd entrepreneurial margin – entrepreneurial appropriative activities – is therefore definitely not originally of Demsetz's provenience.

Some other insights belong to Rothbard, too. For example, a leading economist of property rights Yoram Barzel makes a reference to Alchian and Allen for their point that human rights are only a derivation of property rights.

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[152] Alchian, Armen A. and Demsetz, Harold: "The Property Right *Paradigm*", *The Journal of Economic History*, vol. 33, no. 1, March 1973, p. 16.
[153] Mises, Ludwig: *Liberalism*, Foundation for Economic Education, 1985, p. 19.
[154] Rothbard, Murray: "The Single Tax: Economic and Moral Implications" in *idem.*, *Logic of Action II*, Edward Elgar, 1997, p. 297–298.
[155] Rothbard, Murray: *Power and Market*, p. 129.

> The distinction made between property rights and human rights is spurious. Human rights are simply part of people's property rights. Human rights may be difficult to protect or to exchange, but so are rights to many other assets. See Alchian and Allen ([*Exchange and Production*, 2nd edition, Wadsworth],1977, p. 114)[156]

Rothbard, however, deals with this issue in quite a detail in his *Power and Market* (pp. 238–240) and even makes two references to his earlier articles of as early as 1957. In a similar case, Tom Bethell[157] credits Armen Alchian for calling attention to the insight that we can own and sell shares in private property but not in public property.[158] Murray Rothbard makes exactly the same point when talking about "The Myth of Public Ownership"[159] and makes a reference to F. A. Harper's book published in 1949.[160] We could easily list several more examples of Rothbard's property-based economics.[161] When we add Rothbard's ability to apply logically economic principles into areas traditionally omitted by social scientists such as the area of decentralized conflict solving[162] and his extensive work on natural rights, ethics and nature of the state[163], it must be clear that he developed Misesian praxeology into the point where it not only covers the whole scheme of legal-economic nexus we developed in previous chapters, but also understands the logic and requirement for free competition at all margins. Our logic of social action that gave rise to the scheme of legal-economic nexus can be understood as an extension of Rothbard's "welfare economics scheme" envisaged in his paper "Toward Reconstruction of Utility and Welfare Economics"[164]. Our scheme only visualizes the logic and adds some more "economizing" into the legal part, which Rothbard does not discuss explicitly in that paper.

No other Austrian has so far surpassed Rothbard as a system builder of law&economics, though there have been, of course, famous Austrians who dealt with particular issues of law&economics. The most prominent among those was without doubts F. A. Hayek who won the Nobel Prize in Economics in 1974. It is generally believed that Hayek, in the later part of his career, switched from economics to general social sciences, but this claim is true only if we perceive economics as a very narrow discipline. When economics proper, i.e. the theory of social action as developed in this book is taken as a benchmark, he can for sure be considered to have remained an economist. As Ludwig Van Den Houwe reminds us:

> It is Hayek's emphasis on this theme of the interrelation between the system of rules and its systematic outcome at the level of the order of actions that qualifies him a Law-and-Economics theorist.[165]

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[156] Barzel, Yoram: *Economic Analysis of Property Rights*, Cambridge University Press, 1989, p. 2, n. 1.
[157] Bethell, Tom: *The Noblest Triumph, Property and Prosperity through the Ages*, St. Martin' Press, 1998, p. 313.
[158] Alchian, Armen A.: *Economic Forces at Work*, Liberty Press, 1977, p. 137 originally published as
Alchian, Armen A: "Some Economics of Property Rights", *Il Politico*, vol. XXX, no. 4, 1965.
[159] Rothbard, Murray: *Power and Market*, p. 187–89.
[160] Harper, F. A.: *Liberty, a Path to Its Recovery*, Foundaton of Economic Education, 1949, pp. 106, 32.
[161] Peter Boettke, for example, mentions this story of rediscovery of Rothbardian ideas:

> Following Mises, Rothbard argued prior to the property rights school that "the important feature of ownership is not legal formality but actual rule, and under government ownership it is the government officialdom that controls and directs, and therefore «owns», the property." Compare that with Yoram Barzel's statement 27 years later "The claim that private property has been abolished in communist states and that all property there belongs to the state seems to me to be an attempt to divert attention from who the true owners of the property are. It seems that these owners also own the rights to terminology". (inner references omitted)

Boettke, Peter: "The New Comparative Political Economy", *Forum Series on the Role of Institutions in Promoting Economic Growth* – Forum 6, April 4, 2003, p. 15. n. 14.
[162] Rothbard, Murray: *Power and Market*, chap. 1; Rothbard, Murray: *For a New Libety*, Fox&Wilkes, 1978, chap. 12; Rothbard, Murray: "Law, Property Rights, and Air Pollution" in *idem.*, *Logic of Action II*, chap. 6.
[163] Rothbard, Murray: *The Ethics of Liberty*, New York University Press, 1998.
[164] Rothbard, Murray: "Toward Reconstruction of Utility and Welfare Economics" in Sennholz, Mary (ed.): *On Freedom and Free Enterprise*, 1994.
[165] Houwe, Van Den L.: "Evolution and the Production of Rules – Some Preliminary Remarks", *European Journal of Law and Economics*, vol. 5, 1998, p. 88.
As Hayek himself sets the objective of his book:

> Nowhere is the baneful effect of the division into specialisms more evident than in the two oldest of these disciplines, economics and law. Those eighteenth-century thinkers to whom we owe the basic conceptions of liberal constitutionalism, David Hume and Adam Smith, no less than Montesquieu, were still concerned with what some of them called the "science of legislation", or with principles of policy in the widest sense of this term. One of the main themes of this book will be that the rules of just conduct which the lawyer studies serve a kind of order of the character of which the lawyer is largely ignorant; and that this order is studied chiefly by the economist who in turn is similarly ignorant of the character of the rules of conduct on which the order that he studies rests.

Hayek, F. A.: *Law, Legislation and Liberty,* vol. I*,* Rules and Order, p. 11 (in Czech translation).

Hayek's work was, however, largely limited to a particular theme – intertemporal dimension of the use-of-knowledge problem, i.e. the evolution of rules and emergence of order through cultural evolution. Similarly limited are so far topics on which other Austrian authors have focused: Hans-Hermann Hoppe (on property rights), Peter Boettke (on socialism and transition problems), Dominick Armentano (on antitrust laws), Stephan Kinsella (on contract theory and intellectual property), Walter Block (on blackmail, privatization of roads), Joerg Guido Huelsmann, George Selgin, Lawrence White, Pascal Salin, Huerta de Soto (on property and money), Israel Kirzner (on entrepreneurial theory) etc.[166] All contributed important pieces of knowledge yet nobody has so far reached Rothbard's qualities as a system builder.

An interesting overview and source of reference to still other group of Austrians is offered by Gregory Scott Crespi.[167] He surveys major Austrian contributions and contributors to Law&Economics that gained appreciation in *mainstream law journals*. The article includes discussion of the works of Mario Rizzo, Gerald O'Driscoll, Christopher Wonnell, Roy Cordato, Michael Debow, Thomas Arthur, Linda Schwartzstein, Michael Spicer and Thomas Sowell.[168] These authors show the application of Austrian real-world law and economics (based on dynamic markets, disequilibrium, imperfect knowledge) as opposed to widespread neoclassical legal and economic modeling. As Crespi says:

> ...the Austrian approach ...presents a coherent and comprehensive alternative framework which incorporates a number of important insights largely overlooked in most neoclassical theorizing, and which does not rely upon some of the more unrealistic neoclassical premises.
>
> ...the Austrian approach... has advantages as a pedagogical framework that can effectively focus law students' attention upon certain processes and constraints highly relevant to the operation of the legal system that tend to be obscured by the neoclassical paradigm.[169]

Thus Austrians benefit from their more than a century long elaboration on broadly conceived legal-economic nexus. Their analysis remains both relevant (by focusing on real world issues) and at the same time theoretical (firmly rooted in economic and legal principles). This approach leads Austrian scholars to see the whole legal-economic nexus and formulate laws of social action. No other school of thought can match this achievement. Some schools can provide very interesting case studies about operation of the real world and an interplay between law and economics, but lack the underlying theory to make any general claim (such as law&society, Bloomington research program of Vincent and Elinor Ostroms). Some have a sophisticated theory but remain largely irrelevant because they try to squeeze people into their models rather than to adjust the models to work with real people (Chicagoan mainstream), some refuse to admit the necessity of non-monopolized legal system (Public Choice), etc.

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[166] For the more complete list of Austrian contributions see Huelsmann, Joerg Guido: "Economic Science and Neoclassicism", *The Quarterly Journal of Austrian Economics*, vol. 2, no. 4, Winter 1999.

[167] Crespi, Gregory Scott: "Exploring the Complicationist Gambit: An Austrian Approach to the Economic Analysis of Law", *Notre Dame Law Review*, vol. 73, no. 2, January 1998. See also Crespi, Gregory S.: "Teaching the New Law and Economics", *University of Toledo Law Review*, , vol. 25, no. 3, 1994.

[168] Cordato, Roy: "Subjective Value, Time Passage, and the Economics of Harmful Effects*, Hamline Law Review*, vol. 12, no. 229, 1989; Wonnell, Christopher T.: "Contract Law and the Austrian School of Economics", *Fordham Law Review*, vol. 54, no. 507, 1986; Debow, Michael E.: "Markets, Government Intervention, and the Role of Information: An "Austrian School" Perspective, with an Application to Merger Regulation", *Goerge Mason Law Review*, vol. 14, no. 31, 1991; Arthur, Thomas C.: "The Costly Quest for Perfect Competition: *Kodak* and Nonstructural Market Power", *New York University Law Review*, vol. 69, no. 1, 1994 (He is not explicitly Austrian, but uses a critical assessment of the United States Supreme Court opinion issued in *Eastman Kodak Co. v. Image Technical Services, Inc.* (504 U.S. 451, 1992) based on works by Austrians such as Hayek and Kirzner and questioning the perfect competition framework using the concept of "rivalrous competition".); Moss, Laurence S.: "Government, Civil Society, and Property: Restraining the Legal-Economic Nexus" in Samuels, Warren J. and Mercuro, Nicholas (eds.): *The Fundamental Interrelationships Between Government and Property*, JAI Press, 1999;
Spicer, Michael: "On Friedrich Hayek and Public Administration: An Approach for Discretion Within Rules", *Admin.&Soc's*, vol. 25, no. 46, 1993; Spicer, Michael: "On Friedrich Hayek and Taxation: Tationality, Rules, and Majority Rule", *National Tax Journal*, vol. 48, no. 103, 1995. To this list we can add Schmidtchen, Dieter: "Time, Uncertainty, and Subjectivism: Giving More Body to Law and Economics", *International Review of Law and Economics*, vol. 13, no. 1, March 1993 or more recent articles in *European Journal of Law and Economics* such as Folmer, Henk; Heijman, Wim, J. M. and Leen Auke R.: "Product Liability: A Neo-Austrian Based Perspective", *European Journal of Law and Economics*, vol. 13, 2002; Furubotn, Eirik G.: "Economic Efficiency in a World of Frictions", *European Journal of Law and Economics*, vol. 8, 1999 or Houwe, Van Den L.: "Evolution and the Production of Rules – Some Preliminary Remarks", *European Journal of Law and Economics*, vol. 5, 1998.

[169] Crespi, Gregory Scott: "Exploring the Complicationist Gambit: An Austrian Approach to the Economic Analysis of Law", *Notre Dame Law Review*, vol. 73, no. 2, January 1998, pp. 320–321.

The Austrian approach to law and economics must be therefore considered a powerful alternative to the prevailing mainstream views. Its emphasis on the need to base social theories on existing people's choices[170] (as opposed to someone's guess about possible *future* choices) is the source of different requirements for judges to base their decisions upon. Instead of looking *forward* and trying to calculate an optimal outcome, the Austrian approach urges judges to look *backward* and try to find the way to the resolution of the conflict in the contractual relations between the parties, social norms or logic of private property. It would become crucially important, for example, who came first to the place, what is implied by the title of ownership, who promised what, etc. instead of who is the least-cost-avoider, what are market prices of goods sold or what the judges think about the future. Respect for people's values and choices has therefore a substantial impact on the nature of law and economics scholarship and can be nicely summarized in the following way:

> Some implication of subjectivism for Law and Economics: (1) efficiency follows from consent, (2) in the case of unique good subjectivism always requires specific performance, (3) efficiency means optimization within constraints – prisoners dilemma is efficient, (4) least-cost-avoider principle does not work.[171]

[170] As Ludwig von Mises put it :

> No sensible proposition concerning human action can be asserted without reference to what the acting individuals are aiming at and what they consider as success or failure, as profit or loss.

Mises, Ludwig: *The Ultimate Foundation of Economic Science*, Van Nostrand, 1962, p. 80.

[171] Schmidtchen, Dieter: "Time, Uncertainty, and Subjectivism: Giving More Body to Law and Economics", *International Review of Law and Economics*, vol. 13, no. 1, March 1993, pp. 79–80.

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