THE COASE THEOREM AND PHILOSOPHICAL FOUNDATIONS OF LAW AND ECONOMICS*

by

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In this paper I will claim that methodology of law and economics should be changed from adopting economic analysis of law, namely implementing price theory and welfare economics (economization of law) to the scientific efforts aiming at an interdisciplinary project embracing law and economics as well as jurisprudence. The basis for such a project is purported by the Coase theorem, but may also be found in writings of Hayek and „old institutionalists", such as Veblen, Hale and Commons. The purpose of this paper is thus twofold: firstly, to present briefly the most powerful and popular version of law and economics being at the same time influential legal theory- the Chicago school. Secondly, to analyze the existing alternative approaches to economics of law, related to Austrian school (Hayek), „old institutional" economics (Commons) and transaction cost economics (Coase).

KEYWORDS

The Coase theorem, law and economics, institutionalism, efficiency, nomos, cosmos, taxis, managerial transaction, welfare economics, transaction cost economics, X-efficiency, procedural efficiency, economic rationality, the theory of rational behavior.

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Economics of law is thought to be a relatively new discipline. Many authors draw attention to its origins rooted deeply in a well known article of Ronald

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Coase and his famous theorem.[1] It is Coase who has demonstrated how much economy depends on sound legal system, especially on assignment of private rights and liabilities. Others regard Garry Beckers' efforts to provide a solid and objective basis for social theory and legal reforms as the origins of contemporary law and economics.[2]

In this paper I will claim that methodology of law and economics should be changed from adopting economic analysis of law, namely implementing price theory and welfare economics (economisation of law) to the other attitude consisting in scientific efforts aiming at an interdisciplinary project embracing law and economics as well as jurisprudence.[3] The basis for such project is purported by Coase theorem, but may also be found in the writings of Hayek and „old institutionalist", such as Veblen, Hale and Commons. These efforts are visible as far as new institutional economics and transaction cost economics are concerned.

The aim of this paper is thus twofold: firstly, to present briefly the most powerful and popular approach to economics of law being at the same time influential legal theory as presented by the Chicago school, predominantly by Judge Richard Posner, and to point out limits of this approach from jurisprudential, economic and methodological point of view. The second aim is to analyse the existing alternative approaches to economics of law, related to Austrian school (Hayek), „old institutional" economics (Commons)[4] and transaction cost economics (Coase).

Economics of law is most often associated with the so called Chicago school of law and economics.[5] According to R. Posner, the popularity of this

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1 COASE, R.H. (1960). *The Problem of Social Cost.* Journal of Law and Economics 3, pp. 1-44.

2 POSNER, R.A. (2001). *Frontiers of Legal Theory.* Cambridge, Massachusetts: Harvard University Press, pp. 52-61.

3 About the „jurisprudential niche" and the role of economics of law as jurisprudential theory, *cf.* N. Mercuro, and S.G. Medema (1997), *Economics and the Law. From Posner to Post-Modernism*, Princeton: Princeton University Press, pp. 3-21.

4 I am perfectly aware that some basic assumptions of the „old institutionalism" are at the moment unacceptable for the majority of present mainstream economists. The more interesting thing is, however, the influence of Commons methodology upon Coase, the fact that should not be ignored – *cf.* S.G. Medema (1994), *Ronald H. Coase*, London: Macmillan, pp. 24-26.

5 MERCURO, N., MEDEMA S.G. (1997). *Economics and the Law. From Posner to Post-Modernism.* Princeton: Princeton University Press, chap. 2.

approach results from two factors: the crisis of traditional legal doctrine and the success of the economics of non-market behaviour.[6]

The starting point for economic analysis of law is the assumption that decisions may be based either on intuition and vague moral beliefs or on scientific data. If economics is just a theory of choice it should *prima facie* be an excellent data provider for judges and legislators.

Thus the rationale of the economic analysis of law is rather simple: to implement economics to legal decision-making process. The Chicago school implemented welfare economics with its theory of self-interest, price and efficiency. The basic assumption of the theory regards human nature: it assumes that people are rational and they maximise their satisfactions in a nonmarket as well as in market behaviour. Their preferences may be represented by utility function. The „economic man" may be perfectly rational while braking legal norms if it maximises his utility.

The second pivotal assumption of the economic analysis of law states that individuals respond to price incentives in nonmarket behaviour in the same way as if they were on market. It means that legal sanctions are treated as prices.[7]

The third assumption is that legal decision-making process should imitate market. It means that law should be analysed from the perspective of economic efficiency. The Chicago approach derives from Kaldor-Hicks criterion of wealth maximisation.[8]

The other theory stemming from this methodology is a hypothesis about the internal efficiency of common law, efficiency achieved due to the process of selection of norms by virtue of litigation.[9] The Chicago approach includes both: positive and normative theory of law. The first claims that law, at least common law, is in fact based on efficiency principle and that judges, even if using other terms such as justice, still treat efficiency enhancement

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[6] POSNER, R.A. (2001). *Frontiers of Legal Theory.* Cambridge, Massachusetts: Harvard University Press, pp. 31-46.

[7] COOTER R., ULEN T. (1997). *Law and Economics.* Massachusetts: Addison-Wesley, p. 3.

[8] POSNER R.A. (1992). *Economic Analysis of Law.* 4th edition, New York: Little Brown and Co, p. 10; COOTER R., ULEN T. (1997). *Law and Economics.* Massachusetts: Addison-Wesley, p. 41.

[9] PRIEST G. (1977). *The Common Law Process and the Selection of Efficient Legal Rules.* Journal of Legal Studies 6, p. 65.

as the main purpose of law.[10] The normative theory states that if some parts of legal system are not promoting efficiency, such rules should be changed to reflect the efficiency-enhancing attitude of the whole legal system.

At the moment economic analysis of law might be regarded as one among equal trends of the contemporary jurisprudence.[11] As such the movement found strong opposition among many authors.[12] One of the strongest critics is Ronald Dworkin who opposes the recognition of wealth as a basic value within society and the dependence of other values and allocation of rights upon wealth maximization.[13] Dworkin points out that the initial allocation of rights cannot be instrumental, i.e. based on efficiency principle because the argument is deteriorated by its circularity.[14] The crucial issue, however, seems to be the scepticism among economists or economically oriented lawyers. Ronald Coase in his polemics with Richard Posner refuted not only his economic imperialism, but rather the whole methodology attached to welfare economics.[15] For Coase economics of law was to overcome narrow and artificial approach of the welfare economics, especially concentrated on the price theory and equilibrium model. He directly opposed the expansion of principles of traditional economy to non-market sectors.[16]

Another problem with economic analysis of law is firmly related to the notion of efficiency. For the Chicago school the idea of efficiency is central and indisputable. According to Kaldor-Hicks criterion the notion of efficiency is perceived as a static factor whereas other concepts of efficiency are

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[10] It is not strange, if according to Posner „A second meaning of justice,(...) is simply efficiency"; R.A. Posner (1975), „The Economic Approach to Law", *Texas Law Review* 53, p. 777.

[11] A. T. Kronman describes it as: „the most powerful current in American teaching today. (It) now completely dominates some fields and is a significant presence in others"; KRONMAN, A.T. (1993). *The Lost Lawyer: Failing Ideals of the Legal Profession.* Cambridge Mass.: Harvard University Press, p. 226.

[12] FRIED, CH. (1977. *Difficulties in the Economic Analysis of Rights* [in:] G. Dworkin *et al*. (eds.), *Markets and Morals*, New York, p. 180; COLEMAN J. (1980). *Efficiency, Utility, and Wealth Maximization.* Hofstra Law Review 8, p. 531; E.J.; WEINRIB (1995). *The Idea of Private Law.* Cambridge, Mass.: Harvard University Press, pp. 46-50.

[13] DWORKIN, R. (1998). *Law's Empire.* Oxford: Hart Publishing, 2nd ed., pp. 276-280.

[14] DWORKIN, R. (1980). *Is Wealth a Value?.* Journal of Legal Studies 9, pp. 191-95.

[15] Coase-Posner debate; POSNER, R.A. (1993). *Ronald Coase and Methodology.* Journal of Economic Perspectives, pp. 200-209; COASE R.H. (1993). *Coase on Posner on Coase.* Journal of Institutional and Theoretical Economics, 149, pp. 96-98.

[16] COASE, R.H. (1988). *The Firm, the Market and the Law.* Chicago and London: The University of Chicago Press, pp. 3-5. His approach is influenced by A. Smith and J. R. Commons; MEDEMA, S.G. (1994). *Ronald H. Coase.* London: Macmillan, pp. 24-26, 168.

not attached to allocation of resources between economic agents. H. Leibenstein's concept of "X" efficiency refers to the internal productivity of economic institution.[17] Deakin and Hughes purported with the notion of efficiency in context of legal regulation, the so called technical efficiency.[18] Zerbe as well as Sen called for broadening the notion of efficiency so that also sentimental value could have been encapsulated.[19]

Summarising, it may be stated that economic analysis of law substitutes moral theory with its central notion of justice by economic theory with its central notion of efficiency.[20] Nevertheless the deconstruction of the notion of efficiency results with refutation of the static model of wealth maximisation based on the price theory.

The economic imperialism is, however, not only a theoretical project. It rather reflects a wider social, political and historical phenomenon: the „economisation" of social life. In the last twenty years moral or ideological debate in politics as well as a wider part of social discourse have been dominated by economic debates.[21] Economy plays a more and more important role within the society, due to the long historical process of the collapse of traditional moral and political thinking, technical progress, civilisation changes, globalisation process and the bankruptcy of the centrally planed economies.[22] Social sciences, legal theory and moral philosophy admit the omnipotence of economic relations within the contemporary society. In democratic and liberal pluralistic societies the only linkage among individuals seems to be economic exchange.[23] The contemporary society is no longer based on moral consensus but on free market and liberal democracy being values

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[17] LEIBENSTEIN H. (1981). *Microeconomics and X-Efficiency Theory.* [in:] BELL, D., KRISTOL, I. (eds.). *The Crisis in Economic Theory.* New York: Basic Books Publishers, pp. 97-110.

[18] DEAKIN, S., HUGHES, A. (1999). *Economic Efficiency and the Proceduralisation of Company Law.* Company, Financial and Insolvency Law Review 3, pp. 173-175.

[19] ZERBE, R.O. (2001). *Economic Efficiency in Law and Economics.* Cheltenham: Edward Elgar, pp. 14-31, 152-158; SEN, A. (1995). *Rationality and Social Choice.* American Economic Review 85, p. 15.

[20] COLEMAN, J. (1980). *Efficiency, Utility, and Wealth Maximization.* Hofstra Law Review 8, pp. 531-535.

[21] For example, after 1989 economic issues were regarded as of highest importance within the debate on transition in the postcommunist countries of Eastern Europe.

[22] FUKUYAMA, F. (1989). *The End of History.* The National Interest 6, p. 8.

[23] One of the best exponents of the thesis is HAYEK, F.A. (1976). *Law, Legislation and Liberty. A New Statement of the Principles of Justice and Political Economy,* vol. 2: *The Mirage of Social Justice.* London: Routledge and Kegan Paul, p. 114.

themselves.[24] This observation is shared by pragmatists, functionalists (Rorty) and communitarians (MacIntyre).[25]

The modern economics of nonmarket behaviour is based on philosophical assumptions regarding human nature, ethics and political philosophy. These assumptions and other axioms of economic theory, especially its abstract character and repugnance of realism, are too rigid and narrow when applied to such complex social reality as law.[26] The formalism and axiomatisation of economics was purported principally by Alfred Marshall, who believed that economics had to limit its scope to processes that had a price measurement. According to this approach, the economic laws are simple generalisations about human behaviour measured in terms of money.[27] Thus economics has been definitively founded on models based on axioms abstracting from the real world.[28] Such models embrace the set of ideas such as the notion of equilibrium as stated by Marshall or the concept of the system of markets and general equilibrium endorsed by Walras and then definitely formalised by Arrow and Debreu. This evolution in one word lead from economics regarded as political economy studying historical society as it was understood by A. Smith, to formalised abstract study of interrelated variables applicable to any system of production or exchange, and after Becker's discovery of the economics of non-market behaviour, even to any social relations.[29]

The majority of economic analysis remains a normative project rather than a positive description or explanation.[30] According to Friedman's methodology, the purpose of economics is to predict, not to explain. Posner claims it advantageous but such a defense seems doubtful.[31] In order to explain legal phenomena a richer ontology and a broader scientific perspect-

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[24] MORTON, P. (1998). *An Institutional Theory of Law. Keeping Law in its Place.* Oxford: Clarendon Press, pp. 16-18.

[25] GOLECKI, M.J. (2000). *Cnota czy wspolnota polityczna* (Virtue or Political Community. Some Remarks on Alisdair MacIntyre's *After Virtue. A Study in Moral Theory*). Kwartalnik Konserwatywny (The Conservative Quarterly) 6, pp. 130-132.

[26] BELL, D. (1981). *Models and Reality in Economic Discourse.* [in:] BELL, D. and KRISTOL, I. (eds.). *The Crisis in Economic Theory.* New York: Basic Books Publishers, pp. 76-79.

[27] *Ibid*, p. 56.

[28] *Ibid*, pp. 57-58.

[29] BECKER, G.S. (1976). *The Economic Approach to Human Behaviour.* Chicago: University of Chicago Press.

[30] T. Lawson points out Carl Menger as the author of this approach – LAWSON, T. (1997). *Economics and Reality.* London: Routledge and Kegan Paul, pp. 113-126.

ive are needed. Therefore, a new methodological approach is necessary in order to introduce a truly interdisciplinary research. The possibility of such methodological endeavour may be historically illustrated.

One of the earliest interdisciplinary approaches to law and economics may be found in the theory of J.R. Commons. Commons searched for legal foundations of economy. His theory of property gave rise to more general observations regarding the evolution of law and economy.[32] He defined market as a process and a flow of transactions. Market was possible only if there were at least two transactions - one actual and the next best alternative.[33] The price system operated in a real environment influenced by inequalities between parties.[34] This inequality was connected to the distribution of economic power which created a basis of managerial transactions. The transactions between legal and economic superior and legal and economic inferior took place not on market but within economic institutions. As far as those managerial transactions were concerned the legal framework reflected economic inequality.[35] Thus the economic power induced also a legal power. The notion of legal power and of different categories of legal rights implemented by Commons were closely connected to the Hohfeld's theory of legal power and legal rights. This lead to the development of the concept of managerial transaction and economic institutions.

The version of institutional insight into economics endorsed by Commons was to some extent shared by Ronald Coase. Coase adopted the distinction between bargaining transaction and managerial transaction. The former referred to market exchange, the latter to economic institutions "superseding" price mechanism, such as firm and government. The institutional analysis included in *The Nature of the Firm* passed unnoticed within mainstream economics.[36] It is rather *The Problem of Social Cost* that raised extensive references and comments both by economists and lawyers. In this article

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[31] POSNER, R.A. (1992). *Economic Analysis of Law.* New York: Little Brown and Co, 4th ed., p. 17; FRIEDMAN, M. (1953). *The Methodology of Positive Economics* [in:] FRIEDMAN, M. (ed.). *Essays in Positive Economics.* Chicago: University of Chicago Press, p. 14; S.G. MEDEMA (1994). *Ronald H. Coase.* London: Macmillan, pp.135-136.

[32] COMMONS, J.R. (1974). *Legal Foundations of Capitalism.* New York 1924 (1st edition), reprinted New Jersey: Augustus M. Kelley Publishers, pp. 11-46.

[33] *Ibid*, p. 66.

[34] *Ibid*, pp. 90-97.

[35] COMMONS, J.R.(1934). *Institutional Economics.* New York: Macmillan, p. 634.

[36] S.G. Medema (1994), *Ronald H. Coase*, London: Macmillan, p. 21.

Coase noted that the characteristics of the world of economic analysis, the world of Zero Transaction Costs (ZTC world) made the initial allocations of rights irrelevant. This means that in ZTC world, where information is perfect, there would be no influence of law upon allocation of resources.[37]

But we do not live in such world, says Coase.[38] In a real world of positive transaction costs allocation of rights effects outcome of economic activity. This means that law may increase or decrease transactional costs and allocative efficiency. This also means that what makes market more perfect or less perfect is not economics but rather legal framework. It forms the ground for the so called normative Coase theorem which states that judges taking up any legal decision should be aware of its economic implications. They should also take them into account as to minimise transactional costs „insofar as this is possible without creating too much uncertainty about the legal position itself".[39]

The Chicago school plainly states that law should be based on efficiency calculations. In fact normative Coase theorem does not offer a basis for such unanimous and straightforward interpretation. Coase in his discussion with Pigou suggested limitation of regulation by means of tax law and tax policy. It does not mean however, that he uncritically pushed for liberalisation and limitation of transactional costs by virtue of freedom of contract, liability rules and protection of property. This solution would rather comply with basic assumptions of welfare economics, especially with policy recommendations formulated by K. Arrow referring to the General Equilibrium Model.[40]

There is another way of reducing transactional costs: by substituting market by firm perceived as an institution with its own hierarchy of power of decision-making. The firm however needs its own internal regulations

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[37] The proposition was then called by Stigler as „Coase Theorem"; R.H. Coase (1988), *The Firm, the Market and the Law*, Chicago and London: The University of Chicago Press, p. 14.

[38] It is perhaps the most important conclusion drawn from his analysis. Coase thus put himself on the opposite side of the contemporary mainstream economics, denying accurateness of formal analysis in economics including modern price theory as implemented in economic analysis of law.

[39] R.H. Coase (1988), *The Firm, the Market and the Law*, Chicago and London: The University of Chicago Press, p. 119.

[40] ARROW, K.J. (1969). *The Organization of Economic Activity: Issues Pertinent to the Choice of Market versus Nonmarket Allocation.* [in:] *The Analysis and Evaluation of Public Expenditures: The PPB System.* Joint Economic Committee, 91st Cong. 1st sess., Washington: U.S. Government Prinitng Office, pp. 56-60.

(e.g. company law, insolvency law, etc.). It is somehow paradoxical that there is no escape from law. One can try to maintain ZTC like world but the price would be sometimes extensive regulation (e.g. securities law, stock-exchange law, etc.). But firm has yet another meaning, not linked with economic activity- it is an institution, where transactional costs are reduced by virtue of power and limitation of individual preferences submitted to the purposes of the organisation.

The question arises why law is so necessary for reducing transactional costs? It seems to be jurisprudential theory the endeavour to answer this question.[41] Nevertheless, the most jurisprudential question is related directly to the normative Coase theorem. Is Coase suggesting that law should enhance efficiency? Should it promote free exchange and property rights? The answer to these questions depends on how seriously do we treat the ZTC world. For Coase this is the world of welfare economics. But is it a model-world which should be established in reality? In other words, should we intend to transform the real world of positive TC into ZTC world of economic models? Coase does not directly answer those questions, but to some extent he suggests the solution.[42] The institutional framework arises if the TC are too high. In case of high TC firm will substitute free exchange. Is it better to have market near to ZTC or to have institutional environment? Coase in one place suggested that ZTC world as for example in case of stock exchange requires massive regulation. Such complex regulation will tend to generate additional TC, if it is too complicated. But the observation endorsed by Coase vicariously opposes this „pro-market" solution. Coase seems to be more sceptical when he suggests, that there is no escape from law in the artificial ZTC world. The world reminding ZTC world may technically be built by virtue of massive regulations, and in fact transforms stock exchange in sort of firm with its internal power and organisational hierarchy.[43]

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[41] This issue addresses also a question about the ontological nature of law as underpinning of the economic activity and specifically as a foundation of the market.

[42] About the indeterminacy of Coase normative theorem see DEAKIN, S. (1999). *Law Versus Economics? Reflections on the Normative Foundations of Economic Activity.* [in:] RICHARDSON, M., HADFIELD, G. (eds.). *The Second Wave of Law and Economics.* Sydney, pp. 34-39, who suggests three possible interpretations. According to Deakin none of those is correct, and empirical research is necessary to solve the problem; *ibid*, p. 39.

[43] COASE, R.H. (1988). *The Firm, the Market and the Law.* Chicago and London: The University of Chicago Press, p. 10.

In conclusion I would suggest that normative Coase theorem is a myth based on oversimplification. Coase simply observed a kind of economic regularity concerning the relationship between market as decentralised institution regulated by the price theory and economic institutions regulated by internal relations of power. Neither of them is better - there are complementary elements of economic system. As far as law is concerned, there is no trace of proposition that either public or private, statutory or judicial law is better. Coase analyses only the basic influence of law upon both market and firm or government. His legal analysis is perhaps not extensive but it is profound. Law seems to rule economic system shifting some sectors of economic activity between market, firm and government by virtue of the level of TC. At the same time there is no escape from law. Similarly to Commons, Coase emphasised that economic goods are bunches of rights assigned to legal individuals in accordance with legal rules. Law thus creates the kind of framework of economic system.[44] One of the most important features of this framework remains the certainty about legal position which is the limit of the instrumental purpose oriented legal decision-making process.

The close analysis of Coase theory provides the view substantially different from the slogan about pursuing efficiency in law so characteristic for economic analysis of law. Economics of law seems to be a more profound theory of the relationships between two systems of values, two frameworks of society: law regarded as a normative system providing order and stability for any actions of individuals, and market economy: economic order maintained by legal rules and consisting of activities of individuals. This landscape of the spontaneous social order delimited by law demarcation lines is very akin to Hayek's theory of *nomos*, *taxis* and *cosmos*.

The starting point for Hayek is the epistemological assumption that knowledge and information is dispersed. Individual agents have limited access to whole information regarding complex *milieu* of social interrelations. Spontaneous order is founded upon the notion of free individual action. Nevertheless the liberty of agents is limited by the so called "abstract rules of just conduct". Those rules are prior to legal regulations and evolved in the course of the evolutionary process. Hayek draws distinction between

[44] Coase even suggested that economy seemed to be a function of law. See MEDEMA, S.G. (1994). *Ronald H. Coase.* London: Macmillan, p. 133.

the rules of just conduct identified with *nomos* and the purpose-oriented, organisational rules resulting from legislative process- *thesis*. According to Hayek *nomos* includes rules without any detailed purpose, but the purpose of *nomos* as a set of „principles of just conduct" is to maintain *cosmos*, i.e. spontaneous order. On the other hand *thesis* refers to the purpose oriented norms whose main task refers to the aims of organisation e.g. state. According to two basic types of norms; „natural" *nomos* and „artificial" *thesis,* there are two types of social order; *cosmos* and *taxis*. *Cosmos* refers to spontaneous order, typical for Great Society with its pluralistic approach to values and forms of social as well as individual life whereas *taxis* is the purpose-oriented order of state.

The interrelationship between those two orders and respective two types of rules is a central issue for Hayek. He refers *nomos* to the rules of private law whereas *thesis* rather to public law.[45] According to Hayek *thesis* and *nomos* should not be blend but rather separate since there is real threat of domination of public law over private law. This assumption is however difficult to reconcile with contemporary structure of legal order, where the norms of private and public law interfere between themselves. Another problem with Hayek's theory regards the origin and essence of rules of just conduct. Those rules seem to evolve in course of evolutionary process very similar to the history of common law.[46] In reality they were always effected by public law, but Hayek seems to refer *nomos* rather to ideal model than historically developed and existing in reality set of rules. For him rules of just conduct may be identified with three fundamental rights as stated by Hume: „that of stability of possession, of its transference by consent, and of the performance of promises".[47]

Hayek opposes constructivism of the type evolving from Descares' rational philosophy. He does not recognise the link between constructivism and the moral basis of above stated rules of just conduct. One has to admit, that what for Hayek is just a kind of natural foundation of spontaneous order is in reality nothing more than a special category of moral foundational-

[45] HAYEK, F.A. (1973). *Law, Legislation and Liberty. A New Statement of the Principles of Justice and Political Economy*, vol. 1: *Rules and Order.* London: Routledge and Kegan Paul, p. 132.

[46] *Ibid*, pp. 17-24.

[47] HAYEK, F.A. (1976). *Law, Legislation and Liberty. A New Statement of the Principles of Justice and Political Economy*, vol. 2: *The Mirage of Social Justice.* London: Routledge and Kegan Paul, p. 40.

ism and constructivism based on secularised version of natural law and morality as it was perceived by the Enlightenment philosophers: Hume and Kant.[48]

This is perhaps the reason for certain similarity between Hayek's idea of *nomos* and Weinrib's concept of private law.[49] To some extend both are anti-functionalist, even if Hayek agrees, that *nomos* as a whole is to some extend purpose- oriented. For Weinrib the purpose of law is law itself. Nonetheless many other concepts including total separation of private and public law are similar. *Nomos* is set up predominantly by courts and judges. *Taxis* refers rather to the politically oriented legislation.[50]

Another problem regards the role and ontological nature of law. According to Hayek's account law seems to be both frame (*nomos*) of the social order and the instrument of state (*taxis*). Thus one may sum up that in Hayek's theory law provides expectation of behaviour and at the same time law as a framework is based on enforcement of legal obligations and legal sanction protecting private property and expectations of economic agents.

One general remark may be added: both economists and lawyers trace back very often to Aristotle. Karl Polanyi called him the founder of economics,[51] whereas Ernst Weinrib points out that Aristotle invented private law.[52] In fact the fifth book of *Nicomachean Ethics* on justice seems to be an interdisciplinary reflection on both; economic exchange and the basis of legal relations and obligations.[53] The fundamental difference between utility-value and exchange-value was discovered by Aristotle.[54] He referred commutative

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[48] About the weaknesses of the „Enlightenment project" see; SIMMONDS, N.E. (1984). *The Decline of Juridical Reason. Doctrine and Theory in the Legal Order.* Manchester: Manchester University Press, pp. 48, 60-64; GOLECKI, M.J. (2000). *Cnota czy wspolnota polityczna* (Virtue or Political Community. Some Remarks on Alisdair MacIntyre's *After Virtue. A Study in Moral Theory*). Kwartalnik Konserwatywny (The Conservative Quarterly) 6, p. 134.

[49] WEINRIB, E.J. (1995). *The Idea of Private Law.* Cambridge, Mass.: Harvard University Press, pp. 1-21.

[50] The difference between *taxis* and *nomos* seems to reflect the dichotomy between policy and principle adopted by Ronald Dworkin, *cf.* DWORKIN, R. (1998). *Law's Empire.* Oxford: Hart Publishing, 2nd ed., pp.221-224.

[51] POLANYI, K. (1968). *Aristotle Discovers the Eeconomy.* [in:] DALTON, G. (ed.). *Primitive, Archaic and Modern Economies. Essays of Karl Polanyi.* New York: Anchor Books, p. 81.

[52] WEINRIB, E. J. (1995). *The Idea of Private Law.* Cambridge, Mass.: Harvard University Press, p. 56.

[53] ARISTOTLE. *Nicomachean Ethics* V. 1129-1133.

[54] The best exponent of the thesis is SOUDEK, J. (1952). *Aristotle's Theory of Exchange: An Enquiry into the Origins of Economic Analysis.* Proceedings of the American Philosophical Society 96, p. 45.

justice to what is now called market exchange. Accordingly, the price and exchange-value is usually defined by market forces. Only in case of collapse of voluntary exchange the judge determines the price. He represents not only state but a kind of justice no longer based on commutative but rather on distributive justice.[55] But Aristotle rejected the possibility of founding social life on market exchange. For Aristotle did not distinguish between society and community - Greek *polis* was based on interpersonal relations, on friendship rather than on exchange.[56]

As Polanyi had pointed out, according to Aristotelian tradition there were three levels of social interaction: „gift", „exchange" and „threat". „Gift" operated on a level of friendship and morality, „exchange" on level of market transactions, and „threat" on level of law and state sanctions.[57] Perhaps the most dramatic process in the history of economic thought was its concentration solely on market exchange. This was not the case as far as Adam Smith and his *Lectures on Jurisprudence* or *Wealth of Nations* are concerned.[58] Such identification of all possible social interactions with market exchanges resulted with „economic imperialism".

The crisis of jurisprudence enabled economic analysis of law to penetrate legal practice, legal theory, legal education. Legal theory is in crisis because the contemporary jurisprudential theories attacked by pragmatism give very weak basis for legislation and adjudication. Economics seems more solid. But economic theory is in a state of crisis perhaps even deeper than jurisprudence. The model of perfect market has been revised. Various theories of market imperfections attract attention. Economics as well as jurisprudence requires a broadened perspective, more realistic assumptions, a richer ontology. These propositions may be satisfied by an interdisciplinary ap-

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55 ARISTOTLE. *Nicomachean Ethics.* 1132a22.

56 The theory is embodied in ARISTOTLE. *Politics.* I.8-10. See LEWIS, T.J. (1978). *Acquisition and Anxiety: Aristotle's Case Against the Market.* Canadian Journal of Economics 11, p. 83; MEIKLE, S. (1979). *Aristotle and Exchange Value.* [in:] MILLER, F. and KEYT, R.D. (eds.). *A Companion to Aristotle's Politics.* New York, pp. 163-169.

57 POLANYI, K. (1957). *The Economy as Instituted Process.* [in:] POLANYI, K. *et al.* (eds.). *Trade and Markets in the Early Empires. Economies in History and Theory.* Glencoe: Free Press, p. 250.

58 In this respect A. Smith continued Aristotelian tradition; *cf.* his notion of jurisprudence as a science on commutative and distributive justice (A. Smith (1982), *Lectures on Jurisprudence*, MEEK, R.L. *et al.* (eds.). Indiannapolis: Liberty Fund, pp. 5, 397-401). About the wider scope of Smith's analysis, not limited to the notion of "economic man", but embracing morality, sympathy and generosity – SEN, A. (1995). *Rationality and Social Choice.* American Economic Review 85, p. 15.

proach addressing the question how law as well as economy are possible, how they work within social reality - the reality of complex networks, patterns of exchange, systems of communication. Jurisprudence based on moral foundations has been refuted - because no moral foundation, common value system for complex society are possible to identify. Change in legal theory is thus necessary because jurisprudence does not reflect the paradigm shift from non democratic to democratic law making process.[59] The central institution of society is market; it is in fact market society. It does not mean that morality does no longer play any important role - but morality, custom or convention are not characteristic for market society; they are limited to small groups and communities. According to N. Simmonds, the jurisprudence of market society should be based on assumption, that „property is distributed by means of innumerable individual transactions between consenting parties, and which is pervaded by relationships of an essentially limited, contractual and often transitory nature".[60]

Within the landscape of such market society we have dichotomy between free exchange on the market based on protection of property and freedom of contract and institutions with their hierarchy, power and common purposes. What we really need is a theory on law and economics embracing both: market and institutions and explaining the interrelations between them. Such theory would be interdisciplinary: social, legal and economic. It would be based on assumption, that legal norms play a double role in society. On the one hand there are providing expectation about the behaviour of other agents and thus may form a kind of cognitive resources; on the other law as enforceable normative system protects rights and physically or conventionally enforces obligations.[61]

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[59] MORTON, P. (1998). *An Institutional Theory of Law. Keeping Law in its Place.* Oxford: Clarendon Press, p. 67.

[60] SIMMONDS, N.E. (1984). *The Decline of Juridical Reason. Doctrine and Theory in the Legal Order.* Manchester: Manchester University Press, p. 28.

[61] Such approach is shared by TAMANAHA, B.Z. (1997). *Realistic Socio-legal Theory. Pragmatism and a Social Theory of Law.* Oxford: Clarendon Press, pp. 93-128, who says about „two fundamental categories of the concept of law"; *ibid,* p. 93.