

PREFACE

Human society basically amounts to coordination of people's ambitions and activities for their expected mutual benefit. The coordination may of course be seriously deficient as compared to the ideal we dream of. It may even break down completely and turn into either authoritarianism or anarchy. Then we should not talk about a society.

Most coordination is of an economic nature; hence, it takes place within what is usually called the economic system. But a well-developed economic system can hardly exist unless accompanied by a legal system. Legal rules and arrangements profoundly affect the possibilities for people to act and the incentives behind the acts. This holds true not only for specific regulatory rules that directly control individuals' economic decisions and dispositions. It also holds true for those parts of the legal system which, at least in democratically-oriented countries, provide the basic framework, such as the general laws of property, contract, tort and crime. But law is not an exogenously given force, operating on human behavior solely from the outside. It is itself influenced by the pressures of human activity and the wishes and aspirations driving it. There is an all-pervasive interaction between law and economic life. The "legal system" and the "economic system" thus cannot be regarded as separate phenomena. There is only a fundamentally interdependent "economic-legal system", or "socio-legal system" to the extent purely non-economic behavior is also taken into account.

The basic properties of this economic-legal system are the object of study of this book, with the emphasis on the structure and role of law. There are two major problems. How does law affect economic behavior? This is the first problem, and part of the answer — but by no means the

whole answer — follows rather directly from established economic theory. What has not been heeded by established theory is that decision spheres and incentives are imbued with law in much more fundamental ways than by tax rules and direct regulation only.

Given the importance of law for the structure and performance of the economic system, to what an extent is law a result of endeavors by those who frame it to achieve these effects? This is the second problem, which basically is the opposite of the first problem as it concerns what *determines* law rather than what are the *effects* of law. It has only recently come under serious attack from a number of economists and legal scholars. Their research provides strong support for the idea that core parts of law and the economic system are evolving in response to one another. If names should be given, perhaps the most important ones are Ronald Coase, Guido Calabresi, Richard Posner, James Buchanan, Gordon Tullock, Friedrich Hayek, Kenneth Arrow and Douglass North, some of them economists, some legal scholars. A solid framework was in place around the middle of the 1970s, and a substantial amount of new work has been achieved after that by a number of scholars within both areas of study. New results, insights and perspectives are presented continuously.

It follows that this book belongs to both economics and legal science; that is, to a field that has come to be called “law and economics”, or “economics of law”. As evident from the list of scholars above, the treatment draws heavily on literature in the field often named “new institutional economics”. As for the basic parts of that field of most interest to us here, it might perhaps better be called “new microeconomics” as it strives to extend and deepen the analysis of the problems that have always been the basic object of traditional microeconomics. This material is developed at some length, as it is important to put law squarely into the proper economic framework. There is in fact also a dash of evolutionary biology, which helps us keep in mind that the economic-legal system is a very deeply rooted component of human society.

Besides the way the material is organized and presented, this book also differs from many or most other books in the field by striving consistently to adopt a purely *positive* perspective. The task is to *describe* and *explain* how law affects economic activity, and — conversely — how economic activity affects law. The *normative* problem of what law

should contain, so cherished by legal analysis, is ignored. It is in fact discarded as out of place from the point of view adopted.

The legal order analyzed is not specified in any great detail as it is designed generally to accord with the orders of most democratically-oriented countries of the “Western” type. The analyses and conclusions are intended to apply both to jurisdictions regarded as belonging to the so-called common-law sphere and those outside this sphere. Unavoidably, every reader will find that there are elements in his or her own legal system that do not agree well with the picture provided.

The book gives an overview of the new field in comparatively simple terms, intended for both economists and for legal students, scholars and professionals not yet well acquainted with it. It is neither a true “treatise” nor a regular textbook, but unashamedly something of both. The aim is to stress particularly the major problems and results, and to bring out the essential unity of the various analyses. The book builds on the work already carried out, with a certain emphasis on the achievements of the first generation that created the field and set the tone. What is special is mainly the way the pieces are put together. The guiding principle is to try to identify widespread, systematic patterns in the legal structure.

Directing a book in equal measure towards economists and lawyers may appear bold and optimistic, but it is in perfect accordance with the aim to bridge the unjustified gap between the two fields of learning. More specifically, the book is designed to cater to the needs and interests of four particular groups of readers. They are not listed in the order of importance as they are about equally important:

- students of law in the middle or towards the end of their studies;
- students of economics just beyond their introductory course;
- professional lawyers working academically, or with academic leanings;
- professional economists who have not yet come into contact with the problems and want to have a quick introduction.

The book includes what I believe is enough of an introduction to legal studies for economists who have not yet encountered law. Hopefully it is presented in a way lawyers do not find altogether predictable. Conversely, it contains what I believe is a sufficient amount of basic economics for lawyers. At the same time, an attempt has been made to present this

material in a manner that may appear reasonably fresh for those who already have a basic knowledge of economics. The analytical techniques used in the book are simple. There may be economists who think the discussion is at times somewhat too slow going. Legal students less used to sweeping, sometimes rather bold, analytical constructions might perhaps not always share that opinion. The information should not be withheld that I am an economist, with no formal background in law. But as a professor of economics with half-time duties in a faculty of law over a period of two dozen years, I think I have imbibed a certain amount of general knowledge of legal matters from helpful (although now and then slightly sceptical) colleagues in the legal field.

Although not a textbook in the narrow sense, the book can certainly be used for such purposes. I myself have tried parts of a preliminary version in courses in law and economics at the Faculty of Law of Stockholm University (mainly for so-called Erasmus students from various European countries), as well as second-semester undergraduate courses in both microeconomics and public economics at the University of Hong Kong. To my knowledge, those experiments were clearly successful.

A special problem confronting anyone writing a basic presentation of the field of law and economics is that there is no ready paradigm to employ. For those who want to introduce the field of law itself, there is a tradition natural to follow. As for economics, taken by itself, there is a rather established textbook model (which might be called the “Samuelsonian” model after its originator). The main reason is, of course, that the field of law and economics is new. Hence much of the material still consists of theoretical constructions that may have substantial empirical support but have not yet become firmly established. Thus any author making the endeavor is forced to choose his or her own perspective. As a consequence, I think that, for the time being, any book presenting basic law-and-economics material is bound to have a certain flavor of treatise.

My own method is to organize the analysis around a central “double” hypothesis concerning the relations between the economic system and law. The hypothesis first claims that judge-made law (taken to comprise more than case law emerging directly from court decisions) tends systematically to provide wealth-promoting incentives, in disregard of

the distribution of wealth among people. It has developed as a response to people's wealth-seeking endeavors, by supporting and facilitating market transactions or supplementing them when they are not feasible. The second claim is that politically-based law (excluding basic constitutional law as well as the legal arrangements behind the night-watch state) has the opposite bias. A further component concerns the determination of the mixture between the two kinds of law. There is no claim to originality: most of these ideas have been put forward in quite explicit terms by others, particularly the "founding fathers" referred to above.

I see three good reasons for choosing such an approach. The first is that, in my view, the "double hypothesis" actually has a very substantial amount of empirical support; hence, it tells us very much about the relations between law and the economic system. The second is that the use of a specific theoretical construction as a general framework for the analysis facilitates establishing similarities and differences among the various components. Moreover, it becomes easier to grasp — and remember — each single component. Whether or not, in the end, the theoretical construction turns out to be tenable (which I myself feel convinced it does), it has value as a pedagogical, heuristic device. The third reason is the belief that scientific progress is promoted to some extent by challenge and response. We all eagerly want to understand the relations between law and the economic system, and see them explained. The task is extremely difficult. Few of us really believe that the last word will ever be said. Putting forward a complete construction in quite explicit terms should, however, contribute to refining the theoretical structure and making empirical analyses more focused.

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