Economic Approach to Jurisprudence

Economics of law and law with economics are two interrelated concepts having a very wide perspective. Economics of law has a methodological approach, i.e. the analysis of law from the perspective of economics along with the introspection of the field of economics. Economics has a lot of impact on law, and such an influence cannot be ignored. Although the law has a lot of impact on the economy, this fact has not been taken into consideration in theory.

This is a newly developed discipline, which is gradually coming up. The origin of this approach can be traced to the articles written by Ronald Coase and his theorem.

The alternative approaches to the economics of law, which are commonly in use are related to **Austrian school (Hayek)**, **"old institutional" economics (Commons) and transaction cost economics (Coase) as well as the social systems theory (Pearsons, Luhman and Teubner).**

The first three theories are the most important ones as they lay the foundation, regarding law and economic order. The Foundationalism theory also admits and recognises the existence of the relation between law and the economy. The last theory, which is also known as the system theory, takes into consideration the independent existence of both economy and law as social systems and is therefore known as anti-foundationalist theory. This classification is appropriate to study the difference between modern and postmodern legal theories.

Economic analysis of law

The Chicago School of Law

Economics of law has often been associated with the **Chicago school of law** and economics. According to **R. Posner**, the popularity of this approach results from two factors:

- The crisis of traditional legal doctrine.
- The success of the economics of non-market behaviour.

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. The rationale behind the economic analysis of law is rather simple: **to implement economics to the legal decision-making process.**

Assumptions under the Chicago School Of Law

The Chicago school implemented welfare economics with its theory of **self-interest**, **price** and **efficiency.**

- **Regarding human nature:** it assumes that people are rational and they maximize their satisfaction in a non-market as well as in market behaviour. Their preferences may be represented by a utility function. The "economic man" may be perfectly rational while breaking legal norms if it maximizes his utility.
- **The response of individuals:** individuals respond to price incentives in non-market behaviour in the same way as if they were in the actual market. It means that legal sanctions are treated as prices.
- **Legal decision-making target:** the legal decision-making process should imitate the market. It means that the law should be read from the perspective of economic efficiency. The Chicago approach derives from the Kaldor-Hicks criterion of wealth maximization.

The other theory stemming from this methodology is a hypothesis about the internal efficiency of common law, the efficiency achieved due to the process of selection of norms by virtue of litigation.

The Chicago approach includes both: positive and normative theory of law. It claims that law is based on efficiency principle and that judges, even if using other terms such as justice, still treat **efficiency enhancement as the main purpose of the law**. Presently, economic analysis of law might be regarded as one among equal trends of the contemporary jurisprudence.

Criticism

It was strongly opposed by many of the authors. Some of the greatest critics are as follows.

- **Ronald Dworkin** opposed the recognition of wealth as a basic value within society and the dependence of other values and allocation of Rights upon wealth maximization. Dworkin pointed out that the initial allocation of rights cannot be instrumental, i.e. based on the efficiency principle because the argument is deteriorated by its circularity.
- According to **Coase**," economics of law was to overcome the narrow and artificial approach of the welfare economics, especially concentrated on the price theory and equilibrium model.".He was in opposition of the widening of the traditional principles of the economy to include the non-market sectors.

The economic imperialism is, not only a theoretical project. It reflects a wider social, political and historical phenomenon: the "economization" of social life. The economy has a major role to play in framing the structure of the society, due to the failure of the traditional theories time and again. In addition to this, the technical progress, structured civilization, globalization and the bankruptcy of the centrally planned economies, also fueled up the process.

According to Marshall, “Economics had to limit its scope to processes that had a price measurement.” He also believed that economic laws were generalised facts about the behaviour of human beings, which could be measured in terms of utility. Therefore, it can be seen that economics has been based on the models by taking inspiration from real life.

Thus, these models embrace new ideas such as the concept of equilibrium as devised by Marshall or the concept of the market system and general equilibrium as given by Walras and formalised by Arrow and Debreu. The majority of economic analysis remains a normative project rather than a positive description or explanation.

Therefore, a new methodology is required to do a complete interdisciplinary analysis.

Foundationalist theories on law and economics

1. J.R. Commons Theory

J.R. Commons gave one of the most important and the earliest theory on law and economics. His theory of property lead to generalised observations related to the evolution of law and economy. He termed “market” as a process, wherein the flow of transactions takes place. According to him, the existence of the market was only possible on the collaboration of two characters and transactions i.e. the actual transaction and its next best alternative.

The price system was operating in this areal environment, which was determined by the inequalities between parties. This disparity was related to the distribution of economic power among the society. The transactions between

legal and economic superior and legal and economic inferior took place not in the market but within the economic institutions. The economic power, in turn, influenced the legal power of the institutions, thus widening the inequality.

The notion of legal power associated with the different strata of the society as implemented by Commons was closely connected to Hohfeld's theory of legal power and legal rights. Thus this leads to the development of the concept of the managerial transaction and economic institutions.

2. Ronald Coase Theory

Ronald Coase also shared the same view as **J.R. Commons.** He adopted the distinction between bargaining and managerial transactions, stressed by Commons. The former referred to market exchanges, the matter to economic institutions "superseding" price mechanisms, such as firms and government.

According to Coase, the usage of Zero Transaction Costs (ZTC world) made the initial allocations of rights irrelevant. But, this theory does not work in the real world. In reality, the law has an overall effect on the transactional costs as well as its allocation. This forms the ground for the normative Coase theorem, which states that judges taking up any legal decisions should analyse all the economic factors and their implications thoroughly. In addition to this, they should consider them in order to minimize the transactional costs **"insofar as this is possible without creating too much uncertainty about the legal position itself".**

3. The General Equilibrium Model

The General Equilibrium Model is also a way which helps in minimising the transactional costs: **by substitution of the market with a firm, which can**

be seen as an institution with its own hierarchical authority, capable of decision making power on its own.

Law thus creates a framework for the economic system to function properly. One of the most important features of this framework remains the certainty about the legal position which is the limit of the instrumental purpose oriented legal decision-making process.

The close analysis of Coase theory provides the view that 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.

According to Hayek, free individual action defines the spontaneous order. Nevertheless, the liberty of agents is limited by the so-called **"abstract rules of just conduct".** Hayek created a difference between the rules of just conduct identified with nomos and the purpose-oriented rules resulting from the legislative process- thesis. He further added that nomos is made up of rules without any detailed purpose. Although the main objective of nomos collectively as a set of **"principles of just conduct"** is to maintain cosmos i.e. spontaneous order.

On the other hand, thesis defines the purpose oriented norms whose main task refers to the aims of organization e.g. state**. Further, the term social order is divided into two types, i.e. cosmos and taxis.** Cosmos means the spontaneous order, usually used to refer to the Great Society with its pluralistic approach of values and forms of social and individual life whereas taxis is the purpose-oriented order of the state.

The interrelation and interaction between these two types of orders and the rules are the main issues dealt with by Hayek. He attributes nomos to the rules of private law whereas thesis to public law.

According to Hayek thesis and nomos should not blend together but be separate since there is a real threat of domination of public law over private law because the state has a natural inclination to growing and broadening the scope of the public regulation. This assumption is however difficult to reconcile with the contemporary structure of legal order, where the norms of private and public law interfere between themselves.

Anti-foundationalist theories on law and economics

1. Luhman Theory

The system theory may be traced back to **Talcott Parsons** and his structural functionalism. But the paradigm shift from foundationalist to antifoundationalist social systems theory is associated with the functionalist-structuralism and the theory of law as autopoiesis endorsed by **Luhman**.

According to his theory, the law is characterized as an operationally closed self-referential and self-replicating autopoietic social subsystem. Law may also be defined as systematically and institutionally generalized normative behavioural expectations. This means that law is regarded as a kind of information about the possible actions taken by the legal system and by the subjects of legal norms – legal actors. Thus for Luhman the enforcement of legal norms has no separate significance. According to this theory, it has only the signalling function, spreading information about the fact that state mechanism enforced or has not enforced the legal rule.

On the other hand, the system theory of law does not refer exclusively to the legal system. Social communication is common for all subsystems as a kind of inter-systemic interface. Law is"the product of emergent reality, the inner dynamics of legal communications". Law emerges in the course of the communication process which is not linear but circular. The same is to be said about the economy, which is also a closed system.

2. Teubner's Theory

According to Teubner, law encodes information regarding legality/illegality whereas economy concerns information about utility and non-utility. Both systems are totally autonomous, but intellectually some influence is possible while decoding and translating information. The example such process of translation of the legal information into economic language is e.g. sanctioning. The legal sanction is translated by the economic environment as a mere cost or price. If then such rationale is put into the circulation within the legal system of communication, some kind of **"economisation**" of the legal system takes place.

According to Teubner, "**hand formula" and "doctrine of efficient breach"** are examples of such a process. Both of these are closed systems of the market, and the only interaction possible is via the process of communication. Law and economics co-evolve, along with the social system. Thus the law is hypercycle characterised by legal procedure, the notion of legal act, legal norms and doctrines.

The process of co-evolution of law and economy requires a new regulatory attitude: instead of a traditional "command-and-control" approach, an "option policy" should be adopted, which is generally a type of reflexive regulation. Such regulation has an overall influence on the economic system in a more realistic way. This can be observed by the fact that

the legal acts affect both the systems equally. Thus, the regulations should not only be effective within the scope of legal order but also from the perspective of the economic agents. It is a well-known fact admitted that this theory of social systems gives an interdisciplinary insight of the interrelation between law and economy.

Interdisciplinary Paradigm

The foundationalist and **anti-foundationalist theories** of law and economics contradict each other. This contradiction is related to the historical perspective. The problem is in reality closely connected with the controversy on historical justice in private law. The historical justice has been derived from the notion of the **Aristotelian theory of justice**. He referred commutative justice to market exchange.

The market forces define the price and the **exchange-value** accordingly. Only in case of the collapse of voluntary exchange, the judge determines the price. He does not represent the state but also a kind of justice system which is based on distributive justice. Aristotle rejected the possibility of founding social life on market exchange.

But, Aristotle did not distinguish between society and community – Greek polis was based on interpersonal relations, on friendship rather than on an exchange. The difference between those two types of relationships is based on the assumption that friendship stems from the care about others and not from the self-interest, as in the case of market relations. Therefore the Aristotelian notion of friendship seems like a kind altruistic behaviour, which from the economic perspective may be characterized as irrational or at least unexplainable.

According to Aristotle, there are two basic aspects of the law.

- Firstly, the law has to be seen as a piece of centralized information in the form of a cognitive resource maintaining the expectations about the behaviour of other agents. The nature of law as a cognitive resource is linked to the legal norms and principles communicated in advance and used as a kind of mechanism harmonizing social cooperation. This is what would be called the essence of law, according to the theory of social systems' or the autopoietic theory of law.
- Secondly, the law is an institutionalised normative mechanism which can be used for settlement of disputes, along with being a foundation of social order. The reality of enforcement is not virtual system theory suggests, but rather vicarious. Many legal rules are, in fact, self-imposing and may resemble conventions. The ultimate character of legal sanction gives rise to the law as a unique normative system.

Tony Lawson claims that contemporary economic system is such a deductive system.101 According to its positivistic version the legal system is another kind of normative set of axioms, rules and principles. The normative nature of the economic model is parallel to the notion of a legal one but on the normative level, both systems do not interfere.

Karl Marx and Friedrich Engels

Both, Karl Marx and Friedrich Engels are considered to be the founders of the greatest social and political movement. This movement began in the 19th century and flourished in the 20th century as a political philosophy in Eastern Europe which is the erstwhile Soviet Union and influenced all the decolonised colonies of the world.

Karl Marx propounded the philosophy of Marxism. He is a German-born economic theorist, social commentator, philosopher and revolutionary theorist. Marxism relates to the themes devised by Karl Marx in his works later in his life. He always had the view that society is merely **'superstructural'**, which

reflected the economic base of the society, the class struggle within that society and the interests of the ruling classes.

Marxist philosophy on jurisprudence posits that legal relations are determined by the economic base of particular kinds of society and modes of production. He considers law as an instrument of class oppression that mostly benefits the ruling class while taking away the opportunities from the working or the suppressed class. All this has lead to the belief that capitalism is a very exploitative form of economy. The system where the working class is oppressed and taken undue advantage by the ruling class.

Marx's view of state and law was co-terminus with the understanding of society and social process. Marx synthesised and combined each and every philosophical thought from Aristotle to Hegel. The understanding of the society from the sociological point of view led Marx to pronounce that the desired system should be a Communist Society based on rational planning, co-operative production and equality of distribution and most importantly, liberated from all forms of political and bureaucratic hierarchy.

He stated the money of the state as a Bourgeois concept. He believed that the proletariat has a historical mission of emancipating society as a whole. For him, the law seemed to be nothing more than a function of the economy without any independent existence.

Following are his classification of society into various classes:

1. The Capitalists.
2. The Wage Labourers.
3. The landowners.

He said that the conflict between various classes of society will eventually have to be resolved. The resolution of the conflict will take place in the shape of a

Proletarian revolution. Once this revolution takes place, it will seize the power of the state and transform the means of production in the first instance into State property. He said that the Communist society will have to develop and emerge from a capitalist society and in respects, it is bound to carry with it some marks of capitalist society.

Karl Renner

Karl Renner is an Austrian politician, also known by the name of "Father of the Republic". He led the first government of German-Austria and the First Austrian Republic in 1919 and 1920 and was once again decisive in establishing the present Second Republic after the fall of Nazi Germany in 1945, becoming its first President after World War II (and fourth overall).

He authored **"The institutions of private law and their social functions".** He believed that the Socialists and Marxists have failed to understand that new society as such societies have pre-formed in the womb of the old and that is equally true for the law as well. According to him, the process of change from one given order to another is automatic.

He had a view that the concept of property in terms of Marx did not remain the same in contemporary times. According to him, it was time to rephrase the concept developed by Karl Marx. He propounded that the property whether in socialism and capitalism did not remain as a mere instrument of exploitation rather, the natural forces of change have put property various restrictions upon the property. For eg, the tenants, employees or consumers. However, he also said that the power of property remains the same irrespective of the political character of the state.

Conclusion

The downfall of jurisprudence helped the economic analysis of law to penetrate deep into the legal practice, legal theory and legal education. The traditional Legal theory is in crisis because the contemporary jurisprudential theories attacked by pragmatism give a fragile basis for legislation and adjudication.

A very broadened perspective of law and economics is required, along with realistic assumptions and a rich ontology. These propositions can be fulfilled and applied by using an interdisciplinary approach addressing the question that how law, as well as the economy, can co-exist, how they work within social reality – the reality of complex networks, patterns of exchange, systems of communication.

Within the landscape of the society as a market, we have a free exchange policy, which is based upon the principles such as protection of property, freedom of contract and institutions with their hierarchy, power and common purposes. In reality, the need of the hour is the development of common theory on law and economics, embracing the complexity of mutual relations between market and institutions.

Such an approach should be based on assumptions that legal norms play a dual role in society. On the one hand, they are providing expectations about the behaviour of other agents and thus may form a kind of cognitive resources; on the other hand, the law as enforceable normative system protects rights and physically or conventionally enforces obligations.