THE PRIMACY OF COOPERATION, RATIONAL BARGAINING, AND AN ECONOMIC THEORY OF PART OF THE COMMON LAW

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I. THE PRIMACY OF COMPETITION VS. THE PRIMACY OF COOPERATION

In the first portion of his book, *Risks and Wrongs*,[1] Jules Coleman presents a negative and a positive thesis. He initially criticizes what he calls the "market paradigm," which is a way of understanding moral and legal constraints as parties' rational adaptation to imperfections in competition.[2] He then defends a thesis that the market itself—and presumably other institutions such as norms of corrective justice for tortious wrongs—can best be justified as a rational arrangement for parties who are willing to cooperate with each other for mutual advantage but who do not share a unitary vision of the good life.[3]

The market paradigm, according to Coleman, places competition in a position of primacy over cooperation; cooperative attitudes, which involve non-opportunistic habits and dispositions, are only necessary when the conditions of perfect competition have failed. Coleman views the law-and-economics discussion of institutions that mimic the market when transaction costs are too high for real markets to operate as the legal analogue to the market paradigm in morality. In Coleman's view, this vision reverses the roles of cooperation and competition. The competitive market itself requires a pre-existing willingness of parties to cooperate sufficiently to generate the entitlements that commence competitive processes.[4]

My initial question concerns the role of rationality in Coleman's conception. Coleman clearly wants to defend institutions on the grounds that rational individuals in certain circumstances would choose them. In criticizing the market paradigm,

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1. JULES L. COLEMAN, RISKS AND WRONGS (forthcoming 1992) (manuscript dated July 1991, on file with author; pages cited to manuscript).

2. *Id.* at 54-5.

3. *See id.* at 58-62.

4. *See id.* at 57.

however, he argues that it may be rational for some parties to act in a predatory manner, refusing to confine their competitive activity within a framework of cooperatively-selected entitlements.[5] Perhaps Coleman is building into the circumstances of the choosing parties or the choice situation a "thin" non-prudentially-grounded consensus to refrain from predatory behavior. This effort may be reasonable, but it conflicts with his desire to ground institutions in rational choice alone. Further clarification of rationality's precise role seems necessary.

In any event, placing cooperation in a position of primacy over competition presents a further problem. Coleman's parties are sufficiently heterogeneous that they share little in the way of a vision of a good life. How can such parties reach a consensus, not only to refrain from predatory behavior, but to establish a fair set of entitlements? Having a general, Rawlsian sense of macro-fairness would be insufficient, because entitlements require a mechanism for assigning specific things to specific people. If competitive processes cannot begin until heterogeneous peoples are willing to cooperate with one another sufficiently to agree on a set of fair entitlements, they might never commence.

Fortunately, it is not necessary that parties agree on the fairness of entitlements for competitive processes to begin. The expectation that entitlements will remain stable *is* necessary, however. There is, of course, a certain rhetorical attraction in saying that fairness and stability are not in tension because only reasonably fair entitlements could be reliably stable. It seems equally likely, however, that a requirement that entitlements be subjected to an ongoing fairness inquiry will make the "entitlements" the unstable victims of factional politics.

More fundamentally, the vision of a heterogeneous community[6] choosing a market economy conflicts with historical causation. Heterogeneous communities are notoriously rare and fragile entities. Their existence should not be postulated, but rather explained. One of the main explanations for historical heterogeneous communities has been the prior existence of a market economy. Peoples who previously were entirely hostile to each other became increasingly entangled in trading net-

5. *See id.* at 51.

6. I mean "heterogeneous community" in the sense of people who disagree strongly about the good life but are willing to cooperate with each other.

works. Heterogeneous communities grew from the thin bonds of commonality forged in these networks.

These considerations suggest that the metaphor of cooperation as prior to competition is somewhat misleading. Cooperation among diverse peoples is the desired final outcome. It arises primarily from the prior existence of trading networks, however, which themselves develop because reasonably stable entitlements are in place. The entitlements themselves are probably best viewed in a historical light not as the products of pre-market cooperation, but as the equilibrium of self-interested power struggles.

The important normative question whether to respect entitlements having such unattractive historical roots remains. Here, as elsewhere, the answer depends on the importance of fairness in holdings *relative to* the importance of stable entitlements. My reading of the evidence suggests that as long as the entitlement of self-ownership is maintained, and rights to physical resources are sufficiently diffuse to permit rivalrous markets, striving for stable entitlements promises more gains in terms of both utility and social stability than striving for fair ones.

While this article is not the place to attempt to prove the relative importance of stability vis-à-vis fairness in entitlements, I must stress how much turns on this empirical question. The extant structure of entitlements protects individuals, both as consumers and producers, from monopolistic exploitation. It thus accords individuals the benefits of investing in human capital and becoming as productive as possible. If human beings are inherently unproductive, the libertarian system simply cannot be defended: Entitlements must be continuously revisited to make them more equal.[7] On the other hand, if human productive potential is considerable if not misdirected towards rent-seeking activity, a determinate, traditionally respected, historical structure of entitlements would be one of a nation's most precious assets.

Current events may inform the question whether competi-

7. Of course, some individuals, by virtue of various challenges, *are* inherently unproductive. For this reason, libertarianism cannot be attractive as an exclusive system. Apparently these problems can be handled through general taxation and subsidy schemes, however, so that individual entitlements to individual resources need not be disrupted in any particularistic way. Moreover, if self-ownership truly did reign, the problem of the unemployable would be far smaller than it now appears to be.

tion or cooperation has primacy. In Chile, and to a certain extent in Spain and Portugal, prior authoritarian regimes have respected entitlements long enough to enable tolerant, middle-class communities to evolve. Moreover, what was formerly the Soviet Union provides a test case for Coleman's thesis: a pre-existing community with little in the way of historical private entitlements, seeking to reach sufficient consensus about such entitlements in a heterogeneous society to get a market economy working. One must hope, despite the obstacles, that a genuinely communitarian choice to recognize wholly new, yet stable entitlements is possible.

Perhaps Coleman would not quarrel with my reading of the historical evidence, but would say that the market, once firmly in place, can be defended *as if* it had resulted from the cooperative spirit of diverse people. Coleman's claim that markets are better than other systems at allowing diverse peoples to live together in the same community is valid.[8] No one ever decides that a market society will have a ratio of *X* number of synagogues to *Y* number of churches. As long as we remember where the cooperation comes from and how fragile it is, we need not abandon the metaphor of competition as one part of our cooperative enterprise.

II. A Rational Bargaining Theory of Contract

To contract successfully, parties must identify the prospect for mutual gain, control opportunistic defections, and agree on a division of the gains. Often parties can do so without any affirmative assistance of the state other than aid in protecting pre-existing entitlements. When their own (endogenous) transaction resources prove insufficient, however, Coleman suggests that parties turn to contract law for assistance.[9]

While I have no fundamental problems with Coleman's approach to this issue, I question certain individual aspects of the theory. The first problem concerns the wisdom of broadly incorporating a "division rationality" notion into the mainstream of contract law. In particular, I do not see its relevance to *non-price* contractual terms, which are almost always the ones in dispute. The parties have a mutual incentive to agree on efficient

8. *See* Coleman, *supra* note 1, at 58-62.
9. *See id.* at 118.

non-price terms regardless of their relative bargaining power, because non-price terms confer a different quantum of benefit on one party than they cost the other.

Division rationality seems most relevant when parties have made substantial relationship-specific investments, creating a bilateral monopoly, and now cannot agree on a price term as the contract requires. Rather than refusing to enforce the contract, and thus potentially destroying the value of both parties' investments in the relationship, the courts might seek a theory of the price upon which rational parties should have been willing to agree. Here I agree with Coleman that devising a theory of rational division, if possible, would be better than wholly undermining the parties' agreement by applying an exotic external theory of distributive justice or (as law-and-economics might countenance) tossing a coin to conclude the rent seeking. Such inevitable division problems leave room for the development of Coleman's theory of division rationality.

I also question Coleman's account of *Laidlaw v. Organ*[10] concerning the privilege of nondisclosure. Coleman suggests that the information in question—the coming of the end of the war—was not put to productive use by the parties, even if it was deliberately acquired.[11] Now, purchases and sales that are motivated by information about impending changes of supply and demand often serve the highly productive purpose of moving prices in the correct direction, sending an "early warning signal" of impending scarcities and surpluses to the market. Coleman may argue, however, that in *Laidlaw*, because the information was certain to reach the market very quickly in any event, mistaken economic decisions based upon unrealistic prices were unlikely.

Even on this assumption, however, Coleman still overlooks a productive purpose to speculative trading. People who specialize in acquiring knowledge of impending changes in supply and demand free other, less expert, traders from making their own costly speculative inquiries. Possessing the confidence that the market price reflects the best knowledge of professional traders, and that no realistic prospect of beating the market through one's own search for additional knowledge exists, one will trust the market and spend one's time developing and han-

10. 15 U.S. 178 (1817).
11. *See* COLEMAN, *supra* note 1, at 250.

dling commodities. From society's point of view, having speculative expenses incurred by a few experts, who can make those inquiries at low cost, is better than having duplicative investigations made by an army of amateurs.

One might argue that a rule prohibiting trading without disclosure would deter amateur as well as professional speculation. The prospects for gain from speculation are so great, however, and the likelihood of catching insider trading is so remote, that assuming a legal rule could stamp out speculation is unrealistic. If speculation will occur anyway, it is much better that search costs be incurred by a small number of professional speculators than by a lengthy parade of amateurs duplicating each other's efforts.

One might ask whether efficiency conflicts with morality in the nondisclosure area. This criticism is particularly pertinent given Coleman's thesis that markets build ties among diverse peoples; markets cannot serve that function if fraud-like behavior is sanctioned. The fact that we can turn nondisclosure cases into affirmative fraud cases with little effort illustrates the severity of the problem. In *Laidlaw v. Organ*, for example, the seller asked the buyer whether he knew anything that might affect the price of tobacco; it was not clear what, if anything, the buyer said in reply.

One possibility, of course, would be to draw a sharp distinction between nondisclosure and affirmative deceit, perhaps akin to the tort distinction between omissions and actions. Whether such a sharp distinction can be maintained is unclear, however, because some nondisclosure cases (the seller's failure to disclose the known existence of termites in the house or the opening of a local toxic waste dump) involve conduct that seems very close to lying.[12]

It may be more helpful to focus on the fact that lying is wrong for much the same reason that Professor Fried argues that breaking a promise is wrong: It deliberately flaunts a convention that is designed to give the other party grounds to rely on what one has said.[13] This approach would create the possibility of arguing that nondisclosures, and perhaps even false answers to certain kinds of "forcing" questions, would not be

12. I discuss these issues in Christopher T. Wonnell, *The Structure of a General Theory of Nondisclosure*, 41 CASE W. RES. L. REV. 329 (1991).

13. *See* CHARLES FRIED, CONTRACT AS PROMISE 14-17 (1981).

fraudulent if in context they were consistent with accepted convention. For example, parties to negotiations may understand that a statement like "This is the highest offer we can possibly make" is not to be relied upon but is offered for strategic reasons, perhaps signalling that one party is in fact nearing that highest offer.

This position raises a host of moral and practical problems. Is telling a lie in response to probing questions really moral if the lie is in fact consistent with convention? We are familiar with this mode of thinking in informal personal matters; many people would say it is acceptable to tell a person who asked directly what one thinks of their shoes that they look fine, even if one believes they leave much to be desired. To apply such reasoning to statements comprising the basis of people's undertaking of large financial commitments, however, is quite different.

Moreover, how do we know when such a convention of tolerating particular types of nondisclosures or false statements exists? If speculative trading has the efficient properties identified above, it would not be unreasonable for tobacco merchants to have such a convention; but is affirmative proof of the convention, or merely proof of the practice's efficiency, required? These are important questions worthy of further study.

A final point concerns the connection between Coleman's rational bargaining theory of contract law and his top-level political theory. At the highest level, Coleman's rational, heterogeneous, but cooperative parties are supposed to act in a way that satisfies not only collective rationality (Pareto optimality), but individual rationality as well. In other words, Coleman wants his parties to move not only toward the Pareto frontier, but in a northeasterly path toward that frontier—that is, through Pareto-efficient moves.

Whether contract law can achieve Pareto-efficient movement is unclear. A contract may benefit both parties to the transaction, but it generally harms competitors of those parties. Of course, most contracts do not abridge third party *entitlements*, but the Pareto criterion concerns welfare, not entitlements. Third parties probably lose less than the participating parties gain, because the resources are in higher valued uses, in at least a Kaldor-Hicks sense, and probably a utilitarian sense. This result is not the same thing as Pareto efficiency, however.

It is possible that contract law, considered as a stable, long-term institution, would promote Pareto efficiency, in that all parties would benefit more on balance from being contracting parties than they would lose on balance from being competitors. This assertion, however, requires some strong assumptions about the absence of repeated losers from this process.

Perhaps a more compelling argument, especially given Coleman's desire for stability in a heterogeneous society, would note that the parties themselves generally benefit from contracting, and that these are the people in physical contact with each other. The losses to competitors are not generally part of exploitative personal relationships between competitors and thus do not represent the same threat to stability that losses that are the product of direct interactions would involve.

III. An Economic Theory of Part of the Common Law

The last subject I will address concerns the bifurcation between one part of the common law—contracts, which Coleman defends on economic grounds, and another part—torts, minus products liability, which he defends on grounds of corrective justice.[14] The intuition to bifurcate private law into economic and noneconomic realms may in fact be sound, but Coleman's explanation does not quite capture the rationale for such a distinction.

Generally following Hart, let me distinguish between "primary" rules that define and protect basic entitlements and "secondary" rules that create optional legal forms that parties may choose to use or refrain from using with those entitlements.[15] Could one want a non-economic theory of basic entitlement rules—including property, nonconsensual torts, and crimes—but an economic theory of rules regarding the optional use of entitlements—including contracts, corporations, partnership, wills, and consensual torts?

Economic theory seeks to minimize aggregate costs, and its conclusions are thus contingent on outside empirical assessments, which are subject to change. The fact that these empirical assessments are made from "outside," however, seems inconsistent with the relationship between autonomy and enti-

14. *See* Coleman, *supra* note 1, at 291-303.
15. *See* H.L.A. Hart, The Concept of Law 89-107 (1961).

tlements. Moreover, the fact that empirical assessments change frequently is inconsistent with the ongoing security that the notion of an entitlement seems to embody.

Perhaps, then, one might argue that basic entitlements should *not* depend upon ongoing empirical assessments of costs and benefits. This position might be defended on libertarian or utilitarian grounds. In the libertarian conception, entitlements represent space for the pursuit of projects of value to individuals, together with a state commitment to official neutrality with regard to the value of these projects. Adjusting the boundaries of the entitlement based upon state officials' latest thinking regarding the costs and benefits of alternative projects is the antithesis of this neutrality.

From a utilitarian perspective, boundaries that move with new empirical assessments create perverse incentives. Parties will seek the rents available by convincing public officials to move the lines. They will not undertake investments based upon their expected value, but rather upon a prediction of the likelihood of still having that value on their own side of the entitlement line when it comes time to reap the rewards.

Enabling or "secondary" rules do not represent this type of conflict between entitlements and economic thinking. Public cost-benefit analysis might serve both contracting parties, who can adjust the price term so that both parties benefit more with the public rule than without it. If government's moral assessments of the nature or value of an individual's projects, or its empirical assessments of the means needed for their success, are seriously wrong, the rules can be varied by express agreement. As long as consent trumps public cost-benefit assessments, entitlements and efficiency need not conflict.

Let me compare this account of the division between an economic and a noneconomic part of the common law with Coleman's account. Coleman objects that an economic approach to tort law would suggest that negligently injuring another is morally acceptable as long as one is prepared to pay the quasi-market price.[16] He also suggests that an economic theory might

16. This actually misinterprets the economic theory although some economists may have made the same mistake. If we *know* that particular conduct is negligent in a cost-benefit sense, economic theory would not call for "pricing" it but rather for imposing sanctions sufficient to eliminate it. Prices are used for activities that may indeed be cost justified to a certain degree if they remain profitable after bearing their full social cost. Some conduct that courts see as "negligent" may fit this description.

entail a broad *ex post* search for the cheapest cost avoider, who might have had no historical role *ex ante* in causing the accident. Coleman argues that the structure of tort law—in which injurers, but not others, have moral reasons to respond to the consequences of their wrongs—is more compatible with a corrective justice than an economic theory of tort law.[17]

Understanding how Coleman's theory of torts can be squared with an admittedly economic approach to contract law is difficult. Certainly the structure of the litigation is the same: The contract breacher—not others—has moral reasons to respond to the consequences of the breach. Moreover, a moral intuition tells us that breaching a contract is wrong in a way that the payment of damages does not make right. This intuition parallels Coleman's similar sentiments regarding tort law.

One might think that the doctrine of "efficient breach" argues for a contrary conclusion. That doctrine only makes sense when viewed as a gap-filling rule that is part of the contractual entitlement itself. As our intuitions about the efficient breach doctrine are sufficiently mixed, I doubt many people would defend the doctrine in a case where the parties explicitly negotiated a clause providing that "damages are not an adequate substitute for performance and the doctrine of efficient breach is to have no role in interpreting this contract." In discussing torts, Coleman moves the property-liability rule distinction to the definition of the underlying entitlement;[18] the doctrine of efficient breach, which raises the same distinction, deserves similar treatment.

To summarize, Coleman's explanation does not effectively differentiate between contract and tort law. There is no difference between the law's fundamental approach to a contractual entitlement *once it is defined* and to a tort or property entitlement. Both types of wrongs seem to call for something like corrective justice. The difference is that economic considerations are intimately involved in defining a contractual entitlement. The parties themselves are engaged in economic thinking and the court, to interpret their language and to fill gaps, must be willing to do the same. By contrast, whether economic considerations should define the nature of the basic entitlements we have in property and tort law is unclear.

17. *See* COLEMAN, *supra* note 1, at 512-514.
18. *See id.* at 457-65.

Does Coleman want to keep tort law entitlements free from broad public assessments of costs and benefits? Conflicting evidence exists as to this question, but Coleman's previous writings suggest that he is not comfortable with an Epstein-like strict liability approach.[19] In *Risks and Wrongs*, however, he does discuss "wrongs" that are mere infringements of a right, even if cost-justified in the circumstances. This analysis seems limited to the rare necessity cases such as *Vincent v. Lake Erie*,[20] although the reason for such a limitation is not clear. Coleman also notes that a negligence approach is equivalent to imposing strict liability on the victim, and that it is important not to analyze tort law in a manner similar to criminal law—where personal culpability is more central—because someone must bear the loss. Coleman should clarify why these considerations do not lead to a strict liability approach.

In any event, one might ask whether keeping tort law entitlements free from public assessments of costs and benefits is desirable. The ability to define those entitlements in liability-rule terms suggests that this approach may be practical, because clearly cost-justified activities need not be abandoned if their inevitable encroachments are protected by liability rules only.

A more expansive use of liability-rule entitlements might enable the tort system to accommodate economic concerns without compromising basic entitlements. Additional work in this area is necessary, but some suggestions for reform would be helpful. For example, the contributory negligence defense probably should only be employed if the defendant is willing to compensate the plaintiff for the costs of whatever self-protective actions the plaintiff should have taken. Also, forms of damage (emotional distress, for example) that rational parties would normally not insure against, should be disallowed in tort cases only where the plaintiff is awarded a sum that a contract would have granted her for assuming the risk of such losses.

The administrative costs of such a scheme might be sufficiently high that people would prefer to accept a convention whereby they tolerate being the uncompensated victims of non-negligent accidents to avoid the horror of litigating their own non-negligent rights infringements. If this were in fact the case, I would believe that entitlements had been sufficiently

19. *See* Richard A. Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151 (1973).
20. 124 N.W. 221 (Minn. 1910).

respected. As with the nondisclosure and deceit issue discussed earlier, however, demonstrating the general acceptability of such a convention is difficult.

Moreover, if a convention to tolerate certain rights infringements is only a product of the administrative costs of the tort system, non-tort alternatives that would enable entitlements to be more fully vindicated might exist. Thus, it is probably better for judges to state that entitlements are being defined non-economically. If such entitlements are only being vindicated in cases of wrongdoing, the courts should acknowledge openly that the administrative costs of a tort system (to which there might be superior institutional alternatives) are primarily responsible.