

# Libertarianism, Law and Economics, and the Common Law

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Libertarian legal theory has long had admiration for, but also distrust of, the common law and law and economics. This distrust is partly methodological. Libertarian legal theory has traditionally been deontological and normatively-oriented, typically grounded in natural rights theory and reasoning to normative statements about the content of the law. Law and economics, by contrast, purports to be a positive theory of the common law foremost, while providing a normative justification for the common law as well (namely, social wealth maximization as a normative value). Indeed, it is this primarily positive thrust of law and economics that accounts to a large extent for its influence on legal thinking, while its normative arguments have been much more heavily contested.

To be sure, there is a long and deep affinity between libertarianism, law and economics, and the common law—libertarians clearly appreciate the pivotal historical importance of the English common law in the historical emergence of a free and commercial society. Moreover, in the vast run of cases—including issues such as the enforceability of contracts and the basic value of clear property rights—libertarian philosophy, law and economics, and the common law converge on similar results. Still, I submit that libertarians remain wary of the pragmatism and contextualism that historically has defined common law reasoning. Moreover, conflicts occasionally do arise between libertarianism on the one hand, and the common law and law and economics on the other.

At the outset, I note that for purposes of this essay I will generally use the common law and law and economics interchangeably. This is not because I think that they are actually interchangeable—they are not. In this essay, however, I am going to focus on those issues where it seems to me that the common law deviates from libertarian theory (or where libertarian theory provides indeterminate answers) but the result can be explained as being consistent with law and economics principles, such as the doctrine of

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necessity. This is not to say that there are other areas in which common law doctrine deviates from economic analysis but is consistent with libertarian theory (I am not aware of any), or where the common law deviates from both economics and libertarianism (such as perhaps modern liability law). It is just to focus on those areas of disagreement between two different approaches to law.

To be sure, the generalized descriptions I attach to the competing approaches paint with a broad and crude brush—I hope that those who know me and my work will grant that I have deep sympathies for both approaches to the law, and I have no agenda or desire to misrepresent either. Indeed, to some extent this essay is autobiographical, charting the course of a libertarian who came to embrace the common law and law and economics. This essay describes the kind of questions that prompted my gradual conversion, and in those particular situations where they conflict, I place more faith in the common law and law and economics than philosophical libertarianism and its implications. So while one may in the end contest the frameworks that I have constructed around these two competing visions of law, be aware that these are *my* constructs in the sense that I am an advocate for neither but rather a somewhat disinterested answer-seeker about the world. I have no agenda, other than to come up with the system of law that I think is most conducive to coordination and human flourishing in society.

#### I. LAW AND ECONOMICS V. LIBERTARIANISM IN A WORLD WITHOUT TRANSACTION COSTS

##### A. Law and Economics

Consider a common hypothetical that illustrates differing approaches to legal questions. A factory operates upstream and is the world's sole manufacturer of a children's vaccine that saves, say, one million children worldwide every year. Assume we estimate that the value to "society" of this vaccine is \$1 billion. Downstream lives an old man we will call Mr. Montgomery Burns. Assume that one day each year, the vaccine manufacturer releases a byproduct into the stream that causes a mild smell if Mr. Burns happens to be outside overlooking the stream that day. Let us also assume, then, that Mr. Burns suffers \$100 of harm on average each year from the manufacturing process. Mr. Burns comes into court and sues to enjoin the factory's operation. What should the court do?

The court has two different choices to make. First, it must ask whether the factory is liable to Mr. Burns—in other words, who holds the property right, Mr. Burns to use the water for his aesthetic enjoyment or the factory to produce vaccines for children? Note that I am aware that I have stacked the deck in favor of the vaccine to challenge the common assumption that it is obvious that one might assign the property right to Mr. Burns in this case. Second, if the factory is liable, the question becomes whether Mr.

Burns should be able to enjoin the operation of the factory or whether Burns should be able to simply get damages for the harm he suffers.

Now, one way to get at this answer would be to simply look at other similar cases from the past and apply the precedent to the case and determine whether liability should lie. Assume it does and assume that this gives Burns the right to sue for an injunction and shut down the plant. “So be it,” the classic common law lawyer might say, if that is what precedent mandates. But the mere statement of fact that the common law holds this result is not entirely *normatively* satisfying without some justification for that result.

One justification of the common law rule would be to simply defer to the wisdom of the common law process as having some meta-justification, and thus, justifying the rule itself by reference to the normative justification of the common law superstructure that produces the rule. This is essentially the line of justification pursued by the historical school of jurisprudence associated with thinkers such as Henry Maine<sup>1</sup>, Savigny<sup>2</sup>, and Carlton Kemp Allen.<sup>3</sup> Most notably for current purposes, this justification of particular common law rules by reference to the normative common law process is fundamentally the mode of justification offered by Hayek in *Law, Legislation and Liberty*.<sup>4</sup> Hayek’s argument essentially tracks that of the historical school but with a normative justification: he argues that the common law is a benevolent spontaneous order, and as such, the normative justification resides in the tacit knowledge and unarticulated wisdom embedded in the legal doctrines produced by the evolution of the common law.<sup>5</sup> The justification for individual rules, therefore, lies not in each rule’s individual merits as justified by reference to some normative external benchmark (such as “efficiency” or “egalitarianism”), but rather to propensity of the common law system itself to produce rules that benefit those living within the relevant society to further coordination among them. Moreover, Hayek views the relevant level of selection for common law rules as being at the level of *group selection*—the overall system of rules—not individual selection of particular rules.<sup>6</sup> Each of the individual rules of the common law are interlaced and enmeshed with numerous other rules and sets of private expectations and private orderings that have grown up around those rules. At root, Hayek suggests that rules demonstrate their normative merit through their survival properties: rules co-evolve within some overall order of rules that are subject to a quasi-Darwinian process of

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1 HENRY SUMNER MAINE, *ANCIENT LAW* I (1920).

2 FRIEDRICH KARL VON SAVIGNY, *VON SAVIGNY’S TREATISE ON POSSESSION* (Sir Erskine Perry trans., Lawbook Exchange 6th ed. 2003) (1848).

3 CARLETON KEMP ALLEN, *LAW IN THE MAKING* (Oxford Univ. Press 6th ed. 1958) (1927).

4 See generally FRIEDRICH A. HAYEK, *LAW, LEGISLATION AND LIBERTY, VOLUME 1: RULES AND ORDER* (Univ. of Chicago Press 1983) (1973).

5 Todd J. Zywicki & Anthony B. Sanders, *Posner, Hayek, and the Economic Analysis of Law*, 93 IOWA L. REV. 559, 581–83 (2008).

6 *Id.* at 583–84.

selection.<sup>7</sup> Common law rules that have evolved from this process of selection can be assumed to have valuable survival properties demonstrated by the relative prospering of the groups that have adopted them and have thus stood the test of time. Therefore, one could pursue a normative justification for common law rules by following this line of argument; however, that is not the one I will pursue here.

A legal realist might say, “Woah, see, here is the problem. The common law kills children. We need to update the common law to keep up with the times. The Court should take into account social values, yada, yada, yada, and if it decides it is best for Burns to suck it up, then so be it. Perhaps the justification is economic or Rawlsian or whatever, but children’s vaccines are more important than a selfish old man having to smell an unpleasant aroma once a year.” This attitude appears to be the prevailing ethos among many judges beginning with the New Deal and continuing today.<sup>8</sup> However, this article is not addressed to this question either.

The law and economics approach to the problem, à la Coase, is now well understood. Coase says that in a world with low transaction costs, it really does not matter how the rights are initially allocated as to whether the vaccine factory will remain in operation or not.<sup>9</sup> Assume you give the property right to the factory to pollute. In that case, social wealth is maximized and aggregate efficiency is maximized because using the stream to manufacture the vaccine is worth much more than Burns’ inconvenience. Assume you give the right to Burns to prohibit pollution—does that mean the plant will cease operation and kids will die? No. Why not? Because if the operation of the plant generates a value of \$1 billion, and Burns suffers only \$100 of harm, then in a world without transaction costs (i.e., where parties can easily bargain and contract), the factory will be willing to “buy” the right to pollute from Burns for some price between \$101 and \$1 billion, and then pass along the cost to those who buy the product. The end result will match social efficiency—the stream will be used for the production of the vaccine—regardless of whether the initial property right is given to the factory or Burns. Under either initial allocation of the right, the end result is the same—the vaccine is made—regardless of whether the judge applies precedent or tries to advance “social justice.”

## B. Libertarianism

What about the libertarian approach? I will draw on Murray Rothbard as an exemplar of the standard libertarian perspective, which is a natural rights approach to property rights.<sup>10</sup> Rothbard is particularly useful in that

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<sup>7</sup> *Id.* at 585–86.

<sup>8</sup> *See, e.g.*, James E. Krier, Book Review, 122 U. PA. L. REV. 1664, 1668–69, 1694 (1974) (reviewing RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (1972)).

<sup>9</sup> *See generally* R.H. Coase, The Problem of Social Cost, 3 J.L. & ECON. 1 (1960).

<sup>10</sup> Murray N. Rothbard, *Law, Property Rights, and Air Pollution*, 2 CATO J. 55, 57 (1982).

his argument was made as a direct counterargument to the prevailing Chicago School of Law and Economics' arguments of the time, including Coase.<sup>11</sup> Rothbard makes several arguments in response to the Chicago School argument. Part of Rothbard's critique is not expressly libertarian, such as the observation that wealth effects might matter. Part of Rothbard's critique is that Mr. Burns might have subjective value that should be protected—perhaps he really cares more about not having to close his window one day per year than all of the lives that are saved through manufacturing children's vaccines. Rothbard notes that if these are serious concerns—and they undoubtedly are—then they undermine the strength of the claim by standard law and economics scholars to know how to best allocate property rights to one party or the other.

But so far Rothbard's argument merely deconstructs that of standard law and economics. Rothbard, and the libertarian, must offer a competing rule for allocating property rights and liability in this case. Rothbard offers the principle of physical invasion as his competing normative theory:

The normative principle I am suggesting for the law is simply this: No action should be considered illicit or illegal unless it invades, or aggresses against, the person or just property of another. Only invasive actions should be declared illegal, and combated with the full powers of the law. The invasion must be concrete and physical. There are degrees of seriousness of such invasion, and hence, different proper degrees of restitution or punishment. "Burglary," simple invasion of property for purposes of theft, is less serious than "robbery," where armed force is likely to be used against the victim. [Here], however, we are not concerned with the questions of degrees of invasion or punishment, but simply with invasion *per se*.

If no man may invade another person's "just" property, what is our criterion of justice to be? There is no space here to elaborate on a theory of justice in property titles. Suffice it to say that the basic axiom of libertarian political theory holds that every man is a self-owner, having absolute jurisdiction over his own body. In effect, this means that no one else may justly invade, or aggress against, another's person. It follows then that each person justly owns whatever previously unowned resources he appropriates or "mixes his labor with." From these twin axioms—self-ownership and "homesteading"—stem the justification for the entire system of property rights titles in a free-market society. This system establishes the right of every man to his own person, the right of donation, of bequest (and, concomitantly, the right to receive the bequest or inheritance), and the right of contractual exchange of property titles.<sup>12</sup>

From these basic premises of "just" property ownership derived from the principle of self-ownership, Rothbard goes on to derive a number of corollary conclusions. For example, he denounces the law of defamation and the common law right to privacy as restricting the principle of freedom of speech with no countervailing physical invasion.<sup>13</sup> Moreover, Rothbard

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<sup>11</sup> *Id.* at 57–58.

<sup>12</sup> *Id.* at 60–61.

<sup>13</sup> *Id.* at 62.

(like most libertarian theorists) also concludes that libertarianism requires that the principle of strict liability be followed rather than negligence.<sup>14</sup>

But having staked out an absolutist position, Rothbard soon retreats a bit. For example, he asks, why is it that the invasion of one's property by radio waves does not constitute an actionable nuisance? The reason, he argues, is that these boundary crossings of invasion by radio waves

do not interfere with anyone's exclusive possession, use or enjoyment of their property. They are invisible, cannot be detected by man's senses, and do no harm. *They are therefore not really invasions of property, for we must refine our concept of invasion to mean not just boundary crossing, but boundary crossings that in some way interfere with the owner's use or enjoyment of his property. What counts is whether the senses of the property owner are interfered with.*<sup>15</sup>

He thus concludes,

[s]o we see that the proper distinction between trespass and nuisance, between strict liability per se and strict liability only on proof of harm, is not really based on "exclusive possession" as opposed to "use and enjoyment." The proper distinction is between visible and tangible or "sensible" invasion, which interferes with possession and use of the property, and invisible, "insensible" boundary crossings that do not and therefore should be outlawed only on proof of harm.<sup>16</sup>

Moreover, Rothbard goes on to acknowledge that when it comes to actions for nuisance for noise, property owners do not have a right to be protected from all noise but instead may be protected only from *excessive* noise.<sup>17</sup> Those who have a special desire for quiet, Rothbard observes, must build their own soundproof room.<sup>18</sup> He also would permit high-flying airplanes to violate the airspace above one's home so long as they do not fly too low or too loudly to unreasonably disturb the landowner.<sup>19</sup>

By this time, Rothbard has drifted quite far from his initial premise that any physical invasion of land is an abatable nuisance and anything else is not actionable. In particular, at this point it is not clear what work the concept of "physical invasion" is doing at all in his model—he has provided no explanation for why *physical* invasion is different from any other sort of interference with quiet use and enjoyment. Thus, despite his best efforts to avoid Coase, Rothbard has in fact implicitly come to concede the core premise that underlies the Coase Theorem—that what matters are incompatible and competing uses of scarce resources, and as a result, costs are reciprocal. It is only because *both* parties want to use the same scarce resource that incompatible uses arise. And those costs, broadly defined, arise *only* within a social context. Robinson Crusoe has no need for a law

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<sup>14</sup> *Id.* at 64–68.

<sup>15</sup> *Id.* at 81 (emphasis added).

<sup>16</sup> *Id.* at 82.

<sup>17</sup> *Id.* at 83.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 84–87.



of tort, contract, or property. The need for law arises only when incompatible uses arise. Where resources are not scarce as an economic matter, there is no need for property rights or other laws. So if, for example, Mr. Burns did not live downstream or the vaccine factory did not operate upstream, then there would be no nuisance. Nor would nuisance arise if, for example, Mr. Burns only had a normal, and not a highly sensitive, sense of smell. Should it matter to whether the factory should be liable that Mr. Burns' sense of smell is unusually sensitive? For if the vast majority of people lived in his house, there seemingly would be no nuisance under Rothbard's own terms. It is only because of the *combination* of Mr. Burns and the factory that the need for a liability rule arises. And yet Rothbard's simple rule of physical invasion seems to say little about whether the proper rule would be to essentially tell Mr. Burns to close his window one hour a year or the vaccine factory to board up shop.

Despite his best efforts to articulate simple bright-line rules, Rothbard's clear rules inevitably collapse under the weight of a multitude of *ad hoc* exceptions. But the myriad of exceptions illustrates the central problem—it is precisely the problem of incompatible uses that gives rise to the need to define property rights in the first place. And in the end, it seems he has to resort to redefining the principle of physical invasion to exclude radio waves. But it is not clear why physical invasion would not include invasion by radio waves but would include invasion by a tasteless, odorless, colorless liquid dumped into a stream. If the problem is incompatible uses among *people* then there is no obvious reason (as Rothbard implicitly admits) that it must be intrinsically tied to particular parcels of land or that the concept of physical invasion takes on some particular normative primacy.

Of course, Coase and his followers offer one solution to this dilemma—where transaction costs are low, it does not matter in which party the property right is vested. Once allocated, they can then bargain to an efficient allocation of rights. Moreover, forcing the parties into a market transaction also has the benefit of protecting subjective value. If Mr. Burns really does favor the ability to be free of all smells at all times, then in theory he would be willing to out-bid the desires of the vaccine manufacturers and its customers to bring that result about.

## II. LIBERTARIANISM VS. LAW AND ECONOMICS IN A WORLD WITH POSITIVE TRANSACTION COSTS

The real issue then becomes, “Well what about those situations where transaction costs are not negligible, and as a result, the initial allocation of rights *does* or *might* matter because the parties will have difficulty contracting around the rule established by the court?” Then you must have some way of deciding how to allocate rights and how those rights are enforced by the parties.

Consider, for example, a situation where transaction costs are high. In the case of *Ploof v. Putnam*, the plaintiff went sailing on a lake with his wife and two children and was caught in a sudden and unexpected storm.<sup>20</sup> Plaintiff came up to defendant's dock to escape the storm and tied up his boat to the dock. An employee of defendant unmoored the boat, and it drifted back out to the lake where it was destroyed by the storm. Plaintiff and his family were cast into the lake and injured. Plaintiff sued for damages for the injuries sustained and the destruction of the boat. Who wins? Plaintiff wins—defendant was required to allow the plaintiff to tie up his boat. The cost to the defendant of preventing the wreck was small while the boat was quite valuable. So the ruling is that defendant was required to allow plaintiff to tie up his boat, and plaintiff would be liable for any damage caused by the boat to the dock.

Now if you are a Rothbardian libertarian then presumably you would say, "Hey, the dock is defendant's property and he can do whatever he wants and plaintiff has no right to tie up his boat." And if you have been paying attention you might say, "Hey it does not matter whether plaintiff has the right to tie up to the dock, because even if he doesn't he can enter into a contract with the dock owner to 'rent' the dock for the duration of the storm." But what is the problem with that view? Here transaction costs may be high, not low. The boat is in an emergency situation and defendant has plaintiff over a barrel. Defendant may use that leverage to drive a hard bargain with plaintiff. Now note that there is nothing wrong with that—the initial cost of the boat is a sunk cost (so to speak) and now the bargaining range is between the rental price of the dock and the total value of the boat, and as a result, there seems to be nothing more than a wealth or distributional effect here, not an efficiency effect. So if the dock owner drives a hard bargain and makes money, there is nothing necessarily wrong with that.

So why does *Ploof* say that the boat owner essentially can "take" the dock for the duration of the storm and pay compensation for it? Because the bargaining process itself may be expensive. The time and energy that the parties spend bargaining over the division of spoils may be expensive and result in delay that could prove harmful to the ship or its crew. In the end, hard-bargaining by both parties might lead to a bargaining breakdown in which the ship itself does not get tied up in time and as a result is pushed out to sea and destroyed. For example, the parties just might not reach an agreement. Or the dock owner might decide to invest in a reputation as a hard bargainer and be willing to lose a bargain in this situation in order to capture a larger surplus in the future.

The key concern that implicitly underlies the ruling is that the transactional context is a bilateral monopoly situation that converts this from a positive-sum market transaction to a zero-sum or even negative-sum

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<sup>20</sup> *Ploof v. Putnam*, 81 Vt. 471 (1908).



rent-seeking transaction. The two parties are using real resources—their time and energy—bargaining over the division of the spoils within a bilateral monopoly context—they are not bargaining for an efficiency-enhancing transaction.

So what law and economics scholars suggest is that in situations such as this one, where transaction costs are high, the law should try to *replicate* the bargain that the parties *likely would have struck* had they been able to sit down and bargain out the terms, but are unable to do so because of the high transaction costs. And we expect that absent transaction costs, the bargain would have been that plaintiff could tie up at the dock but would be required to compensate the dock owner for any damage that the boat ended up doing to the dock. To be sure, we do not and cannot know for sure what the parties would have done, but there is strong intuition that this would be the result.

Does this mean on a perfectly sunny day you can just pull up to some guy's dock and tie up and then force him to sue you for rent for using his dock? No. In that situation you have to bargain between yourselves and reach a voluntary deal. Why—what is the difference? In this situation you are not in distress and you could conceivably tie your boat up somewhere else, so there is no need to use this particular dock.

So note the insight of law and economics here—it ends up operating as both a positive and a normative theory. First, as a positive theory, it purports to correctly explain what the law actually *is*—the law of necessity operates as an exception to the general rule of property and tort that your property is yours to keep. It also purports to explain, as a positive matter, the limits on the rule—you can do this only if you are in duress and need to do it as a matter of necessity. If the parties *can* bargain with some degree of ease, then they *must* bargain. Moreover, law and economics offers a normative justification for the rule. The law is trying to cut through the waste of resources that could arise from either a complete bargaining breakdown (from the boat being wrecked) or the rent-seeking costs of bargaining over a purely distributional issue. So it is asserted that we maximize social wealth and interpersonal coordination by replicating the bargain the parties would have struck (applying the logic of the Coase Theorem) and simply use the force of the law to involuntarily “force” the parties to act *as if* they had voluntarily entered into that transaction.

To be sure, there are potential costs from this “hypothetical bargain” approach, and thus, one should be cautious about invoking it. One potential cost is that there might be efficiency concerns as well as distributional concerns. For example, it might be the case that docking slips are scarce, in that there are more boats needing to be docked than docking slips available, in which case *Ploof* essentially creates a “first come, first served” rule for allocating the docking slip. As a result, it is possible that a more valuable boat might come along later and would be willing to pay a higher price for the docking slip than the first boat that arrives. But it turns out that even if

this were to occur—a big if, of course, in the face of a brewing storm—it is not clear that this is an effective rejoinder to the doctrine of necessity rule. For just as the first boat owner and dock owner could bargain (but might not because of the transaction costs and bilateral monopoly situation), the second boat owner equally could bargain to “buy” the right to dock from the dock owner and first boat owner. True, the bilateral monopoly problem could arise again, but that is not fundamentally different from the original problem that was presented.

A second objection might be that the dock owner could have subjective value about his dock and leasing it to this individual. While that is possible, and subjective value might be present in more situations than is conventionally thought,<sup>21</sup> in this case, the likelihood that the dock owner has serious subjective value is low, and even if he does, it seems unlikely that the subjective value is large.

Third, there might be a moral hazard problem. But one suspects that it is probably small as well. It is possible that at the margin, boat owners as a class will be slightly less careful about checking the weather or braving ominous weather in a world where the doctrine of necessity exists. However, it is difficult to believe that this incentive effect for moral hazard will be large if the boat owner is required to compensate the dock owner for the fair usage of the dock and any damage caused. Moreover, the alternative rule might, at the margin, encourage *overprecaution* by boat owners—if they know that in the face of a storm they run the risk of paying a monopoly price for the right to dock their boat in a storm, then boat owners may avoid taking out their boats when the weather is hardly threatening at all.

All of these objections crystallize a larger potential objection to the common law rule: the law and economics analysis of this situation rests on a series of armchair empirical assessments. In particular, law and economics is assuming on one hand that the potential cost of rent-seeking, which arises from bargaining under the potentially high-transaction cost environment of a bilateral monopoly situation, is high and that under these narrow situations the benefits of channeling interactions through voluntary market exchanges is relatively low. Forcing the parties to bargain expressly will protect subjective value and might address the problem of efficient allocation of resources; however, the potential for waste of resources and potentially even a complete bargaining breakdown are thought to warrant invocation of the doctrine of necessity in circumscribed circumstances.

Now consider the flip side of *Ploof*—a situation where the parties enter into a voluntary transaction but it nonetheless is not enforceable. The case is *Alaska Packers v. Domenico*.<sup>22</sup> Here are the facts. The year is 1900.

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<sup>21</sup> See Todd J. Zywicki, *A Unanimity-Reinforcing Model of Efficiency in the Common Law*, 46 CASE W. RES. L. REV. 961 (1996) (discussing the ubiquity of subjective value).

<sup>22</sup> *Alaska Packers' Ass'n v. Domenico*, 117 F. 99 (9th Cir. 1902).

The company charters a salmon fishing vessel and has just made a huge capital investment in building a big salmon cannery factory up in Alaska. The way the industry works is that the salmon fishing season is only a couple of months long, so all of the salmon must be caught during that time. Then the fish are delivered to the cannery for smoking and packaging, which need to be done within a short time after the salmon are caught. The salmon company, of course, is counting on the salmon harvest to provide them with the revenues to pay off the cannery. If the salmon do not come in, then the investment in the factory will be squandered.

The company hires a crew of fishermen in San Francisco before the season actually starts. They get on the boat and cruise up to Alaska to start fishing. Once the fishermen get there they make a demand—we are not fishing any more unless you give us a raise (the actual facts are actually more interesting but asking for a raise basically captures the essence of the demand). In response to this demand, the captain of the boat originally refuses, but after the fishermen stay on strike the captain finally relents. The fishermen then go back to work and finish out the season. The fishermen return to San Francisco at the end of the season and the owner of the company pays them only what they were *originally* contracted to be paid, not the modified deal for double salary. The fishermen sue, saying that they had a valid contract for the higher wage rate.

What is the holding? Fishermen lose. Why? Well, the common law doctrine is the “pre-existing duty rule” which says that once you contract to do something, you cannot then refuse to do what you contracted to do unless the other side gives you more money (what we call “consideration”). Now this doctrinal resolution in and of itself begs the real question, which is “why” does it matter whether the party gives additional consideration? And if you take a rights-based approach of “enforce contracts” it is not obvious which of the two contracts to enforce—the first one or the second modified one? Both were freely consented to.

One might try to argue that the second contract was invalid because there was a lack of free consent by the employer—essentially that the modification was extracted under duress. But, of course, this argument amounts merely to an effort to escape the conundrum by way of *ipse dixit*—by simply defining the second contract to be invalid or caused by duress. In fact, the second contract was not formed under what common law would consider as duress. A mere threat to breach a contract does not constitute duress to the non-breaching party. Otherwise, every time an employer provided a raise to an employee who was considering leaving to take another job at higher pay, it would constitute duress. Moreover, there simply is no reason why parties cannot voluntarily agree to enter into a contract but then also voluntarily agree to modify the contract later if the relevant information about the world changes.

Law and economics, however, provides a mechanism for understanding why the court’s decision in *Alaska Packers* makes sense

(leaving aside the hoary fiction of the pre-existing duty rule). For *Alaska Packers* is essentially *Ploof* in reverse, and the proper answer is also *Ploof* in reverse. What is the difference between the stormy day and the sunny day in the *Ploof* scenario? On the sunny day, we make you bargain because if you do not like the first guy's deal, you can go to the next dock and ask to tie up there. Both dock-owners and boat-owners are interacting in what is basically a competitive market with substitutes available for both sides. On the stormy day you cannot, so we invoke necessity to "force" a bargain. Here it is the opposite. Why do we treat the bargain struck in San Francisco as the "real" bargain as opposed to the bargain on the boat in Alaska? Because in San Francisco, there is a competitive labor market. In Alaska there is not. And why can the fishermen succeed in getting a higher price for their work in Alaska? Because of the exigencies of time and the ability of the fishermen essentially to hold hostage the company's investment in the salmon cannery. The company needs them to work in order to get enough fish to recover its capital investment in the construction and operation of the salmon cannery. So like *Ploof*, what is driving the fishermen's actions in *Alaska Packers* is rent-seeking behavior where the fishermen are expending real resources (the opportunity cost of remaining idle and the canning factory remaining idle) that are designed to expropriate the company's investment in the cannery to raise their wages. By not working, they can essentially destroy the value of the cannery by there being no fish. In this way it is like the dock owner in *Ploof* who knows he can drive a hard bargain because the alternative is the destruction of the boat. And like in *Ploof*, we do not want to encourage people to invest real resources in what is primarily rent-seeking activity designed just to extract a larger distributional share rather than an efficiency gain by the fishermen essentially trying to capture some of the value of the cannery itself. So again, the transaction costs are high—but here the transaction costs are high because of the threat of strategic behavior by the fishermen. Once more it appears that law and economics gives us both the positive and normative explanations—wherever possible, we want parties to bargain in situations with competitive markets, such as on the dock in San Francisco rather than on the boat in Alaska. So here, rather than essentially creating a forced transaction, we are nullifying a freely-bargained transaction.

#### A. The Limiting Principle

But the libertarian might respond, "This analysis proves too much: if we are concerned about transaction costs, why not get rid of market exchanges completely? Rather than having parties negotiate and use up transaction costs, why not have courts come in and order how assets should be allocated?" Consider an example. I own a photograph of "The Immaculate Reception" autographed by Franco Harris himself. Assume its market value would be \$100 on eBay but there are currently no others listed for sale. And assume you come to me and offer me \$125 for it and I turn you down. You sue and you say to the court, "Look Your Honor, it is

clear what is going on here. Zywicki is like the dock owner in *Ploof*. There are very few of these things, so if I cannot buy it from Zywicki, then I cannot buy it from anyone else. And look it is only worth \$100, but he is refusing to take \$125 for it. Obviously he is taking advantage of my situation to try to extort a higher price out of me than it is worth. So I want you to order him to give it to me and I will give him \$101 and social welfare will be maximized.”

Does this work? No. Why not? Because it is not true that this is like *Ploof*. Why not? Because the real reason I am not selling is because the picture truly is worth more to me than \$100 or \$125. Why? Because I received my autographed picture as a gift, so it has idiosyncratic or subjective value to me, making it worth more to me than the market price. On the other hand, I might be acting strategically—perhaps I say it has subjective value but it does not and I really am just trying to get you to pay more, so I am “holding out” on you and trying to act like the dock owner in *Ploof*. Is this plausible? No, because there are in fact substitutes or close substitutes for this particular picture, it is just a matter of finding them. So I do not actually have hold out power over you.

So what does this mean? In general, we have a default preference for individuals to make exchanges via a voluntary market setting rather than having courts engage in “forced” transactions. Why? In part because we are concerned about the presence of idiosyncratic or subjective value. For courts to coerce transactions where transaction costs are low and bilateral monopoly problems nonexistent risks sacrificing the benefits of market exchanges.

Forced transactions along the lines of *Ploof* therefore, should be a narrow exception to the general rule that economic activity should be organized through voluntary market exchanges and not by asking courts to circumvent the market process and thereby to “force” transactions when market processes are fully capable of providing a consensual and economically efficient means for allocating resources. Admittedly, *Ploof* can create a temptation to turn judges into central planners and to be unduly deferential to market exchanges. The same principle explains why the “on the dock” transaction should prevail over the “at sea” transaction in *Alaska Packers*.

And one can easily point to situations at law where judges—often instigated by law and economics scholars themselves—have done exactly that. Consider the imposition of strict products liability in tort and the displacement of contractual warranty law for products liability with tort law. The rise of strict products liability in tort was one of the early innovations conjured up by law and economics scholars, most notably then-professor and now-judge Guido Calabresi.<sup>23</sup> And, to be sure, strict

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<sup>23</sup> See generally GUIDO CALABRESI, *THE COST OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (Yale Univ. Press 1970).

adherence to libertarian freedom of contract principles likely would have averted this intellectual dead-end by honoring the right of the parties to enter into consensual risk allocation arrangements regarding these products.

In retrospect, however, it is evident that strict products liability in tort was predicated on faulty economics. For quite plainly the intellectual error at the root of strict products liability is the central planner's fallacy that the judge (or any other central planner) can accurately anticipate and weigh all of the possible effects of the rule. Consider an easy example. It has been estimated that the cost of liability and liability insurance now comprises thirty percent of the cost of a stepladder.<sup>24</sup> All the better, a naïve lawyer-economist might think: stepladders can be dangerous and if people are injured by stepladders economic efficiency requires that they must "internalize" the costs of those injuries. So if a person is injured by a foreseeable use of a stepladder, say by falling off it, then stepladder manufacturers should be liable. Moreover, perhaps it makes sense for stepladder manufacturers to bear the cost of compensating stepladder consumers, and "spread" the cost of those injuries across many stepladders simply by raising the price.

But this analysis is faulty in two ways. First, the effect of making the ladder company liable essentially compels every consumer to purchase a personal injury liability policy with every stepladder that they purchase—and given the administrative cost of running the tort system, it would be an exceedingly expensive insurance policy. But the overwhelming number of consumers already have health insurance policies, and thus, forcing them to buy an *additional* insurance policy is simply a waste of money. They already have insurance, and thus, it is perfectly rational that they might want to forego a mandatory purchase of an insurance policy from the ladder company. Moreover, there is no reason to believe that the ladder company is in a better position to provide health insurance to a consumer at a lower cost than an actual insurance company. Thus, the effect is to coerce consumers to buy *both* a ladder and an insurance policy when they often will only want the ladder itself.

But there is a second and larger problem that arises. Once the price of a ladder is increased by thirty percent, many consumers will not purchase a ladder who otherwise would. But the burned out light bulb in the ceiling still needs changing regardless of whether the consumer has a stepladder or not. So we know what happens next—rather than standing on a stepladder, the consumer stands on a chair which then topples over and causes injury. Yet everyone knows you are not supposed to use a chair for changing a light bulb, thus the consumer is unlikely to be able to recover against the chair-maker for injuries caused from that use of the chair. The net result, therefore, is not to cause the ladder-maker to internalize the costs of the ladder, it simply is to shift consumer behavior away from relatively more

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24 PETER HUBER, LIABILITY: THE LEGAL REVOLUTION AND ITS CONSEQUENCES 3 (1990).



safe ladders to relatively less safe chairs increasing the overall number of injuries suffered.

Does this unfortunate doctrinal development demonstrate that law and economics is thus an inferior mode of analysis compared to libertarian contractarianism? Perhaps, and one reasonably could make that case. On the other hand, I think it is more reasonable to observe that just because there is a potential for bad economic analysis, it does not necessarily mean that it would be worthwhile to throw out the baby with the bathwater and abandon well-grounded economic analysis.

Instead, what the example of the misuse of economics to support the rise of strict liability and the abandonment of contract law really cautions against is overindulgence in the central planner's fallacy. The real lesson taught by this unfortunate intellectual error is that judges should be humble when considering constructing new legal rules that would supplant longstanding contractarian and voluntary solutions.<sup>25</sup> Stepladders are bought and sold in a competitive market after all, and thus, consumers can choose among a variety of ladder companies potentially offering a variety of different "insurance" policy riders for their ladders. Consumers could thus choose whether to buy a ladder with or without the insurance rider. One suspects that most would prefer a cheaper ladder and to supply their own health insurance, rather than a more expensive ladder sold with implicit insurance. And most certainly, many marginal consumers who are priced out of the ladder market and forced to stand on a chair (thereby dramatically increasing their chance of injury) will almost certainly have preferred the less-dangerous and less-expensive option to be able to buy a ladder.

### III. LIBERTARIANISM AND LAW AND ECONOMICS COMPARED

Although this article has focused on examples of situations in which libertarianism and law and economics are in conflict, it should not be forgotten that as a general rule they strongly agree. The libertarian emphasis on the protection of property rights and nuisance is sound economics as well as clear articulation of property rights, and general enforcement of contractual exchanges are generally good for economic efficiency and interpersonal coordination as well.

Nevertheless, there are times where the pragmatic, contextual, economically-animated logic of the common law reaches conclusions different from that of libertarianism. From my personal perspective, I have come to conclude that the common law and law and economics approaches provide rules superior to that of libertarian philosophy. Admittedly, I am smuggling in normative intuitions to support this conclusion: that the implicit normative purpose of the common law is to further interpersonal coordination and maximize the surplus of social living more than it is the

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<sup>25</sup> Zywicki & Sanders, *supra* note 5.

protection of individual rights. The particularities of that debate go beyond the scope of this article.

But in the end there are two basic ideas that have led me away from the Rothbardian natural rights vision of law toward a more Hayekian and law and economics view of the common law. First, I am unable to escape the logical conclusion that at root, costs are reciprocal—that conflicts arise over incompatible uses of scarce resources because the parties are mutually interfering with *each other's* use of those resources. And that second, the purpose of law is to maximize the gains of social living by maximizing the benefits of interpersonal coordination and minimizing waste. In the end, I find that cases like *Ploof* and *Alaska Packers* strike me as correctly decided and the economic principles that underlay them are sound as well—and between those outcomes and the outcomes provided by libertarian philosophy I find the results of law and economics and the common law superior to libertarianism.