

“The Fugitive”
The figure of the judge in Coase’s economics
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Abstract

“The problem of social cost” (Coase 1960) asserts a normative role for the judge, that of allocating the property right to the person who would pay the most for it. A possible inconsistency is often raised: Coase sees the figure of the judge as willing and able to reach economic efficiency, but criticises the actors of public intervention, particularly regulators, who are fallible, vulnerable to political pressures and lack information. The present article examines both this inconsistency and some elements of Coase’s theoretical system that could justify it. I shall show that Coase’s giving this role to the judge comes precisely from his criticism of public intervention. But this means that his judge escapes these criticisms and his comprehension of human nature on which they are also based. Consequently, the figure of the judge escapes the tenets of the theoretical system that first rendered it necessary. Some reasons could explain this difference of treatment between the judge and the other figures of public intervention in Coase’s system, but Coase too strongly opposes common law on one side and regulatory and statutory law on the other, and he leaves unexplained the motivation of judges. Unearthing the implicit beliefs that underpin his argument in favour of common-law solutions to externalities contributes to illustrate its weakness and brings to light that this preference is presupposed rather than established.

Key words: Ronald H. Coase, common law, externalities, regulation, statute law

JEL classification codes: B31; B52; D62; K40

1. Introduction

While “The problem of social cost” (Coase 1960) is best known for the “Coase theorem” that George Stigler (1966, 113) brought out of it, it is also well known that this “theorem” is far from exhausting the message of this article. Ronald Coase (1960) suggested through examples that, in the presence of externalities,² if transaction costs are nil and if property rights are clearly defined and allocated, agents achieve an optimal output that is independent of the initial allocation of rights. Most of his article, however, examines the consequences of the introduction of transaction costs. When they are not nil, the result may no longer be optimal or independent from the initial distribution of rights, which means that other solutions may be

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² Although it existed since the 1950s, Coase does not use the word “externality,” but instead the expression “harmful effects,” to stress his questioning of the traditional-Pigovian treatment of this concept (Coase 1988a, 27).

necessary and that law may have an influence on the economic output. Coase thus brought to light the influence of the initial distribution of property rights on the economic result.

Coase (1960) drew a normative implication from this influence: common-law judges *should* take into account this economic influence of their decisions when allocating property rights. And he couples this normative role of judges to the empirical claim that they actually *do*: they introduce economic efficiency considerations in their deliberations, as would suggest several cases analysed in the “Social cost” article. This was the very beginning of the debate over the efficiency of the common law, more famously brought to the fore by Posner (1972).³

At first sight, there is an inconsistency in Coase's analysis of externalities. On the one hand, he sees the figure of the judge as willing and able to reach economic efficiency. On the other, he criticises the actors of public intervention, particularly regulators, who are fallible, vulnerable to political pressures and lack information. As Simpson wrote, for example, “Coase, who on questions of allocation and delimitation of rights has in mind private law, nowhere treats judicial decisions in private law by the courts of the state as a form of governmental intervention or action. Private law, evolving through judicial decisions, is, for reasons never made explicit, privileged against the criticisms he directs against government intervention” (1996, 61). It would be more accurate to say that Coase prefers one form of governmental intervention (through common law) that he views as efficient, to the others (through regulatory and statutory law) that he finds inefficient. This preference has been, to some extent, mentioned, but not thoroughly analysed.

I will substantiate the idea that, in Coase's economics, the figure of the judge (common law) seems to avoid the fallacies this author associates with regulators (administrative agency) and legislators (statutory law). Coase often stressed that regulators lack information, and that they are human beings who are fallible and pursue their own interests. But Coase's judge appears as a specific figure of public intervention, paradoxically closer to the price system than to public intervention. His role is not only to make the operation of the price system possible (by defining and distributing property rights), but also to economise on its operating by distributing these rights so as to render it unnecessary. The figure of the judge, therefore, escapes the criticism he addressed to public intervention and the view of human nature on which this criticism is based. In this sense, the judge is a “fugitive” in Coase's economics.

I will show that a judge maximising the value of production is logically necessary to complete Coase's economic theory, but that this figure does not fit into the overall structure

³ For a review of this debate, see, e.g., Rubin (2000).

that first rendered it necessary (the view of human nature and governmental intervention). Can this inconsistency be removed within Coase's thought? In other words, can the judge's desire and ability to substitute himself to the market be explained in his theoretical system? We cannot claim that there is an inconsistency without first giving credit to the author, i.e. having ascertained that the inconsistency does not come from a poor exegesis. Hence, I will suggest – and evaluate – some explanations of the difference of treatment between the judge and the other figures of public intervention, within the structure of Coase's argument. If these explanations are not convincing, his inconsistency will emerge stronger from this investigation.

Substantiating the thesis of Coase's inconsistency regarding the judge calls for a detailed analysis of the roles of this judge, leading to a theoretical reconstruction of Coase's analysis. Hence this paper provides an interpretation and evaluation of his thought on the relative merits and demerits of common law on the one hand and regulatory and statutory law on the other. It restitutes Coase's position in this debate, in the history of which it is often mentioned as a precursor of Posner's, but seldom analysed for itself. Moreover, if his inconsistency was removed, this would strengthen his argument in favour of a common-law solution to externalities, relatively to other governmental solutions. However, unearthing the implicit beliefs that underpin his argument contributes to illustrate its weakness and brings to light that his preference for common-law solutions is presupposed rather than established.

The following section details Coase's view of the common-law judge and section 3 contrasts it to his view of other governmental agents (regulators and legislators). In section 4, I shall make explicit, and call into question, some of the reasons that could explain this difference of treatment in Coase's framework. Section 5 concludes.

2. The roles of the judge in Coase's analysis of externalities

The roles that Coase gives to the judge are determined by the conjunction of three claims – theoretical, normative and empirical – which closely interact with each other.

Theoretical claim: the initial distribution of property rights influences the economic result

“The problem of social cost” starts with distinguishing the ethical problem of responsibility from the economic one, which is reciprocal (Coase 1960, 2). If a policy protecting her is instituted, the presence of the “victim” harms the “responsible” of the nuisance, *i.e.* imposes a cost upon him. Reiterating his prior analysis (1959, 26-7) of the *Sturges v. Bridgman* (1879) case that concerned a doctor who could no longer practice because of the noise generated by

his neighbour, a confectioner, Coase writes: “To avoid harming the doctor would inflict harm on the confectioner. The problem posed by this case was essentially whether it was worth while, as a result of restricting the methods of production which could be used by the confectioner, to secure more doctoring at the cost of a reduced supply of confectionery products” (1960, 2).

The reciprocal nature of the economic problem is therefore tightly linked to the criterion of economic efficiency: “To avoid the harm to B would inflict harm on A. The real question that has to be decided is: should A be allowed to harm B or should B be allowed to harm A? The problem is to avoid the more serious harm” (*ibid.*, 2). The aim is to reach economic efficiency, defined as the maximisation of the value of production (*ibid.*, 15).⁴

If the pricing system operated without costs, the role of the judge would just be to define property rights, no matter how, but in a definite and predictable way⁵: “all that matters (questions of equity apart) is that the rights of the various parties should be well-defined and the results of legal actions easy to forecast” (*ibid.*, 19). Exchanges on these property rights (including those whose use implies effects on others) could then take place and yield an optimal result, independent from their initial allocation: this is the idea Stigler named “the Coase theorem.”

However, transaction costs may prevent some exchanges of rights and, when this is the case, the initial allocation of rights is not modified or, at least, not until the optimal allocation is reached:

In these conditions the initial delimitation of legal rights does have an effect on the efficiency with which the economic system operates. One arrangement of rights may bring about a greater value of production than any other. But unless this is the arrangement of rights established by the legal system, the costs of reaching the same result by altering and combining rights through the market may be so great that this optimal arrangement of rights, and the greater value of production which it would bring, may never be achieved. (*ibid.*, 16)

Coase did not aim at demonstrating the neutrality of law or the independence of the economic result from the property rights allocation; on the contrary, this is the thesis of the economic influence of law that is important: “with positive transaction costs, the law plays a crucial role in determining how resources are used” (Coase 1988a, 178).

⁴ Though Coase (1960, 43) mentioned the necessity of an ethical evaluation, he never even started it (Pratten 2001, 620).

⁵ Following Coase (1960), I will not distinguish liability rules and property rights in this analysis (see Calabresi and Melamed 1972).

In this case, since the legal distribution influences the economic result, what should be done?

Normative claim: the judge should take this economic influence into account

Coase answers this question in two steps. He first assumes that the initial delimitation of rights is given and inefficient, and that negotiations are too costly (Coase 1960, 16). It is here that he makes his comparative institutional approach explicit: the economist or the policy-maker must compare the values of production yielded by different arrangements and choose the one in which it is maximised, taking into account the costs of operation of these arrangements and the costs of change from one to another.⁶ The arrangements that have to be compared are the market, the firm, direct regulation (e.g., zoning), and “to do nothing about the problem at all” (*ibid.*, 18).

In the second step (section VII of “The problem of social cost”), Coase wonders: when property rights are not yet allocated, how to allocate them the most efficiently? From the theoretical claim that the initial distribution of rights influences the economic result, he immediately infers a normative claim about the judge:

when market transactions are so costly as to make it difficult to change the arrangement of rights established by the law [...], the courts directly influence economic activity. It would therefore seem desirable that the courts should understand the economic consequences of their decisions and should, insofar as this is possible without creating too much uncertainty about the legal position itself, take these consequences into account when making their decisions. Even when it is possible to change the legal delimitation of rights through market transactions, it is obviously desirable to reduce the need for such transactions and thus reduce the employment of resources in carrying them out. (*ibid.*, 19)

In Coase's thought, “taking the economic consequences into account” means aiming at maximizing the net value of production. Limiting the need for exchanges indeed entails distributing, right from the start, the property right to the person who values it the most, that is to say, imitating the result of the market. If exchanges cannot take place, this could improve efficiency. Even when transaction costs do not prevent exchanges of the right, limiting the need for exchanges economises on these costs. Coase asserted again this rule in his “Nobel Prize” speech: “It is obviously desirable that these rights should be assigned to those who can use them most productively” (1992, 718).⁷

⁶ On Coase and the comparative institutional approach, see Medema and Samuels (1998), Medema (1996), Bertrand (2014).

⁷ This normative rule to be followed by judges was also taken up in 1977: “I have argued, in my ‘Problem of Social Cost,’ that rights to perform certain action should be assigned in such a way as to maximize the total wealth (broadly defined) of the society. The same is true when we come to what are termed personal rights or civil liberties, the kind of activity covered by the First Amendment” (Coase 1977a, 32).

From the discovery of the positive influence of the property-rights distribution, Coase (1960) inferred the prescriptive rule according to which this influence has to be taken into account by the courts when distributing property rights. It is the role of the judge to somehow apply the comparative institutional method: she has to compare the values of production yielded by alternative allocations of a right, and distribute it to the person who will use it in the way that maximises the output value.⁸

Empirical claim: the judge does take this economic influence into account

“The problem of social cost” also asserts that judges are, at least partly, aware of the reciprocity of the problem, and of the economic consequences of their decisions. Coase examines a series of nuisance cases, immediately after having asserted that judges had to take into account these consequences. The empirical claim indeed follows the normative one: “it is clear from a cursory study that the courts have often recognized the economic implications of their decisions and are aware (as many economists are not) of the reciprocal nature of the problem. Furthermore, from time to time, they take these economic implications into account, along with other factors, in arriving at their decisions” (Coase 1960, 19).

Regarding reciprocity, he already had argued earlier in his text that judges understand it. About *Bryant v. Lefever* (1878-1879), in which the plaintiff's chimneys began to smoke after his neighbour rebuilt his house, with higher walls, Coase insists that “[t]he smoke nuisance was caused both by the man who built the wall *and* by the man who lit the fires” (*ibid.*, 13, his emphasis). And he argues that the judges' treatment of this case exhibits their same understanding (*ibid.*, 13).

As evidence that judges take the economic influence into account, Coase puts forward the following elements. Regarding the United States tradition, he relies on Prosser (1955, 398-9 quoted in Coase 1960, 19): “It is only when [a person's] conduct is unreasonable, *in the light of its utility and the harm which results* [emphasis added, RHC], that it becomes a nuisance.” In contrast, says Coase, British writers are less explicit,

[b]ut similar views, if less strongly expressed, are to be found. The doctrine that the harmful effect must be substantial before the court will act is, no doubt, in part a reflection of the fact that there will almost always be some gain to offset the harm. And in the reports of individual cases, it is clear that the judges have had in mind what would be lost as well as what would be gained in deciding whether to grant an injunction or award damages. (1960, 20)

⁸ For criticisms of this rule, see, e.g., Samuels (1974; 1981), Schmid (1989), Simpson (1996), Medema and Samuels (1997; 1998).

His examples are borrowed from some English nuisance cases: *Webb v. Bird* (1861 and 1863) regarded the construction of a school which obstructed currents of air near a windmill; *Adams v. Ursell* (1913) had to do with a fried fish shop; *Andreae v. Selfridge and Company Ltd* (1938) was related to the damages imposed on a company demolishing buildings that surrounded a hotel. But most explicit are his comments on the quotes from the *Sturges v. Bridgman* case, in which judges insisted on the fact that what will be defined as a nuisance depends on the neighbourhood, so that “[w]hat has emerged has been described as ‘planning and zoning by the judiciary’” (*ibid.*, 21, quoting Haar 1959, 95). To Coase, “[i]t was of course the view of the judges that they were affecting the working of the economic system – and in a desirable direction” (1960, 10).⁹ But he adds that “the judges seem to have been unaware” (*ibid.*, 10) of the necessity of comparing gains and benefits from the protection of such or such use of the concerned neighbourhood. This does not prevent him from concluding from these cases that “the courts [...] often make, although not always in a very explicit fashion, a comparison between what would be gained and what lost by preventing actions which have harmful effects” (*ibid.*, 27-8). The words “not very explicit” are to be given their full meaning. Coase insists on this implicit aspect: “The courts do not always refer very clearly to the economic problem posed by the cases brought before them but it seems probable that in the interpretation of words and phrases like ‘reasonable’ or ‘common or ordinary use’ there is some recognition, perhaps largely unconscious and certainly not very explicit, of the economic aspects of the questions at issue” (*ibid.*, 22).

According to Coase, judges compare costs and benefits, of course implicitly, of course among other factors, but, yet, we have this general idea that efficiency enlightens the judges’ way. Above all, he will stick to the empirical claim that judges take into account the economic consequences of their decisions. He repeated it 30 years later, commenting on his 1960 article: “I pointed out that the judges in their opinions often seemed to show a better understanding of the economic problem than did many economists even though their views were not always expressed in a very explicit fashion. I did this not to praise the judges but to

⁹ For a discussion of Coase’s interpretation of this case, see Simpson (1996). Moreover, this praise for zoning by the judiciary may be opposed to Coase’s criticism of regulatory (Pigovian) zoning, illustrating once again the difference between the judge and the regulator. The “Pigovian” rule would be too general and neglect the cost-benefit analysis: “I need not devote much space to discussing the [...] error involved in the suggestion that smoke producing factories should, by means of zoning regulations, be removed from the districts in which the smoke causes harmful effects. When the change in the location of the factory results in a reduction in production, this obviously needs to be taken into account and weighed against the harm which would result from the factory remaining in that location” (Coase 1960, 42).

shame economists” (1993, 251). And he used the work done by legal scholars on this subject since then to confirm his interpretation.¹⁰

As has already been noted (by, e.g., Simpson 1996), but neither expanded nor explained, the judge is not perceived by Coase as the other figures of governmental intervention and escapes the criticisms he addressed to regulators and legislators, to which we turn.

3. Judge-made law v. Regulation

In “The problem of social cost” itself, Coase criticises the regulation solution to externalities, be it issued by regulatory or statutory law.¹¹ When property rights are given and when the market and the firm are too costly, he envisages governmental solutions, such as regulation on the technology employed or zoning, promulgated by statute law or, “more likely,” by governmental agencies (regulatory law) (Coase 1960, 17). However, if direct regulations may appear useful when transaction costs are high, this solution encounters some problems:

the governmental administrative machine is not itself costless. It can, in fact, on occasion be extremely costly. Furthermore, there is no reason to suppose that the restrictive and zoning regulations, made by a fallible administration subject to political pressures and operating without any competitive check, will necessarily always be those which increase the efficiency with which the economic system operates. Furthermore, such general regulations which must apply to a wide variety of cases will be enforced in some cases in which they are clearly inappropriate. (*ibid.*, 18)

These problems are those of any public regulation in Coase's mind: (1) it is by definition too general to be appropriate in all circumstances; (2) regulators operate without competitive check; (3) they lack information and (4) are fallible; (5) they pursue their own interest and therefore are subject to political pressures and industry capture. Apart from the first one, these problems derive, I shall argue, from Coase's specific view of the nature of public intervention, and his view of the regulator as an individual driven by his personal interest.

Coase's view of the nature of public intervention

In Coase's analysis, governmental intervention appears as an alternative to the price system (for resources allocation), as does the firm. Like the firm, it directs transactions (Coase 1960,

¹⁰ For example, he wrote in 1996: “As legal scholars, such as Judge Posner and others writing on the economic analysis of law, have adopted a similar view [that judges take economic consequences into account], this suggests that my interpretation of Prosser and the judges, ill-informed though it may have been, may well have been correct” (Coase 1996, 105-6).

¹¹ This section draws on previous works on Coase's view of the role and efficiency of government, by Medema (1994, ch 5), Medema and Samuels (1998), Pratten (2001), Campbell and Klaes (2005) and Bertrand (2010).

17). Hence it faces the same administrative or organisational costs (Coase 1946, 172), particularly the decreasing returns to management mentioned in “The nature of the firm” (Coase 1937, 394-5). In contrast to the firm, the government “is able, if it wishes, to avoid the market altogether” (Coase 1960, 17).¹² This difference adds two specific costs: the absence of competitive check and the lack of information. These two consequences can be found in Coase's criticism of the allocation of radio frequencies by the Federal Communications Commission (FCC):

Quite apart from the malallocations which are the result of political pressures, an administrative agency which attempts to perform the function normally carried out by the pricing mechanism operates under two handicaps. First of all, it lacks the precise monetary measure of benefit and cost provided by the market. Second, it cannot, by the nature of things, be in possession of all the relevant information possessed by the managers of every business which uses or might use radio frequencies, to say nothing of the preferences of consumers for the various goods and services in the production of which radio frequencies could be used. (Coase 1959, 18)

The *absence of competitive check* here refers to the absence of monetary evaluation of the governmental agency's costs and benefits. It also means that the agency, unlike the firm, does not have to maximise profit. It does not have the same incentive to use resources efficiently (nor the possibility, in the absence of market prices), an example being the waste brought about by the administrative allocation of radio frequencies by the Interdepartment Radio Advisory Committee (IRAC) and the FCC (Coase 1962; Coase and Johnson 1979).

Moreover, in the absence of prices, regulators *lack information* on preferences and costs. In his article on the marginal cost pricing of natural monopoly, Coase began by reminding the reader that the pricing system has the advantage over the government, as a mode of resources allocation, of conveying information on preferences that a central planner cannot afford and, more often than not, at a lower cost: “No Government could distinguish in any detail between the varying tastes of individual consumers [...]; without a pricing system, a most useful guide to what consumers' preferences really are would be lacking” (1946, 172). In his article on social cost, lack of information and problems of calculation are also some of the difficulties faced by a taxation solution to externalities.

Coase's view of the judge as able of and actually applying a cost-benefit analysis is therefore at odds with his criticisms of regulators as lacking competitive check and information. Likewise, his view of the judge is far from his view of human nature on which these criticisms are also based.

¹² And it possesses the monopoly on legitimate violence (Coase 1960, 17).

Coase's view of the regulator as a human being

In addition indeed, Coase sees regulators as fallible and following their personal interest, thus vulnerable to political pressures and industry capture: they are human beings among others. While this view may appear rather close to public-choice theory, it is not based on the same assumptions. Coase's criticisms of the view of man as a rational maximiser are well-known (e.g., Medema 1995). He wrote for example: "There is no reason to suppose that most human beings are engaged in maximizing anything unless it be unhappiness, and even this with incomplete success" (1988a, 4). Utility is even "a nonexistent entity which plays a part similar, [he] suspect[s], to that of ether in the old physics" (*ibid.*, 2).

Coase's own view of human being would be closer to that he attributes to Smith, whom he quotes with approval. His article on "Adam Smith's view of man" (Coase 1976) allows him to legitimate his criticism of rational utility maximisation: "Smith would not have thought it sensible to treat man as a rational utility-maximiser. He thinks of man as he actually is – dominated, it is true, by self-love but not without some concern for others, able to reason but not necessarily in such a way as to reach the right conclusion, seeing the outcomes of his actions but through a veil of self-delusion" (*ibid.*, 545-6). Two ideas that emerge from this article are relevant here. First, a person can be mistaken, she is *fallible*, and may even be "stupid." This is a feature on which Coase increasingly insisted during his later years, for example in a recent interview: "it's not possible to study how things are dealt with without realizing the importance of the stupidity of human behavior" (2012, 20'). Second, a person is *guided by self-love*, which does not exclude "concern for others" or benevolence (Coase 1976, 533).¹³

These features apply to governmental agents. They are fallible. And benevolence for relatives results in favouritism: "A politician, when motivated by benevolence, will tend to favour his family, his friends, members of his party, inhabitants of his region or country (and this whether or not he is democratically elected). Such benevolence will not necessarily redound to the general good" (*ibid.*, 544). Regulators' following their self-interest (in its larger Smithian meaning) explains their subjection to political pressures, including by interest groups¹⁴ and, then, industry capture. Industry capture is also explained by a kind of empathy from the regulators of that industry:

¹³ Coase does not seem to really distinguish sympathy from benevolence (on this distinction, see, e.g., Dellemotte 2011).

¹⁴ See, e.g., Coase and Johnson (1979).

However fluid an organization may be in its beginning, it must inevitably adopt certain policies and organizational forms which condition its thinking and limit the range of its policies. Within limits, the regulatory commission may search for what is in the public interest, but it is not likely to find acceptable any solutions which imply fundamental changes in its settled policies. The observation that a regulatory commission tends to be captured by the industry it regulates is I think a reflection of this, rather than, in general, the result of sinister influences. *It is difficult to operate closely with an industry without coming to look at its problems in industry terms.* (Coase 1966, 442, my emphasis)¹⁵

Industry capture, and the role of interest groups more generally, is again something that Coase recognises in Smith's analysis, which "explains that government regulations will normally be much influenced by those who stand to benefit from them, with the result that they are not necessarily advantageous to society" (Coase 1977b, 319).¹⁶

To sum up, regulators are just human beings. They are fallible and they do not follow general interest,¹⁷ but their own interest, which is plural (love of their relatives, political interest, etc.): "Regulators commonly wish to do a good job, and though often incompetent and subject to the influence of special interests, they act like this because, like all of us, they are human beings whose strongest motives are not the highest" (Coase 1974b, 389). Since "government regulators may have in mind ends other than raising the value of production" (Coase 1974a, 61), since the government is "ignorant, subject to pressure, and corrupt" (Coase 1988a, 26), their activities usually produce more harm than good.¹⁸

Coase's opinion that, in general, public regulation would do more harm than good, is in his eyes also an empirical claim, in the sense that it is derived from empirical studies, his and others' (Coase 1974a; 1988b; 1996).

However, the judge as envisioned by Coase seems to be exempted from his understanding of human beings and of their motives that applies to regulators. He recognises that judges may be mistaken in their applying cost-benefit analysis (Coase 1960, 38), but he believes that they pursue, at least among other aims, economic efficiency, and not their personal interest, and that they are immune to corruption, political pressures and industry capture.

¹⁵ See also Coase (1965, 166): "It is often said that regulatory commissions are, in the end, captured by the industries which they regulate. There is much truth in this observation and the FCC is well on the way providing us with another example."

¹⁶ In Smith, legislators' partiality to merchants, for example, may be removed by good constitutional rules (the System of Natural Liberty), see Diatkine (2014).

¹⁷ In Coase's view, even more radically, general interest above the satisfaction of individual preferences does not exist (Pratten 2001, 623-4).

¹⁸ Again, he attributes the same belief to Smith, whose "opposition to more extensive government action did not arise simply because he thought it was unnecessary, but because government action would usually make matters worse. Governments lacked both the knowledge and the motivation to do a satisfactory job in regulating an economic system" (Coase 1977b, 319).

This difference of treatment between the judge and other governmental agents is most visible when Coase opposes the efficiency of the allocation of nuisance liability by common law to the inefficiency of that allocation by statute law.

The inefficiency of statutory attribution of rights

Coase criticises not only regulation solutions (be they promulgated by a regulator or a legislator), as we have just seen, but also the solution by allocation of property rights by a legislator.

In the section VII of “The problem of social cost,” which examines “[t]he part played by economic considerations in the process of delimiting legal rights” (Coase 1960, 16), he asserts, as already said, that judges often take into account the economic consequences of their decisions and compare costs and benefits of alternative allocations of rights. However, noting that “[t]he discussion in this section has, up to this point, been concerned with court decisions arising out of the common law relating to nuisance,” he goes on to another means of allocating property rights (or liabilities) for nuisance, namely statute law: “Delimitation of rights in this area also comes about because of statutory enactments” (*ibid.*, 23). And he claims that, in general, this mode of allocation by the legislator is inefficient, because it protects harm producers – gives them the right to pollute – beyond what would be economically desirable. This is another empirical claim, to be opposed to that of the efficiency of the judge. Coase asserts that “[t]he effect of much of the legislation in this area is to protect businesses from the claims of those they have harmed by their actions. There is a long list of legalized nuisances” (*ibid.*, 24) both in England and in the United States.¹⁹

This finding first criticises the Pigovian-tradition economists who would be eager to ask public authorities to extend liability to all harm producers and who, more generally, turn themselves towards the government as soon as they observe a divergence between private cost and social cost, while this divergence is actually due to the government. “The kind of situation which economists are prone to consider as requiring corrective Government action is, in fact, often the result of Government action” (*ibid.*, 28).²⁰

¹⁹ He relies on the third edition of the *Halsbury's Laws of England* and, for the United States, on cases regarding the operation of some airports and which referred to legislations authorizing nuisances (for example, *Delta Air Corporation v. Kersey*, *Kersey v. City of Atlanta*, 1942; *Smith v. New England Aircraft Co.*, 1930).

²⁰ And Coase's irony towards Pigovian-type economists is worth quoting: “When they are prevented from sleeping at night by the roar of jet planes overhead (publicly authorized and perhaps publicly operated), are unable to think (or rest) in the day because of the noise and vibration from passing trains (publicly authorized and perhaps publicly operated), find it difficult to breathe because of the odour from a local sewage farm (publicly authorized and perhaps publicly operated) and are unable to escape because their driveways are blocked by a road obstruction (without any doubt, publicly devised), their nerves frayed and mental balance

Coase's observation then suggests that statute law protects harm producers much more than what would be efficient, therefore at an inefficient level. And he partly explains this by the government's protection of its own activities:

Of course, it is likely that an extension of Government economic activity will often lead to this protection against action for nuisance being pushed further than is desirable. For one thing, the Government is likely to look with a benevolent eye on enterprises which it is itself promoting. For another, it is possible to describe the committing of a nuisance by public enterprise in a much more pleasant way than when the same thing is done by private enterprise. (*ibid.*, 26-7)

This means that statute law may counteract the common law's tendency towards efficiency: "While statutory enactments add to the list of nuisances, action is also taken to legalize what would otherwise be nuisances under the common law. [...] Such action is not necessarily unwise. But there is a real danger that extensive Government intervention in the economic system may lead to the protection of those responsible for harmful effects being carried too far" (*ibid.*, 28).

Legislators, when attributing property rights as well as when regulating, do not aim at maximising the value of production, which is allegedly what judges do. Why does Coase give different attributes to these figures of judges, legislators and regulators?

4. Explaining the judge's efficiency in Coase's framework?

The inconsistency thesis

Coase started by asserting that a clear definition and allocation of property rights (including rights to harm others) is necessary for the price system to operate. When the definition or allocation are not clear enough, the situation is brought before courts, and the judge, says Coase, should take into account the economic consequences of his decisions and allocate the right to the person who values it the most. This normative rule is substantiated by the following argument: if the right is not distributed in the hands of the person who values it the most, then either some resources will be lost in exchanging this right, or some regulations (by regulators and legislators) would have to be set up, which would be even more costly. In addition, Coase's giving this role to common law rather than to statute law may be explained by his empirical claim that legislators have a tendency to legalise nuisances beyond what would be economically desirable. The normative role given to the judge is therefore tightly linked to the inefficiency of regulatory and statutory law. In other words, the figure of the

disturbed, they proceed to declaim about the disadvantages of private enterprise and the need for Government regulation" (Coase 1960, 26).

judge is necessary in Coase's economics because of his view of the inefficiency of public intervention and the view of human nature on which this view is partly based. However, this figure precisely escapes these views of public intervention and of human nature, views that made its role necessary in the first place. This does not mean that, in Coase's view, judges will always choose the economically efficient solution since they may be mistaken, they do not pursue economic efficiency only, and some of them do not take into account economic considerations.²¹ However, "The problem of social cost" betrays a great confidence in judges, at least one that is deeper than for regulators and legislators.

Is it possible to explain why would the judge, in Coase's system, avoid the pitfalls that burden regulators and legislators? In his thought, some reasons seem to lie in the system of common law itself.

The implicit advantages of common law in Coase's thought

Coase insists on several relative advantages of common law (including by mentioning the relative drawbacks of regulation and statutory attribution of rights), in terms of adaptation, information, or understanding of reciprocity. These advantages relate to some features of common law that he implicitly brings to the fore.

First, Coase's analysis suggests that the judge's fallibility has far less dramatic consequences than regulators' and legislators': courts' decisions can be appealed and they are open to other judges' interpretations in similar cases. For example, the decision on which Coase relies to assert that judges understand the reciprocity of the problem is an appeal decision (*Bryant v. Lefever*, about the smoking chimney, see Coase 1960, 11-2).²² And we must not forget Coase's argument that exchanges of rights attributed by a common-law judge can take place to modify this initial allocation.

The second characteristic of common law that seems essential in Coase's argument is its adversarial nature. One of its advantages is that it poses the problem to the judge almost immediately in economic (and reciprocal) terms, as a problem of comparison between costs and benefits. This already appeared in Coase's first comment of the *Sturges v Bridgeman* case: "What the courts had, in fact, to decide was whether the doctor had the right to impose additional costs on the confectioner through compelling him to install new machinery, or

²¹ Coase himself gives one example of judges not taking into account economic considerations. In *Bass v. Gregory* (1890), a pub that brewed beer in a cellar was confirmed in his right to let the air circulate from a hole in a well situated in a neighbour's yard, by the "doctrine of lost grant" (Coase 1960, 14). Coase insists on the irrelevance of such an argument from an economic point of view: "the 'doctrine of lost grant' is about as relevant as the colour of the judge's eyes" (*ibid.*, 15).

²² Another appeal decision is examined in "The problem of social cost": the reduction of damages paid in *Andreae v. Selfridge and Company Ltd* (Coase 1960, 22-3).

move to a new location, or whether the confectioner had the right to impose additional costs on the doctor through compelling him to do his consulting somewhere else on his premises or at another location” (1959, 26). This way of posing the problem derives from the adversarial nature of common law and would impose itself to the judge, as at least one way of looking at it. This is this way of posing the problem that would allow judges to understand better than economists do the nature of the economic problem posed by harmful effects. Coase's argument in “The problem of social cost” is indeed that, contrary to what could be naively expected, economists are stuck in their ethics of responsibility, which prevent them from understanding the reciprocity of the problem, while judges take into account economic considerations to solve a problem that they view as reciprocal.

Third, what Coase seems to retain from common-law judges is that they act *ex post*, considering specific and actual cases while legislators and regulators decide *ex ante*, on a great variety of cases to come.²³ In this perspective, common law would make a resolution of nuisance problems on a case-by-case basis possible, thus retaining all its specificity to each situation. This is no doubt important for Coase, who argues that “[t]he result brought about by different legal rules is not intuitively obvious and depends on the facts of each particular case” (1988a, 178). This is a great difference with regulatory and statutory law in Coase's mind: not only will decisions not be applied to inappropriate cases, but they will also be easier to make since it may seem simpler to decide *ex post* on one case rather than *ex ante* on numerous (and sometimes hypothetical) cases at the same time. Judges also need less information to decide on one case than regulation does to decide on a multitude of (hypothetical) circumstances.

The proximity of judges to the specificities of each situation would also give them better information than would have remote agencies. Coase indeed partly explained information problems by the distance from the centre: “The remoteness of the centre from the areas affected by the decision may lead to a failure to understand the significance of the issues under consideration” (1962, 39).

Coase's attachment to case-by-case solutions can be seen in what he considers an evidence that judges take into account economic considerations: this evidence lies mainly in the fact that they do not decide automatically (*ex ante*) what constitutes a nuisance, but think about the particular case and sometimes decide differently on similar cases (on the nuisances caused to windmills for example, see Coase 1960, 20-1). But his preference for standards

²³ On the relative merits of giving content to the law *ex ante* (rules) or *ex post* (standards), see Kaplow (1992)'s seminal contribution.

against rules is most visible in his comparison between a rigid rule of liability for rabbits' owners (one example of Pigou 1932) and a standard interpreted by common-law judges:

The objection to the rule in *Boulston's* case [a 1597 case that established a precedent] is that, under it, the harbourer of rabbits can *never* be liable. It fixes the rule of liability at one pole: and this is as undesirable, from an economic point of view, as fixing the rule at the other pole and making the harbourer of rabbits always liable. But, as we saw in Section VII, the law of nuisance, as it is in fact handled by the courts, is flexible and allows for a comparison of the utility of an act with the harm it produces. [...] To bring the problem of rabbits within the ordinary law of nuisance would not mean *inevitably* making the harbourer of rabbits liable for damage committed by the rabbits. This is not to say that the sole task of the courts in such cases is to make a comparison between the harm and the utility of an act. Nor is it to be expected that the courts will always decide correctly after making such a comparison. But unless the courts act very foolishly, the ordinary law of nuisance would seem likely to give economically more satisfactory results than adopting a rigid rule. (Coase 1960, 38, his emphases)

Coase thus brings to light three characteristics of common law that could explain the relative efficiency of judges: common law would be flexible, adversarial and *ex post*. Do these characteristics apply to common law only? And are they sufficient to make the judge economically efficient?

Restoring the thesis of Coase's inconsistency

Coase's belief in a fundamental difference between judges on the one hand and legislators and regulators on the other can be called into question, which would restore the inconsistency of his differential treatment and therefore undermine the justification of his preference for a common-law solution to externalities.

First, in a Coasean setting, the costs of each system would have to be taken into account and this would mitigate the strength of some of Coase's arguments. For example, statutes or regulations apply to numerous similar cases, and this economises on the costs of resorting to judges for each case. In other words, Coase sees the costs of rules but not their benefits compared to standards, which Kaplow sums up: "Rules cost more to promulgate; standards cost more to enforce. With regard to compliance, rules' benefits arise from two sources: Individuals may spend less in learning the content of the law, and individuals may become better informed about rules than standards and thus better conform their behavior to the law" (1992, 577). Regulations have other advantages in terms of information. On the production side, they can rely on expertise, which benefit from scale economies. On the enforcement side, they are easier to find and learn than common-law decisions. Therefore, and more generally, Coase seems to forget the costs of common law while he never forgets costs of the market or costs of the other types of public intervention.

In addition, Coase deals differently with judges, legislators and regulators because they pertain to different institutional arrangements. However, he seems to overestimate the specificity of common law compared to regulatory and statutory law. All three are both providing rules *and* dispute resolutions.

On the one hand, regulatory and statutory laws may have some of the advantages of common law mentioned earlier. Regulations also require interpretation by courts and may also be overturned. This means that they leave room to adjudication, interpretation and choice (Michelman 1980), by courts which may be closer, better informed, more specific. Fallibility is thus not irreversible: not only can regulations be changed when new information is available, but they also can be interpreted and modified by courts.²⁴ And the argument of the advantage of the adversarial nature is also valid for regulatory law, via administrative litigation (Wangenheim 2000).

On the other hand, common law may also have the same disadvantages as statutory and regulatory law. The common-law judge may produce a precedent that will be used as directing the treatment of more or less similar cases.²⁵ The presence of a precedent, while economizing on the costs of decision, diminishes the judge's flexibility (adaptation to specific cases and to changing conditions) and increases the consequences of fallibility. Eventually, the judge's reasoning anticipates that she is producing a precedent and therefore takes into account future and hypothetical cases. Thus the precedent "essentially transforms the standard into a rule" (Kaplow 1992, 577), but delays the benefits of the rule until the precedent is established although entailing the same cost of promulgation (Kaplow 2000, 511-2). In the "Problem of social cost," Coase gives the example of a common-law decision constrained by a precedent to declare that a public authorized airport has the right to harm its neighbourhood (*Delta Air Corporation v. Kersey*, *Kersey v. City of Atlanta*, see Coase 1960, 25).

Common law on the one hand and statutory and regulatory law on the other are less opposed than Coase seems to believe. More fundamentally, these three systems are complementary. Attribution of property rights by statutes may need to be completed by common law. Statutory and regulatory laws choose the level of detail of the regulation (rule or standard) and therefore the importance of the role of the common-law judge. What remains

²⁴ Without mentioning the fact that the adaptation to circumstances is a questionable criterion of efficiency. For example, Epstein argues that "the importance attributable to changing social conditions as a justification of new legal doctrines is overstated and quite often mischievous" (1980, 253).

²⁵ On the efficiency of precedents, see Harnay and Marciano (2004) and Marciano and Khalil (2012), but their notions of efficiency are different from Coase's.

is that Coase is favourable to standards interpreted by common-law judges who would be efficient. But why would they be?

Coase indeed relies on the judges' motivation. He suggests that the judge, contrarily to the legislator, takes into account, at least to a certain extent, the economic criterion.²⁶ Therefore the difference between judges on the one hand and regulators and legislators on the other would lie not only in the means at their disposal (the common-law system with its better information, adaptation and flexibility) but also, and maybe above all, in the aim they would pursue. However, that they understand reciprocity and seem conscious of costs and benefits can mean that they consider these elements, but not that they decide in accordance with them. Even if Coase's argument of their taking into account economic arguments was valid, it would not be sufficient to claim that judges are not subjected to political pressures and industry capture, and that they do not need a competitive check to be efficient. Why would the judges' motivation be different from legislators' and regulators'? Why, when motivated by self-love, would they pursue economic efficiency? In fact, this question remains pending. To the best of my knowledge, Coase's texts do not give any explicit reason.

It is not the place here to discuss the motivations of judges (see, e.g., Posner 2008), but it is possible to mention just a few elements that could also have a role on their decisions (and for some of them go contrary to economic efficiency): the influence of organized interest groups, monetary interests (Leff 1974, Horwitz 1977), desire for reputation (Miceli and Cosgel 1994, Harnay and Marciano 2004) and policy views. But in Coase's works, there is no justification for bringing closer the judge's self-love and the pursuit of economic efficiency.

Finally, even if the motivation of common-law judges was actually different from legislators and regulators, why would they have the information needed to decide according to the efficiency criterion? Why would they obtain all the information that is necessary since, like regulators and legislators, they have no price? The problem is all the more crucial when costs and benefits are subjective and therefore not observable nor measurable.²⁷ This is a common Austrian criticism, summed up by Pasour: "The calculation problem lies at the heart of the Coase approach. A court cannot determine whether the railroad or farmer's use of affected land has greater value for at least two reasons. First, market signals in this case are unreliable as a measure of social cost," for, in the presence of externalities, prices would not reflect opportunity costs, which are not knowable since subjective. "Second, adds Pasour, the

²⁶ Note that the role of the interactions of judges with lawyers and juries is not mentioned by Coase.

²⁷ Contrarily to the notion of subjective opportunity cost that Coase (1938) developed in his youth, in his 1960 article, he assumes that the judge takes into account the costs of a decision that he will not bear, thus objective costs, and that these costs are measurable in practice (see Bertrand 2014).

Coasean judge, constrained by the Mises-Hayek knowledge problem, cannot obtain the information necessary to determine the most efficient pattern of resource use. . . . In short, the Mises-Hayek arguments are just as applicable to the Coasean judge as to the Pigouvian tax assessor and the overall central economic planner” (1996, 249-50). Even in Coase's setting, judges' cognitive capacities would have to be as limited as those of regulators and legislators. For example, even *ex post*, judges do not base their decisions on *all* the relevant factors (Kaplow 1992, 594).

To sum up, in Coase's framework, it would be possible to consider that judges, legislators and regulators are human beings of the same kind, all motivated by self-love, but that self-love is expressed differently according to the institutional arrangement in which they operate. Common-law features that Coase underlines are, however, neither specific to common law nor sufficient to make judges' motivation coincide with economic efficiency.

5. Concluding remarks

“The problem of social cost” asserts a normative role for the judge: to allocate the property right to the person who would pay the most for it, thus diminishing the need for exchanging this right and hence the costs associated with such an exchange. It has been shown that Coase giving this role to the judge comes from a conjunction of empirical theses about: i) the inefficiency of both regulation (be it promulgated by regulators or legislators) and allocation of property rights by legislators, and ii) the efficiency of such allocations by judges. This has two consequences. First, the judge as envisioned by Coase seems to be exempted from his view of public intervention and his comprehension of human beings and of their motives (inspired by Adam Smith). Second, the figure of the judge escapes the tenets of Coase's theoretical system that made it first necessary. This paper provided some reasons that could explain, in Coase's view, this difference of treatment between the judge and other figures of public intervention: by nature, common law would be adversarial, *ex post*, and flexible.

Some elements, however, call into question Coase's belief in a fundamental difference between judges and other public agents, and therefore restore the thesis of his inconsistency. The costs of each system are not evaluated or compared. The opposition Coase makes between common law on the one hand, and statute and regulatory law on the other, is to be softened. The features of common law that could help judges to take into account economic considerations are not sufficient to assert that they do or that they are motivated by economic efficiency; they are not either sufficient to claim that they have all the necessary information

and cognitive abilities. Eventually, specific motivations and abilities of judges remain unexplained.

Coase's confidence in the common-law solution to externalities is therefore rather presupposed than argued for. But this does not mean that this solution must be dismissed. Other conceptions of efficiency are more favourable to it. Coase conceives efficiency as an external standard (Pareto optimality or maximization of the value of production²⁸), whereas thinking efficiency as an evolutionary process makes it lie upon the litigation system and not on the motivations and capacities of judges (Rubin 1977, Priest 1977, Goodman 1978, Landes and Posner 1979, Cooter and Kornhauser 1980). Here again, however, the specificity of common law, i.e. its relative advantage, would have to be argued for (Rubin 1982).

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²⁸ In Coase's theoretical framework, Pareto-optimal allocations are equivalent to allocations that maximize the net value of the production (Kaldor-Hicks efficiency).

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