

ESTABLISHING A MORAL DUTY TO OBEY THE LAW  
THROUGH A JURISPRUDENCE OF LAW AND  
ECONOMICS

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I. INTRODUCTION

This Article will examine whether a legal system with a jurisprudence of law and economics can establish a moral duty to obey the law. It is assumed that a jurisprudential system of law and economics is wealth-maximizing.<sup>1</sup> If the jurisprudence can also be found to command a moral duty to obey the law, then a legal system has been established that simultaneously answers two of the most fundamental issues in society. This investigation limits its scope of wealth-maximizing legal systems to two schools of “free market” law and economics—the Chicago and Austrian schools. Part II of this Article determines that the most effective methodology to establish a moral duty to obey the law measures the procedural assurances of substan-

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1. While the two systems covered in this investigation most likely are not both perfectly wealth-maximizing, it is assumed that they, at least, both greatly increase wealth. This Article will not question each school’s assertion that it is wealth-increasing.

tive justice. This methodology was recently developed by Randy Barnett.<sup>2</sup> Part III of this Article establishes substantive justice through the natural rights<sup>3</sup> recognized by the philosophy of classical liberalism, the protection of which will establish substantive justice.<sup>4</sup> Finally, Part IV evaluates the policies of the two law and economics schools to determine the level of procedural protection they would provide for those natural rights as a jurisprudence.

## II. ESTABLISHING A MORAL DUTY TO OBEY THE LAW

Political theologians have long understood that it is desirable to escape the chaos and uncertainty that human nature makes inherent in the state of nature. The desirability of escaping the state of nature is the premise of Thomas Hobbes<sup>5</sup> and John Locke's<sup>6</sup> classic works, and earlier philosophers such as Aristotle would not even concede that an individual could exist outside the politic.<sup>7</sup> As characterized by Locke, being outside the state of nature allows one to stop building fences and start sowing farms.<sup>8</sup> In essence, moving outside the state of nature is desirable because it provides security and maximizes

2. RANDY E. BARNETT, *RESTORING THE LOST CONSTITUTION: THE PRESUMPTION OF LIBERTY* (Princeton Univ. Press 2004). Randy E. Barnett is the Carmack Waterhouse Professor of Legal Theory at the Georgetown University Law Center. He is also a senior fellow at the Cato Institute.

3. For purposes of simplicity, this Article will specifically address the views of natural rights held by John Locke, hereinafter referred to as Lockean Natural Rights. Any inference from these natural rights will be informed by the philosophy of classical liberalism.

4. Classical liberalism is a philosophy of the Enlightenment era that is founded upon the principle of individual liberty. Many philosophers and theologians contributed to the intellectual foundation of the natural rights of classical liberalism, but prominent among them were John Locke, David Hume, Adam Smith, Immanuel Kant, Thomas Jefferson and, more recently, Robert Nozick. *See generally* DAVID BOAZ, *LIBERTARIANISM: A PRIMER* 16, 56-7 (The Free Press 1997) (describing the key concepts of classical liberalism and how the philosophy of classical liberalism has come to be closely aligned with today's libertarianism).

5. On the state of nature, Hobbes wrote that:

In such condition, there is no place for Industry; because the fruit thereof is uncertain: and consequently no Culture of the Earth; no Navigation, nor use of the commodities that may be imported by Sea ... no Arts; no Letters; no Society; and which is worst of all, continuall feare, and danger of violent death; And the life of man, solitary, poore, nasty, brutish, and short. . . .

THOMAS HOBBS, *LEVIATHAN* 89 (Rev. Student ed., Cambridge Univ. Press 1996) (1651). On the need to remove oneself from the state of nature, Hobbes wrote that: "The finall Cause, End or Designe of men . . . is the foresight of their own preservation, and of a more contented life thereby; that is to say, of getting themselves out from that miserable condition of Warre . . ." *Id.* at 117.

6. Locke's picture of the landscape of human interaction in the state of nature was not as dismal as Hobbes', but he readily acknowledged a number of problems, such as the lack of dispassionate neutral arbitrators determining the extent to which a natural right was violated and demanded retribution. JOHN LOCKE, *TWO TREATISES OF GOVERNMENT* §5-§§ 7, 127 (Kessinger Publ'g 2004) (1690).

7. *See* HADLEY ARKEYS, *FIRST THINGS: AN INQUIRY INTO THE FIRST PRINCIPLES OF MORALS AND JUSTICE* 11-30 (1986).

8. LOCKE, *supra* note 6, at § 123.

utility. Almost all political philosophers acknowledge that the only way to escape the state of nature is through a government which has some method to enforce compliance with laws and some degree of centralization.<sup>9</sup> The key motivation and revelation of Hobbes' and Locke's Enlightenment era scholarship was that there needed to be a moral justification to remove an individual from the state of nature and into this governmental order. If there is such a moral justification, then each individual has a moral duty to obey the law.

A reason to obey the law can be either prudential or moral. A prudential reason to obey the law is simply because doing so is in one's own best interest.<sup>10</sup> A moral reason to obey the law is because one has an intrinsic philosophical reason to do so.<sup>11</sup>

Prudential reasons to obey the law do not prescribe a moral duty upon the individual and, hence, need no moral justifications.<sup>12</sup> For example, if the law dictates that one cannot drive more than fifty-five miles per hour upon penalty of a ticket, then he may decide to drive below fifty-five miles per hour if he determines that the risk of getting a ticket is great enough. But he would have no moral duty to do this; it is simply a rational choice of self-interest. As a prudential reason to obey the law was never sufficient for Locke or Hobbes, it is also insufficient for purposes of this Article.<sup>13</sup>

A moral reason to obey the law assigns an intrinsically binding duty upon the individual. Perhaps the most common reason to obey the law is legal positivism.<sup>14</sup> A strict legal positivist believes that a government gains legitimacy over individuals simply by being sovereign over them.<sup>15</sup> In order to be sovereign over individuals, citizens have to be in a habit of obedience to the government and that government must not be in a habit of obedience to a determinant human

9. The exceptions are anarcho-capitalists, such as David Friedman, who hold that private law, courts, and police are equally if not more capable of bringing individuals out of the state of nature. DAVID FRIEDMAN, *THE MACHINERY OF FREEDOM: GUIDE TO A RADICAL CAPITALISM* 114-26 (Open Court 2d ed. 1989); see BRUCE L. BENSON, *THE ENTERPRISE OF LAW: JUSTICE WITHOUT THE STATE* 349-78 (1990); BRUCE L. BENSON, *TO SERVE AND PROTECT: PRIVATIZATION AND COMMUNITY IN CRIMINAL JUSTICE* 73-318 (1998). See *generally* ANARCHY AND THE LAW: THE POLITICAL ECONOMY OF CHOICE (Edward P. Stringham ed., 2007) (specifically, articles in Part I detail theories of and articles in Part IV detail historical applications of anarchy and subscription-based law).

10. BRIAN BIX, *JURISPRUDENCE THEORY AND CONTEXT* 169 (Carolina Academic Press 3d ed. 2004); N.E. SIMMONDS, *CENTRAL ISSUES IN JURISPRUDENCE* 23-24, 66 (Sweet & Maxwell Lmt. 1986).

11. See sources cited *supra* note 10.

12. See sources cited *supra* note 10.

13. See Hadley Arkes, *News for the Libertarians: The Moral Tradition Already Contains the Libertarian Premises*, 29 HARV. J.L. & PUB. POL'Y 61, 61 (2005) ("[B]eings who can give and understand reasons deserve to be ruled with a rendering of reasons . . .").

14. See SIMMONDS, *supra* note 10, at 77.

15. See JOHN AUSTIN, *THE PROVINCE OF JURISPRUDENCE DETERMINED* 193-213 (Promethium Books 2000) (1832).

superior.<sup>16</sup> Under a philosophy of pure positivism, the most ruthless dictators of recent history—Pol Pot, Joseph Stalin, and Saddam Hussein—would command a moral duty of obedience.<sup>17</sup> Such a theory is facially absurd, as is the idea that legal positivism establishes a moral duty to obey the law.

### A. *Legitimacy from Consent*

Much of modern liberal philosophy, especially Western philosophy, is premised on consent.<sup>18</sup> Consent is powerful enough to turn a legal bad into a legal good and is certainly sufficient to establish a moral duty to obey the law. For example, consent is powerful enough to turn battery into boxing. That being the case, the ideal method of establishing a moral duty to obey the law is through an individual's own consent to be governed by that law. Sir William Blackstone expresses this idea clearly: “[N]o subject of England can be constrained to pay any aids or taxes, even for the defence of the realm or the support of government, but such as are imposed by his own consent, or that of his representatives in parliament.”<sup>19</sup>

Due to the vast power of consent, if there is consent to be governed, then one can consent to give up, or alienate, one's rights.<sup>20</sup> As

16. *Id.*

17. See generally F.A. HAYEK, THE CONSTITUTION OF LIBERTY 236-46 (1960) (arguing that by removing all constraints on what government can legitimately do, legal positivism clears the way for facism).

18. Leslie Green, *Law and Obligation*, in THE OXFORD HANDBOOK OF JURISPRUDENCE AND PHILOSOPHY OF LAW 514, 525 (Jules Coleman & Scott Shapiro eds., 2004) (referencing PATRICK RILEY, WILL AND POLITICAL LEGITIMACY (1982)); see JULIUS STONE, THE PROVINCE AND FUNCTION OF LAW 222 (Williams S. Hein & Co. Inc. 1968).

19. 1 SIR WILLIAM BLACKSTONE, 2 COMMENTARIES \*135 (Chicago: The Univ. of Chicago Press 1979) (1765). See generally *Chrisholm v. Georgia*, 2 U.S. (Dall.) 419 (1793). “[T]he basis of sound and genuine jurisprudence; laws derived from the pure source of equality and justice must be founded on the CONSENT of those, whose obedience they require.” *Id.* at 458 (Wilson, J., concurring) (comment made in the context of determining that the source of the United States' authority is the popular sovereignty of the people, not authorization from the states). Modern jurisprudence has determined that this constitutional doctrine was overturned by the Eleventh Amendment. *Alden v. Maine*, 527 U.S. 706 (1999); *Seminole Tribe v. Florida*, 517 U.S. 44 (1996). But see John F. Manning, *The Eleventh Amendment and the Reading of Precise Constitutional Torts*, 113 YALE L.J. 1633 (2004); Randy E. Barnett, *The People of the State?: Chrisholm v. Georgia and Popular Sovereignty*, Expresso Preprint Series Working Paper 2014, available at <http://law.bepress.com/expresso/eps/2014>.

20. Although one can alienate his rights, many liberal Western philosophers maintain that the power of consent does not extend to consenting to slavery. See JOHN STUART MILL, ON LIBERTY 120 (Cosimmo 2005) (1859) (presenting a utilitarian reason against voluntary slavery); see also RANDY E. BARNETT, THE STRUCTURE OF LIBERTY: JUSTICE AND THE RULE OF LAW 78-80 (Oxford Univ. Press 1998) [hereinafter BARNETT, STRUCTURE OF LIBERTY]; Randy E. Barnett, *Contract Remedies and Inalienable Rights*, 4 SOC. PHIL. & POL'Y 179 (1986) (presenting a rights-based argument against voluntary slavery and forms of specific performance for personal service contracts. Barnett's distinction is based upon the idea that one can alienate his acquired rights but not his inherent rights); Letter from Lysander Spooner to Thomas F. Bayard (May 27, 1882), in THE LYSANDER SPOONER READER 123,

long as the government acts within the rules which the individual has consented to, that government is not violating the individual's natural rights.<sup>21</sup> Therefore, if there is consent to be governed and the government is acting within the rules to which the individual has agreed, that individual has a moral duty to obey the law.

The most obvious method of consent to be governed would be actual consent. If an individual did actually consent to be governed by the law, then he would have a moral duty to obey that law. However, for the reasons explained below, no such consent is realistically possible in any large geographically-based government.<sup>22</sup> The first of two possible methods of actual consent is where the individual physically consents to be governed.<sup>23</sup> For example, an individual would be giving actual consent if, when he turned eighteen years old, he walked up to the National Archives Building in Washington, D.C. and signed an addendum to the Constitution. This, of course, is not realistic and is not observed in any national government today, so there is no actual consent through one's own physical consent. The second method—and also a frequently used argument for the current existence of actual consent—is that when a previous generation actually consents to be governed and thereby establishes for themselves a moral duty to obey the law, future generations are also consenting and have a moral duty to obey the law. This is a type of agency theory. However, because no form of agency theory accepts that an agent can agree to bind someone not yet born, there is no actual consent by a current generation that has been established by a past generation.<sup>24</sup>

Another potentially legitimate method of consent is implied consent. Implied consent means that even though one has not explicitly consented to be governed, one's actions have implied that consent.<sup>25</sup> The most common arguments for why individuals have implicitly consented to be governed are that they have participated in the voting process, that they have continued to reside in a jurisdiction, and

123-24 (1992). *But see* ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 331 (Basic Books 1974) (supporting a rights-based argument for voluntary slavery). Of note, Locke would not have accepted that one could negotiate himself into slavery. *See* LOCKE, *supra* note 6, at § 23.

21. *See infra* notes 66-79 and accompanying text.

22. All governments in our world's history have been geographically based. By this I mean that the nation is comprised of all land within certain borders. As is explained later, this makes consent impractical if not impossible. A nongeographically based government, however, could realistically have truly voluntary actual consent. However, even in geographically based nations, actual consent is given by many government officials, voluntary immigrants, and armed forces members. *Id.*

23. Philosophers of law rarely talk about actual consent to the law as a practical justification for a moral duty to obey the law. This is not because such consent would not be productive but, rather, because it is unrealistic.

24. *See* BIX, *supra* note 10, at 136; DAVID HUME, SELECTED ESSAYS OF THE ORIGINAL CONTRACT 279 (Oxford Univ. Press 1993).

25. *See* AUSTIN, *supra* note 15, at 527-28.

that they have paid taxes in that jurisdiction.<sup>26</sup> All of these arguments, though, fail.

Those who argue that voting provides an implied consent to be governed reason that by voting one is injecting himself into the governing process and, hence, taking ownership of it. If the voter's candidate or position wins, then he is obligated to follow the rules which his candidate imposes upon others. If one's candidate or position loses, then he is obligated to accept the result of the process in which he has voluntarily participated. If one does not vote, then he has voluntarily chosen inaction and must accept the outcome.<sup>27</sup>

The fatal flaw in this logic is that the voter is not voluntarily taking part in the election. The voter is not acting voluntarily because there is no way for him to not act.<sup>28</sup> If the individual votes, then one is said to consent, but if he refrains from voting, he will be said to have assented to the result through a lack of protest.<sup>29</sup> Because it is not consent if one cannot say "no," voting cannot amount to an individual's consent to be governed. Voting could only be considered consent if an individual could withhold his consent by choosing not to vote. But even then, if withholding consent only meant not being held to the whims of the elected winner—in such policies as taxes—would the individual truly be voluntarily consenting. If, instead, the individual who withholds his vote was still at the whim of the majority's tax policy, then voting is a form of self-defense, not consent, just as shooting a man who is running at you with a knife is self-defense, not murder.<sup>30</sup>

Those who argue that residence in a jurisdiction provides an implied consent to be governed by a sovereign reason that by choosing not to leave a jurisdiction, an individual is choosing to live under its laws.<sup>31</sup> Residing in a sovereign jurisdiction is a voluntary choice to be bound by the decisions of the sovereign and hence prescribes a moral duty to obey the laws of that jurisdiction. The fundamental flaw with this reasoning is that it assumes the sovereign has the initial authority to demand consent from an individual in order for that individual

26. *Id.*

27. See 1 JOHN PLAMENATZ, *MAN AND SOCIETY: A CRITICAL EXAMINATION OF SOME IMPORTANT SOCIAL AND POLITICAL THEORIES FROM MACHIAVELLI TO MARX* 240 (Longman 1963).

28. An individual's action is not voluntary if he cannot choose to not do it.

29. HERBERT SPENCER, *SOCIAL STATICS* 318-28 (Adamant Media Corp. 2000) (1892).

30. LYSANDER SPOONER, *NO TREASON: THE CONSTITUTION OF NO AUTHORITY* 31, 38-39 (Pine Tree Press 1966) (1870).

31. Notably, John Locke took the position that residence established a duty to obey the law, although he used the term "legitimacy of government." LOCKE, *supra* note 6, at § 119. While this Article adopts Locke's theory of Natural Rights, it does not adopt his theory of establishing of a duty to obey the law. Furthermore, while Locke is a key figure in the development of classical liberalism, his theory of residence has not been adopted by the majority of classical liberal scholars.

to maintain his residence and his property rights to his land. This proposition is circular and has been called bootstrapping: A establishes authority over B by maintaining that B can only remain on his land by recognizing the authority of A.<sup>32</sup>

The residency-as-implied-consent argument further fails because of the extremely high costs of leaving one's residence. Due to this high cost, it cannot be derived from an individual's lack of moving that he is affirmatively stating that he is consenting to be governed.<sup>33</sup> Asking someone to give up his home, his heritage, his relationships with the community, and his job in order to say "no, I don't consent" is hardly a neutral proposition. Because saying "no" is such a costly option, the weight of the fact that the resident did not say no is greatly diminished. While this is a strong argument against any consent value of maintaining residence, there would seem to be more consent value for one who moves to that jurisdiction.

Those who argue that paying taxes provides an implied consent to be governed reason that by providing the financial wherewithal for the government's actions, one is effectively becoming a part of the government. The fatal flaw of this argument is, again, that since there is no way to say "no," saying "yes" is not voluntary and, therefore, not consent. "The fact is that the government, like a highwayman, says to a man: 'Your money, or your life.' And many, if not most, taxes are paid under the compulsion of that threat."<sup>34</sup>

There is an additional argument that hypothetical consent to be governed establishes a moral duty to obey the law. Hypothetical consent is said to be established when a rational person would consent to be governed.<sup>35</sup> The most widely accepted version of hypothetical consent relies upon a test of when an individual who is blind to his particular circumstances in life—his intelligence, wealth, opportunities, et cetera would decide to consent to the laws.<sup>36</sup> Whatever one may think of the merits of this test of legitimacy, because the consent is hypothetical, it is not any act of consent and does not morally bind

32. BARNETT, *supra* note 2, at 18-19 (citing Lea Brilmayer, *Consent, Contract, and Territory*, 74 MINN. L. REV. 1, 10-13, 16 (1990)).

33. BARNETT, *supra* note 2, at 19, 41-42 (citing FRANK H. KNIGHT, *FREEDOM AND REFORM: ESSAYS IN ECONOMICS AND SOCIAL PHILOSOPHY* 419 (1982)); BIX, *supra* note 10, at 169; DAVID HUME, *SELECTED ESSAYS OF THE ORIGINAL CONTRACT* 283 ("Can we seriously say, that a poor peasant or artisan, has a free choice to leave his country, when he knows no foreign language or manners, and lives, from day to day, by the small wages which he acquires? We may as well assert that a mar, by remaining in a vessel, freely consents to the dominion of the master; though he was carried on board while asleep, and must leap into the ocean and perish [in order to avoid consenting].").

34. SPOONER, *supra* note 30, at 17.

35. JOHN RAWLS, *A THEORY OF JUSTICE* (1971).

36. This is termed the "veil of ignorance." *Id.*

as an act of consent would.<sup>37</sup> Furthermore, it is virtually impossible for third parties to determine what conditions an individual would consent to. For example, Rawls' veil of ignorance is afflicted by utter ignorance of individuals' level of risk aversion or risk loving.

There is no actual or implied consent to be governed and, therefore, no consent-based moral duty to obey the law. The idea that there is consent is not simply false but also dangerous because it establishes a patina of legitimacy in the government no matter how abusive its laws.<sup>38</sup>

### B. Legitimacy Without Consent

In addition to theories based upon of consent of the governed, there are theories that do not rely upon consent to establish a moral duty to obey the law.<sup>39</sup> The strongest non-consent based arguments for establishing a moral duty to obey the law are that a moral duty arises from gratuity or fair play, that a moral duty arises only when individual laws are substantively just, and that a moral duty arises to the entire system to the extent that there are procedural safeguards assuring the justness of the laws the system produces.<sup>40</sup>

37. See BIX, *supra* note 10, at 136-37; RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 150-54 (1977) (discussing the very real distinction between Rawls' hypothetical consent and actual consent); Tony Honore, *The Social Contract Interpreted*, in MAKING LAW BIND 139, 154-55 (1987) (illustrating that while an actual contract can create new duties, a hypothetical one does not except under bizarre circumstances); *id.* at 156-57 (delegitimizing the hypothetical contract because the hypothetical man is prevented from entering into any alternative which he might have preferred).

38. See BARNETT, *supra* note 2, at 43-45.

39. See MILL, *supra* note 20, at 119-39 (affirming that many of the following theories are not consent based); H.L.A. Hart, *Are There Any Natural Rights?*, 64 PHIL. REV. 175, 185-86 (1955); John Rawls, *Legal Obligation and the Duty of Fair Play*, in LAW AND PHILOSOPHY 3, 10 (Sidney Hook ed., 1964).

40. There are also theories of legitimacy from the intrinsic value of democratic choice. *E.g.*, Thomas Christiano, *An Argument for Democratic Equality*, in PHILOSOPHY AND DEMOCRACY 39 (Thomas Christiano ed., 2003) (generally arguing that the primary element of justice is met by giving each person an equal opportunity to dictate how society is organized. However, these choices are limited to "collective property," and the scope of democratic choice can come into conflict with other elements of justice.); Joshua Cohen, *Procedure and Substance in Deliberative Democracy*, in PHILOSOPHY AND DEMOCRACY, *supra*, at 17 (arguing that in a society of reasonable pluralism—all western societies—legitimacy is met when democratic choices are made according to reasons that are compatible with every reasonable person's moral code. The moral code must be based on terms that everyone can accept.); David Estlund, *Beyond Fairness and Deliberation: The Epistemic Dimension of Democratic Authority*, in PHILOSOPHY AND DEMOCRACY, *supra*, at 69 (arguing that legitimacy is derived from a combination of fair, deliberative procedures and from decisions that are based on reasons that are not objectionable to any reasonable citizen). These theories are sophisticated and may deserve merit in an environment where consent is given. But without consent they do not provide legitimacy. *E.g.*, GUIDO PINCIONE & FERNANDO TESÓN, RATIONAL CHOICE AND DEMOCRATIC DELIBERATION: A THEORY OF DISCOURSE FAILURE 219 (2006); Richard J. Arneson, *Democratic Rights at a National Level*, in PHILOSOPHY AND DEMOCRACY, *supra*, at 95, 96-97.

### 1. *Gratuity and Fair Play*

The refutation of the arguments for gratuity and fair play are similar, so they will be addressed at the same time. The theory of gratuity is that there is a moral duty to obey the law when an individual receives benefits from another.<sup>41</sup> By receiving the benefit, he incurs a debt of gratitude toward his benefactor.<sup>42</sup> The theory of fair play is that the existence of a cooperative enterprise gives rise to a duty of obligation to the system.<sup>43</sup> The typical benefit referred to is the generalized benefit that one receives from living in a prosperous society, not a direct benefit such as a transfer payment.<sup>44</sup> The fatal flaw with these positions is that because the benefit is not asked for but instead forced upon the individual, gratuity and “returning the favor” are virtues, not legal obligations.<sup>45</sup> It is not a normally recognized legal principle that one may demand payment from another after unilaterally conferring a benefit upon that other person.<sup>46</sup>

The other relevant flaw of these theories is that in order for them to confer a moral duty, the recipients must either be active participants in the cooperative scheme or have contemplated the benefits and burdens of accepting the benefits along with the coinciding duties.<sup>47</sup> The reality is that most people have not “accepted” because they do not regard themselves as a part of a cooperative scheme and they have not contemplated and accepted the burdens that theoretically accompany the benefits. Receiving the generalized benefit of being a member of society is nothing that citizens ask for, voluntarily accept, or have the ability to reject. Individuals simply receive the benefit, and most often the recipients are either incapable of not taking advantage of the “societal benefit” or would have to go to great

41. BIX, *supra* note 10, at 170; Plato, *The Moral Obligation to Obey the Law*, in PHILOSOPHY OF LAW 210, 213-18 (Joel Feinberg & Jules Coleman eds., 6th ed. 2000).

42. BIX, *supra* note 10, at 170; Plato, *supra* note 41, at 213-18.

43. Hart, *supra* note 39, at 185-86. “When any number of persons conduct any joint enterprise according to rules, and thus restrict their liberty, those who have submitted to those restrictions when required have a right to similar submission from those who have benefitted from their submission.” *Id.* at 185. “[T]here is a mutually beneficial and just scheme of social cooperation . . . [which] requires a certain sacrifice from each person . . . under these conditions a person who has accepted the benefit of the scheme is bound by a duty of fair play to do his part . . .” *Id.*; see RAWLS, *supra* note 35, at 9-10.

44. See RAWLS, *supra* note 35, at 342-45, 347-48.

45. See generally JEREMY WALDRON, LAW AND DISAGREEMENT 214-19 (2004); Randy E. Barnett, *A Law Professor's Guide to Natural Law and Natural Rights*, 20 HARV. J.L. & PUB. POLY 655, 666-78 (1997) [hereinafter Barnett, *Law Professor's Guide*]; Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 296-300 (1986) [hereinafter Barnett, *Consent Theory*]. These sources provide elaborations on the difference between legally requiring behavior which is simply good versus legally requiring behavior which doesn't violate others' rights.

46. M.B.E. Smith, *Is There a Prima Facie Obligation to Obey the Law?*, 82 YALE L.J. 950, 953-54 (1973).

47. A. John Simmons, *The Principle of Fair Play*, 8 PHIL. & PUB. AFF. 307, 307-12 (1979).

lengths to avoid it.<sup>48</sup> Since it is very difficult or impossible to reject these benefits, accepting them is not sufficient to establish a moral duty to obey the law.

Possibly the most important reality that undermines the theory of gratuity is that even when benefits are directly and voluntarily received, because the government has monopolized the market by crowding out all other alternatives, there is no choice for individuals but to accept its services.<sup>49</sup> So while one might accept the government's services of fire protection when the fire department puts out the fire in his backyard, it is precisely society's rules which prohibit the existence of any other fire service which he could accept instead. Furthermore, when an individual has been forced to pay into a system, it would be unreasonable to ask him to turn away that service which he has already paid for. His acceptance of services for which he has already paid can hardly demonstrate that he owes a continuing duty to the system. Finally, when other individuals are receiving subsidized services, to ask one to pay full price is to ask him to put himself at a competitive disadvantage, which in our competitive world is a huge obstacle.<sup>50</sup>

Even if the theories of gratuity and fair play were accepted, they would only apply to laws which, when followed, provide a benefit to the other members of society.<sup>51</sup> For example, there would be no moral duty to wait at a red light of an empty intersection at 3:00 in the morning. One could owe a duty of reciprocity to others, but the law would have to actually grant individuals a benefit for that duty to be established.

48. RAWLS, *supra* note 35, at 336, 344.

49. There is no reasonable option but to accept the benefit of public roads or police protection because through the use of force government has artificially crowded out any substitute.

50. For example, in the U.S. Supreme Court case *Rumsfeld v. Forum for Academic and Institutional Rights*, 126 S. Ct. 1297 (2006), law schools wanted to establish their own standards for employers who could interview on campus. However, the U.S. government disagreed and demanded that the schools reflect the government's standards upon pain of having federal grant money taken away. Because all law schools receive a significant amount of grant money from the U.S. government, it was virtually impossible for any school to disobey the government, as doing so would put it at a huge competitive disadvantage with respect to every other law school. See Amicus Curiae Brief of the Cato Institute in Support of Respondents at 14-16, *Rumsfeld v. Forum for Academic and Institutional Rights*, 126 S. Ct. 1297 (2006) (No. 04-1152). See generally Ayn Rand, *The Question of Scholarship*, THE OBJECTIVIST, June 1966, at 11, 15 (building off the logic that mandatory payment into the pool which funds those grants makes self-financing more difficult).

51. Smith, *supra* note 46.

## 2. *Substantive Justice à la Carte*

The idea that a law is owed a duty of obedience only when it is substantially just has been in place since Thomas Aquinas.<sup>52</sup> The theory is quite straightforward, and Aquinas says it best himself in stating that “[unjust laws] are acts of violence rather than laws . . . a law that is not just, seems to be no law at all.”<sup>53</sup> In other words, a human positive law must not violate a law of justice.<sup>54</sup> Broadly speaking, under such a system, a law only holds a moral duty of obedience insofar as it is compatible with moral norms.<sup>55</sup> The legitimacy of this method of jurisprudence is founded upon the understanding that, even absent consent of the parties, it is legitimate for government to enforce the rights of individuals. Such a system would establish legitimacy but is not effective in furthering the purpose of government in bringing citizens out of the state of nature. The system fails to do this because it does not provide a method of resolving disputes and, in practice, is not a functional system at all.<sup>56</sup> This system would rely upon individuals determining the justness of each law they encounter and is really no different than the state of nature, as one of the main benefits of escaping the state of nature is that neutral third parties preside over controversies.<sup>57</sup>

## 3. *Systemwide Procedural Assurances of Substantive Justice*

The method of establishing a moral duty to obey the law which this Article accepts and later utilizes to analyze justness of jurisprudential systems of law and economics is based upon systemic proce-

52. Thomas Aquinas lived in the thirteenth century and is widely considered the most influential natural law theorist. RAYMOND WACKS, *UNDERSTANDING JURISPRUDENCE* 17 (Oxford Univ. Press 2005) His position is often summarized by the latin phrase *lex iniusta non est lex* (“an unjust law is no law at all”). See Norman Kretzmann, *Lex Iniusta Non Est Lex: Laws on Trial in Aquinas’ Court of Conscience*, 33 AM. J. JURIS. 99 (1998).

53. Brian Bix, *Natural Law Theory*, reprinted in *PHILOSOPHY OF LAW*, *supra* note 41, at 7, 9.

54. More accurately, according to Aquinas, human-created law is not law at all if it is incompatible with the natural law of justice. Edward J. Damich, *The Essence of Law According to Thomas Aquinas*, 30 AM. J. JURIS. 79, 81 (1985).

55. See generally JOHN FINNIS, *NATURAL LAW AND NATURAL RIGHTS* (Clarendon Press 1980). A system of justice that relies on the protection of natural rights is a correctness theory of legitimacy, as opposed to procedural correctness. A major problem with this type of system is always that there is a disagreement over how to define “correct.” This disagreement threatens to undermine the stability obtained from governance, which was a primary reason to leave the state of nature. This threat is a driving force for a procedurally based system. Estlund, *supra* note 40, at 70. However, as long as individuals have easy rights of escape between governments, disagreements with the definition of correct standards can be solved through political realignment.

56. A legal system where individuals can choose to follow the law sometimes but not others is not a system of law and order at all. There is no difference between this condition and individuals acting of their own accord without government in the state of nature.

57. See LOCKE, *supra* note 6. See generally HOBBS, *supra* note 5.

dural assurances of substantive justice.<sup>58</sup> The foundation for this methodology was first proposed by George Smith<sup>59</sup> and later developed by Randy Barnett.<sup>60</sup> The methodology establishes the justness of a legal system by determining whether the system maintains procedural methods which provide assurances that the resulting laws will protect justice.<sup>61</sup> The logic of the methodology is that a given level of protection provides for a corresponding level of certainty that any given law is just. Therefore, the level of protection these procedural methods provide prescribes the corresponding legitimacy of the legal system and, consequently, the level of moral duty to obey the law.<sup>62</sup> This methodology allows for a legal system which is both legitimate and efficient in establishing a centralized legal system that effectuates individuals being brought out of the state of nature.<sup>63</sup>

This method of analyzing the level of justness—and hence the level of moral duty that exists in any of its citizens to obey the law—provides a method by which to evaluate the legitimacy of the jurisprudential system of the Chicago school of law and economics and the Austrian school of law and economics.

58. This could be considered a system of imperfect procedural justice with an independent standard of justice. See RAWLS, *supra* note 35, at 85-86.

59. See George H. Smith, *Justice Entrepreneurship in a Free Market*, 3 J. LIBERTARIAN STUD. 405 (1979) [hereinafter Smith, *Free Market*]. George Smith proposed a legal system that was legitimate on libertarian grounds but was not totally voluntary. His system was based upon a truly public finding of fact and a verification of guilt which placed all burdens on the state and allowed no aggression on the defendant until guilt was determined. *Id.* at 421-24; George H. Smith, *Justice Entrepreneurship Revisited: A Reply to Critics*, 3 J. LIBERTARIAN STUD. 453, 456-58, 465-66 (1979) [hereinafter Smith, *Reply to Critics*].

60. BARNETT, *supra* note 2 (applying this methodology to the U.S. Constitution); see also Randy E. Barnett, *Libertarianism and Legitimacy: A Reply to Huebert*, 19 J. LIBERTARIAN STUD. 71 (2005) (stating that he derived this methodology from Smith). George Smith has said that this methodology has roots in Robert Nozick's recognition of legitimate procedural rules even in an "ultraminimal state." See Smith, *Free Market*, *supra* note 59, at 406-07. There are also notable similarities between the theory of procedural assurances and Lon Fuller's theory of justice, which relies upon a set of procedures necessary to make a legitimate law. See generally LON FULLER, *THE MORALITY OF LAW* 33-94 (1964) (Fuller's system is often considered one of pure procedural justice, but strong arguments are made that the procedures required are tools to achieve substantive justice.).

61. See Arneson, *supra* note 40. Arneson is discussing the merits of democracy, but has the same fundamental proposition as Barnett—that without consent the legitimacy of a political procedure rests on that procedure's ability to protect individual rights. There is no intrinsic merit in the procedure, only in the substantive outcome. "According to this [best results] approach, the procedures that work to produce the fairest outcomes are by definition the fairest procedures, so no trade-offs between fair procedures and fair outcomes enters into the picture." *Id.* at 10.

62. BARNETT, *supra* note 2, at 48, 51.

63. The methodology does not have the pitfalls of impossibility which actual consent does in large geographically based governments and does not fail to establish an entire legal system, as the à la carte method does.

### III. THE SYSTEM OF JUSTNESS: PROTECTION OF LOCKEAN NATURAL RIGHTS

The methodology of establishing a moral duty to obey the law discussed in this Article relies upon a specific definition of justice. This Article will define justice as the protection of Lockean natural rights.<sup>64</sup> However, in the general application of this methodology, any definition of justice can be used.<sup>65</sup>

Lockean natural rights are founded upon a belief that “every man has a Property in his own Person.”<sup>66</sup> More precisely, each individual begins with absolute ownership of himself. As such, every man has complete and absolute dominion over his own body. It is important to conceptualize that a man’s body is both his flesh and his mind.<sup>67</sup>

Two derivative rights flow from man’s absolute right over his own person: the right to think and make decisions and the right to property created with his own labor. The right to make decisions with one’s own mind necessarily requires that there is a freedom of autonomy in those decisions.<sup>68</sup> Anything less than full autonomy in making one’s own decisions is an infringement upon his natural right to make those decisions. Taking away this autonomy would be, in ef-

64. See generally *supra* notes 4-5. More specifically, justice is the protection of all of one’s natural rights. The logic of this Article is that Lockean natural rights are the only natural rights one possesses. The term “Lockean natural rights” encompasses a set of rights that is further described below. It is not, however, a rote acceptance of the rights John Locke arrived at. Classical liberal scholars have further developed Locke’s logic and their body of work is followed here. For example, see *infra* note 159.

65. See BARNETT, *supra* note 2, at 3-4.

66. LOCKE, *supra* note 6, at 28. Locke’s principle of a right to one’s own body is founded on religious grounds. Secular foundations to the right to one’s own body can be found in the philosophies of Immanuel Kant and Ayn Rand. For Immanuel Kant’s philosophy, see IMMANUEL KANT, *GROUNDING OF THE METAPHYSICS OF MORALS* (Mary Gregor ed., Cambridge Univ. Press 1998) (1785) (human rationality and ability to reason are the origination of natural rights, which necessitate free will); for Ayn Rand’s philosophy, see AYN RAND, *THE NEW INTELLECTUAL* 182 (1961) (“The source of man’s rights is not divine law or congressional law, but the law of identity. A is A—and man is man. *Rights* are conditions of existence required by man’s nature for his proper survival. If man is to live on earth, it is *right* for him to use his mind, it is *right* to act on his own free judgment, it is *right* to work for value and to keep the product of his work. If life on earth is his purpose, he has a *right* to live as a rational being: nature forbids him the irrational.”); Leonard Peikoff, *Objectivism: The Philosophy of Ayn Rand*, 353-54 (1991) (“Man’s rights require proof through the appropriate process of reduction. . . . Each of man’s rights has a specific source in the objectivist view of metaphysical nature . . . . All rights rest on the fact that man survives by a means of reason . . . that man is a productive being . . . the ethics of egoism.”).

67. See CHARLES FRIED, *MODERN LIBERTY* 95-107 (2007).

68. “[To] take this decision from you makes them a part-owner of you; it gives them a property right in you. Just as having such partial control and power of decision, by right, over an animal or inanimate object would be to have a property right in it.” NOZICK, *supra* note 20, at 173; see also CHARLES FRIED, *CONTRACT AS PROMISE* 7-8, 16 (1981) (describing the fundamental liberal doctrine that one has complete autonomy over his own mind).

fect, paternalism,<sup>69</sup> and paternalism is the ultimate antithesis of self-ownership.<sup>70</sup>

As when one makes a decision with his mind and he owns it, and when he crafts an idea he owns it, when one's hands mold clay he owns the resulting sculpture. One's absolute property right over his own body creates additional property rights in goods when his labor is combined with materials which are otherwise not owned by another.<sup>71</sup>

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69. See Alan Schwarz, *A Reexamination of Nonsubstantive Unconscionability*, 63 VA. L. REV. 1053, 1061-62 (1977) (concluding that the application of unconscionability doctrines on nonsubstantive grounds for buyer incompetence, form contracts, or poverty actually harms these consumers. Such laws only benefit lawmakers who believe that the poor are then forced to make what are in the lawmakers' beliefs "wise" decisions.). Even those who support the doctrine of unconscionability accept it as a paternalistic doctrine. See Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563, 624-49 (1982); Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763, 764 (1983). *But see* Seana Valentin Shiffrin, *Paternalism, Unconscionability Doctrine, and Accommodation*, 29 PHIL. & PUB. AFF. 205, 221-24 (2000) (arguing that the unconscionability doctrine is not inherently paternalistic because the state is merely refusing to use force to effectuate the contract). For a rebuttal to Professor Shiffrin's proposition, see *infra* note 74. Shiffrin agrees that truly paternalistic acts do intrude upon individuals' sacred autonomy, but yet leaves some room for such policies. Shiffrin, *supra*, at 220 n.25.

70. See Gerald Dworkin, *Paternalism, in MORALITY AND THE LAW* (Richard A. Wasserstrom ed., 1971); MILL, *supra* note 20, at 95. "Neither one person, nor any number of persons, is warranted in saying to another human creature of ripe years, that he shall not do with his life for his own benefit what he chooses to do with it." *Id.* Even the limited scope for paternalism to prevent an individual from making incorrect, irrational, and/or future liberty restricting choices has been criticized by some writing for the philosophy of libertarianism, see e.g., Gregory Mitchell, *Libertarian Paternalism Is an Oxymoron*, 99 NW. U. L. REV. 1245, 1260-69 (2005), on the grounds that such policies still violate one's natural right to autonomy of the self. See FRIED, *supra* note 67, at 46-50. "[A]s human beings we do not just experience good and evil but reflect upon and choose them, that goods not chosen are hardly human at all . . . . It follows that when we are deprived of our power of choice, we are not just infantilized, we are dehumanized, whatever good things are returned to us in exchange." *Id.* at 50. In other words, the value of our actions is that we choose them. If we do not make that choice, the value of that result is undermined. The implication of this is that preempting one's choices prevents that individual from making decisions of value. However, unfortunately paternalism is found throughout our law. See Eyal Zamir, *The Efficiency of Paternalism*, 84 VA. L. REV. 229, 230 (1998).

71. Locke terms materials which no one has a property interest in as being in the state of nature. This is Locke's famed Labor theory of property. "Whatsoever then he removes out of the state that nature hath provided, and left it in, he hath mixed his labor with, and joined to it something that is his own, and thereby makes it his property." LOCKE, *supra* note 6, at § 27. For simplicity's sake we will not include the right of first appropriation as a Lockean Natural right. Some classically liberal scholars consider the right of first appropriation (also referred to as homesteading) one and the same as Locke's labor theory, but they are technically distinct. See Peter Benson, *Philosophy of Property Law, in THE OXFORD HANDBOOK OF JURISPRUDENCE AND PHILOSOPHY OF LAW*, *supra* note 18, at 752, 762-63 & n.16 (illustrating the distinction through the interpretation of the historic case *Pierson v. Post*, 3 CAL. 175 (N.Y. Sup. Ct. 1805)); Richard A. Epstein, *Possession as the Root of Title*, 13 GA. L. REV. 1221, 1224-30, 1238-43 (1979). Of significant note, Locke's theory contains a proviso that purports to limit the ability to acquire property. This theory has been strongly rebutted by classical liberal scholars. See *infra* note 159.

So, an individual naturally has absolute property rights in three things: his body, the autonomous decisions and ideas that are produced by his mind, and the goods which are produced by a combination of his labor and nonappropriated materials.<sup>72</sup>

From these three natural rights flow two necessary conditions: the freedom to contract and the freedom from contract.<sup>73</sup> Freedom to contract holds that an individual may freely and voluntarily enter into a contract, that a contract shall not be held void, and that a contract shall be enforced.<sup>74</sup> Voluntariness includes all deliberate<sup>75</sup> actions

72. This is also commonly known as Locke's trilogy of Life, Liberty, and Property.

73. See BARNETT, *STRUCTURE OF LIBERTY*, *supra* note 20, at 65-68; Richard E. Speidel, *The New Spirit of Contract*, 2 J.L. & COM. 193, 194-99 (1982); see also JOHN STEWART MILL, *PRINCIPLES OF POLITICAL ECONOMY* 290 (Donald Winch ed., 1970) (1848). Though Mill was a utilitarian and did not base his philosophy on natural rights, his philosophical work is a foundation of classical liberalism and is appropriate to shed light on the necessary deduction of freedom of contract from one's property right in himself.

74. The idea that the state may enforce contracts on an unwilling party can appear on its face to be a limit on individual liberty. See Mark Pettit, Jr., *Freedom, Freedom of Contract, and the "Rise and Fall,"* 79 B.U. L. REV. 263, 287-90 (1999); Shiffrin, *supra* note 69, at 221-24. However, allowing oneself the ability to bind his future self is allowing for his autonomy by enlarging the realm of voluntary agreement. To not allow a man to bind his future self would take away his self-determination. See FRIED, *supra* note 68, at 16, 20-21. Also, once one voluntarily consents, he has done so through the free exercise of his mind and is therefore morally bound to the consequences. *Id.* Peter Benson, *Abstract Right and the Possibility of a Nondistributive Conception of Contract: Hegel and Contemporary Contract Theory*, 10 CARDOZO L. REV. 1077, 1177-96 (1989). Arguably more important than the promisor being morally bound to honor his contractual promise, when the act of contract is a manifestation of promisor's consent a right against the promisor has been acquired by the promisee. Barnett, *Consent Theory*, *supra* note 45, at 296-300. As it is just for the government to enforce all rights, it is just for the government to enforce this right. Fried's theory is commonly interpreted as a being based upon good behavior. In short, the state must enforce contracts because it is good behavior to honor one's promise. A strong objection to this, though, is that it is not legitimate for the government to enforce behavior which is simply good. In contrast, Barnett's theory is based upon consent which leads to rights. It is certainly legitimate for the government to enforce rights. The difference between Fried's and Barnett's theories parallels the difference between a jurisprudence based upon natural law and one based upon natural right or moral right and legal right. See Barnett, *Law Professor's Guide*, *supra* note 45, at 666-78). See generally JEREMY WALDRON, *LAW AND DISAGREEMENT* 214-19 (2004)). Therefore, forcing compliance with a contract voluntarily entered into is not counter to individual liberty. See AYN RAND, *Man's Rights, in THE VIRTUE OF SELFISHNESS* 149-50 (1964). Also, the application of not enforcing contracts most likely reduces the aggregate level of individual liberty. FRIED, *supra* note 68, at 8; Todd D. Rakoff, *Is "Freedom from Contract" Necessarily a Libertarian Freedom?*, WIS. L. REV. 477, 491-92 (2004). The following statement by Sir George Jessel is a well-recognized pronouncement that freedom to contract is composed of three elements: contracts are entered into voluntarily, contracts shall not be held void, and contracts shall be enforced.

It must not be forgotten that you are not to extend arbitrarily those rules which say that a given contract is void as being against public policy, because if there is one thing which more than any another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice. Therefore, you have this paramount public policy to consider—that you are not lightly to interfere with this freedom of contract.

which are done without fraud or duress.<sup>76</sup> Freedom *from* contract holds that an individual may refrain from transferring his property rights.<sup>77</sup> While in theory a legal system could exist where one of these freedoms would exist without the other,<sup>78</sup> logic dictates that abrogating either the freedom to or the freedom from contract is an infringement upon the individual's natural right to his own property.<sup>79</sup>

The conditions upon which the following jurisprudential systems will be evaluated to determine whether they protect Lockean natural rights are the right to one's own body, the right to the autonomy of decision, and the right to the property which one produces, along with the necessary derivatives of freedom to contract those rights and the freedom from contracting those rights.

#### IV. EVALUATING THE CHICAGO AND AUSTRIAN LAW AND ECONOMICS JURISPRUDENTIAL SYSTEMS THROUGH BARNETT'S METHODOLOGY

A jurisprudence of law and economics proposes that judges determine cases based upon the most economically efficient outcomes.<sup>80</sup> In this way, law and economics is a procedural methodology of jurisprudence.<sup>81</sup> This methodology has multiple schools, but this Article will examine only the Chicago and Austrian schools. This study will survey the outcomes of legal controversies under these two schools in order to determine whether, as jurisprudential procedures, they protect Lockean natural rights and the requisite freedoms discussed

*Id.* at 479-80 (quoting *Printing & Numerical Registering Co. v. Sampson*, (1875) 19 L.R. Eq. 462, 465).

What Sir Jessel terms freedom of contract, Rakoff terms freedom to contract in order to accommodate the slightly distinct concept of freedom from contract. *See id.* at 481, 488.

75. "Deliberate" refers to the deliberateness of the act committed by the individual, not the consequential action or the resulting end.

76. Rakoff, *supra* note 74, at 480.

77. *Id.* at 481; BARNETT, *STRUCTURE OF LIBERTY*, *supra* note 20, at 65. The term "freedom from contract" is sometimes expanded to include the lack of legal enforcement of a voluntary agreement. *See* Edwin Patterson, *An Apology for Consideration*, 58 COLUM. L. REV. 929, 949-52 (1958). However, for the reasons explained in note 51, this Article's use of the term "freedom from contract" does not include Patterson's lack of enforcing contracts.

78. Modern legal systems often respect the freedom to contract more than they do the freedom from contract.

79. Robert Nozick's entitlement theory of justice, which holds that justly held property rights must be either justly originally acquired or justly transferred, mandates that transfer must be both free (freedom to contract) and voluntary (freedom from contract). NOZICK, *supra* note 20, at 159-64. *See generally* Honore, *supra* note 37, at 156-57 (explaining how freedom from contract, which he terms freedom not to contract, is a necessary principle for the philosophical foundations of contract).

80. NICHOLAS MERCURO & STEVEN G. MEDEMA, *ECONOMICS AND THE LAW: FROM POSNER TO POST MODERNISM AND BEYOND* 105-07 (2d ed. 2006). *See generally* LOUIS KALPOW & STEVEN SHAVELL, *FAIRNESS VERSUS WELFARE* 52-58 (2002); RICHARD POSNER, *PROBLEMS OF JURISPRUDENCE* 353-61 (2005).

81. As a jurisprudence which resolves controversies according to a written (or unwritten) law is a procedure, so is a jurisprudence which resolves controversies according to economic efficiency.

above. So far as these schools' policies protect Lockean natural rights, a jurisprudence based upon them would also protect those rights. Each system would then serve as a procedural safeguard for Lockean natural rights. As such, to the degree that each jurisprudential system protects Lockean natural rights, they are legitimate and are owed a moral duty of obedience by individuals.<sup>82</sup>

#### A. *Introduction to the Chicago and Austrian Schools*

The Chicago school is based upon *modern* neoclassical economics and the Austrian school is based upon Austrian economics.<sup>83</sup> Both the modern neo-classical and the Austrian schools of economics are derived from the marginalist revolution of the mid-1800s.<sup>84</sup> The marginalist revolution featured a number of insights, but most relevant to the understanding of the Chicago and Austrian schools is the movement's ability to derive economic laws from the observation of individuals making their own subjectively-based choices.<sup>85</sup> Economists from the marginalist revolution concluded that individual actors made decisions to buy, sell, or refrain from acting based upon their own subjectively valued incentives and costs in order to advance their own ends.<sup>86</sup> Furthermore, these actions resulted in the creation of objectively wealthier markets.<sup>87</sup>

The modern neoclassical school grew to embody the assumptions that individuals exhibit maximizing behavior, that individuals exhibit stable preferences, and that markets are close to and strive to reach equilibrium.<sup>88</sup> The assumption that individuals exhibit maximizing behavior includes the proposition that both buyers and sellers

82. See *supra* Part II.B.3.

83. For a neoclassical economics introduction, see JOHN M. LEVY, *ESSENTIAL MICROECONOMICS FOR PUBLIC POLICY ANALYSIS* 61-64 (1995).

84. The marginalist revolution in economics is attributed primarily to the works of Stanley Jevons, Léon Walras, and Carl Menger. Of the three, the works of Menger were the most influential on the Austrian school. A.M. ENDRES, *NEOCLASSICAL MICROECONOMIC THEORY: THE FOUNDING AUSTRIAN VERSION* 1-8, 19-23 (1997). See *id.* at 210-21 for a more direct discussion of the similar origins of modern neoclassical and Austrian schools and where they went their separate ways. See ALLEN OAKLEY, *THE FOUNDATIONS OF AUSTRIAN ECONOMICS FROM MENGER TO MISES* 54-61 (1997) (discussing the subjectivist foundation of Menger's marginalist scholarship). This subjectivism, the reader will see, is at the foundation of Austrian economics.

85. Joseph J. Spengler, *The Marginal Revolution and Concern with Economic Growth*, in *THE MARGINAL REVOLUTION IN ECONOMICS* 203, 212 (R.D. Collison Black et al. eds. 1973).

86. *Id.*

87. See William Jaffe, *Léon Walras' Role in the "Marginal Revolution" of the 1870s*, in *THE MARGINAL REVOLUTION IN ECONOMICS*, *supra* note 85, at 113, 118-21; Donald Winch, *Marginalism and the Boundaries of Economic Science*, in *THE MARGINAL REVOLUTION IN ECONOMICS*, *supra* note 85, at 59, 62-63. Menger's work, however, doubted the ability to verify objectively wealthier markets. *Id.* at 64.

88. GARY S. BECKER, *THE ECONOMIC APPROACH TO HUMAN BEHAVIOR* 5 (1976).

are fully rational and have high levels of information.<sup>89</sup> The assumption that the market is in equilibrium includes the proposition that there is no price taking—which necessitates perfect competition and a lack of monopolies—and that those products are standardized. The modern neoclassical school also assumes that all goods are assigned property rights and those property rights are enforced. It is not explicitly stated that property rights can be valued objectively, but the school's methodology necessarily does so through its use of utility functions, its utilization of interpersonal comparisons of value, and its overlooking of the inherent subjective nature of individual decisionmaking.<sup>90</sup> Through these assumptions, the neoclassical school's analysis is based upon system-wide models.<sup>91</sup>

While the Chicago school's model attempts to reflect the system, the Austrian school's<sup>92</sup> model attempts to reflect individual actions.<sup>93</sup> In doing so, the Austrian school's critique of the Chicago model is that by trivializing the very real, inherently subjective nature of individual decision-making, its results are a distortion of reality.<sup>94</sup> The Austrian school asserts that due to the Chicago school's demand for determinacy, its model crowds out very significant questions of subjective assessment, institutional context, social embeddedness, knowledge, judgment, entrepreneurship, creativity, process, and history.<sup>95</sup> The Austrian school is not alone in making this criticism.<sup>96</sup>

89. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 3 (5th ed. 1998). The microeconomic foundations of modern neoclassical economics are predicated on full information, but more advanced applications of the methodology do include some considerations of information levels. To illustrate this through contrast, see *infra* note 155 and accompanying text.

90. See Steven Horwitz, *Subjectivism*, in THE ELGAR COMPANION TO AUSTRIAN ECONOMICS 17, 20-21 (Peter J. Boettke ed., 1994); Walter Block, *Austrian Theorizing: Recalling the Foundations*, Q.J. AUSTRIAN ECON., Winter 1999, at 21, 31, available at [http://www.mises.org/journals/qjae/pdf/qjae2\\_4\\_2.pdf](http://www.mises.org/journals/qjae/pdf/qjae2_4_2.pdf). See generally Israel M. Kirzner, *The Subjectivism of Austrian Economics*, in THE DRIVING FORCE OF THE MARKET: ESSAYS IN AUSTRIAN ECONOMICS 41, 43-45 (2000). (Note: these sources are all Austrian critiques of the Chicago school.)

91. *Id.*

92. This Article dedicates significantly more space to describing and distinguishing the Austrian school from the Chicago school than it does in describing the Chicago school only because the Austrian school is widely misunderstood while the Chicago school is very mainstream. This level of attention is not in any way intended to argue for the correctness of the Austrian school's position over that of the Chicago School.

93. Gregory B. Christiansen, *Methodological Individualism*, in THE ELGAR COMPANION TO AUSTRIAN ECONOMICS, *supra* note 90, at 11 (The neoclassical school also begins its analysis with methodological individualism, but ends up extrapolating future actions from past actions and making assumptions that actors will make future choices based upon these models.).

94. See *supra* note 90.

95. *Id.*; *supra* note 142.

96. See Warren J. Samuels, *Determinate Solutions and Valuational Process: Overcoming the Foreclosure of Process*, 11 J. POST KEYNESIAN ECON. 531, 538-41 (1989); see also Peter J. Boettke, *What Is Wrong with Neoclassical Economics (and What Is Still Wrong with Austrian Economics)?*, in BEYOND NEOCLASSICAL ECONOMICS: HETERODOX APPROACHES TO ECONOMIC THEORY 22, 29 (Fred E. Foldvary ed., 1996).

The Keynesians and other heterodox schools make the same criticism of the Chicago school. However, unlike these heterodox schools which attempt to utilize some form of aggregate analysis to resolve questions, the Austrian School extends the traditional neoclassical principles of microeconomics which they share with the modern neoclassical school—namely, individuals advancing their own ends through meaningful, subjectively based choices and market interactions which increase their utility—in order to account for the subjective nature of individual decisionmaking.<sup>97</sup>

There are two main projects within the Austrian school. Both are generally characterized by the above description, but the two have significantly different methodologies.<sup>98</sup> The first is primarily represented by Frederick H. Hayek.<sup>99</sup> Hayek's project does not fundamentally disagree with the Chicago neoclassical model but, rather, concludes that the assumptions discussed above are too expansive.<sup>100</sup> To this effect, the project attempts to reform the Chicago school's perspective and models.<sup>101</sup> In many respects this project does not disagree with the equilibrium analysis of the Chicago school, but concludes that the vast majority of economic growth results from entrepreneurial developments advancing production possibility rather than from static markets reaching equilibrium. The other Austrian school project is primarily represented by Ludwig von Mises and Murray Rothbard.<sup>102</sup> The Mises-Rothbard project has fundamental differences from the modern neoclassical model the Chicago school relies upon.<sup>103</sup> This project rejects the neoclassical economic theory use of consumer indifference in utility functions, the use of cardinality in utility functions, the continuity of utility functions, and the neoclassical theory of uncertainty and probability.<sup>104</sup> Understanding these differences between Chicago's neoclassical and Austrian economics will facilitate understanding why the schools reach different policy positions.

The neoclassical utility function incorporates a theory of consumer indifference, necessarily assuming that it is possible for economists

97. See Murray N. Rothbard, *Praxeology: The Methodology of Austrian Economics*, in THE FOUNDATIONS OF MODERN AUSTRIAN ECONOMICS 28, 30-31 (Edwin G. Dolan ed., 1976); *supra* notes 80-83 and accompanying text.

98. Bryan Caplan, *The Austrian Search for Realistic Foundations*, S. ECON. J. 65(4), Apr. 1999, at 823, 823-24; Block, *supra* note 90, at 21.

99. See sources cited *supra* note 98.

100. See sources cited *supra* note 98.

101. See sources cited *supra* note 98. Hayek's alterations of the neoclassical model focused mostly on information economics, theory of the firm, entrepreneurship, and monetary economics. See generally F.A. VON HAYEK, THE ESSENCE OF HAYEK 3042, 131-59, 211-80 (Chiaki Nishiyama & Kurt R. Leube eds., 1984).

102. See sources cited *supra* note 98.

103. See sources cited *supra* note 98.

104. E.g., Block, *supra* note 90, at 22-29.

to determine economic actors' motives and information without the real action of each actor.<sup>105</sup> The Mises-Rothbard project's rejection of this theory is founded on the premise that only through an actor's real act of selection can his preference be deduced.<sup>106</sup> This is because only the subjective individual actor knows his own introspective characteristics. Consequently, it is impossible to determine the actor's value or preference without his real action.<sup>107</sup> The implication of this is an undermining of the utility curve from which economists predict individual actor's choices.<sup>108</sup>

The neoclassical utility function operates primarily on ordinal valuation but necessarily, to a degree, also on cardinal valuations.<sup>109</sup> A cardinal valuation is a quantification of preference and is used in empirical valuations to create a utility function, while an ordinal valuation is simply a preference of option A over option B.<sup>110</sup> Under the neoclassical model, cardinality is used to determine how an individual acts to maximize his utility,<sup>111</sup> while under the Mises-Rothbard project's model only ordinal preferences are used to determine how an individual acts to satisfy the highest-ranked feasible preference on the individual's value scale.<sup>112</sup> The Mises-Rothbard project's complete rejection of the use of cardinal valuations is premised on the concept that an economist is unable to deduce an actor's intensity of preference through the actor's selection of good A or good B. For example, while the actor selects the second apple over the first orange, *see* note 122, this tells us nothing about how *much* more the actor values the second apple over the first orange. The Mises-Rothbard project's rejection of cardinal valuation is also based upon there being a lack of a means to empirically quantify intrinsic happi-

105. *See* LEVY, *supra* note 83, at 61-64.

106. Mises stated, "The scale of value manifests itself only in real acting; it can be discerned only from the observation of real acting." LUDWIG VON MISES, HUMAN ACTION: A TREATISE ON ECONOMICS 102 (Scholar's ed., The Ludwig von Mises Inst. 1998) (1966), available at <http://www.mises.org/humanaction/pdf/HumanActionScholars.pdf>.

Rothbard stated, "The crucial fallacy is that "indifference" cannot be a basis for action. If a man were really indifferent between two alternatives, he could not make any choice between them, and therefore the choice could not be revealed in action." MURRAY N. ROTHBARD, MAN, ECONOMY, AND STATE: A TREATISE ON ECONOMIC PRINCIPLES (1962), reprinted in MAN, ECONOMY, AND STATE WITH POWER AND MARKET 1, 307 (Ludwig Von Mises Inst. 2d ed. 2004) (1962), available at <http://www.mises.org/rothbard/mespm.pdf>.

107. *Id.*

108. Rothbard, *supra* note 97, at 21.

109. MERCURO & MEDEMA, *supra* note 80, at 103; Block, *supra* note 90, at 25-26. *But see* Caplan, *supra* note 98, at 827.

110. *See id.*

111. A cardinal valuation of apples and oranges would be represented by the equation  $utility = a * \ln(\text{quantityofapples}) \pm (1 - a) * \ln(\text{quantityoforanges})$ .

112. An ordinal valuation of apples and oranges would be represented by {1st apple, 2nd apple, 1st orange, 3rd apple . . . }.

ness or utility.<sup>113</sup> The only thing that can be deduced is that the actor valued the second apple more than the first orange.<sup>114</sup> The implications of this are that it undermines the Chicago school's ability to compare utility to price ratios, such as  $MU_1 \div P_1 = MU_2 \div P_2$ .<sup>115</sup> Utility functions are the method through which cost-benefit calculus is done, which is further used in the calculus of interpersonal comparisons of utility.<sup>116</sup> Therefore, according to the Mises-Rothbard project neither utility functions nor interpersonal comparisons of these calculations can be done.

The neoclassical utility function incorporates a theory of continuity in the economic actor's selection of alternatives.<sup>117</sup> This theory allows for smooth graphical lines, which allows for the creation of predictive graphs.<sup>118</sup> The Mises-Rothbard project rejects this continuity theory on the premise that individuals are not able to make decisions based upon infinitesimally small distinctions.<sup>119</sup> Consequently, a graphical representation of their behavior does not generate a perfectly smooth line.<sup>120</sup> The consequence of the inability to chart precise points further undermines the economist's ability to use a utility line in a graph.<sup>121</sup> Furthermore, as the data are not continuous, the data points cannot even be used in a function equation to produce a curve.<sup>122</sup>

113. Weight has pounds, height has inches, distance has miles, temperature has degrees Fahrenheit, but intrinsic happiness and utility have no valuation.

114. "Value scales of each individual are *purely ordinal*, and there is no way whatever of measuring the distance between the ranking; indeed, any concept of such distance is a fallacious one." ROTHBARD, *supra* note 106, at 222.

115. "[While neoclassical economics holds] that in equilibrium the ratio of the marginal utilities of the various goods equals the ratio of their prices . . . we can see [that conclusion's] absurdity clearly, since utilities are not quantities and therefore cannot be divided." *Id.* at 262.

116. See Figure 1.

117. Mercurio & Medema, *supra* note 80, at 103.

118. See LEVY, *supra* note 83.

119. [I]t must first of all be objected that the peculiarly mathematical conception of in-finitesimal quantities is inapplicable to economic problems. The utility afforded by a given amount of commodities . . . is either great enough for valuation, or so small that it remains imperceptible to the valuer and therefore cannot affect his judgment.

LUDWIG VON MISES, *THE THEORY OF MONEY AND CREDIT* 44 (Yale Univ. Press 1953), *available at* [http://www.mises.org/books/Theory\\_Money\\_Credit/Contents.aspx](http://www.mises.org/books/Theory_Money_Credit/Contents.aspx).

Rothbard stated, "[H]uman beings act on the basis of things that are *relevant* to their action. The human being cannot see the infinitely small step; it therefore has no meaning to him and no relevance to his action." ROTHBARD, *supra* note 106, at 306.

120. See and contrast Figures 2 & 3. See ROTHBARD, *supra* note 106, at 264.

121. *Id.*

122. Block, *supra* note 90, at 21, 26.

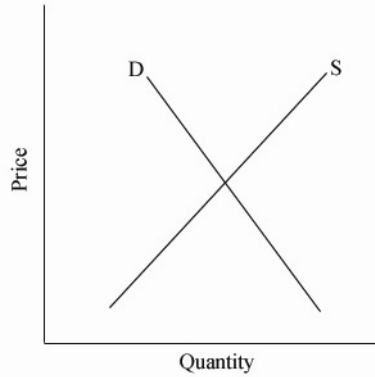


Figure 1: Chicago graph of supply and demand

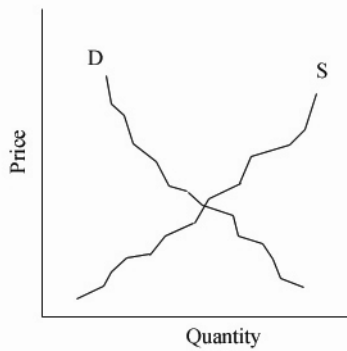


Figure 2: Austrian graph of possible supply and demand (1)

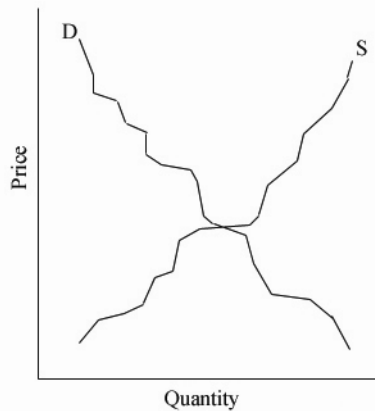


Figure 3: Austrian graph of possible supply and demand (2)

The neoclassical theory of uncertainty and probability asserts that for any given situation, an economist can determine the known prob-

ability distribution of the outcome.<sup>123</sup> If this were the case, the population would be a “class probability.” In order for there to be a class probability, all relevant facts must be known.<sup>124</sup> The Mises-Rothbard project rejects class probability as a universal theory.<sup>125</sup> Mises-Rothbard theorists emphasize that an economist must distinguish between class probabilities and case probabilities.<sup>126</sup> While the probability of outcomes for class probabilities can be predicted (for example, the lottery), the Austrian School asserts that in real life the *vast* majority of actions are case probabilities for which the probability of any given outcome cannot be predicted.<sup>127</sup> Case probabilities cannot be predicted by an economist because economists know nothing about the individual actor’s subjective preferences, knowledge, entrepreneurship, and so on.<sup>128</sup> Rothbard asserts that one of the only accurate uses of case probability in economics is insurance.<sup>129</sup> Furthermore, the Austrian school asserts that new ideas and scenarios are always emerging and serve to alter or replace models based upon past events.<sup>130</sup> Because of these complications, models based upon current or past information cannot be used to predict the probability of any future outcome.<sup>131</sup>

These distinct characteristics of the Austrian school methodology result in the school’s adherence to assumptions that are different than the Chicago school’s. The Austrian school holds the following assumptions. First, buyers and sellers are *not* fully informed nor fully rational. Second, their levels of information and rationality are not static. Through realizing the consequence of their own mistakes

123. See MARK SEINDENFELD, *MICROECONOMIC PREDICATES TO LAW AND ECONOMICS*, 5-19 (1996).

124. The quintessential example of a class probability is the lottery.

125. Block, *supra* note 90, at 31.

[The use of class probability] is the crux of the failure of neoclassical economics to make good on its exultant promise to predict the future. As long as there is free will, as long as people are “free to choose,” prognostication is a chimera. Even if their past acts could be accurately characterized by a normal distribution, or according with some specific elasticity or another, this does not at all warrant the assumption that they will continue to do so in the future.

*Id.* Of note, Block’s use of the phrase “free to choose” is in reference to the Nobel Prize-winning neoclassical economics book, Milton Friedman’s *Free to Choose* (2d ed. 1987), a title which seems to Block a great irony for a methodology which purports to predict individuals’ choices.

126. *Id.*

127. *Id.*

128. Mises stated, “[F]or economists to use class probability, we must know everything about the behavior of a whole class of events or phenomena; but about the actual singular events or phenomena we know nothing but that they are elements of this class.” MISES, *supra* note 106, at 107; Block, *supra* note 90, at 21, 31.

129. ROTHBARD, *supra* note 106, at 552-55.

130. MISES, *supra* note 106, at 177-91 (this is a fundamental principle of the Austrian school and is shared by both Austrian projects).

131. See *supra* notes 105-08, 119-22, 125-28 and accompanying text.

and observing the consequences of others' mistakes, individuals will be motivated to gather more information and become more rational actors.<sup>132</sup> Third, more efficient actors are encouraged to make themselves more prevalent in the market while less efficient actors are encouraged to limit their involvement. Fourth, entrepreneurship<sup>133</sup> is a significant variable in efficient operations; individuals possess varying levels of entrepreneurship, and good entrepreneurship can be increased through incentives. Fifth, products are not necessarily standardized. Sixth, all goods are assigned property rights and those property rights are enforced.<sup>134</sup> Seventh, property rights can only be valued subjectively,<sup>135</sup> so it is both impossible and incorrect to evaluate property rights objectively.<sup>136</sup>

While the Austrian school does not assume that information is complete, that individual actors are completely rational, or that individual actors are ideal entrepreneurs, the school recognizes that increasing these variables is vital to increasing efficiency.<sup>137</sup> To that end, the school seeks policies that reward acquiring knowledge, processing knowledge with rationality, and acting with good entrepre-

132. ISRAEL M. KIRZNER, PERCEPTION, OPPORTUNITY AND PROFIT STUDIES IN THE THEORY OF ENTREPRENEURSHIP 121-33, 135-36 (1979). The term "rational" is used here, but within the context of Austrian economics the term "error" is more appropriate. This is because it is a fundamental principle of the school that all individuals act for rational purpose, though they may err in being alert for information, err in learning how to process and apply that information, or not even be capable of making the proper decision. *Id.*; LUDWIG VON MISES, THEORY AND HISTORY: AN INTERPRETATION OF SOCIAL AND ECONOMIC EVOLUTION 268 (The Mises Inst. 1985) (1957), available at <http://www.mises.org/th/theoryhistory.pdf>.

133. Entrepreneurship is, fundamentally, a function of one's ability to perceive and forecast the future. See Murray N. Rothbard, *Professor Hérbert on Entrepreneurship*, 7 J. LIBERTARIAN STUD. 281, 287 (1985). A business owner's level of entrepreneurship is his ability to predict and act upon future prices of goods and labor; his ability to perceive an unmet demand in the ever-dynamic market, develop a product to fill that niche, and deliver that product to the consumers; and his ability to combine the assets of multiple actors. See *id.* at 281-82. The common element here is alertness to opportunity. Israel M. Kirzner, *Equilibrium vs. Market Process*, in THE FOUNDATIONS OF MODERN AUSTRIAN ECONOMICS 115, 120 (Edwin G. Dolan ed., 1976). While Israel Kirzner's version of entrepreneurship is based on being alert to new opportunities to increase a market's efficiency, another approach within the Austrian school is Joseph Schumpeter's entrepreneurship, which is based on a leader breaking away from the routine and destroying existing inefficient structures. *Id.* at 235-54.

134. See Walter Block, *Private Property Rights, Economic Freedom, and Professor Coase: A Critique of Friedman, McCloskey, Medema, and Zorn*, 26 HARV. J.L. & PUB. POL'Y 923, 923-24 (2003).

135. Hayek called the economic planners' concept that utility can be objectively measured their "fatal conceit." F.A. HAYEK, THE FATAL CONCEIT: THE ERRORS OF SOCIALISM (W.W. Bartley, III ed., 1989).

136. Joseph Becker, Comment, *Procrustean Jurisprudence: An Austrian School Economic Critique of the Separation and Regulation of Liberties in the Twentieth Century United States*, 15 N. ILL. U. L. REV. 671, 691, 693-94 (1995).

137. KIRZNER, *supra* note 132, at 121-33, 135-36; Sanford Ikeda, *Market Process*, in THE ELGAR COMPANION TO AUSTRIAN ECONOMICS, *supra* note 90, at 23, 23-24.

neurship.<sup>138</sup> Likewise, the school seeks policies that deter the failure to acquire knowledge, the failure to rationally process knowledge, and the failure to act with good entrepreneurship.<sup>139</sup>

The Austrian school of law and economics also stresses that markets are always a better source of information than individual actors.<sup>140</sup> The effectiveness of markets is the function of the vast number of actors who combine their information, rationality, and motivation for accuracy to create the market's demand, quantity, and price.<sup>141</sup> The Austrian school takes this theory to its logical conclusion in holding that a judge or administrative agency clerk, being only a single actor, can never accurately substitute his knowledge for the market's knowledge by determining an alternative price.<sup>142</sup>

These comparisons exhibit the central underlying methodological differences between the two schools. The Chicago school believes that generalized models of the system can be used to model economies and within that economy individual actors' decisions can be predicted on this stochastic model. The Austrian school operates on the under-

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138. *See id.*

139. *See id.*

140. The most classic example of this is Mises' theory regarding money, which holds that goods can only be accurately valued by a market. Murray Rothbard, *The Austrian Theory of Money*, in THE FOUNDATIONS OF MODERN AUSTRIAN ECONOMICS, *supra* note 97, at 161, 161-62. As such, a central planning authority could never accurately label the true value of a good. *See* MISES, *supra* note 106, at 395-97; MISES, *supra* note 119, at 29-194. This axiom played out in the skewed product valuations of the USSR. THOMAS SOWELL, BASIC ECONOMICS: A CITIZEN'S GUIDE TO THE ECONOMY 9-12 (2004). The Chicago school would not disagree with this analysis of the value of money and this reason for the Soviet Union's demise.

141. *Id.*

142. MERCURO & MEDEMA, *supra* note 80, at 301; *see* F.A. Hayek, *The Use of Knowledge in Society*, in THE ESSENCE OF HAYEK 211, 212-15 (1984); F.A. HAYEK, LAW, LEGISLATION AND LIBERTY: VOLUME 1 94-123 (1973). Between these two sources, Hayek comes to this position for Burkian reasons (traditional practices carry with them a presumption of soundness due to the likelihood that many actors over many generations have correctly aggregated institutional knowledge), reasons of self interest (only the actor directly effected has the proper motive to acquire proper levels of information and process it accurately), subjectivist reasons (only the affected actor can accurately value the goods and services), and for reasons of consistency in the rule of law (consistency in the law allows actors to efficiency structure their interactions). Todd J. Zywicki & Anthony B. Sanders, *Posner, Hayek, and the Economic Analysis of Law* 7-11, 19, 47 (George Mason Law & Economics Research Paper No. 07-05, 2007), available at <http://ssrn.com/abstract=957177>; Walter Block, *Coase and Demsetz on Private Property Rights*, 1 J. LIBERTARIAN STUD. 111, 115 (1977); Block, *supra* note 134, at 930, 938; MURRAY N. ROTHBARD, *Law, Property Rights, and Air Pollution*, in THE LOGIC OF ACTION TWO: APPLICATIONS AND CRITICISMS FROM THE AUSTRIAN SCHOOL 121, 126-27 (1997), available at <http://www.mises.org/rothbard/lawproperty.pdf> (Rothbard's rejection of this possibility is due to his principle that, being only a single actor, a judge will not have enough information to value accurately, that valuations must be subjective, and that interpersonal comparisons of utility are impossible).

standing that models must be specific to individual actors' decisions and that these individual decisions cannot be predicted precisely.<sup>143</sup>

### A. *Freedom from Contract*

Freedom from contract is the freedom to refrain from exchange.<sup>144</sup> According to a system of Lockean natural rights, an individual's freedom of choice gives him complete autonomy in choosing whether to contract or to refrain from contracting.<sup>145</sup> Forcing an individual to enter into a contract would result in an involuntary "agreement" and therefore would violate the individual's natural rights.<sup>146</sup>

The Chicago school's general principle regarding freedom from contract is that individuals will voluntarily enter into all contracts that are utility-maximizing.<sup>147</sup> They will do so because they have high levels of information and are fully rational.<sup>148</sup> Because this will happen, forcing individuals to enter into contracts that they would not voluntarily enter into would be forcing a transaction which is not Pareto-efficient.<sup>149</sup> However, in theory at least, this leaves open the desirability that individuals who do not have full information or are not acting with full rationality should be forced into the efficient transactions which they overlooked.<sup>150</sup>

One of the Chicago school's most central insights is that high transaction costs can prevent the reassignment of property rights to the most efficient holder.<sup>151</sup> Proponents of the Chicago law and economic field propose that when there are high transaction costs which

143. *Id.*

144. BARNETT, STRUCTURE OF LIBERTY, *supra* note 20, at 65. The phrase "freedom from contract" has been given many meanings. Rakoff, *supra* note 74, at 477-88. Rakoff's topic was the use of the phrase in the modern legal sense. That he examines five meanings of the term and discards only the one applied here shows the intuitive injustice of imposing a contract on an individual.

145. *See supra* note 79 and accompanying text.

146. If there were consent to the law, then one could consent to not be free from contract. As established earlier, however, there is no consent to the law; so, in order to protect Lockean natural rights, the legal system must protect the freedom from contract.

147. Anthony T. Kronman & Richard A. Posner, *Introduction: Economic Theory and Contract Law*, in THE ECONOMICS OF CONTRACT LAW 1, 1-3 (Anthony T. Kronman & Richard A. Posner eds., 1979).

148. POSNER, *supra* note 89, at 3-12, 17-19.

149. *Id.* at 11.

150. *But see id.* at 15-16. While Posner states that the voluntariness of contracts is a good validation that they are utility increasing, he leaves open the possibility that there are conditions where an involuntary transaction could be more desirable. As is illustrated later, this is a core principle of the Coase theorem and is most clearly applied in the case of eminent domain and monopoly dissolution. There is, however, a distinction between forcing a contract for Coasean reasons—high transaction costs—and forcing a contract because the individual has low levels of information or rationality.

151. R.H. Coase, *The Problem of Social Cost*, 3 J.L. ECON. 1, 13 (1960).

are determined to prevent otherwise utility maximizing transactions, the court should take a role in reallocating these rights.<sup>152</sup>

The Austrian School's general principle regarding freedom from contract is very similar to that of the Chicago school. Individuals will enter into contracts when they determine that, according to their own subjective valuations, the transactions will increase their utility.<sup>153</sup> Despite the subjective nature of these transactions, when they are combined into a market the result is an objective increase in net utility.<sup>154</sup> It is not always the case that all utility-maximizing transactions will be entered into because information, rationality, and entrepreneurship are not perfect.<sup>155</sup> However, individual actors should be allowed to enter into transactions which are not perfect because, though not instantly realizing the optimal gains from a perfect transaction, the individual actor will become more knowledgeable and a better entrepreneur. In the long run this will lead to those individuals entering into more efficient transactions and contributing to accurate product valuation by the market. Also, it is virtually impossible for an outside actor to know whether the transaction not voluntarily entered into by the actor would have been subjectively beneficial to him because economists know nothing about an individual's utility.<sup>156</sup> More fundamentally, there is no way for a third party to calculate whether the benefit for one party is greater than the cost for another party, because interpersonal comparisons of utility are impossible.<sup>157</sup>

In order to get a more detailed understanding of the two schools' jurisprudential positions on honoring freedom from contract, their positions on monopoly and eminent domain will be examined.

### 1. Monopoly

Antitrust laws are applied to deconcentrate a market when it is dominated by a single or very few actors.<sup>158</sup> According to a system of justice based upon Lockean natural rights, the owners of a property

152. *Id.* at 13.

153. ROTHBARD, *supra* note 106, at 84-91.

154. *See* ROTHBARD, *supra* note 106, at 113-23; *supra* note 140.

155. KIRZNER, *supra* note 132, at 121-33, 135-36. Individuals are both *rationaly* ignorant and *radically* ignorant. Rational ignorance occurs when an individual knows the costs and benefits of acquiring information and rationally chooses against investing the resources to acquire that information. Radical ignorance occurs when an individual is not even aware of the possibility of gaining that information. Remedying radical ignorance is a task of the Austrian school which the Chicago school assumes away and, therefore, does not take on. The Austrian school sees the problem of radical ignorance arising from low levels of perceptiveness. *See* Ikeda, *supra* note 137, at 23.

156. ROTHBARD, *supra* note 106, at 84-89, 238-41.

157. *Id.* at 258-61.

158. W. KIP VISCUSI ET AL., *ECONOMICS OF REGULATION AND ANTITRUST* 257-62 (3d ed. 2000).

right must be free from contract. Breaching this principle violates their natural property rights.<sup>159</sup> Property rights equally apply to legitimate interests in a business.<sup>160</sup> As such, the application of anti-trust law uniformly violates an individual's natural property right.<sup>161</sup>

The monopolization of a market is unquestionably not allowed in the Chicago school.<sup>162</sup> A primary assumption of the Chicago school is that the market operates in near-perfect competition.<sup>163</sup> According to the Chicago school, in the state of perfect competition, there is a com-

159. It is noteworthy that Locke actually included a proviso to his theory of acquisition which limited the extent to which one individual could acquire property from the state of nature. "For this Labour being the unquestionable property of the Labourer . . . at least where there is enough, and as good left in common for others." LOCKE, *supra* note 6, at 19. However, this "exception" has been discredited by classical liberal scholars. The criticisms are on the grounds that the proviso is self-contradictory, that the original assumption that all resources are given to man in common is incorrect, or that it is incorrect to ever apply the proviso because individual appropriation never worsens the conditions of others. *E.g.*, Carl Watner, *The Proprietary Theory of Justice in the Libertarian Tradition*, 6 J. LIBERTARIAN STUD. 289, 298-303 (1982). For arguments that nonappropriated property is held by no one, see RICHARD A. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 11-12 (1985) [hereinafter EPSTEIN, TAKINGS]; Epstein, *supra* note 71, at 1228-28; Roger Pilon, *The United States Supreme Court's Treatment of Property* (forthcoming 2007) (manuscript at 8-10, on file with author). Even if Locke's proviso is correct, I contend that the proper application would be in the narrowest sense of monopoly—where there is no substitute to be found for a true necessity such as food, water, or shelter. In the analysis of a necessity, the relevant market would not be a particular type of the necessity (that is, one owner of all apple orchards), but rather all food (that is, one owner of the only supply of food on an island).

160. Just as there is no distinction between property created with one's hands and that which is created with one's mind, *see supra* note 67 and accompanying text, there is no distinction between physical and intellectual property. Richard Epstein, *Liberty v. Property? Cracks in the Foundations of Copyright Law*, 42 SAN DIEGO L. REV. 1, 20-25 (2005). *But see* Tom W. Bell, *Indelicate Imbalancing in Copyright and Patent Law*, in COPYFIGHTS: THE FUTURE OF INTELLECTUAL PROPERTY IN THE INFORMATION AGE 1 (2002).

161. Roger Pilon, *Corporations and Rights: On Treating Corporate People Justly*, 13 GA. L. REV. 1245, 1342-45 (1979); *see id.* at 1320-27; D.T. ARMENTANO, ANTITRUST POLICY: THE CASE FOR REPEAL 69-70 (1986); ADAM SMITH, AN INQUIRY INTO THE CAUSES OF THE WEALTH OF NATIONS 144 (1976) (1776). "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible indeed to prevent such meeting, by any law which could be executed, or would be consistent with liberty and justice." *Id.* (Supporters of anti-trust policy often cite the first half of this phrase, but conveniently leave the second half out. Of course, Smith's objection could be interpreted only as applicable to restrictions on freedom of speech or assembly. However, given that Smith's main concern in the treatise was private ownership of property, his comment almost certainly was directed against the idea of laws limiting an owner's control over his property right in his business.)

162. POSNER, *supra* note 89, at 295-308. However, recently, a large number of Chicago theorists have allowed for small degrees of market concentration for circumstances such as economies of scale and "natural" monopolies. *See* ROBERT H. BORK, THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF (2d ed. Free Press 1993) (Bork, a noted Chicago school lawyer, describes a number of efficiency increases from market concentration, raises the rarity of monopolistic market concentration, and determines that the resources used to police antitrust policies are oftentimes wasted.); MERCURO & MEDEMA, *supra* note 80, at 148-51.

163. VISCUSI ET AL., *supra* note 158, at 73-78.

petitive level of output and price.<sup>164</sup> In contrast, if a monopoly arises, it will restrict output and increase price in order to maximize profits.<sup>165</sup> Additionally—because the state of monopoly is so advantageous—in order to reach or maintain this state an actor will expend resources.<sup>166</sup> An expense of resources to reach or maintain a monopolistic state does not serve any beneficial market purpose, so this effort is a misallocation of resources.<sup>167</sup> Furthermore, in the absence of direct seller rivalry, monopoly suppliers can afford to become “lazy” and use their resources less efficiently.<sup>168</sup> In sum, compared to the market of perfect competition, a monopoly will choose actions that misallocate resources and reduce social welfare.<sup>169</sup> The Chicago school also thoroughly opposes any government creation of a monopoly.<sup>170</sup>

The Austrian school recognizes the inefficiencies of monopolies, but holds that “true” monopolies cannot naturally occur.<sup>171</sup> Furthermore, the Mises-Rothbard project claims that if a true monopoly occurred, no measurement besides that of the market could determine the most efficient levels of price and quantity.<sup>172</sup> Finally, because the Austrian school accepts product differentiation, by definition—to a degree—all producers are monopolist.<sup>173</sup> All sellers hold unique

164. *Id.*

165. *Id.* at 78-80. This inefficiency is referred to as “dead weight loss.”

166. *Id.* at 85-86. Firm efforts will take the form of both jockeying within the marketplace (that is, through advertisement) and for government favors. The literature on rent-seeking behavior details the lengths to which firms will go to achieve government-provided and -protected market share.

167. *Id.*

168. *Id.* at 84-85. This is referred to as “X-inefficiency.”

169. *Id.* at 86-88.

170. MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 129-31 (2d ed. 1982) (focusing on government-created labor monopolies resulting from imposing licensing requirements, granting legal immunity to labor unions, and selectively not arresting or prosecuting union members when they break laws in the name of striking) Government-created monopolies include any form of protection or favoritism given by the government. Such assistance can arise through regulation, trade barriers, and outright grants of monopoly status. The negative consequences of government-created monopolies are the same as those of traditionally occurring monopolies, so the Chicago school opposes them. DAVID FRIEDMAN, *supra* note 9, at 39-45. See generally *infra* note 189 (describing recent legal treatment of government created monopolies).

171. One group within the Austrian school holds that the only natural occurrence of a monopoly is when a single party has absolute control over an essential input—for example, all the orange trees and orange seeds. Jerome Ellig, *Industrial Organization*, in *THE ELGAR COMPANION TO AUSTRIAN ECONOMICS*, *supra* note 90, at 244, 246. Mises and Kirzner are amongst this group. *Id.* Another group doubts even this possibility of monopoly. This group concludes that many times when a single party has complete control over a market, the profits being realized will provide enough incentive for entrepreneurs to discover new technology with which to break into the market. There will, in theory, be instances where no technology advancements will allow entrepreneurs to break into the market, but it is impossible to tell when this would be the case. *Id.* Rothbard and Rizzo are members of this group. *Id.*

172. *Id.*

173. ROTHBARD, *supra* note 106, at 666-71.

niches that are without perfect competitors and, as a result, they capture profits that are above marginal cost.<sup>174</sup> These true profits, however, are not problematic but, rather, necessary signals for the wider market's reallocation of resources.<sup>175</sup> Because entrepreneurs are so effective at capturing true profit, it is claimed by many Austrians that absent the use of force,<sup>176</sup> no efforts of a monopolist will be able to effectively keep competitors out of a market.<sup>177</sup>

It is further claimed by some that even if a monopoly could be formed, output and price could not be identified as being at monopolist levels.<sup>178</sup> This is a result of the Austrian conclusion that output curves are not smooth and that the true cost of an item is the alternative or opportunity foregone.<sup>179</sup> As explained earlier,<sup>180</sup> output curves are not smooth as a result of individuals not being able to make fine value distinctions.<sup>181</sup> Whereas the neoclassical model can determine and compare the competitive price and quantity to the monopolistic price and quantity, as illustrated in Figure 4, the Austrians believe that the lack of smoothness to the curve makes this impossible, as illustrated in Figures 5 and 6.<sup>182</sup> Furthermore, an outside observer cannot determine the value of a good to an individual actor because the true value is either the cost of the alternative to acquiring the good or the foregone opportunity. The value of the alternative is entirely subjective, and the economist can only observe ordinal measurements,<sup>183</sup> so the observer has no information on the actors' subjective valuation of the alternatives.<sup>184</sup>

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174. KIRZNER, *supra* note 132, at 123-25; ISRAEL M. KIRZNER, THE DRIVING FORCE OF THE MARKET—ESSAYS IN AUSTRIAN ECONOMICS 19 (2000) [hereinafter KIRZNER, DRIVING FORCE].

175. *Id.*

176. For example, consider government-created monopolies, the labor unions of the early 1900s (which used force against "scabs"), or companies such as DeBeers Diamonds, which, in the past, used violence to consolidate ownership of diamond mines.

177. ROTHBARD, *supra* note 106, at 651-53, 659-61.

178. *See id.* at 687-98. Not all Austrians would agree with this point.

179. *See supra* note 120.

180. *See supra* notes 119-16 and accompanying text.

181. *See id.*

182. *See id.*

183. *See supra* notes 106-16 and accompanying text.

184. *See id.*

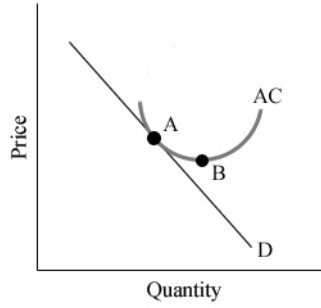


Figure 4: Chicago graph of monopoly output

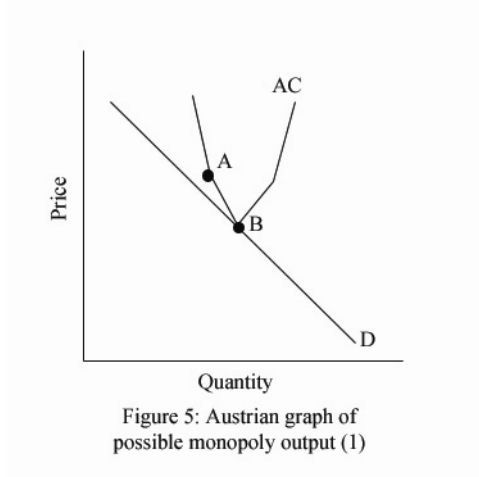


Figure 5: Austrian graph of possible monopoly output (1)

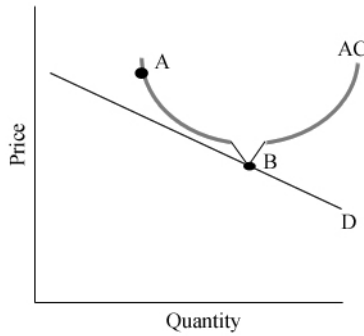


Figure 6: Austrian graph of possible monopoly output (2)

To the extent that “small monopolies”<sup>185</sup> occur, the Austrian school does not hold that their existence is inefficient.<sup>186</sup> Instead, the price-taking that small monopolies get is necessary to signal the reallocation of the market’s resources.<sup>187</sup> This price-taking is also a necessary motivation for entrepreneurs.<sup>188</sup>

According to the Austrian school, the only possible existence of a real monopoly occurs because of government force or government-sanctioned force.<sup>189</sup> A government-created monopoly embodies the negative characteristics of restricting output and increasing price but prevents market forces from facilitating competitors entering the market to capture profit by undermining the inefficiencies. Because of this, a government-created monopoly should never occur.<sup>190</sup>

## 2. Eminent Domain

Eminent domain is the legal procedure by which a governmental entity can forcibly acquire land owned by a private party.<sup>191</sup> The pro-

185. A “small monopoly” is a seller who is not in perfect competition and is taking some real profits. In a small monopoly there is still, however, a substantial level of competition.

186. Ellig, *supra* note 171, at 244-45.

187. *Id.*

188. *Id.*; KIRZNER, DRIVING FORCE, *supra* note 174, at 19; Rothbard, *supra* note 97, at 30-31.

189. ROTHBARD, *supra* note 106, at 668-71, 747-48. Rothbard defines government-created monopolies very broadly to include required licensing, required quality standards, tariffs, immigration restrictions, minimum wage laws, and maximum hour laws. *Id.* at 1089-14. There is some disagreement within the Austrian school over whether a monopoly can arise due to environmental characteristics or not. *See supra* note 171. Even if there can be, there is also disagreement over whether this monopoly could be identified. *Id.* Furthermore, there is controversy over whether such monopoly could be accurately valued by a third party. *Id.* Of note, the common law of the 16th, 17th, and 18th centuries embodied a similar position to this. This common law position was that only a grant of exclusive right or a restriction of labor to an economic activity was a monopoly. *See Darcy v. Allein*, 77 Eng. Rep. 1260 (K.B. 1062); *The Case of Tailors of Ipswich*, 77 Eng. Rep. 1218 (K.B. 1614); BERNARD H. SIEGAN, ECONOMIC LIBERTIES AND THE CONSTITUTION 21-24 (2d ed. 2006). Grants of monopoly were prohibited by the crown but, according to most interpretations, allowed by parliament. SIEGAN, *supra*, at 22. Since the early part of the 20th century, U.S. jurisprudence has struck down certain types of interstate protectionism under the dormant commerce clause, *see Granholm v. Heald*, 544 U.S. 460 (2005) (holding that a state requiring greater burdens for out of state wine shipments than in state shipments violated the dormant commerce clause, even in light of the Twenty-First Amendment), but for the most part has not struck down local protectionism. *Compare Powers v. Harris*, 379 F.3d 1208, 1221 (10th Cir. 2004), *cert. denied*, 544 U.S. 920 (2005) (stating that “economic protectionism constitutes a legitimate state interest. . . . [W]hile baseball may be the national pastime of the citizenry, dishing out special economic benefits to certain in-state interests remains the favored pastime of state and local governments.”), *with Craigmiles v. Giles*, 312 F.3d 220, 224 (6th Cir. 2002) (stating that “protecting a discrete interest group from economic competition is not a legitimate governmental purpose”). (Note the circuit split on the issue. The split was emphasized in the Tenth Circuit’s opinion, presumably to encourage the Supreme Court to accept certiorari).

190. ROTHBARD, *supra* note 106, at 668-71, 747-48; MURRAY N. ROTHBARD, POWER AND MARKET: GOVERNMENT AND THE ECONOMY (1970), *reprinted in* MAN, ECONOMY AND STATE WITH POWER AND MARKET 1047, 1089-1114 (Scholars ed., Ludwig von Mises Inst. 2004) (1970).

191. *See* 1 JULIUS L. SACKMAN, NICHOLS ON EMINENT DOMAIN § 1.11 (rev. 3d ed. 2001).

tection of Lockean natural rights does not allow for the forceful expropriation of one's property—whether the land acquired is for public use, public purpose, or private use. Unless an injury is being rectified, the only just transfer of a property interest is done voluntarily.<sup>192</sup>

The Chicago school allows the use of eminent domain for a number of reasons. The most common economic justification for eminent domain is that it is necessary to break a land owner's monopoly.<sup>193</sup> For almost identical reasons as to why monopolies are not allowed in competitive markets for goods and services, they are also not allowed for real property.<sup>194</sup> For example, train companies that need to purchase property from multiple owners in order to build a straight track and large building projects which need to purchase property from multiple owners in order to avoid the "leopard effect"<sup>195</sup> face the danger of individuals holding out in order to capitalize on their position of leverage.

Typical Chicago school analysis, so far as it objectively values property, would also allow for eminent domain to override a property owner's subjective "overvaluation" of their land. However, it is noteworthy that the Chicago school does not purposively value property objectively instead of subjectively.<sup>196</sup> The school's purpose in overlooking the individual's subjective valuation is to create a system-wide model.<sup>197</sup> Perhaps in light of this, in the case of eminent domain of private homes some Chicago school scholars recently have deviated somewhat from this pure doctrine of objective valuation.<sup>198</sup> It is un-

192. NOZICK, *supra* note 20, at 149-53 (discussing the entitlement theory of distributive justice).

193. EPSTEIN, TAKINGS, *supra* note 159, at 164-65; Richard Posner, *Foreword: A Political Court*, 119 HARV. L. REV. 31, 94-95 (2005); see POSNER, *supra* note 89, at 61-68. "A good economic argument for eminent domain, although one with greater application for railroads and other right of way companies than to the government [i.e. schools, parks, and municipal buildings], is that it is necessary to prevent monopoly." *Id.* at 62. "The only justification for eminent domain is that sometimes a landowner may be in a position to exercise holdout power, enabling him to obtain a monopoly rent in the absence of an eminent domain right." Posting of Richard Posner to The Becker-Posner Blog: The Kelo Case, Public Use and Eminent Domain, [http://www.becker-posner-blog.com/archives/2005/06/the\\_kelo\\_case\\_p.html](http://www.becker-posner-blog.com/archives/2005/06/the_kelo_case_p.html) (June 26, 2005). Here Posner states that he does not know whether the plaintiff in the *Kelo* case, Susette Kelo, was indeed a holdout, but implies that if she were the case was properly decided.

194. POSNER, *supra* note 89, at 62-63.

195. The term "leopard effect" is used to describe the landscape of a development that is spotted with various land owners who could not be bought out by a developer.

196. See *supra* notes 87-90 and 94-95 and accompanying text

197. *Id.*

198. POSNER, *supra* note 89, at 62.

The familiar argument that the eminent domain power is necessary to overcome the stubbornness of people who refuse to sell at a "reasonable" (that is, the market) price is bad economics. If I refuse to sell for less than \$250,000 a house that no one else would pay more than \$100,000 for, it does not follow that I am irrational, even if no "objective" factors such moving expenses justify my insisting on such a premium. It follows that I value the house more than

certain how far these Chicago school economists would extend this exception, but for the very reason that recognizing subjective value in this case is already an exception, it is hard to believe that they would extend it to many other circumstances.

As a result of the Chicago school allowing for the determination of utility through cardinal measurements, it also allows for the interpersonal comparison of utility. Through interpersonal comparisons of utility, eminent domain can be justified as utility-maximizing.<sup>199</sup>

The most notable achievement by the Chicago school is the reallocation of property rights in a manner that compensates for high transaction costs.<sup>200</sup> According to the Coase theorem, high transaction costs prevent the reassignment of property rights to the most efficient holder.<sup>201</sup> In such a case, the court should reallocate those rights to the party they would be held by absent the high transaction cost.<sup>202</sup> This theory has been applied by the school to eminent domain.<sup>203</sup> While the school identifies many problems in the use of eminent domain, such as the encouragement of rent-seeking and bad decisions due to the assigned fair market value being too low,<sup>204</sup> when those variables can be removed or screened by a judge, then in certain circumstances an action brought about through eminent domain can be Pareto-optimal.<sup>205</sup>

other people. This extra value has the same status in economic analysis as any other value.

*Id.* "Maybe [subjective values could be determined]. Ancient Athens had a clever method of self-assessment for property tax purposes: Anyone could force you to sell your property to him at your self-assessed valuation." *Id.* at 75 n.3.

199. See Thomas W. Merrill, *The Economics of Public Use*, 72 CORNELL L. REV. 61, 90-93 (1987) (Merrill is a Chicago economist who leaves open this possibility); Walter Block, *Coase and Kelo: Ominous Parallels and Reply to Lott on Rothbard on Coase*, 27 WHITTIER L. REV. 997, 997-1014 (2006) (Block is an Austrian economist and here explains how Chicago analysis can endorse eminent domain takings in situations such as *Kelo v. New London*, 125 S.Ct. 2655 (2005)).

200. [W]hen market transactions are so costly as to make it difficult to change the arrangement of rights established by the law. In such cases, 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.

R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 19 (1960).

201. *Id.* at 13, 15-16.

202. *Id.* at 29-34, 36-38. "Actually, very little analysis is required to show that an ideal world is better than a state of laissez faire . . ." *Id.* at 27.

203. See Merrill, *supra* note 199, at 90-93; A. Mitchell Polinsky, *Resolving Nuisance Disputes: The Simple Economics of Injunctive and Damage Remedies*, 32 STAN. L. REV. 1075, 1088 (1980).

204. See Merrill, *supra* note 199, at 75-77, 81-88.

205. See James Geoffrey Durham, *Efficient Just Compensation as a Limit on Eminent Domain*, 69 MINN. L. REV. 1277, 1300-04 (1985). "In eminent domain actions, therefore, Pareto Optimality is achieved when the owners of the property taken are fully compensated for the costs of the actions." *Id.* at 1279 n.12.

As many proponents of the Austrian school do not accept that there can be true monopolies absent government-authorized force, they do not believe in the use of eminent domain to break up land owners' monopolies.<sup>206</sup> The Austrian school holds that in almost all cases where it is thought that a land owner possesses a monopoly, in reality there is not one.<sup>207</sup> There are multiple alternatives that are not explored by the parties precisely because eminent domain is an option. For example, common tools proposed by Austrian economists to eliminate the holdout problem are the purchase of call options on alternative land plots,<sup>208</sup> secret purchases,<sup>209</sup> and combination auctions.<sup>210</sup>

As the Austrian school strictly values land subjectively, it does not allow for eminent domain to be used to undermine a property owner's "overvaluation" of his land.<sup>211</sup> Furthermore, because the Austrians are very skeptical of an individual judge's ability to determine the market value of the property, they do not believe that a judge can accurately accomplish the task of valuation.<sup>212</sup>

As a result of the Austrian school's strict adherence to subjective valuation and its denial of the ability to use cardinal measurements, it is impossible to make interpersonal comparisons of utility. As such,

206. Bruce L. Benson, *The Mythology of Holdout as a Justification for Eminent Domain and Public Provision of Roads*, 10 INDEP. R. 165, 168-173 (2005), available at [http://www.independent.org/pdf/tir/tir\\_10\\_2\\_1\\_benson.pdf](http://www.independent.org/pdf/tir/tir_10_2_1_benson.pdf); see Walter Block & Matthew Block, *Roads, Bridges, Sunlight, and Private Property Rights*, 7 J. ECON. STUD. HUMAN. 351 (June-Sept. 1996), available at [http://141.164.133.3/faculty/Block/Blockarticles/roads1\\_vol7.htm](http://141.164.133.3/faculty/Block/Blockarticles/roads1_vol7.htm); Walter Block & Richard Epstein, *Debate, Debate on Eminent Domain*, 1 N.Y.U. J.L. LIBERTY 1144, 1149-50, 1157 (2006) (Professor Block asserts that eminent domain is not necessary to efficiently assemble land for roads.) It is noteworthy that Block's proposal is in large part reliant upon a rejection of the ad coelum doctrine and instead upon having a more strict application of land that is homesteaded (that is, one has not homesteaded the land underneath his home).

207. See Benson, *supra* note 206. Benson also proposes that in the case where the seller is only transferring part of his property the holdout problem is much less than is commonly thought. This is due to the frequent increase in the value of the remainder of his property. *Id.* at 170.

208. Block & Epstein, *supra* note 206, at 1149-50.

209. Benson, *supra* note 206, at 170-71 (Benson points out that while efforts to keep government transactions secret can be undermined by public disclosure laws, large purchases by private actors do not suffer the same problem. These kind of private transactions traditionally are able to be made quickly. He proposes that projects traditionally done by the public where the land is acquired through eminent domain, such as the construction and management of roads, should instead be done privately. Consequently, they could keep their acquisition secret.).

210. *Id.* at 171-73 (citing STEVEN E. LANDSBURG, *THE ARMCHAIR ECONOMIST AND EVERYDAY LIFE* 29-30 (1993)). (Note: this method requires at least two options to leverage against each other.)

211. According to the Austrian methodology, the only value is the subjective value. There is no such thing as the objective value. Hence, there can be no objective valuation. Horwitz, *supra* note 90. Note that Posner recently agreed with this in the context of eminent domain. See *supra* note 198.

212. See *supra* note 142.

eminent domain cannot be justified as a transfer of resources to a party who values it more.

Finally, the Austrian school does not agree with the Coase theorem's need to reallocate resources in the case of high transaction cost.<sup>213</sup> As such, it would not use eminent domain in such a fashion.<sup>214</sup>

Both the Chicago and Austrian schools provide a high level of general protection for an individual's natural right to freedom from contract. However, despite the general protection that the Chicago school provides, the school actively undermines the natural right to freedom of contract in the case of monopoly and often actively undermines the right through the use of eminent domain power.

### B. Freedom to Contract

Freedom to contract is the freedom to voluntarily enter into legally binding agreements.<sup>215</sup> According to a system of justice based upon Lockean natural rights, an individual's voluntary choice to enter into a contract must be honored.<sup>216</sup> To restrict this freedom is to violate the individual's natural rights.<sup>217</sup>

The general principle of the Chicago school regarding freedom to contract is that contracts which are entered into freely maximize wealth because actors with perfect knowledge and rationality will enter into agreements that provide the greatest increase of utility.<sup>218</sup> Through individuals freely contracting, markets are able to accurately assign the true costs of goods and allocate them to their most efficient use.<sup>219</sup> As contracts serve no purpose other than facilitating individual transactions that are themselves utility-maximizing, each contract must, *ex ante*, maximize the utility of both parties.<sup>220</sup> For these reasons, the Chicago school is generally extremely protective of the right to freedom of contract.<sup>221</sup> The Chicago school would almost universally support the holding of the historic *Lochner* case<sup>222</sup> and overturn minimum wage laws, collective bargaining statutes, man-

213. KIRZNER, DRIVING FORCE, *supra* note 174, at 260 (proposing that if there were a method to increase utility by altering transaction costs, astute entrepreneurs in the market would have created and exercised this method). *See generally* Block, *supra* note 134 (taking on the application of the Coase theory by the Chicago scholars referenced in the title and showing how their analysis is both unnecessary and destructive through undermining private property rights); ROTHBARD, *supra* note 142, at 124-25.

214. Block, *supra* note 134; *see also supra* notes 206-13.

215. *See supra* note 77 and accompanying text.

216. *See supra* notes 73-79 and accompanying text.

217. *Id.*

218. *See supra* note 147.

219. *See id.*

220. *See id.*

221. *See id.*

222. *Lochner v. New York*, 198 U.S. 45 (1905) (striking down the State of New York's economic regulation of the maximum weekly working hours for bread bakers).

datory pension statutes, insurance regulation, and even antidiscrimination laws<sup>223</sup> and building codes.<sup>224</sup>

The general principle of the Austrian school regarding freedom to contract is that it serves two purposes. For an Austrian economist, it is important to recognize that actors have varying levels of information. Very few have near-perfect information, and most are rationally or even radically ignorant.<sup>225</sup> For actors who do have a high level of information and effective entrepreneurial perceptiveness, freedom of contract allows for a transaction that is highly utility increasing.<sup>226</sup> For those actors who do not have a high level of information, freedom of contract increases entrepreneurial perceptiveness, leading to their future transactions involving terms that bring the market closer to the accurate valuation of the product.<sup>227</sup> Most importantly, though, freedom of contract is the most effective method by which information can be collected and refined to determine the actual value of a good or service.<sup>228</sup> The Austrian school does not defend freedom of contract because it produces perfect efficiency but rather because it—more so than any judicial or legislative intervention—produces outcomes which are both immediately efficient and lead to the greatest increase in future efficiency.<sup>229</sup> Additionally, the Austrian school holds that because the contract chosen is that of the greatest utility, when a contracting party's primary option is removed the alternative is necessarily of lesser value.<sup>230</sup> As with the Chicago school, the Austrian school would support the holding of *Lochner* and overturn minimum wage laws, collective bargaining statutes, mandatory pen-

223. GARY S. BECKER, *THE ECONOMICS OF DISCRIMINATION* 19-38 (2d ed. 1971); RICHARD A. EPSTEIN, *FORBIDDEN GROUNDS: THE CASE AGAINST EMPLOYMENT DISCRIMINATION LAWS* 32-78 (1992); see POSNER, *supra* note 89, at 365-71.

224. See POSNER, *supra* note 89, at 685-89; Herbert Hovenkamp, *The Political Economy of Substantive Due Process*, 40 *STAN. L. REV.* 379, 384-95 (1987); see also Richard S. Markovits, *The Distributive Impact, Allocative Efficiency, and Overall Desirability of Ideal Housing Codes: Some Theoretical Clarifications*, 89 *HARV. L. REV.* 1815, 1831 (1976) (discussing building codes).

225. KIRZNER, *supra* note 132, at 121-33, 135-36.

226. According to the Austrian school, it would be very rare for an individual to have perfect information, so the transaction will not be utility-maximizing. However, to the extent that an individual's information is good and the decisions are rational, the transaction will increase utility.

227. See, e.g., KIRZNER, *supra* note 132, at 124-27, 148-51 (Kirzner distinguishes between increasing efficiency through encouraging individuals to act more rationally, increasing their efficiency in acquiring information, and increasing the effort they dedicate to acquiring information and designing economic structures that encourage those with greater natural ability act rationally and acquire information to act frequently. All of these consequences increase economic utility.).

228. See F.A. Von Hayek, *The Use of Knowledge in Society*, in *THE ESSENCE OF HAYEK*, *supra* note 101, at 211, 211-223.

229. See F.A. HAYEK, *Competition as a Discovery Procedure*, in *THE ESSENCE OF HAYEK*, *supra* note 101, at 254, 260-61.

230. HANS-HERMANN HOPPE, *A THEORY OF SOCIALISM AND CAPITALISM* 15 (1989).

sion statutes, insurance regulation, antidiscrimination laws, and building codes.<sup>231</sup>

In order to get a more detailed understanding of the two schools' jurisprudential positions on honoring freedom to contract, their positions on breach of contract due to impossibility, frustration of purpose, or impracticability; mistake; force or fraud; and unconscionability will be examined.

### 1. *Impossibility, Frustration of Purpose, and Impracticability*

The defense of impossibility arises when a party's performance is made nearly or absolutely impossible "without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made."<sup>232</sup> The doctrine of frustration of purpose arises when performance of the contract is physically possible but at least one party's underlying purpose of the contract is no longer attainable.<sup>233</sup> The doctrine of impracticability arises when the performance of a contract is deemed impractical.<sup>234</sup> Impracticability is based upon the terms of the contract no longer being mutually beneficial.<sup>235</sup> The Lockean natural rights position on these three defenses is premised on the foundations that the parties are obligated to honor the conditions to which they voluntarily agreed.<sup>236</sup> In the cases of frustration of purpose and impracticability, the terms voluntarily agreed to must be upheld; efficient breach is not legitimate. Specific performance is the closest to the actual terms agreed to, but in many cases the more realistic remedy is expectation damages.<sup>237</sup> In the case

231. ROTHBARD, *supra* note 106, at 892-900. (We are only interested here in the support by Rothbard and other Austrian school scholars for the economic effect of Lochner's doctrine, not their opinion of the jurisprudence of substantive due process or a broader reading of the Privileges or Immunities clause.)

232. RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981).

233. RESTATEMENT (SECOND) OF CONTRACTS § 265 (1981); *see* Krell v. Henry, (1903) 2 K.B. 740, (excusing a contract where the plaintiff rented an apartment to view a coronation procession but the procession was cancelled).

234. Performance of the contract is physically possible and the underlying conditions of the bargain achievable, but as a result of an unexpected event enforcement of the promise would entail a much higher cost than originally contemplated. RESTATEMENT (SECOND) OF CONTRACTS § 261 (1981); *see* Mineral Park Land Co. v. Howard, 156 P. 458, 459-60 (Cal. 1916) (holding a contract to extract gravel impossible where the defendants discovered after making the contract that extracting gravel was cost prohibitive).

235. *See id.*

236. *See* FRIED, *supra* note 68, at 17-21; Barnett, *Consent Theory*, *supra* note 45, at 296-300; *supra* note 74.

237. *See* FRIED, *supra* note 68, at 17, 21-22; Peter Benson, *The Idea of a Public Basis of Justification for Contract*, 33 OSGOODE HALL L.J. 273, 321-26 (1995). *See generally supra* note 74. *But see* Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489 (1989); Richard Craswell, *Expectation Damages and Contract Theory Revisited* 1-22 (Stan. L. Sch. Working Paper No. 325, Aug. 2006), available at <http://ssrn.com/abstract=925980> (Craswell asserts that theories deriving from personal autonomy, such as Fried's and Barnett's, do not demand any one type of remedy. His claim

of true impossibility, since the party has no choice but to breach, he has a duty to rectify the non-breaching party for the entire expectation damages.<sup>238</sup>

The Chicago school recognizes the defense of impossibility, frustration of purpose, and impracticability to avoid honoring a contract.<sup>239</sup> The three doctrines are necessary to the Chicago school because the school's assumption is that any contract must be, *ex ante*, mutually beneficial.<sup>240</sup> The Chicago school allows for the legal defense of impossibility, frustration of purpose, and impracticability when the promisee is the superior risk bearer.<sup>241</sup> Such a defense is only available so far as the circumstance is not contractually provided for.<sup>242</sup> In the case of impracticability, if a contract were to become impractical, it should be breached and the party who, *ex ante*, would have been able to insure against the risk of breach should bear the cost.<sup>243</sup> An example of this can be seen in a contract for one party to produce a good for another. For example, if the costs of production were to rise more than fifty percent, making the cost of production greater than the contracted sale price,<sup>244</sup> the Chicago school would discharge the contract if at the formation of the contract the performer was in a worse position to insure against the risk.<sup>245</sup> The cost of this excuse should be allocated to whichever party would have been better able to insure against this risk.<sup>246</sup>

The Austrian school allows for almost no use of impossibility or impracticability. According to the Austrian theory, only the agreement that the parties reached can measure the true value of the products and services exchanged.<sup>247</sup> If an actor misvalues the risk or benefits of a contract, then he has behaved as an inefficient actor.<sup>248</sup> Such behavior must be discouraged, as bad judgments by actors misallocate resources and contribute to skewing the market's value of

is largely based upon the understanding that a contract is not simply for a product or service, but for that item under a set of conditions, such as different remedies upon breach. None of those conditions are more legitimate than the other, so it is inaccurate to suppose that the default remedy consistent with autonomy is any one of them.)

238. *See id.*

239. *See* Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83, 90-91 (1977).

240. *See* Kronman & Posner, *supra* note 147, at 1-3.

241. *See* Posner & Rosenfield, *supra* note 239, at 90-91, 97-98, 117.

242. *Id.* at 90.

243. *Id.* at 83-85.

244. *Iowa Elec. Light & Power Co. v. Atlas Corp.*, 467 F. Supp. 129, 139-40 (N.D. Iowa 1978), *rev'd on other grounds*, 603 F.2d 1301 (8th Cir. 1979), *cert. denied*, 445 U.S. 911 (1980).

245. Posner & Rosenfield, *supra* note 239, at 90-91.

246. *Id.*

247. *See* Rothbard, *supra* note 140, at 106-26. This is because values are purely subjective and an individual's preferences can only be measured through his action.

248. *See* KIRZNER, DRIVING FORCE, *supra* note 174; *supra* note 137.

the good or service.<sup>249</sup> As such, discouragement of bad judgment and encouragement of good judgment by actors is a necessary precondition to increasing the efficiency of resource allocation.<sup>250</sup> To allow a party to escape financially costly performance under a contract because he failed to use efficient entrepreneurship to predict future costs when the other party did does not provide the necessary encouragement of efficient entrepreneurship needed to increase the market's greater efficiency.<sup>251</sup> Efficient entrepreneurship occurs in large part because efficient entrepreneurs are rewarded while inefficient entrepreneurs are punished.<sup>252</sup>

The only scenario under which the Austrian school would allow the defenses of impossibility, frustration of purpose, or impracticability is when both parties assumed that the risk would not occur and no level of entrepreneurial perceptiveness reasonably could have contradicted either party's assumptions.<sup>253</sup> For example, in the previously mentioned case where the cost of production increased more than fifty percent, the Austrian school would not discharge the parties' obligations under the contract.<sup>254</sup> Under this and most circumstances, perceptive entrepreneurs could have reasonably perceived this risk. Such perceptive entrepreneurship needs to be encouraged, not made irrelevant.<sup>255</sup> In contrast, the famous case of *Taylor v. Caldwell* is an instance when, arguably, no level of entrepreneurial ability would have been able to prevent the impossibility of performing the contract.<sup>256</sup>

In this area of contract law, the Chicago school's jurisprudence provides a moderate level of conflict with the protection of Lockean natural rights. The Austrian school's jurisprudence more thoroughly protects Lockean natural rights. There are a small number of instances, though, where the Austrian school would allow efficient

249. *Id.* The proper valuation of goods and services by the market is fundamental to efficiency. See MISES, *supra* note 106, at 257-59. "The [unfettered] market process is the adjustment of the individual actions of the various members of the market society . . . . The market prices tell the producers what to produce, how to produce and in what quantity. . . . It is the center from which the activities of the individuals radiate." *Id.* at 258; see Rothbard, *supra* note 140, at 19-20, 85-87.

250. See KIRZNER, *supra* note 132, at 132, 135-36, 148-49, 215-17; sources cited *supra* note 249.

251. See sources cited *supra* note 250.

252. See *id.*

253. See Christopher T. Wonnell, *Contract Law and the Austrian School of Economics*, 54 *FORDHAM L. REV.* 507, 526-27 (1986).

254. See *id.*

255. See *supra* note 227.

256. See *Taylor v. Caldwell* (1863) 122 Eng. Rep. 309, 312, 315 (K.B.) (holding a contract for the rental of a music hall void because the hall burned to the ground); see also Wonnell, *supra* note 253 (stating that *Taylor v. Caldwell* fell within the category of cases in which both parties assumed a risk would not occur and no level of "entrepreneurial perceptiveness reasonably could have contradicted [that] assumption").

breach on impracticability grounds because no entrepreneurial perceptiveness reasonably could have contradicted either party's assumption. While a natural-rights-based policy would never allow for breach in a case of impracticability, the Austrian school would still protect natural rights in the majority of cases.

## 2. *Defense of Mistake: The Duty to Disclose*

The defense of mistake doctrine is accurately characterized as a duty to disclose information.<sup>257</sup> The doctrine requires that, under certain circumstances, one party has a duty to disclose information to the other party.<sup>258</sup> Information is not limited to facts but also includes creative insights. The Lockean natural rights position on defense of mistake is that there should be no legal duty to disclose.<sup>259</sup> The natural freedom to contract is predicated on voluntariness, not knowledge. If a party was incorrect about an assumed fact, this does not undermine voluntariness. Hence the mistake does not undermine the binding nature of the contract.<sup>260</sup> Furthermore, one party has no right to information that the other possesses.<sup>261</sup> An individual in no way has a Lockean natural right to information another possesses as a result of his own creation or has acquired through voluntary transaction.

The Chicago school universally prescribes some level of duty to disclose information.<sup>262</sup> The level of disclosure required varies amongst scholars,<sup>263</sup> but a middle position is that there is a duty to disclose information acquired without deliberate and costly effort but no duty to disclose information obtained with deliberate and costly efforts.<sup>264</sup> This position reflects a desire to promote the acquisition of information through internalizing its benefits,<sup>265</sup> but when possible requires the dissemination of information to all parties to reach per-

257. See Anthony T. Kronman, *Mistake, Disclosure, Information, and the Laws of Contracts*, in *THE ECONOMICS OF CONTRACT LAW*, *supra* note 147, at 114, 117.

258. *Id.*

259. See *supra* notes 67-70 and accompanying text. See generally Walter Block, *Towards a Libertarian Theory of Blackmail*, 15 *J. LIBERTARIAN STUD.* 55, 55-58 (2001) (starting from the position that one has a right to the information he creates or acquires legitimately, Block deduces that blackmail should not be prohibited).

260. This is not to be mistaken with the "right to lie"—that is, fraud, which will be addressed later.

261. See *supra* note 259.

262. Richard Epstein supports a relatively high duty to disclose and calls the lack of disclosure "low-level frauds." Richard Epstein et al., *Coercion vs. Consent: A Reason Debate on How to Think About Liberty*, *REASON*, Mar. 2004, at 40, 49, available at <http://www.reason.com/0403/fe.ra.coercion.shtml>. Richard Posner also equates a lack of disclosure to fraud. POSNER, *supra* note 89, at 111; M.J. Trebilcock, *The Doctrine of Inequality of Bargaining Power*, in *THE ECONOMICS OF CONTRACT LAW*, *supra* note 147, at 78, 84-85.

263. See *id.*

264. Kronman, *supra* note 257, at 118-21. See generally *supra* note 263.

265. See Kronman, *supra* note 257, at 118-21.

fect knowledge.<sup>266</sup> The need to force the exchange of information between the parties is a product of the Chicago transaction being predicated upon perfect information.<sup>267</sup>

The Austrian school is less amenable to the defense of mistake but does not discard it altogether.<sup>268</sup> Proponents of the Austrian school do not assert that mistakes do not take place or that mistakes do not result in transactions that are not utility maximizing. Rather, Austrians maintain that allowing mistakes to occur encourages more efficient entrepreneurship.<sup>269</sup> Knowing that they cannot rely upon a defense of breach, parties will take better precautions to fully inform themselves prior to future transactions, actors who are good entrepreneurs will be encouraged to engage in more transactions, and actors observing from the sidelines will be encouraged to follow the example of the good entrepreneur.<sup>270</sup>

Entrepreneurship is also taken into account by the Austrian school as a skill for perceiving opportunities to acquire knowledge and using existing knowledge in the most effective way.<sup>271</sup> The Chicago school calculation of how costly information was to acquire, however, does not take into consideration the value of effective entrepreneurship.<sup>272</sup> Allowing a party to breach a contract based upon mistake could amount to one party confiscating the gains from entrepreneurship that another party contributed.<sup>273</sup>

The Austrian school also recognizes the inefficiency of a bad contract, and its analysis tends to mirror the Chicago "how costly was the information to acquire" test while also recognizing the value of entrepreneurial skill level.<sup>274</sup> According to the Austrian school, if the information was a product of purposeful entrepreneurship, then it is not to be undermined and freely captured by the other party.<sup>275</sup> Therefore, there is no duty to disclose and the contract should not be

266. In addition to the economic cost of a party not benefiting ex ante due to incomplete or bad information, there can be economic costs such as the redundant acquisition of information. POSNER, *supra* note 89, at 111.

267. See *supra* notes 147-52 and accompanying text.

268. Wonnell, *supra* note 253, at 528.

269. See KIRZNER, *supra* note 132, at 132, 135-36, 148-49, 215-17.

270. See *id.*

271. See ROTHBARD, *supra* note 106, at 509-56; ISRAEL M. KIRZNER, *Introduction to METHOD, PROCESS, AND AUSTRIAN ECONOMICS: ESSAYS IN HONOR OF LUDWIG VON MISES* 1, 3-4 (Israel M. Kirzner ed., 1982); see also Jack High, *Alertness and Judgment: Comment on Kirzner*, in *METHOD, PROCESS AND AUSTRIAN ECONOMICS: ESSAYS IN HONOR OF LUDWIG VON MISES*, *supra*, at 161, 167; see *supra* notes 133-37.

272. See *id.*

273. See *id.*

274. See Wonnell, *supra* note 253, at 528-30; see also KIRZNER, *supra* note 132, at 148-49, 158, 175-80.

275. *Id.* Note: this specifically excludes windfall profits due to luck. KIRZNER, *supra* note 132, at 177-80.

voided under the defense of mistake.<sup>276</sup> If the information is not a product of entrepreneurship, then the marginal value of encouragement is insignificant and does not outweigh the inefficient contract<sup>277</sup>—so the contract should be voided under the defense of mistake.<sup>278</sup>

Furthermore, Austrians are skeptical of a judge's ability to accurately reassess the values of the conditions of the contract. Their skepticism is due to their strict adherence to the principle that the value of the conditions is only measured subjectively by the parties and the inability of any individual actor to decipher the true market value.<sup>279</sup> Austrian economists could also rely upon this doctrine to undermine any defense of mistake.

In the area of defense of mistake contract law, the Chicago school's jurisprudence would not provide a great deal of protection for the natural freedom to contract. The Austrian school's jurisprudence also does not offer a rigorous defense of this application of the freedom, but it provides slightly more than the Chicago school.

### 3. *Fraud and Force*

The defense of fraud is applicable when a false material assertion is knowingly made and the other party relies upon it.<sup>280</sup> The defense of force, which is also known as physical duress, is applicable when physical threat compels a party to assent.<sup>281</sup> The Lockean natural rights position regarding fraud and force is that they are a legitimate and necessary legal defense.<sup>282</sup> Fraud, at first glance, might not seem the same as force, but philosophically they are identical in principle. Just as the use of force negates the ability of the party to voluntarily consent or refrain from consenting, the use of fraud undermines the consent which is at the core of contract. When fraud occurs, what the party was consenting to is, in actuality, not the actual conditions of

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276. Wonnell, *supra* note 253, at 528-30; see KIRZNER, *supra* note 132, at 148-49, 158, 175-80.

277. See sources cited *supra* note 276.

278. See sources cited *supra* note 276.

279. See *supra* note 142.

280. RESTATEMENT (SECOND) OF CONTRACTS §§ 162, 164 (1981).

281. RESTATEMENT (SECOND) OF TORTS § 172 (1965).

282. FRIED, *supra* note 68, at 80; see also *id.* at 22-24. "The person who disregards me . . . who takes account of my individuality—my thinking, reason, judgment—and forces me to bend my will to his violates my liberty. His plan depends on the fact that I have plans, and he makes me make his plans my plans. . . . Consider two opposite ways in which we take into account other persons and their distinct capacities as individuals: we can cooperate with them or we can coerce them. . . . In cooperating we elicit choices by inviting the other to join in our choices, to make our choice his. Coercion can be made to look like cooperation—the offer you can not refuse." *Id.* at 22-24.

the contract.<sup>283</sup> To undermine the ability to refrain from assenting is a violation of the Lockean natural right to autonomy of one's mind.<sup>284</sup>

Fraud is a valid legal defense according to the Chicago school.<sup>285</sup> In the Chicago school, the underlying reason why contracts are Pareto efficient is because both parties enter into the contract with full rationality and high levels of knowledge and conclude that with this transaction they will be better off.<sup>286</sup> Because actors have perfect information, these exchanges represent the exact level of utility each actor receives from the exchange.<sup>287</sup> If fraud occurs, then this necessarily distorts the information possessed by the parties and skews the valuations of the exchanging parties. Each exchange no longer is commenced on high levels of information and the utility maximizing outcome is no longer reached.

According to the Austrian school, fraud is conceptually much like mistake except that whereas mistake is reasonably rectified through good entrepreneurship, fraud is not.<sup>288</sup> As under most of the previous scenarios, Austrians do not dispute the Chicago analysis that a lack of information leads to inefficient, non-pareto superior transactions.<sup>289</sup> In the case of force and fraud, the Austrians agree with the Chicago conclusion to recognize the legal defenses.<sup>290</sup> The Austrian school recognizes these defenses because it is concluded that entrepreneurship could not reasonably anticipate and counteract fraud or avoid force.<sup>291</sup> Proceeding upon a fact related by the other party is a necessary part of the transaction. If the facts presented by the other party could not be relied upon, the necessary double-checking would require an unnecessarily large amount of resources.

By recognizing the legal defense of fraud and force, both schools protect the Lockean natural right for autonomy of one's mind in the process of determining whether to assent or refrain from assenting to the contract.

#### 4. *Unconscionability*

The defense of unconscionability can be asserted when the terms of a contract are harsh, unfair, or unduly favorable to one of the par-

283. *Id.* "Fraud involves a similarly indirect use of force: it consists of obtaining material values without their owner's consent, under false pretenses or false promises." AYN RAND, *The Nature of Government*, in *THE VIRTUE OF SELFISHNESS* 144, 150-51 (1964).

284. *See id.*

285. POSNER, *supra* note 89, at 113.

286. *See supra* notes 147-49.

287. *See id.*

288. *See* KIRZNER, *supra* note 132, at 217.

289. *See* ROTHBARD, *supra* note 106, at 19-20, 85-87; *supra* notes 137-39, 154-55.

290. *See* KIRZNER, *supra* note 132.

291. *Id.*

ties in light of the relevant market conditions.<sup>292</sup> This can occur when the price is inferior to that of the market, when the terms are at market price but that market price is monopolistic, or because there were harsh nonprice terms.<sup>293</sup> The case of monopoly has previously been dealt with, so only contracts with terms inferior to market price and contracts with harsh nonprice terms will be addressed here.

The Lockean natural rights position regarding unconscionability is that since the terms were negotiated voluntarily, they must be enforced.<sup>294</sup> One party may not breach terms that he voluntarily agreed to because he no longer wants to follow through with the contract.<sup>295</sup> The only exception would be for agreements that the party could not say “no”—making his agreement not truly consensual.<sup>296</sup> Such an exception would only be realized for essential items for which there is of only one source—for example, where there is only one source of food. If the item is essential, then the consumer can not say “no.” If there is a suitable substitute, though, then there is no longer a true monopoly and this exception would no longer apply. There is also, arguably, an exception for contractual terms which an individual did not use his cognition in agreeing to. If the conditions were “agreed to” simply in passing, reflexively, or without some degree of contemplation it could be said that the agreement to those terms is not a product of the individual and he therefore is not bound by it.<sup>297</sup>

The Chicago school recognizes a limited application of the common law defense of unconscionability.<sup>298</sup> The premise of the doctrine as the

292. U.C.C. §2-302 (2005) (amended 2003); RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981).

293. *See generally id.*

294. *See supra* notes 68-70, 74-75 and accompanying text.

295. *Id.*

296. An inequity in bargaining power does not preclude you from saying “no” and hence does not invalidate consent. It might reduce the desirability of the terms you come to agreement on, but this does not undermine the voluntariness.

297. *See* Richard Craswell, *Remedies when Contracts Lack Consent: Autonomy and Institutional Competence*, 33 OSGOODE HALL L.J. 209 (1995); Richard Craswell, *Property Rules and Liability Rules in Unconscionability and Related Doctrines*, 60 U. CHI. L. REV. 1 (1993). This exception for form contracts would be most applicable to a Rand-like origin of one’s rights to contract. Because the Randian story of the origin or rights is that they derive from rational thought, an act such as reflexively signing a form contract which is not based upon rational thought is, arguably, not binding. *But see* Randy E. Barnett, *Consenting to Form Contracts*, 71 FORD. L. REV. 627, 634-36 (2002) (Barnett argues that under his theory, which makes contracts binding through consent, in most cases there is not a problem enforcing form contracts. This is in contrast to Fried’s theory, which makes contract binding as a promise, where there may be much more room for not enforcing form contracts.).

298. The school recognized the doctrine as an extension of fraud, failure to disclose, frustration of purpose, and mutual mistake. ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 189-91 (2d ed. 1997). These are all applications where information and/or rationality is imperfect. *See* Richard Craswell, *Freedom of Contract*, in CHICAGO LECTURES IN LAW AND ECONOMICS 81, 88-95 (ERIC A. POSNER ed., 2000). The school does not apply the doctrine to terms that provide large profit to either bargainer, however. *See infra* note 302 and accompanying text.

Chicago school applies it is that the actors have made a decision with poor information.<sup>299</sup> This transaction must therefore be below Pareto efficiency and, according to the Chicago school, should not be enforced.<sup>300</sup> Instead, the transaction should be negated so that a more efficient transaction based upon more complete information instead can be undertaken.<sup>301</sup> However, according to the Chicago school the doctrine should never be used simply to eliminate contract terms that provide large returns to the seller.<sup>302</sup> If these terms reflect the accurate rate of risk then they should be enforced.

The Austrian school does not recognize a defense of unconscionability for terms inferior to the market price.<sup>303</sup> The primary reason that the Austrians do not recognize the defense is that they do not operate under the assumptions that individual actors are fully rational or have high and static levels of information.<sup>304</sup> Instead, the Austrian school holds that rationality is a learned trait.<sup>305</sup> Making actors realize the consequence of their decisions makes them more rational actors and ultimately contributors to a marketplace that facilitates efficient transactions and thus contributors to the market's accurate valuation of goods.<sup>306</sup> Alternatively, letting actors "off the hook" fails to encourage rational decision-making and does not advance long-term efficiency.<sup>307</sup>

Additionally, the Austrians do not recognize the defense of unconscionability because they do not believe that an economist can accurately measure an individual actor's subjective value of a good.<sup>308</sup> The Austrians' strict adherence to subjective valuation, along with their denial of the economist's ability to make cardinal measurements, results in an inability to determine what the actor's subjective value of the item was or to make any interpersonal comparison of utility.<sup>309</sup>

299. See Craswell, *supra* note 298, at 88-95. The school also applies the doctrine in certain cases of duress, fraud, and necessity, but that is not the specific application or interest here. See Richard Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293, 295-300 (1975).

300. See Craswell, *supra* note 298, at 88-95. However, Craswell accurately notes that in the real-life application the substitute would have to be more efficient. *Id.* at 96-98. While discussing unconscionability, Chicago scholars seem to invariably leave out of the specific topic of actors with bad information and/or bad rationality. See, e.g., Epstein, *supra* note 299; Posner, *supra* note 89, at 126-30.

301. See Craswell, *supra* note 298, at 88-95; see *supra* notes 88-89, 147-50 and accompanying text.

302. See POSNER, *supra* note 89, at 129; Epstein, *supra* note 299, at 93, 305-15.

303. See Wonnell, *supra* note 253, at 535-42.

304. See *id.*; *supra* notes 132, 137-39 and accompanying text.

305. See Wonnell, *supra* note 253, at 518-21; *supra* notes 132, 137-39 and accompanying text.

306. See *id.*

307. See THOMAS SOWELL, KNOWLEDGE AND DECISIONS 110-11 (1996).

308. See *supra* notes 90, 97.

309. See *id.*; *supra* note 142.

Finally, the Austrians do not recognize the defense of unconscionability because even if it were possible for an economist to measure and predict an individual's subjective valuation, Austrians do not believe it possible for a judge to obtain and analyze the information in a market as accurately as the market would itself because a judge is only a single actor.<sup>310</sup> In contrast to a judicial edict altering the sales price, if the profits generated are greater than the margin, then entrepreneurs will move in to capture that profit because they are the most sensitive measuring tool in an open market.<sup>311</sup> The possibility of a judge incorrectly determining that the price paid was above the true market price would have the effect of negating the market's self-correcting mechanism and decreasing the availability of those goods to the consumers.<sup>312</sup>

In this area of contract law, the Chicago school's jurisprudence provides some conflict with the Lockean freedom to contract. The Austrian school, on the other hand, is consistent in upholding Lockean freedom to contract.

As a general principle, the jurisprudence of each school protects the natural freedom to contract. This is exemplified by the schools' upholding of the principles of freedom to contract in the cases of minimum wage, product regulations, and pension statutes, under which a large number of contract issues fall. However, the exceptions analyzed show that the Chicago school is less consistent than the Austrian school in protecting the Lockean freedom to contract. The jurisprudence of the Austrian school is not perfect at protecting the Lockean freedom to contract, but its methodology is thorough nonetheless.

## V. SYNTHESIS AND CONCLUSIONS

It is desirable for individuals to interact in a society of law. But, such law is, by definition, coercive.<sup>313</sup> In order to justify this coercion, there must be a moral justification for that law. If there is a legitimate and compelling justification for the law, then there is a moral duty to obey the law.

The most common methods of establishing a moral duty to obey the law, such as consent, are either fictional or fail. Instead, it is possible to establish a moral duty to obey the law to the degree that the law embodies procedural assurances for the protection of justice. The

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310. *Supra* note 142.

311. Ellig, *supra* note 171, at 244-45.

312. See SOWELL, *supra* note 307, at 169. "The costs of an industry are difficult—if not impossible—for third parties to determine. . . . [C]osts are foregone options—and options are always *prospective*. . . . Government regulations and their estimates of 'cost' are based on objective statistical data on actual outlays." *Id.*

313. See *supra* introduction to Part II.

moral duty imposed through this method is not a nominal “yes or no” scale, but rather a gradient one.

The Chicago and Austrian schools of law and economics both provide for a jurisprudence based on economic efficiency. In this respect, the policies of the schools are procedural assurances of an outcome. To the extent that each school’s procedures provide for the protection of justice, a legal system based upon them is owed a moral duty of obedience.

Justice is the protection of Lockean natural rights. Lockean natural rights derive from the ownership of one’s own body. From that single right derives the right to the process and product of one’s mind and the right to ownership of property created from resources in the state of nature. In order to respect those rights, the freedom from contract and the freedom to contract must be fully protected.

The Austrian school provides a very high amount of protection for Lockean natural rights. The school’s general doctrine provides sweeping protections for freedom from contract and freedom to contract. When case studies of doctrines within those two categories are examined, the Austrian school almost universally protects those freedoms. There are a few examples where the school’s policy does not provide complete protection for natural rights, such as some instances of mistake and a very few instances of impracticability, but overall there is a very high level of protection for natural rights.

The Chicago school provides a moderate amount of protection for Lockean natural rights. The school’s general doctrines also provide sweeping protections for freedom from contract and freedom to contract, such as opposing minimum wage laws, collective bargaining statutes, mandatory pension statutes, insurance regulation, and antidiscrimination laws. However, when case studies of doctrines that fall within those two categories are examined, it is observed that the Chicago school does not provide as sweeping a level of protection as it first seems. The Chicago school is most deficient in the case studies within freedom from contract, failing to protect Lockean natural rights under either monopoly antitrust law or eminent domain law. However, as these case studies are the exception rather than the norm, they should not be over emphasized—the cliché “don’t miss the forest for the trees” resonates.

From these observations, it can be concluded that a jurisprudence based upon Austrian law and economics would be owed a high moral duty of obedience to the law. The Austrian system is not perfect in

protecting natural rights, so the moral duty is not as high as if consent had been given, but the duty owed would be very high nonetheless.<sup>314</sup>

A jurisprudence based upon Chicago law and economics would not be owed as high a moral duty as the Austrian school. A Chicago-based legal system is marked by too many instances where the individual's natural rights are actively undermined, such as monopoly, eminent domain, and much of unconscionability, mistake and impracticability. However, because the general doctrine is extremely protective and is applicable to most cases, the moral duty owed would be relatively high. For purposes of perspective, a Chicago-based system would almost certainly offer a greater level of protection for Lockean natural rights than any modern government and, hence would be owed a greater moral duty of obedience.

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314. It would be unwise to dismiss a system because it is not perfect. If a particular jurisprudence provides the great benefit of being able to bring individuals out of the state of nature through moral methods while also providing great increases in utility, it should not be condemned for a small number of flaws. In the words of Justice Janice Rodgers Brown, "The question is not whether we are perfect, but whether our regime is reasonably good. . . . Perfection cannot be achieved, what we strive for is the best for human liberty." Justice Janice Rodgers Brown, Address Before the Federalist Society 2006 Leadership Conference (July 15, 2006). Also, as was discussed previously as a principle of Austrian economics, the true value of an option is in comparison to the alternatives. Therefore, if the Austrian system is the most effective method to achieve our goals, it should not be dismissed. See *generally* Arneson, *supra* note 40, at 96 (Arneson's system of legitimacy, which I have stated is principally very similar to the one used in this Article, determines the legitimacy of government upon which system is *the most* effective at protecting fundamental rights. A system that is not perfect, but is still the most effective, is still legitimate, that is until a more effective one is developed. Of note, building on Locke's theory that one would not give up more rights than he had in the state of nature, in order to be legitimate even the best system would still have to meet this baseline of rights protection in order to be considered legitimate.) Finally, George Smith, an initial developer of this methodology, succinctly addressed this issue of imperfection:

Infallible procedures, however, are not available to fallible beings, so it is not surprising that we will inevitably fall short of . . . "ideal." (It is "very unlikely," [a critic] notes, "that any procedure will ever attain such perfection in the real world." For "very unlikely" I would substitute "impossible," and I must wonder why an unattainable goal is regarded as perfection.)

Smith, *Reply to Critics*, *supra* note 59, at 465.