Ernst-Joachim Mestmäcker reviews legal theories of Richard Posner and Friedrich A. von Hayek, who are famous for their contribution to law and economics.

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Mohr Siebeck

ERNST-JOACHIM MESTMÄCKER

A Legal Theory without Law

Walter Eucken Institut

Beiträge zur Ordnungstheorie und Ordnungspolitik
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A Legal Theory without Law

Posner v. Hayek on Economic Analysis of Law

Mohr Siebeck

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Preface

The language of economics is English. Legal scholarship is for obvious reasons tied to the language of the applicable law. Even studies in comparative law are mostly directed towards the author's own legal order that is to learn from foreign experience. This division of languages and labour leads to regrettable gaps in scholarly discourse. Even contributions by famous authors like Richard A. Posner and F. A. von Hayek are frequently interpreted in national isolation. I publish this essay on Posner v. Hayek in English because the underlying controversy is accessible in English only.

I am greatful for comments by Anne van Aaken, Heike Schweitzer, Manfred E. Streit and Viktor J. Vanberg. Remaining errors are mine.

Hamburg, March 2007 *Ernst-Joachim Mestmäcker*

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> The economist's retrospective interpretation of how the market system operates does not, however, mean that we are now able to replace it by some deliberate arrangements.
>
> F. A. v. Hayek

I. The issues

The law has become a preferred subject of economic analysis. There is, according to Richard Posner, a "movement of economic analysis: from Bentham to Becker."[1] The insights of the pioneers of the movement "have been generalised, empirically tested, and integrated with the insights of the 'old law and economics' to create an economic theory of law having explanative power and empirical support. The theory has normative as well as positive aspects".[2] The application of the analytical tools of economics to other fields of knowledge is not limited to the law.[3] But the law in all its complexity has proved one of the most promising and fertile fields to test new applications of the received methodology of neoclassical welfare economics. In the United States economic analysis has become one of the most influential theoretical approaches to law. Important German contributions attest to the cross cultural influence on legal and economic scholarship.[4]

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[1] *Posner*, Frontiers of Legal Theory, 2001, p. 31–61 (quoted as Frontiers).

[2] *Posner*, Economic Analysis of Law, 2003, p. 24 (quoted as Economic Analysis).

[3] For an overview see *Radnitzky, Gerard/Bernholz, Peter* (eds.) Economic Imperialism, The Economic Method applied outside the Field of Economics, 1987.

[4] *Schäfer, H.-B./Ott, C.*, Lehrbuch der ökonomischen Analyse des Zivilrechts, 5. Aufl. 2005; *dies.* (Hrsg.), Allokationseffizienz in der Rechtsordnung, 1989; *Eidenmüller, Horst*, Effizienz als Rechtsprinzip: Möglichkeiten und Grenzen der ökonomischen Analyse des Rechts, 1995; *Behrens, Peter*, Die ökonomischen Grundlagen

Hayek is, of course, famous for his contributions to the constitutional foundations of a free society. This does not, however, apply to his profound analysis of law and economics.[5] Posner even discards this part of Hayek's theory as formalistic and inhospitable to economics.[6] Their controversy will be used to analyse, in a historical perspective, the relation of law to economics.

des Rechts, 1986; *Aaken, Anne van*, "Rational Choice" in der Rechtswissenschaft, 2003; with different methodology *Richter, Rudolf/Furubotn/Eirik G.*, Institutions and Economic Theory: The Contribution of the New Institutional Economics, 1997 (German edition: Neue Institutionenökonomik, 3. Auflage, Tübingen 2003).

[5] Representative of this analysis are F. A. von Hayek's studies on "Law, Legislation and Liberty". Volume I, Rules and Order, 1973; Volume II, The mirage of social justice, 1976, Volume III, The political order of a free society, 1979. For a discussion see *Mestmäcker*, Regelbildung und Rechtsschutz in marktwirtschaftlichen Ordnungen, 1978 (A tribute on the occasion of Hayek's 85th birthday); *Mestmäcker*, Organisationen in spontanen Ordnungen, Friedrich von Hayek Vorlesung 1992, reprinted in: *Mestmäcker*, Recht in der offenen Gesellschaft, 1993, S. 74–98.

[6] *Posner*, Law, Pragmatism, and Democracy, 2003, p. 278 (quoted as Pragmatism). For details see below p. 27–42.

II. Posner's economic theory of law "from the outside"

Posner distinguishes two conceptions of economics. Economics that studies markets only and economics as a method that applies the rational actor model to human behaviour in general.[7] It is the rational actor model that qualifies economics to provide an analysis of law in general and beyond market regulation. The relation of antitrust laws and public utility regulation to economics were (almost) a matter of course. Since the law in general deals with conflict resolution which necessarily implies a choice among different possible solutions, there seems to be no limit to the application of rational choice to all branches of the law. Rational choice is based upon a cost-benefit analysis with wealth maximisation as the ultimate goal (the maximand). Rational choice as applied to individuals consists in a cost-benefit analysis which chooses the best available means to the choosers' end.[8] Applied to legislation or judicial decisions, cost-benefit analysis inquires whether they are efficient means to wealth maximisation. Efficiency is, of course, analysed under the assumption that individuals subject to these rules maximise their utility.

Distributive effects are referred to other branches of law or of government.

Wealth maximisation in this context is to be understood "not in strictly monetary terms but rather as the summation of all the valued objects, both tangible and intangible, in society, weighted by the prices they would command were they to be traded in markets". Market transactions are taken as paradigmatic of morally appropriate ac-

[7] *Posner*, Economic Analysis, p. 23.

[8] *Posner*, Frontiers, p. 252.

tion.[9] Wealth maximisation assumes, however, that individual actions that are rational and – according to Posner – moral as well, contribute to the wealth of society. This links wealth maximisation to social policy. By substituting wealth for utility as maximand, Posner distinguishes his approach from utilitarianism. The aggregation of happiness across persons is branded as the "barbarism of utilitarian ethics".[10] The macro level of Posner's economic analysis is taken from welfare economics: the efficient allocation of resources as modelled by Pareto-superiority, mitigated by Kaldor-Hicks efficiency.[11]

Economic analysis of law is based on a theory of markets and prices resulting from voluntary market transactions. If transactions take place under conditions of perfect competition the market guarantees the most efficient allocation of resources. The resultant equilibrium of supply and demand maximises welfare if every change would lead to an inferior situation. This is the fascinating and influential Pareto-model of welfare economics.[12] Because of the rarity of conditions that make competition perfect, Kaldor-Hicks efficiency is accepted as a less demanding substitute. Transactions are treated as efficient in spite of external effects if those who lose are compensated or may be compensated by those who win. The economic analysis of law is not, however, limited to voluntary market transactions. In the words of Richard Posner: "If we insist that a transaction be truly voluntary before it can be said to be efficient – truly voluntary because all potential losers have been compensated – we shall have few occasions to make judgements of efficiency, for few transactions are voluntary in that sense."[13] The alternative approach is to guess whether, if a voluntary transaction had been feasible, it would have taken place. The task then is to reconstruct (to mimic) the market.

The undoubted success of the "movement" is a success for economics as a discipline and for economists who find a fertile field to test the assumptions and the explanatory power of their models. The almost uncontroversial and salutary effect of cost-benefit analysis is

[9] *Posner*, Frontiers, p. 98.
[10] *Posner*, Frontiers, p. 97.
[11] *Posner*, Economic Analysis, p. 13.
[12] For details see *Knieps*, Wettbewerbsökonomie, 2005, S. 7–9.
[13] *Posner*, Economic Analysis, p. 15.

the discipline it imposes on decisions, particularly on political decisions, and in revealing implied valuations.[14] This is not a matter of course. In societies that have a tradition of relying on the inherent wisdom and prescience of government – including government monopolies – even the obligation of cost-benefit analysis has been criticised as an encroachment of economics into the preserved domain of the sovereign. All too often the appeal to public interest or to the privilege of the "political question" is used to hide the actual costs of, and the real interests in, controversial government policies. In European law, this issue is most prominent in the controversies surrounding the position or privileges of public undertakings and of undertakings "entrusted with the operation of services of general economic interest" (Article 86 EC-Treaty). In cases of this kind, positive and normative uses of cost-benefit analysis tend to converge.

Cost-benefit analysis is indispensable across a wide range of policy decisions to inform competent authorities of the costs of alternative means to given ends.[15] And economics is indispensable where the law deals with complex economic facts to enable legislators, government officials or judges to know what they are dealing with and what the effects of their decisions are likely to be.

Cost-benefit analysis is end-neutral. It can be applied to any given purpose. Constitutions, statutes and precedents, however, are as a rule not end-neutral.[16] The question then is how to accommodate the normative implications of economic analysis with diverse non-economic legal purposes. In law, the relation of ends to means is more than a pragmatic methodological operation. One of the central themes of legal philosophy is unearthing law's underlying rationale(s). Further, the purposes of constitutions, statutes or precedents inform their interpretation. Wealth maximisation is no substitute for the purpose of law in general.

Posner answers some of the most frequent objections against the sweeping generalisations of rational choice and wealth maximisation, by enumerating what rational choice as a model of human behaviour does not mean: "Individuals are not taken to be hyper rational, emo-

[14] *Posner*, Frontiers, p. 123.
[15] *Posner*, Frontiers, p. 124.
[16] See only *Bentham*, Of Laws in General, 1970, chapter 3, p. 31.

tionless, unsocial, supremely egoistic, omniscient, utterly selfish, non strategic men or women, operating in conditions of costless information acquisition and processing".[17] But even if omniscience and costless information are obviously unrealistic, these exaggerations ascribed to critics do not explain the kinds of motives and of knowledge assumed for rational choice. Nor is it obvious why conduct or legal rules that according to cost-benefit analysis are efficient, contribute to wealth maximisation or to the implementation of non-economic legal purposes.

We expect answers to questions of this sort from legal scholarship. If economic analysis does more than making products of law amenable to the application of price theory, the "more" requires legal analysis of economic systems. The question does not arise where principles of law and economics are identified. This is true of Jeremy Bentham's utilitarianism. When one of the founders and leading practitioner of economic analysis develops his legal theory,[18] expectations are high to have the province of law and the tasks of legal scholarship outlined or even defined. There is, however, according to Posner, but one scientific analysis of law; that is the external analysis by social sciences in general and economics in particular. This approach excludes the legal profession's internal perspective of law. Excluded are "both philosophy of law (legal philosophy or jurisprudence) which is concerned with high level abstractions such as legal positivism, natural law, legal hermeneutics, legal formalism, and legal realism – and the analysis of legal doctrine, or its synonym legal reasoning, the core analytical component of adjudication and the practice of law".[19] The list is not complete and does not prepare us for Posner's own legal theory. It is not complete because among the ejected disciplines are legal history and comparative law.[20] It does not prepare us for the return of some "high level abstractions" of legal philosophy. Their vindication appears to be inevitable if you assume or want to prove that efficiency of rules is not identical with their binding force. This is why legal positivism, represented by Kelsen's "philosophy", is allowed to create a space for economic analysis and "forge a link between positivism and legal pragmatism."[21]

The strict separation of economics as science of wealth maximisation and law as an order backed by threats (Kelsen) excludes rival traditions of economics and key functions of law. The continuing challenge is to accommodate, in a free order, the dichotomy of economic liberties and equal justice. The following discussion deals primarily with law and economics without, however, disregarding implied or ancillary general issues of legal theory.

[17] *Posner*, Frontiers, p. 256.
[18] *Posner*, Frontiers; *Posner*, Pragmatism.
[19] *Posner*, Frontiers, p. 2/3.
[20] See below p. 56–62.
[21] *Posner*, Pragmatism, p. 251. Posner's reliance on Kelsen is discussed below p. 52–56.

III. New economic and the old European enlightenment

Posner is determined to reorient the law in a more scientific economic and pragmatic direction.[22] The question then is what the law and the science of law have to expect from the new economic enlightenment. Its implications go beyond the relation of law to economics. They concern the role of law in democratic societies that cherish individual liberties as well as economic welfare. These issues are the heritage of the European enlightenment.

The discovery of the market as a coherent model of the economic system called for a new role for government and law in the organisation of an enlightened society. The law became independent from immutable principles of natural law, abolished heritable privileges and accepted the new discipline of economics as an ally.[23]

This alliance did not and does not exclude fundamental differences in the architecture of government, legitimacy and limits of governmental powers or the role of legislation and individual rights in the pursuit of happiness. There was, however, a fundamental consensus that a free society had to be a just society reconciling freedom and equality. There was no longer a general mandate of governments to suppress selfish interests in favour of the public interest. The public interest was rather to result from the interaction of "natural liberties", of rules of conduct and market forces.[24] Justice, according to David Hume, was based upon a convention that guaranteed the stability of

[22] *Posner*, Frontiers, p. 145.

[23] *Gay, Peter*, The Enlightenment: An Interpretation 1969, p. 322.

[24] *Smith, Adam*, An Inquiry into the Nature and Causes of the Wealth of Nations, 1976, Vol. II, p. 708.

possession, its transfer and the performance of promises.[25] The interdependence of a system of justice and an economic system based upon "natural liberties" was best articulated by Adam Smith. In his system, government had only three duties to attend to; duties of great importance, indeed, but plain and intelligible to common understandings nonetheless: first, the duty of protecting society from the violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works ... .[26] The exact administration of justice is not identical with the economic system but is its foundation. It follows that there is no natural harmony between law as the source of justice and economics as the source of welfare.

Jeremy Bentham who, according to Posner, inspired law and economics[27] argued for direct implementation of economic policies through legislation.[28] He identifies the interest of the community with the sum of the interests of its several members who in turn maximise their self interest.[29] Utility is a standard by which to judge the interest and actions of individuals as well as that of the community in general and the legislator in particular. The end and the sole end which the legislator ought to have in view is the happiness of the individuals, who constitute the community.[30] This theory is incompatible with individual rights against the government and the legislator. Proof of this consequence is Bentham's radical critique of the Declaration of Rights by the French National Assembly of 1791, along with the American Declaration of Independence.[31] The tension between

[25] *Hume*, A Treatise of Human Nature and Dialogues Concerning Natural Religion, in: The Philosophical Works, Vol. II Reprint of the London Edition 1886, 1964 p. 293.

[26] *Smith*, Wealth of Nations, 1976, Vol. II p. 687.

[27] *Posner*, Frontiers, p. 33.

[28] *Bentham*, An Introduction to the Principles of Morals and Legislation, 1970, p. 11–37 of the principle of utility.

[29] Ibid p. 12 No. 4.

[30] Ibid p. 34.

[31] *Bentham*, A Critical Examination of the Declaration of Rights, in: *Bhikhu, Parekh*, Bentham's political thought, 1973, Chapter 20. For a more detailed analysis

sovereign power, majority rule and majority happiness as opposed to individual rights is probably the most challenging heritage of the enlightenment.

Bentham[32] (like Hobbes) finds individual rights against the sovereign to be a contradiction in terms. Antipodes to this position are John Locke and Immanuel Kant. In explicit opposition to Thomas Hobbes and to utilitarianism, Immanuel Kant maintains that there can be principles of law only but not of happiness. Liberty under the rule of law as a principle for the constitution of a community means: Nobody may impose upon me his or her concept of happiness.[33] This applies to persons, to a majority in a community and to governments. Everybody may pursue his happiness in any way to his liking as long as he respects the liberty of others, in turn compatible with the same liberty of everybody under a general rule. A government based upon the principle of benevolence towards the people represents the greatest possible despotism, that is, a regime which would abolish all liberties and leave citizens without rights. In a constitution based upon the principle of justice, "the people have inalienable rights against their sovereign even though those rights are not enforceable."[34] Inalienable is in particular "the freedom of the pen". All subjects have the individual right to make public their opinion that governmental measures are incompatible with the principle of justice and the rule of law. This postulate implies more than freedom of opinion. It is based upon the principle that the people have a negative right to judge for themselves whether the highest legislator has enacted a law which is incompatible with the common will.[35] This reasoning entails the legitimacy of and the demand for individual rights as a limitation of governmental powers.

That this challenge is still with us shows a controversy between leading scholars who both subscribe to law and economics. The controversy highlights key issues of jurisprudence. While Posner denies, Epstein maintains the existence of legal principles that are relevant beyond the United States' legal system.[36] It is this fundamental dissent that deserves analysis in the face of the undisputed global impact of the United States' legal system and its methodological offspring – the economic analysis of law. To be compared is Posner's position that law and legal theory are necessarily limited to national legal systems with his confidence in the universal applicability of the economic analysis of law. These questions go beyond the elucidation of the universal or parochial nature of legal systems. They concern for one the relation of law to economics, assuming that they are not identical. *Posner* came close to this opinion in the first 1972 edition of his "Economic Analysis of Law", arguing for the implicit economic logic of the common law.[37] Later he interpreted this as a mere flirt with such a position.[38] The authorities *Posner* and *Epstein* rely on for their conflicting views are proof enough that we are dealing with universal issues, or rather "old European issues": *Posner* allies his legal theory with Kelsen and his theory of democracy with Schumpeter; for his pragmatism in general he even refers to Carl Schmitt. *Epstein* relies, in addition to John Locke and Kant, on Hayek. Hayek is really at the heart of the controversy. For *Posner*, who relates not to have read *Hayek* until 2002, *Hayek* is "a thorough going formalist" who proposes to fill gaps in the law "by custom".[39] For *Epstein*, *Hayek* is an important inspiration for "simple rules for a complex world".[40] As far as *Posner* is concerned, *Hayek* has proffered no contribution to, nor made a call for, the economic analysis of law.

Theories of law and of democracy are not independent from each other. In a democracy, the most important source of law is, of course, legislation adopted by elected representatives of the people. The democratic process is to confer legitimacy on legislation that necessarily

see *Mestmäcker*, Mehrheitsglück und Minderheitsherrschaft. Zu Jeremy Benthams Kritik der Menschenrechte, in: *Mestmäcker*, Recht und ökonomisches Gesetz, 2. Auflage 1984, S. 158.

[32] *Bentham*, Of Laws in General (N. 14) 1970, p. 68.

[33] *Kant*, Über den Gemeinspruch das mag in der Theorie richtig sein taugt aber nicht für die Praxis, in: Kant's Werke, VIII, Seite 276, 290.

[34] Ibid p. 303.

[35] Ibid p. 304.

[36] *Posner*, Pragmatism, p. 94; *Epstein*, Skepticism and Freedom, 2003, p. 73–83. For a review of Posner's book see *Epstein*, The Perils of Posnerian Pragmatism, 71 Univ. Chicago L. Rev. 639–682 (2004). Rejoinder by *Posner*, Legal Pragmatism Defended, 71 Chicago L. Rev. 683–690 (2004).

[37] *Posner*, Economic Analysis of Law, Boston 1972, p. 98.

[38] *Posner*, Pragmatism, p. 78, N. 30.

[39] *Posner*, Pragmatism, p. 277/78.

[40] The title of *Epstein's* book of 1995.

interferes with the freedom of some citizens. There are, however, constitutional rules applied by independent courts that may take precedence over legislation. It is this tension between the democratic legitimacy of ordinary legislation and constitutional rules as interpreted by "wise old men" that is a major theme of both *Posner* and *Epstein*. They disagree fundamentally, however, in the analysis of this tension. *Posner* forcefully expresses the inherent limitations and shortcomings of legislators and judges but finds no fault with the resultant US system. In the last sentence of his book *Posner* states: "Pragmatic liberalism is clear eyed; it is not complacent." Complacency is, however, an appropriate summary of *Epstein's* criticism.[41] Fundamental differences of this kind do not exclude common ground in the legitimate and indispensable application of rational choice to appropriate cases of law or politics.

The Posner/Epstein controversy centers on Posner's view of democracy, law and economics in the United States' system. I propose to take up a more European controversy. It is more European not because of the relevant issues, but because of the key, and contradictory, roles Posner assigns to European authors: Hayek is exposed as representing the engrained shortcomings of European legal theory, being formalistic, past-dependent and indifferent to modern economics; Kelsen, the positivist, offers a wider space for the economic analysis of law and for everyday pragmatism.

[41] *Epstein*, The Perils of Posnerian Pragmatism, 71 Univ. Chicago L. Rev. 675, 680 (2004).

IV. Law and economics in perspective

1. Utility v. happiness

Posner's economic analysis of law and his legal theory without law "from within" do not exhaust the relation of law to economics. This theory delegates the rationality of law, its generation, use and interpretation to economics. Representative of such an approach is Jeremy Bentham. Posner disagrees with Bentham's aggregation of utility across persons, suggesting that it treats people as cells in the overall social organism rather than as individuals.[42] He comes close, however, to another tenet of Bentham's theory.

Rationality means choosing the best available means to the chooser's end.[43] To be compared then are the alternative means known to the chooser in terms of cost, comfort and other dimensions of utility and disutility.[44] Substituting utility for pleasure, Posner's cost-benefit analysis is similar to Bentham's "felicific calculus".[45] In weighing or balancing utilities, costs stand for pain, benefits stand for pleasures. The resemblance becomes even more obvious when the concept of utility is broadened to include emotions and rational shortcuts. Posner proposes to give a "rational construal"[46] to non-economic or partly irrational behaviour. This confounds, however, the general difficulty of relating individual rational conduct to wealth maximisation. By including wide concepts of utility and disutility in

[42] *Posner*, Frontiers, p. 97.
[43] *Posner*, Frontiers, p. 252.
[44] *Posner*, Frontiers, p. 252/253.
[45] *Bentham*, An Introduction to the Principles of Moral and Legislation, 1970, Chapter VI, "Value of a lot of Pleasure and Pain, How to be Measured", p. 40.
[46] *Posner*, Frontiers, p. 253.

the cost-benefit analysis, the assumed connection of rational choice and wealth maximisation becomes indeterminate.

A different approach to law and economics views the economic system as a system of liberty based on a legal order that provides for and guarantees the constituent economic liberties as individual rights. Abstract legal rules for otherwise unregulated individual planning are an integral part of the economic system, providing information that makes a rational division of labour and allocation of resources possible. Representative of this approach are Adam Smith and F. von Hayek.

Posner's radical critique of Hayek's position reveals fundamental differences in relating law to economics. Before turning to this controversy it is useful to sketch its origins.

2. The visible hand of the law

Adam Smith is famous as the father of modern economics and as the advocate of limited government. Less recognised are his contributions to law and economics. In the history of ideas, his image of "laissez faire" contributed to the neglect of the key role of law in Adam Smith's theory. Adam Smith – contrary to Bentham – distinguishes the economic system from the legal order without however separating them. The link between the economic and legal systems is not left to the wisdom of government or the legislator. It follows from and is part of a system of natural liberty. The economic system requires "the abolition of all systems either of preference or of restraints", in order to make competition possible and to discharge the government from the duty of supervising the industry of private individuals and directing it towards the employment most suitable in the interests of society. For the proper performance of this task "no human wisdom or knowledge could ever be sufficient."[47] The resultant economic system, free from governmental restraints, does not exclude but presupposes an exact administration of justice:

[47] *Smith*, An Inquiry into the Nature and Causes of the Wealth of Nations, 1976, Vol. II, p. 687.

> "Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payments of debts of all those who are able to pay."[48]

Where no government in a system of liberty has the knowledge to direct individual economic activities in the interests of society, it follows that this limitation applies to the instrumental use of the law as well. That finding does not, however, detract from, but rather explains, the key role of legal rules compatible with free markets. Individuals, contrary to the government, have the knowledge necessary to plan and implement their own economic decisions by relying on prices and legal rules. The rules of law, particularly the rules of private law, make possible and implement individual economic planning. They are the instruments of the "granite of self interest"[49] and help to guide individual industry towards its most useful employment. Private law rules (contract, property, torts) are, however, not merely the instruments of self interest. They simultaneously make individual liberty compatible with the liberty of others under a general rule. Judges when called upon to resolve conflicts have at their disposal knowledge of the facts that are necessary to understand the conduct, contract or property of the parties before them. This is all the knowledge a judge needs to act as an impartial and well informed spectator.[50] A telling mistake is John Rawls' interpretation of the impartial spectator as a device of utilitarian theory for viewing the interest of society as if it were the interest of a single person. The spectator is conceived of as carrying out the required organisation of the desires of all persons into one coherent system of desire and is even seen as the ideal legislator.[51] Adam Smith, however, is not a utilitarian. The

[48] *Smith*, Wealth of Nations, p. 910.

[49] *Stigler*, Smith's travels on the ship of state, 1975, p. 237–246.

[50] The concept of the impartial spectator is fully developed in: *Smith, Adam*, The Theory of Moral Sentiments, 1976. It is applied to law as well in *Smith, Adam*, Lectures on Jurisprudence, 1978. For an overview see *Raphael, D. D.*, The impartial spectator, in: *Skinner/Wilson*, see N. 49, 83–123; *Mestmäcker*, Die sichtbare Hand des Rechts, in: *Mestmäcker*, Recht und ökonomisches Gesetz, 2. Auflage 1984, 104–135.

[51] *Rawls, John*, A Theory of Justice, 1973, p. 27.

spectator, organising the society as a hypothetical legislator, is in direct conflict with Adam Smith's legal and economic theory.

In the history of ideas and in the war of ideologies, the clear distinction between government as author of potentially detrimental economic restraints and government as a guardian of a system of individual rights, contracts and competition has frequently been neglected or distorted. By ascribing natural harmony of interests to the economic system and artificial identification of interests to law, it became possible to argue that the underlying economic theory presupposed a system without law and that necessary political exemptions proved the whole approach irrational and self-contradictory.[52] Similar identifications of law with government can be found by those who agree and those who disagree with the system of natural liberty. This has contributed to defamation, or superficial praise, of the market economy as a system without law. Karl Marx recognised the key role of private property in market economies, but he tried to discredit all private law as being an instrument of class warfare, illegitimate dominion and enslavement of the working classes. He succeeded in changing the political agenda from the efficient division of labour to a just and equal distribution of wealth. His communist followers succeeded in destroying the rationality of the economic system through central planning.

The Adam Smith approach was taken up and elaborated by Hayek and German liberals. Hayek associated himself with, and was part of, the so-called Freiburg School. Other representatives of the school included the economist Walter Eucken and the lawyer Franz Böhm. Both developed the concept of an economic order that combined the rationality of the market economy with the mandates of economic and political liberty. These ideas became decisive in the transition of the German war economy to a market economy. The Treaty of Rome of 1958 incorporated, as a matter of law, a common market and a system of undistorted competition. The European Internal Market is based upon an "interdependence of the legal and economic orders".[53]

[52] See, for example, *Halèvy, Elie*, The Growth of Philosophic Radicalism, 1972, p. 488.

[53] *Eucken, Walter*, Grundsätze der Wirtschaftspolitik, 1. Auflage 1952, 7. Auflage 2004, particularly p. 332–337. The influence of these ideas is documented by Walter Hallstein, the first president of the EC-Commission, in: *Hallstein, Walter*, Wirtschaftliche Integration als Faktor politischer Einigung (1961), in: *Hallstein, Walter*, Europäische Reden, 1979, S. 242 ff. For a more detailed analysis of the influence of this school of thought on the Treaty of Rome, see *Mestmäcker*, Die Grundlagen einer europäischen Ordnungspolitik an der Universität Frankfurt am Main, 2003, S. 12–20.

In 1933 (!), Franz Böhm set himself the task of proving that the teachings of economics could be translated into a legal constitution: "It is the attempt to translate the teachings of classical economic philosophy from the language of economics into the language of the science of law".[54]

These authors developed their thoughts separately, but had in common the aim of establishing and safeguarding democracy so as to protect individual liberties and limit and control the powers of government, as well as those of private cartels and monopolies. Good motives are no substitute for the empirical verification or refutation of scientific hypothesis. But it would deprive us of important information if we were to separate the history of ideas from the experience of their authors. And it is worth bearing in mind that the major works of these authors were, in the original meaning of the word, "untimely considerations". Since Richard Posner discusses and takes issue with von Hayek's writings, this controversy highlights alternative approaches to economics and law.

[54] *Böhm, Franz*, Wettbewerb und Monopolkampf, 1933, Reprint 1964. Präambel.

V. Efficiency: The purpose of legal rules or the product of competition (Posner v. Hayek)

Posner and Hayek are preferred targets for criticism that looks to law and economics as economic imperialism propagating an "acquisitive capitalist culture". Both are said to be representatives of a movement that disregards socio-legal realism.[55] These observations underestimate Posner's claim to pre-eminence in the realm of economic analysis of law and Hayek's original and innovative contribution to economics and law. Hayek's philosophy of law, according to Posner, closes the space for economic analysis and forbids judges from having anything to do with economics.[56] Hayek the economist was, according to Posner, a formalist.[57] The Hayekian judge is required to be a "thoroughgoing formalist".[58]

Posner explains at length what formalism is or how formalists think.[59] Formalism encapsulates everything Posner's everyday pragmatism is to overcome: logic by experience, the objective process of distinctive legal reasoning by practical reasoning; deductive reasoning by a more complex intellectual procedure than the simple application of abstract premises to the facts of the case. Even though Posner taunts his readers with the proviso that his own description of formalism "may seem little better than a strawman", he does not hesitate to reduce Hayek's legal theory to formalism. But later on this account is said to be hasty: "So far all I have said is that he rejects an economic

[55] *Fink, Eric M.*, Post-realism, or the jurisprudential logic of late capitalism. A socio legal analysis of the role and diffusion of law and economics, 55 Hastings L. J. p. 931–963 N. 32 (2004).
[56] *Posner*, Pragmatism, p. 251.
[57] *Posner*, Pragmatism, p. 288.
[58] *Posner*, Pragmatism, p. 278.
[59] *Posner*, Pragmatism, p. 19–23.

analysis that says that judges should use economics to help decide their cases; and to the extent that this rejection is based on economic grounds, it just means that he has a different economic theory of law from that of people like me".[60] To register Hayek's theory does not mean recognising it as an alternative economic approach to law. There is no discussion of where and why Hayek's economic theory diverges from Posner's. There is no reference to Hayek's writings in Posner's major treatise "Economic Analysis of Law".[61] There is, consequently, no attempt to relate Hayek's economic theory to his own legal theory. Without this link the essence of Hayek's position is difficult to comprehend. This applies particularly to a sceptic like Posner whose legal theory of "everyday pragmatism" starts from the premise that there is no genuinely scientific conception of law from within the law.[62] Philosophy, and even the different kinds of philosophical pragmatism, are said to contribute nothing that the law can use.[63]

Some of Posner's criticism of Hayek's legal theory is certainly influenced, perhaps biased, by the assumed truth of his own "everyday pragmatism". This may explain, but it does not justify Posner's treatment of Hayek's theory; a theory that is made to appear as a mixture of philosophical speculation, irrational aversion to economic planning, belief in natural law, an outmoded concept of law as custom and the refusal to accept the rationality of modern social sciences. How misleading these representations are becomes fully evident only in Posner's silences: competition as a discovery procedure, a key element in Hayek's theory of knowledge and rules, is not even mentioned.[64]

1. Two famous ideas

Posner initially refers to Hayek's "two famous ideas": that socialism is incapable of organising a modern economy efficiently; and that socialism, even democratic socialism, is the "road to serfdom". Posner

[60] *Posner*, Pragmatism, p. 282.
[61] *Posner*, 6th Edition 2003.
[62] *Posner*, Frontiers, p. 2.
[63] *Posner*, Pragmatism, p. 47.
[64] *Hayek*, Competition as a Discovery Procedure, 1984, p. 254–265.

praises the first and rejects the second idea. The "doctrinaire cast" of Hayek's legal theory[65] is ascribed to his aversion to economic planning and an irrational belief in open society as a spontaneous order that relies on custom as the only legitimate source of law.[66]

In this vein, Posner uses Hayek's critique of socialism as proof of his irrational belief in markets. Posner writes: "Socialism in either the limited form advocated by social democratic parties or in the extreme form instituted in the communist countries leads, via the unworkability of socialism, to capitalism."[67] This thesis is at odds with the alternative reading of Hayek that socialism leads inexorably to totalitarianism.[68] Central economic planning, according to Hayek, is indeed an earmark of communist, as well as fascist, totalitarianism.[69] There is, however, no indication in Hayek's work, as Posner assumes, that all kinds of socialism lead, because of their unworkability, to capitalism. There is no reverse equivalent to the Marxist prophecy of the unavoidable transformation of capitalism into socialism. And there is certainly no indication of a gradual infusion of the rationality of markets into planned economies, as an equivalent to the gradual birth of socialist rationality under the involuntary guidance of capitalist monopolies and cartels.[70] Hayek argues against the prediction of irresistible economic forces towards a planned society and confirms the possibility and the political necessity of establishing and preserving a competitive order.[71] This order is not self-enforcing. It requires adequate institutions and a legal order that has the task of maintaining competition and leaving competition to provide an optimal use of economic resources.

As far as the political message is concerned, Hayek shows why Communist and Nazi economic systems are incompatible with individual freedom while democratic socialist systems may gradually undermine or emasculate a free order.

[65] *Posner*, Pragmatism, p. 283.
[66] *Posner*, Pragmatism, p. 276.
[67] *Posner*, Pragmatism, p. 275.
[68] *Posner*, Pragmatism, p. 274.
[69] *Hayek*, The Road to Serfdom (1944) Chicago 1995, Chapt. 7.
[70] The gradual transformation of capitalist into socialist rationality was forcefully argued by *Hilferding*, Das Finanzkapital, 1910.
[71] *Hayek*, The Road to Serfdom, Chapt. 3.

The relation of Soviet totalitarianism and National Socialism in Germany to Socialism is a matter of dispute. Posner denies such a relation. Both systems relied, however, for their political and economic purposes on central economic planning. Their ideologies promised equal participation of the working classes in the benefits of the new systems. And the political effects were identical: All economic or social positions were at the pleasure of the government or the party. The power that goes with central planning contributed to, and was a necessary component of, the regimes' totalitarian character. The fact that the Nazi government did not socialize the means of production does not argue against its socialism. It just shows that central planning can be implemented without the formal expropriation of the means of production. The "socialization" of cartels proved them to be efficient organisations for economic planning.

2. Sources of law

The general and implicit criticism of Hayek's legal theory because of his preoccupation with central planning becomes direct and specific with respect to his understanding of the sources of law and rules of just conduct. Hayek is said to recognise custom as the only legitimate source of law. A legal judgement that does not draw its essence from custom is not true law. The only thing a judge should do is enforce custom without regard to the consequences. Hayek is said to extinguish any role for economic or other social scientific analysis in adjudication.[72] The reduction of Hayek's theory of law and adjudication to custom distorts both the concept of custom and the role of law. Telling is Posner's statement that Hayek does not think that all customs should be made enforceable.[73] The suggestion is, for those who take the difference of custom, customary law, judge-made law and legislation for granted, a strange argument.

Posner's rhetoric makes it necessary to prove the obvious. Hayek refers frequently to the cooperation of private parties who rely for

[72] *Posner*, Pragmatism, p. 280.
[73] Ibid, p. 278.

their mutual expectations on custom.[74] The major message is that the trust in mutual, legitimate expectations without interference by governments or courts is one of the characteristics of a spontaneous order, as of any private law system. Posner reads this as binding courts to enforce custom only.[75]

Hayek is, however, quite clear and outspoken about the difference between custom as observed conduct and rules and the role of courts in cases of conflict. I quote: "Only when it is clearly recognised that the order of actions is a factual state of affairs distinct from the rules which contribute to its formation can it be understood that such an abstract order can be the aim of the rules of conduct."[76] The reason why the judge will be asked to intervene is that the rules which secure such a match of expectations are not always observed or sufficiently clear or adequate to prevent conflicts, even when observed. Since new situations in which the established rules are not adequate will constantly arise, the task of preventing conflict and enhancing the compatibility of actions by appropriately delimiting the range of permitted actions is, of necessity, a never-ending one, requiring not only the application of all the established rules, but also the formulation of new rules necessary for the preservation of the order of actions.[77]

In his criticism, Posner plays with the double meaning of custom growing out of social practice and usage and custom as a legal concept that is the foundation of the common law.[78] As far as terminology is concerned, custom as a legal concept is, according to the Oxford dictionary, a usage which by continuance has acquired the force of law. Courts will speak of custom as a source of law when they adhere to precedents. The distinction is meticulously analysed by Jeremy Bentham. Posner's reading of Hayek is proof enough that Bentham's analysis is still relevant. Outside the law, the custom of a single person or a multitude of persons is, according to Bentham, "an assemblage of such acts either simultaneous, successive or both, of the

[74] Hayek, Law, Legislation and Liberty, Vol. I, 84, 97, 119.
[75] *Posner*, Pragmatism, p. 277 N. 74–78.
[76] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 113/114.
[77] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 119.
[78] In: Pragmatism, p. 279 Posner identifies custom with social norms and, at p. 280, custom is defined as being acephalous, as being without a "custom giver".

same kind among which a uniformity, a similarity, is observable".[79] In this sense, custom is made up of acts past, but none of them future. It follows that a custom as such does not qualify for a rule that governs future conduct.

Custom as a source of law is most properly called customary law. To constitute a custom in the legal sense of the word two things are necessary: the content of the custom that has to be legalised and an act at least of the person or assemblage of persons that are to legalise it. These persons are judges whose orders are binding under the threat of punishment. The idea of the common law is made up of customs thus generated.[80] We need not here follow Bentham's severe criticism of the common law as being, similar to customary law, incomplete and uncertain and law only by "clothing" itself as statutory law.[81]

Bentham's analysis focuses on the difference between custom as acts of the past and customary law constituting, together with statutory law, a branch of the law, both being imperative.[82] Even though customary law relies for its content on the past, its imperatives are (frequently) addressed to and binding on the parties to a case. The rules that can be derived from prior decisions govern future cases and the expectations of the legal community. In the words of the sceptic Bentham: "It is only in as far as subsequent decisions are rendered conformable to the rules that are fairly to be drawn from prior decisions that such prior decisions can answer, in any even the most imperfect degree, the purpose of a law".[83]

Hayek and Bentham, and we may assume Posner too, are in agreement that imperatives aim at future conduct. Hayek is, however, said to defend a belief that a judge should not consider the consequences of what he is doing, because judges produce better results if they just

[79] *Bentham*, A Comment on the Commentaries and a Fragment on Government, 1977, p. 181.
[80] *Bentham*, ibid, p. 185. The judges are not the custom giver missed by Posner but the law givers.
[81] *Bentham*, Of Laws in General, 1970, p. 194.
[82] *Bentham*, An Introduction to the Principles of Morals and Legislation, 1970, p. 198.
[83] *Bentham*, Of Laws in General, 1970, p. 190.

enforce existing rules and understanding, come what may, leaving any improvements to legislation or the evolution of custom.[84]

3. Rules of just conduct

The rules of just conduct that constitute a spontaneous order are not limited to "existing rules" that derive their legitimacy from custom. The law the judge has to find may consist in some yet unarticulated rule "which serves the same function as the unquestioningly accepted rules of law – namely to assist in the constant re-formation of a factually existing spontaneous order".[85] There is no contradiction in Hayek's theory of evolution and the special quality of the rules of law that we can, to a certain extent, shape, so that they lead in combination with other rules and under expected real circumstances to the formation of an overall order.[86] If the judge in such a case were confined to decisions which could be logically deduced from the body of already articulated rules, often he would not be able to decide a case in a manner appropriate to the function served by the system of rules as a whole.[87] This applies to codified private law systems and systems of precedence. To avoid a widespread misconception with regard to the interpretation of codes, Hayek adds that it is now probably universally admitted that no code can be without gaps.[88] The judge must not merely fill gaps. Even where rules give an unambiguous answer but are in conflict with the general sense of justice, the judge must be free to modify his conclusions and to find a new rule.[89] The mandate and legitimacy of finding new rules are, however, predicated upon their compatibility with the structural characteristics of the overall order into which the new rule has to be incorporated. Here Hayek insists – contrary to Posner's verdict – that law and lawyers have to

[84] *Posner*, Pragmatism, p. 43.
[85] *Hayek*, Law, Legislation and Liberty, Vol. II, p. 60.
[86] *Hayek*, Rechtsordnung und Handelnsordnung, in: Hayek, Rechtsordnung und Handelnsordnung. Aufsätze zur Ordnungsökonomik, 2003, p. 35, 51.
[87] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 116
[88] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 117/118.
[89] Ibid, p. 118.

consult economic theory in order to find adequate answers to new and unforeseen conflicts.

The role of economics according to Hayek is not to examine individual transactions and their contribution to some predetermined optimum or to the implementation of government policies or to further the "public interest". The application, interpretation and modification of rules of just conduct are informed by the spontaneous order, of which they are a constituent part. Hayek's economic theory starts with and is based upon a systematic criticism of the received general equilibrium theory. This paradigm of neo classical economics is, according to Hayek, unsuitable to contribute to an explanation of the coordination of actions of decentralized autonomous economic decision-makers.[90] The challenge is to understand how the economic activities of autonomous decision-makers are coordinated through markets. Nobody can have knowledge of all facts of the overall order. The socially valuable knowledge is widely distributed throughout the community in tiny packets, rather than being concentrated in the hands of experts.[91] Actors are able to make use of widely distributed knowledge through "codes". The economic "code" is the price system, the legal "code" consists of rules of just conduct. They allow individuals to pursue their own objectives by making use of their subjective knowledge. To allow coordination of individual plans (and purposes) in a world of diverse and unknown other plans these rules must be "independent of purpose and be the same, if not necessarily for all members, at least for a whole class of members not individually known. They must be applicable to an unknown and undetermined number of persons and instances. They have to be independent of any common purpose".[92]

The process which enables individuals to use more knowledge than they individually have and to find out whether their plans are successful is the process of competition. Competition as a discovery process is the complement to rules of just conduct. The function of competition is to discover facts that without competition would remain

[90] For a summary see *Streit, Manfred E.*, Cognition, Competition and Catallaxy. In Memory of F.A. von Hayek, Constitutional Political Economy, Vol. IV, 1993, 223, 235.
[91] *Posner*, Pragmatism, p. 102 registers Hayek's "influential idea", but fails to connect it with Hayek's legal theory.
[92] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 50.

unknown or would not be used. If we do not know the facts that we hope to discover by means of competition, we can never ascertain how effective competition is in discovering those facts that (in the abstract) might be discovered.[93] Manfred Streit rightly comments that with this statement efficiency beyond the individual logic of choice becomes an irrelevant concept.[94] The hostility of Austrian economics to efficiency as a guide to public policy, registered but not explained by Posner,[95] has here its source.

In Hayek's theory, rational choice is limited to the micro level. Individual choice (or planning) is contingent upon the information provided by competition as part of the overall order. This order manifests itself in the experience that it is highly probable that individual plans may be implemented through transactions that are governed by abstract rules of just conduct. The adjustment of individual plans is brought about by a system of negative feedback: while many expectations will coincide, some expectations must be disappointed. This is the essence of competition as a game: some will win and others will lose. Disappointed expectations may be due to inefficiencies. There are, however, many other causes that may explain or contribute to the frustration of individual plans. These causes may be and frequently are outside the control of individual players. You may lose without deserving to lose.

If we knew in advance the most efficient allocation of resources there would be no need to rely on at times wasteful and erratic markets and competition. Posner himself, certainly a champion of efficiency, recognises the limits of this approach to public policy in the key area of merger control: "If the merger has not yet been consummated, the realisation of cost savings lies in the future and is thus a matter of speculation flavoured by hope. If the merger has been consummated, disentangling its effects from after influences on the firm's cost is likely to be intractable".[96]

[93] *Hayek*, Competition as a discovery procedure. In: *Nishijama/Leube*, p. 254, 255 = Der Wettbewerb als Entdeckungsverfahren, in: Hayek, Rechtsordnung und Handelnsordnung. Aufsätze zur Ordnungsökonomik, 2003, p. 132 ff.

[94] *Streit, Manfred E.*, Cognition, Competition and Catallaxy. In Memory of F. A. von Hayek, Constitutional Political Economy, Vol. IV, 1993, p. 236.

[95] *Posner*, Pragmatism, p. 287.

[96] *Posner*, Antitrust Law, 2nd edition, 2001, p. 133.

4. Whose common law?

Posner and Hayek rely on the common law to authenticate their respective legal theories. In the first edition of his famous "Economic Analysis of Law" Posner argued that the common law exhibits a deep unity that is economic in character. Differences in the law of property, the law of contracts and the law of torts are said to be primarily differences in vocabulary, detail and specific subject matter rather than in methods of policy.[97] In later writings, Posner remarked that he "flirted with this idea". In light of his new scepticism towards the conservative tendencies of lawyers in general and judges in particular his original position appears to be obsolete.

Hayek refers to the common law as proof of the empirical possibility of a spontaneous order in harmony with his conception of the rule of law.[98] Posner does not compare his own use of the common law with Hayek's analysis. After recognizing that there is after all some Hayekian economic analysis of law,[99] he proposes its possible interpretation in a "continental tradition".[100] This is a pretext for supplying Hayek's theory of the rule of law with its references to philosophy with some Posnerian rationality. For this purpose Posner refers to Aristotle's corrective justice and to Max Weber's concept of "formal rationality". These positions are said to be close to Hayek's theory[101]. Posner then criticises Hayek for choosing to rely on the common law, rather than on continental civil law systems (like Max Weber): "Hayek turned Weber upside down by arguing that the common law was a better institutional framework for achieving formal rationality than the civil law."[102] This is, to be charitable, strange logic. It may be appropriate for a professor grading papers to recommend to students authorities they have missed. But Posner does not stop with his suggestion of proper authorities for Hayek's theory. He goes on to present his own interpretation of Max Weber's "formal rationality of

[97] *Posner*, Economic Analysis of Law, 1972, p. 98.

[98] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 85.

[99] *Posner*, Pragmatism, p. 280.

[100] *Posner*, Pragmatism, p. 284.

[101] Ibid p. 286.

[102] Ibid p. 286.

German and continental civil law systems" in order to blame Hayek for misinterpreting a position he did not rely on in the first place. A possible explanation, if not an excuse, for this kind of reasoning may be Posner's preconception of European legal formalism. And since Hayek is a European, his theory must suffer from the same shortcomings. But Posner, furthermore, does not notice or overlooks Hayek's position on Max Weber that makes the controversy even more imaginery.

Hayek quotes Max Weber's "purposive rationality". But he does so only to show how it is directly opposed to his own theory. He finds it an impossibility to be guided only, as Max Weber proposes, by explicit particular purposes which one consciously accepts, and to reject all general values whose conduciveness to particular desirable results can not be demonstrated, – "or to be guided only by what Max Weber calls 'purposive rationality'".[103] Even more explicit is Hayek's refutation of Max Weber's discussion of the relation between "legal order and economic order": "For Weber order is throughout something which is 'valid' or 'binding' which is to be enforced or contained in a maxime of law. In other words, order exists for him only as organisation and the existence of a spontaneous order never becomes a problem. Like most positivists or socialists he thinks in this respect anthropomorphically and knows order as taxis but not as cosmos and thereby blocks for himself the access to the genuine theoretical problems of a science of society".[104]

In exposing the dangers of a formalistic as well as a political interpretation of legal rules, Hayek relies on the contributions of common law judges to the rule of law. Posner insists, however, that Hayek sees the role of common law judges as a passive one, falsely identifying law with custom.[105] We are back at Posner's untenable thesis that Hayek identifies law with custom.

In the context of the transformation of planned to market economies, the Posner/Hayek controversy on the role of the common law became newly relevant. The issue is whether certain private law

[103] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 58.
[104] *Hayek*, Law, Legislation and Liberty, Vol. II p. 170 Fn. 50. Hayek relates Weber's position to Kelsen's pure theory of law. See page 49/50.
[105] *Posner*, Pragmatism, p. 277.

systems – notably the common law or the civil law systems – are more or less qualified to facilitate the transformation from a planned to a market economy. Posner endorses the view that the common law provides a better framework for economic development than the civil law because judges in common law countries are more independent from governments and more reliable enforcers of property rights.[106] The last point is the reason why Hayek finds the common law experience most conducive to free markets. It does not follow, however, as Posner argues, that we can expect judges in developing countries to be as independent from governments as their common law colleagues have been. If the question is to be answered on the basis of the substantive and procedural characteristics of the respective legal systems the answer is highly speculative. It is difficult to evaluate private law systems as such or certain of their substantive or procedural rules with respect to their comparative qualification for the transformation of planned economies to market economies. The overall legal or constitutional framework determines where and to what extent private law is permitted to govern economic activities. For a market economy, freedom of contract, property rights, free access to markets and occupations are determinative. In this respect, the details of passing of title, performance, standard of care or rules of evidence are of secondary importance.

5. The abstract society

Legal rules in a free order are not end-related and must abstract from the multitude of individual plans they are to coordinate. In the economic analysis of law the key concepts – rational choice and efficiency – are end-related. The term efficiency is used to denote the allocation of resources in which value is maximised.[107] This implies that the end-relation of rules of individual conduct is taken for granted, the end being the maximisation of wealth. Posner disregards this basic difference between his own theory and Hayek's. He takes up

[106] *Posner*, Pragmatism, p. 283.
[107] *Posner*, Economic Analysis, p. 11.

another aspect of abstraction. The law must be impartial and the judge must abstract from the social position and personal characteristics of the parties before him. In this respect, Posner does not differ from Hayek who specifies the development from "status to contract" and recognises a decline of the spontaneous order because of the tendency to protect the economic status of certain groups in the name of social justice.[108] But these principles, relevant as they are for the basic functions of law in modern western societies, do not cover Hayek's concern with purpose-independent rules which govern the conduct of individuals towards each other.[109] These rules are the essence of an abstract society.

They are compared with rules based on the solidarity of small groups in primitive societies. The rules relying on solidarity were incompatible with the market economy and the open society:

> "The greatest change which men have still only partially digested came with the transition from the face to face society to what Sir Karl Popper has appropriately called the abstract society: A society in which no longer the known needs of known people but only abstract rules and impersonal signals guide action towards strangers"[110].

Hayek specifies the function of abstract rules for a market economy by referring to the dynamics of the systematic disappointment of certain expectations:

> "Which expectations ought to be protected must therefore depend on how we can maximize the fulfilment of expectations as a whole. Such maximization would certainly not be achieved by requiring the individuals to go on doing what they have been doing before. In a world in which some of the facts are unavoidably uncertain, we can achieve some degree of stability and therefore predictability of the overall result of the activities of all only if we allow each to adapt himself to what he learns in a manner which must be unforeseeable to others".[111]

The legal rules that make this dynamic process possible are without specific purposes: "The law leaves it to everybody's voluntary

[108] *Hayek*, Law, Legislation and Liberty, Vol. II, p. 141.
[109] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 85.
[110] *Hayek*, Law, Legislation and Liberty, Vol. III, p. 162.
[111] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 103.

will which purpose he pursues with his conduct".[112] This is, according to Kant, a quality of all legal rules, the ultimate purpose of which is equal liberty.

Contract law is a case in point. Contracts contribute to the exchange of goods and services under conditions of the division of labour by abstracting from the expectations, purposes and plans the parties have beyond the contract and how third parties are affected. If future risks and projects are to be shared the instrument is the partnership or corporation with abstract limitations of their own. This is not, as Posner suggests again and again, due to Hayek's aversion to central economic planning. It is not only planning boards that lack the information of the overall economic effects of individual or collective actions. In market economies, individual and collective actors share with the government, legislators and courts ignorance as to the ultimate economic effects of their decisions or actions. Hayek arrived at this fundamental thesis not by criticising socialism but by criticising traditional price theories. Price theory and its models of competition and production are predicated upon the actor's perfect knowledge of market conditions. This assumption of market and price transparency eliminates some of the key problems of economics: how to deal with the inevitably uncertain chain of causation which is inherent in the market system.

Part of the abstract rules of open society are unknown and unwritten rules of behaviour that are observed unconsciously. They are the grammar of social institutions. People observe them without necessarily knowing that they are conforming to rules. Here the relation to other social scientific analogies – missed by Posner – is to the sociological theory of institutions and to systems theory.[113] Institutions reduce the information we need to act rationally and stabilise expectations in complex societies. Rules of this kind are partly the products of custom. Legal rules are, however, known rules, binding, enforceable and sanctioned through remedies. These are generated through

[112] *Kant*, Die Metaphysik der Sitten, 2. Teil Werke Bd. 6, S. 382. Quoted by *Hayek*, Law, Legislation and Liberty, Vol. I, p. 113 N. 26. The German Text reads: „In der Rechtslehre wird es jedermanns freier Willkür überlassen, welchen Zweck er sich für seine Handlungen setzen wolle."
[113] Noted by *Hayek*, Law, Legislation and Liberty, Vol. III, p. 159.

legislation, in the common law system through courts and in the case of contracts by private parties. They protect property rights and make exchange of goods and individual planning for the future possible. They are the legal foundation of market economies. Like the price system they enable individuals to make use of more information than they individually have and to organise their own economic affairs through participation in markets.

6. The rule of law

Hayek's legal theory expounds the relation of free markets to the rule of law. Contrary to Posner's pragmatic legal theory, Hayek's theory takes into account in addition to the law's impact upon free markets and property rights their contribution to political liberties.[114] The rule of law is used as a short definition of the interdependence of the legal order and the economic system. In this respect Hayek relies on and elaborates Walter Eucken's theory of the interdependence of the legal and economic orders. As in the United States, the initial application of this theory was to competition policy and competition law (antitrust). Cartels and privately owned monopolistic infrastructures had been looked upon and treated as private law organisations, without taking into account their external effects and their incompatibility with the legal economic and political essence of a free society. Nazi and Fascist corporate planning systems have shown the ease of legislative or administrative transformation of these organisations into instruments of regulation and planning.

A private law system offers as such little resistance against its subjection to regulation and planning.

The German Democratic Republic introduced a system of central economic planning without, initially, abandoning the Civil Code. There was just one amendment: the validity and enforceability of

[114] Posner discusses these questions in a comprehensive theory of democracy in distinguishing concept (i) democracy as idealistic, deliberative and Deweyan from concept (ii) democracy as pragmatic and Schumpeterian. Posner extends his everyday pragmatism to democracy, constitutional law and judicial review. See *Posner*, Pragmatism, p. 97–249. Review by Oliver Lepsius, in: Der Staat, 2005, S. 326 ff.

contracts was made dependent upon their conformity with the central plan. An even more radical and technically simple device was used by the Soviet Union in the implementation of economic planning. Legal personality as the ability to have rights or duties was reserved for explicitly empowered organisations. The activities of individuals that interfered with their jurisdiction were legally non existent, frequently with the exception of criminal liability.[115] The Nazi government left private property rights formally untouched, subjecting them, however, to strict central regulation. Cartels – widespread in Germany in 1933 – proved convenient instruments of government planning. Managers became government officials, prices and production were subject to government planning, membership became compulsory in order to eliminate the remnants of competition from outsiders.

It is against this background that we must interpret Hayek's dictum, "a socialist judge would really be a contradiction in terms".[116] Posner's comment is as surprising as it is wrong: "But so, according to Hayek's logic, would be a capitalist judge".[117] The argument is understandable only as the opinion of a thorough going pragmatist who is unwilling to see the difference of context. Hayek's position that neither the judges nor the parties involved need to know anything about the resulting overall order or about "any interest of society"[118] follows from his information theory. Information is available, and must be used, in a "piecemeal" fashion. To encourage the judge or the parties (for instance cartel managers) to interpret their action in the light of the public interest is to invite ideologies into the law. Adam Smith reminded us that "you cannot expect much good done by those who affect to trade for the public good".[119] To exclude the public interest from private controversies and litigation does not mean – as Posner maintains – that the judge has to close his or her eyes to the circumstances the parties take into account in entering into contractual relations and that inform the contract's in-

[115] A perfect case of Kelsen's pure theory of law in action.

[116] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 121.

[117] *Posner*, Pragmatism p. 277.

[118] *Hayek*, Law, Legislation and Liberty, Vol. I, p. 119.

[119] *Smith, Adam*, An Inquiry into the Nature and Causes of the Wealth of Nations, Vol. I, p. 456.

terpretation. The by-product of a legal system based on the rule of law is expectations that people can rely on. These legitimate expectations depend upon the consistency and predictability of legal rules and their interpretation by courts. They are necessary conditions of individual planning in a market economy and safeguard against arbitrary practices.

VI. Science of law or the relevance of normative experiences

The Posner/Hayek controversy highlights the normative implications of a rationality that deals with and is partly determined by the scarcity of economic resources. Rational choice based on economic self interest is undoubtedly among the most profound standards used to understand and to predict human behaviour. A society that relies on markets as the primary institution to deal with scarcities can not ignore the contribution of rational choice to our understanding of contracts, property rights or liability for torts or negligence. This is common ground for Posner and Hayek.

Posner's and Hayek's economic theories provide, however, for different rules of law: Posner subsumes the law under economics, Hayek incorporates abstract rules of just conduct into his theory of a free order. The differences in their respective legal theories do not end here. Posner associates his theory with Kelsen's pure theory of law.[120] He is a thorough going positivist. This position, like his departures from legal theory from within, contributes to the ascendancy of economic analysis. Posner's message is strengthened by his eloquence, suffers from ungenerous irony towards legal scholarship and loses some credibility by at times providing misleading references to opposing views. The project to reduce the science of law and its history, the application and interpretation of statutes and precedents, to "everyday pragmatism" will not further the implementation of economic analysis, underestimating (or ignoring) as it does the key role of normative experiences for "the life of the law".

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[120] *Posner*, Pragmatism, p. 250.

Hayek's different cognitive interests are best summarised in the preface to his book "The Constitution of Liberty": "This book is not concerned with what science teaches us. My aim is the exposition of an idea, to show how it can be achieved, and to explain what its realisation would do in practice."[121] There are wide and fundamental differences between Posner's optimistic rationality and Hayek's sceptic consideration of cultural development. In Hayek's theory, reason itself, its generation and its inherent limitations are the product of cultural development. The challenge is to understand, to preserve and to gradually perfect the precarious achievements of civilisation. This requires insight into the evolution of self-maintaining complex structures, the stratification of rules of just conduct and the discipline imposed by freedom in an open and abstract society.[122] These values depend upon solving the most important and difficult problem facing free societies: the effective limitation of power. This problem is the primary task and the challenge for law and for the science of law. In Hayek's theory there is – in contrast to Posner's approach – wide space for legal scholarship or a legal science from within the law. This science deals with experiences gained in the generation and application of those values that make a free and just society possible. It is a science of normative experiences acknowledged in the application of rules accessible through legal history and comparative law. The living law, legislation and adjudication are predicated upon an order, the rationality of which informs the implementation and interpretation of its rules. There is no need for a "Grundnorm" or a rule of recognition (Hart) to deal with complex legal structures. The rules that are part of an open society and that make this society possible are necessarily open to diverse normative experiences and not limited to national legal systems.

The discussion of the Posner-Hayek controversy has so far followed Posner's criticism. The apparent shortcomings of that criticism have simultaneously revealed some of the limitations of Posner's economic analysis as a contribution to legal science from the outside and the inside. Posner warns against the pitfalls of a useless search for elu-

[121] *Hayek*, The Constitution of Liberty, Chicago 1960.
[122] *Hayek*, Law, Legislation and Liberty, Vol. III, p. 153–168.

sive principles of justice, Hayek encourages the search for principles that satisfy the demands of justice and the rationality of economics. Posner's thesis that all conduct that follows rational choice is moral and is presumably legal indicates a hypothesis that is to be tested in terms of morals, law and economics. The aim is not to discredit the most useful and rich discipline of economic analysis of law, but to look for its position in a legal order which may not be reduced to rational choice in the service of efficiency.

VII. Limits of rational choice

Rational choice and cost-benefit analysis have their own limitations. They concern the methodological limits of rational choice as such and its practical shortcomings.

(1) Indifference to existing social institutional arrangements mars Posner's work, according to J. M. Buchanan.[123] In law, the most important institutional arrangements are the intra-legal criteria of precedent, custom, tradition, expected ways of doing things, and predicted patterns of behaviour.[124] Recognising this implied limitation of his approach, Posner proposes to eliminate it by excluding the intra-legal perspective from his scientific legal theory.[125]

(2) Rational choice, like utilitarianism, has no limiting principle. There is no purpose that does not lend itself to a cost-benefit analysis of the means of its implementation.

(3) In economic analysis, the given economic end is to be implemented through means that require a minimum expenditure of resources. Such an analysis does not aim at and cannot by itself create an obligation. In the words of Immanuel Kant: "As the use of certain means has no other necessity but that required by the end, it follows that all acts, that are prescribed by morality for ulterior purposes are accidental, and do not qualify as obligations as long as they are not subsidiary to a purpose that has necessity (is binding) in itself" (author's translation).[126] In other words: an analysis of the relation of

[123] *J. M. Buchanan*, Good Economics – Bad Law, 60 Virginia L. Rev., 483–492 (1974); for a recent comparative analysis of Buchanan's and Posner's approach to law and economics, see *Alain Marciano*, Value and Exchange in Law and Economics, Buchanan versus Posner, 2006, forthcoming in the Review of Austrian Economics.

[124] *Buchanan*, ibid. p. 489.

[125] See above N. 19.

[126] *Kant*, Untersuchung über die Deutlichkeit der Grundsätze der natürlichen Theologie und der Moral zur Beantwortung der Frage, welche die Königliche Akademie der Wissenschaften zu Berlin auf das Jahr 1763 aufgegeben hat, in: Kant's Werke, Bd. II, 276, 298, zitiert bei *Cassirer*, Kants Leben und Werk, 249. German Text: „Da nun der Gebrauch der Mittel keine andere Notwendigkeit hat, als diejenige, so dem Zwecke zukommt, so sind solange alle Handlungen, die die Moral unter der Bedingung gewisser Zwecke vorschreibt, zufällig und können keine Verbindlichkeiten heißen, solange sie nicht einem an sich notwendigen Zwecke untergeordnet werden."

ends to means teaches us only how to be skilful, prudent or efficient. It does not imply or create normative obligations. This distinction is basic and its relevance is not limited to Kant's theory of practical reason. It is applicable whenever we are dealing with strict obligations, particularly with prohibitions the purpose of which is to prevent commercialisation. Some rights are inalienable. To be ones own master – the principle of autonomy – is the most fundamental condition of a free society. John Locke and Kant invest every human being with property in his or her own person. The principle transcends the protection of property because the owner of that property cannot dispose of it. The most obvious case is the prohibition of slavery, be it through law or through contract. This is more than a lesson of history. The principle that in all legal relations the human being must not be reduced to means and must always be an end in himself or herself defines the essence of individual liberty.[127]

Uncertain but nevertheless substantial limits to commercialisation follow from the value of human dignity. There are, it is true, wide variations between different societies in recognising these limits as legally relevant. Such rules, legal or social, are nevertheless an important – and some will feel indispensable – modification to rational choice. These limits are applicable in particular to rational choice by individual or collective monopolies.

In every legal order limits to rational choice or to individual liberties are frequently the product of new rules adopted by the judiciary in order to preserve a minimum of equity in the resolution of unforeseen conflicts.

[127] On Autonomy, Equality and Slavery, see *Epstein*, Scepticism, 2003, p. 36/37. On the limits of efficiency as a standard of justice see *Behrens*, Die ökonomischen Grundlagen des Rechts, 1986, S. 195–197; *Eidenmüller*, Effizienz als Rechtsprinzip, 3. Aufl. 1995, S. 463 ff.

Law in this perspective is not deemed to be absolute or immune to outside scientific insights. But law demands recognition and observance of its values enshrined in substantive or procedural norms.

(4) Rational choice is predicated upon and related to market prices and market valuation. If there are no markets, they must be "mimicked". This means that the transaction must be viewed as if there were a market.[128] This yardstick was proposed for the regulation of monopolies long before the economic analysis of law.[129] And it has been exposed to the criticism that it is frequently impossible or highly arbitrary to mimic the market and the outcome of competition. Hayek finds this operation arbitrary because under conditions of competition it is impossible to reconstruct the conditions of transactions that in fact did not take place.[130] In these cases economic analysis is counterfactual.

(5) Limitations follow from the assumptions that feed into the ex ante analysis of future risks and costs. The assumption of positive information costs – the costs of acquiring and using information – recognises the problem[131] but does not solve it. "Bounded rationality" is another term for the inevitable imperfect knowledge of actors' preferences, as well as of prevailing and future conditions that influence the effects of rational or irrational choice.

(6) A further limitation of cost-benefit analysis is its deliberate discounting of distributive effects. The resultant political questions concerning the effects of economic inequality in society are referred to the political system: the advantage of democracy as a political system is said to be its ability to mediate between equality and stability.[132] This does rightly imply that transactions subjected to cost-benefit analysis do have substantive effects on wealth distribution but leaves unanswered the question whether and how these effects should be taken into account in the generation and interpretation of legal rules.

[128] *Posner*, Frontiers, p. 99.

[129] See the proposal by *Eucken*, Grundsätze der Wirtschaftspolitik, 1st edition 1952, 7th edition 2004, to regulate monopolistic infrastructures "as if there were competition".

[130] See above N. 93.

[131] *Posner*, Economic Analysis, 2003, p. 17.

[132] *Posner*, Frontiers, p. 115.

It is rather obvious that even market-related policies, particularly cost-based monopoly regulation, take into account their distributive effects, particularly effects on consumers.

VIII. On the frontiers of Posner's legal theory

There are some tenets of Posner's legal theory from outside or from inside the law that colour his legal universe. Interrelated themes are everyday pragmatism (1.), legal positivism (2.) and the dangers of past-dependent law (3.).

1. Everyday pragmatism

Major reasons for everyday pragmatism are negative: since it is impossible to reach consensus on "the good", it is impossible to achieve consensus on a theory of justice;[133] legislators and courts cannot arrive at a consensus by reasoning from common priorities and ends; philosophy, including pragmatic philosophy, offers nothing that the law can use or that can determine the ends of democracy.[134] Since there is no moral compass, legal and political thinking need a new focus. That focus is to be "everyday pragmatism". First we learn what legal science and the law have to overcome: legal formalism, abstract moral and political theory as a guide to judicial decision making; consequentialism, that like utilitarianism evaluates actions by the value of their consequences; giving controlling weight to systemic consequences; and the idea, based on the rule of law and the separation of judicial and legislative functions, that judges apply law only and do not make it.[135] Finally, there is no general analytic procedure that distinguishes legal reasoning from other practical reasoning. The task of the judge is "to make the decision that is reasonable in the circumstances, all things considered".[136] "All things" include the decision's specific consequences, as far as they can be discerned, but also the standard legal materials and the desirability of preserving rule of law values.[137] But even these generalities must be taken with a grain of salt. Precedents, certainly a part of the rule of law in the context of the common law, are thoroughly discredited in Posner's discussion of the law's dependence on the past.[138] And the rule of law rhetoric is suspected to be an accidental and readily dispensable element of our legal ideology.[139] The dominant theme and the message of everyday pragmatism is the encouragement of wide judicial discretion. In unexceptional – that is, normal – cases, purposes that delimit contractual, statutory, constitutional, or common law provisions are said not to be discernible. Consequently, in these cases the judge is free to decide what the purpose of the law is: at common law, the purpose is given by the judges and can be changed by them. These considerations are then transferred to constitutional law as judge-made law.[140] Beyond judicial discretion in the interpretation of legal instruments, "Posner's pragmatism has little to say about the normative ends we choose to adopt".[141]

Under a generalised rule of reason, almost all depends on judges who are reasonable men or women. But that is not enough. Even reasonable men or women have different backgrounds, dispositions, convictions and prejudices. The answer is Posner's proposal to recruit a diverse and representative judiciary, composed of judges with diverse origins, experiences, attitudes, values and cast of mind. The analogy is, of course, to the democratic process and to the limited deliberative potential of judges, as of voters. The diversity of the American people should be represented.[142] If we needed confirmation that in dealing with everyday pragmatism, we are simultaneously dealing

[133] *Posner*, Frontiers, p. 20.
[134] On democracy see *Posner*, Frontiers, p. 130.
[135] *Posner*, Pragmatism, p. 61.
[136] *Posner*, Pragmatism, p. 64.
[137] *Posner*, Pragmatism, p. 64.
[138] *Posner*, Frontiers, p. 145–192 see below p. 56–62.
[139] *Posner*, Frontiers, p. 191.
[140] *Posner*, Pragmatism, p. 68.
[141] *Sullivan, Michael/Solove, Daniel J.*, Can pragmatism be radical? Richard Posner and legal pragmatism, 113 Yale L. J. 687, 694 (2003).
[142] *Posner*, Pragmatism, p. 211; for a further identification of democratic and judicial deliberation see *Posner*, Pragmatism, p. 139.

with economic analysis in modern American law, it is given by Posner: "The economic or the pragmatic approach to law is external only in a purely linguistic sense."[143]

Posner purports to restrict his everyday pragmatism to the American legal system. That does not prevent him, however, from comparing the accomplishments of pragmatism in the United States with assumed characteristics of the European legal systems.[144] To relate his account of European legal systems would be embarrassing because it is not even a caricature of the character of European legal systems, the role of governments, of courts and the attitude of judges. And there is not even a reference to that most European of legal systems, that of the European Union.

Silence is nevertheless inadequate, because Posner sees no strain in the application of the economic analysis of law to European legal systems.[145] And he even ventures a far-reaching recommendation for Europe: "Europe is at the crossroads, where one part leads to discretionary adjudication on the Anglo-American model while the other is the continuation of the tradition of judicial modesty that (to an American) is the most striking feature of the European judiciary."[146] Judicial activism is, however, in the European Union and in some member states as controversial as it is in the United States.

2. Positivism

Posner's thesis that there are scientific approaches to law from the outside only – particularly from economics – is given up a few years later in favour of that most exclusively inside theory of law – Hans Kelsen's "Pure Theory of Law".[147]

The "Pure Theory of Law" is the most highly developed form of positivism.[148] Positivism confirms most of Posner's negatives of his everyday pragmatism. Positivism recognises as law every command

[143] *Posner*, Pragmatism, p. 81.
[144] *Posner*, Pragmatism, p. 95/96.
[145] *Posner*, Pragmatism, p. 287.
[146] *Posner*, Pragmatism, p. 288.
[147] *Kelsen, Hans*, Reine Rechtslehre, 1934. Posner too uses this first edition.
[148] *Hayek*, Law, Legislation and Liberty, Vol. II, p. 48.

that issues from the competent controlling authority. That authority is mostly, but not necessarily the sovereign state. In such a legal order there is no space for legal history or for comparative law.

Posner was surprised that Kelsen's philosophy of law opens a space for economic analysis and "forges an important link between legal pragmatism and legal positivism".[149] He ascribes his surprise to Kelsen's reputation as a Kantian and to his own image of Kant's "moralistic" conception of law. Without entering into a discussion of Kant's fundamental distinction between law and morality, the comparison with Kelsen's position may clarify some aspects of the "Pure Theory of Law" and account for some objections against everyday pragmatism. In distinguishing legal from moral obligations, Kelsen is indeed a Kantian. Even though, according to Kant, all duties (obligations) as such are part of ethics, it does not follow that the rules („Gesetzgebung") that result are ethical. The example of contracts is a case in point. In the words of Kant: "Ethics commands that I perform a contractual obligation even though the other party cannot enforce my performance: the rule (pacta sunt servanda), however, and the corresponding duty are part of the law".[150]

It does not follow, however, that Kelsen's radical elimination of all content from the concept of law is in harmony with Kant's theory of law. Nor does Kant propose a universal definition of natural law or justice, conceived of as a body of universal principles found instan-

[149] *Posner*, Pragmatism p. 251.
[150] *Kant*, Metaphysik der Sitten, S. 219. The German original reads: „Hieraus ist zu ersehen, daß alle Pflichten bloß darum weil sie Pflichten sind, mit zur Ethik gehören; aber ihre Gesetzgebung ist darum nicht allemal in der Ethik enthalten, sondern von vielen derselben außerhalb derselben. So gebietet die Ethik, dass ich eine in einem Vertrage getane Anheischigmachung, wenn mich der andere Teil gleich nicht dazu zwingen könnte doch erfüllen müsse: sie nimmt das Gesetz (pacta sunt servanda) und die diesem korrespondierende Pflicht aus der Rechtslehre als gegeben an. Also nicht in der Ethik, sondern im Jus liegt die Gesetzgebung, das angenommene Versprechen gehalten werden müssen". Kant's theory is incompatible with Posner's and Holmes' interpretation of contracts as an acquisition of an option to break it. The difference follows, however, not from the legal consequences provided for by positive legislation; the difference follows from Kant's insistence on an ethical obligation to keep promises that is irrelevant in a pragmatic and economic interpretation of contracts. This does not imply that, as a matter of law, Holmes' interpretation of contracts is to be accepted. As a matter of experience, such an interpretation is incompatible with the key role of long term and relational contracts for individual economic planning in a market economy.

tiated in every society's legal system.[151] The fatal misunderstanding is the identification of universal principles with the positive law of every society. Positive law, according to Kant, is a matter of experience and is not necessarily in harmony with the principles of justice. But there are, according to Kant and contrary to Kelsen, principles of justice that are to guide legislation and adjudication. These principles follow from the inalienable rights of citizens against their sovereign to be respected in their dignity and liberty as self-governing individuals. The sovereign may not impose duties upon its subjects which the subjects would not impose upon themselves. This position is explicitly contrary to Hobbes, Bentham and their positivist followers, who find rights against the sovereign self-contradictory.

In this respect, Kelsen is not a Kantian. Law, in his theory, is a normative system backed by credible threats of using physical force against the violator of the norm. The norm is a legal norm not because of its content, but because it is created in a certain way, ultimately in a way determined by a presupposed basic norm.[152] The basic norm creates competences to create subordinate norms. This norm is assumed to be common to all legal systems. It is, however, not part of the legal system, but establishes the fact of control. Control means that the organisation of governmental and judicial powers is observed and that legal sanctions are enforceable. In international law, a new government, after a revolution or occupation, will be recognised when it has such control.[153] Posner's embrace of a legal theory that is content-neutral and therefore open to everything – including the economic analysis of law – is easy to understand. It creates space, a wide space indeed, for drawing on economics and the social sciences and other extra-legal sources of knowledge for aid in formulating legal doctrines.[154] But this optimistic statement is circular. Since the content of law is indeterminate (and, in the last analysis, a matter of sociology or ideology),[155] so too are the legal doctrines these disciplines

[151] This is, however, how Posner summarizes the position of his non-pragmatic opponents, *Posner*, Pragmatism, p. 253.

[152] *Posner*, Pragmatism p. 257, *Kelsen* p. 198.

[153] Posner rightly points out the factual analogy between recognition in international law and the Grundnorm in national law. *Posner*, Pragmatism p. 260.

[154] *Posner*, Pragmatism, p. 266.

[155] *Posner*, Pragmatism, p. 268.

may help to produce. The fact that Kelsen's theory is compatible with the economic analysis of law and recognises the judges' freedom in filling gaps through the creation of a lower norm on the basis of a higher norm,[156] is no substitute for a critical appreciation of its further implications and limitations.

These are provided by Hayek. He finds Kelsen's theory a product of constructivist rationality; a distortion of scientific analysis by deducing results from his own definition of the essence of law; an ideology in the service of unlimited government and socialism; the refutation of a concept of justice ignoring viable negative tests of justice that identify unjust norms.[157] In light of these arguments it is difficult to understand, let alone condone the charge that Hayek fails to recognise the difference between Kelsen's concept of law and the rule of law.[158]

The limitations of Kelsen's theory, that Posner neglects, affect even its usefulness as a vehicle of economic analysis of law. The law, according to Kelsen, is basically a certain order or organisation of power.[159] This is the function of the Grundnorm and the delegation of legislation and judicial powers based thereon. You do not have to be a formalist interested in systems only to recognise that law as the organisation of power divorces itself from some of its most important sources. There is no place for the factual rule-making and rule orientation in everyday life. Contracts are part of the legal system not only because the partners acquire the opportunity to breach the contract or because such breaches are sanctioned by law if the other party does go to court. Contracts are constituent elements of every market economy and they have effects like legal norms. The understanding of law as the organisation of power fits, however, perfectly planned economies. Even in such systems there is, of course, space for economic analysis of law if you think of the plan as law and of the planners as rational beings.

It may be a terminological accomplishment that we can distinguish law from bad law and that an act by a competent authority that orders

[156] *Posner*, Pragmatism, p. 267.

[157] *Hayek*, Law, Legislation and Liberty, Vol. II, p. 48–56.

[158] *Posner*, Pragmatism, p. 281.

[159] *Kelsen*, Reine Rechtslehre, 1934, S. 70.

murder is still "law". The accomplishment is meaningless for a policeman who is ordered by a competent authority to torture prisoners and may not refuse to obey. And it is of no consolation for those who are tortured that they know they will at least suffer according to "law".[160]

3. The end of legal history?

Legal history, according to Posner, is an obstacle to enlightened legal theory. He finds the legal profession the most historically oriented – more bluntly, the most "past dependent" of the professions.[161] The ingrained attitudes of lawyers, being suspicious of innovation, paradigm shifts and the energy and brashness of youth, are obstacles to those who wish to reorient the law in a more scientific, economic and pragmatic direction.[162] This rejection of precedents and scholarly history as guides to legal reasoning is all the more surprising – not to say puzzling – as Posner once came close to arguing that "the common law is compatible with and even proves the relevance of economic analysis of law".

To promote his thesis that in law the past should not rule the present,[163] Posner relies on and adopts Nietzsche's great sceptical essay on history in "Untimely Considerations".[164] The law, subdued by history, needs the energy and brashness of youth heralded by Nietzsche. The task is to overcome and to expose the various masquerades of the legal profession's historical reasoning. To be exposed is "a parallel instrumental conception of history written by judges and other legal professionals. Judges write history like commissars."[165] This is heavy stuff, to paraphrase Posner's reference to

[160] *Posner*, Pragmatism, p. 261.
[161] *Posner*, Frontiers, p. 145.
[162] *Posner*, Frontiers, p. 145.
[163] *Posner*, Frontiers, p. 169.
[164] *Nietzsche*, Unzeitgemäße Betrachtungen, 2. Stück, Vom Nutzen und Nachteil der Historie für das Leben, Werke I, S. 210–285. The following quotations are from the German edition.
[165] *Posner*, Frontiers, p. 152.

Nietzsche. But it is a dummy and a distortion of the legitimate uses of history in both law, philosophy and indeed economics.

Most of our legal rules and institutions are both "past dependent" and "path dependent". They are part of the social arrangements that enable human beings to orient themselves in a complex society with a minimum of scientific insight and information. In the words of Richard Epstein:

> "put simply the material of the common law forms a vast depository of raw data (which no moral philosopher could hope to come to duplicate by unaided reflection) needed to fashion a sound set of legal rules for our political and social institutions."[166]

Properly refined and pruned these principles that lie behind the endless array of discrete cases allow us to establish a complete and well-defined set of relationships between private individuals that meet simultaneously the practical concerns of ordinary individuals, the moral concerns of philosophers and the efficiency concerns of economists.[167]

The teachings of history, it is true, are never conclusive because comparisons with or without certain developments are counterfactual.[168] The United States is in the happy situation of having no experience of modern tyrannies. The German experience with Nazism and the worldwide experience with Communism are rather convincing evidence of what it means to live in a community without the rule of law. In other words: to live in a community without justice. The eradication of the rule of law usually had high priority on the list of revolutionary objectives and "accomplishments". This experience is one of the reasons why sovereign European countries were and are prepared to accept as binding a charter of human rights as interpreted by the Strasbourg Court of Human Rights and the guarantee of economic liberties as interpreted and enforced by the Luxembourg European Court of Justice.[169]

[166] *Epstein*, Scepticism and Freedom, 2003, p. 14.
[167] For a similar summary of the common law, see *Hayek*, Law, Legislation and Liberty, Vol. I, p. 86.
[168] *Posner*, Frontiers, p. 20.
[169] The repudiation of a revised treaty of European Union called a Constitution

The comparison of judges with commissars shows Posner's characteristic ease in dealing with events of history in parts of the world which were in fact going to hell, – if not "in a handbasket"[170], but with brash contempt of all historical accomplishments of civilisation. It was the strategy of the 20th century ideological tyrannies to propagate the end of history and a new age in which received values, particularly values enshrined in tradition, customs and law were but prejudices. Isaiah Berlin has shown that it was left to the 20th century to do more than just doubt the possibility of final solutions to the age-old questions of metaphysics, ethics and politics: for the first time, such questions as liberty and authority, sovereignty and natural rights, the ends of the state and of individuals were treated so as to vanish from the questioner's consciousness like evil dreams that would not trouble him any more.[171] This method of indoctrination "secures agreement on matters of political principle by removing the psychological possibility of alternatives which itself depends or is held to depend on the older form of social organisation rendered obsolete by the revolution and the new social order".[172]

Communist and fascist tyrannies aside, there is, according to Isaiah Berlin, a progressive and conscious subordination of political to social and economic interests[173]. Outside the purely technical sphere where one asks only what are the most efficient means towards this or that practical end, words like "true" or "right" or "free" and the concepts which they denote are to be redefined in terms of the only activity recognised as valuable, namely the organisation of society as a smoothly working machine.[174]

Posner does not propose to redefine these concepts. He finds them scientifically irrelevant. His pragmatism informs, however, his understanding of history; and the way he interprets those unhappy would-be historians, like judges, scholars of legal history in general

by popular votes in France and the Netherlands only proves that politicians have more difficulties in understanding the lessons of history than the populations of democratic societies.

170 *Posner*, Frontiers, p. 162.
171 *Berlin*, On Liberty, p. 75/76.
172 Ibid, p. 77.
173 Ibid, p. 80.
174 Ibid, p. 78.

and Dworkin in particular.[175] There is probably no modern writer or lawyer who argues, as Posner suggests, that the past as such is normative.[176] What the past of the law can teach us depends on the reason we find the legal experiences of another generation relevant. Legal history is relegated to irrelevance when recognised as such only in the form of a "disinterested study" of events, chronology or record of the past.[177] Posner himself proves the point. He finds the legal experiences of other times irrelevant:

> "In the case of legal precedent the cookie-cutter method will sometimes work; some cases are undeniably identical in all conceivably relevant respects to previously decided cases. But when there are merely analogies there is no metric of similarity that will enable a later case to be decided by reference to an earlier one".[178]

The thesis that precedents, like history, are merely a source of potentially useful data[179] denies the possibility of recognising normative principles that governed former cases and that may be relevant in another context. To deny this possibility is to deny that we are, in our way of thinking, dependent upon the insights and ideas of other ages. The history of ideas, of legal and moral insights, cannot be reduced to factual data.

It is the cognitive interest that determines the lessons to be learned from history. If you want to understand the conditions that are conducive to the development of the rule of law, it will not help just to register events and uses or abuses of law. The reason for a normative approach to history in general and legal history in particular was forcefully argued by Immanuel Kant.[180] He proposed to orient historical enquiry towards the idea of a constitution based upon the concept of human rights that every individual is endowed with as a human being. Such a speculative enquiry takes into account the challenge for and the ability of human beings to contribute to such a de-

175 *Posner*, Frontiers, p. 161.
176 Ibid, p. 161.
177 Ibid, p. 146
178 Ibid, p. 163.
179 Ibid, p. 161.
180 *Kant*, Idee zu einer allgemeinen Geschichte in weltbürgerlicher Absicht (Idea of a general history with a view to universal citizenship), Akademieausgabe Bd. 8, S. 18–31.

velopment. And it may contribute to finding conditions favourable to its realisation.

In the context of legal history, Nietzsche is a difficult witness from philosophy. The use and abuse of his philosophy to demonstrate the superiority of vitality and youthfulness over "the mystification of the past"[181] was a standard of Nazi propaganda.[182] This fact, needless to say, does not make Nietzsche a Nazi. In order to understand Nietzsche's message in his philosophy of history, we have to take into account his cognitive interests. Posner finds it in Nietzsche's reliance on "life as the final arbiter". This is a rather vague maxim and says nothing of its relevance for law which is not even mentioned in this text. The meaning of vitality, not questioned by Posner, is supplied by Nietzsche: life as such is will to power and self sustenance is but one of the indirect and frequent consequences thereof.[183] And even more explicit: "Only where life is, is there will: not the will to live, but – hear my word – the will to power" (author's translation).[184] Even though it would be a simplification to reduce Nietzsche's philosophy to this maxim, it is a dominant theme. And it implies the mandate of the strong few to dominate a community and of a strong community to dominate other communities. Power may certainly be looked upon as one of the great moving factors in history. But in legal theory, the control and limitation of power is certainly more relevant than its praise.

To find the history of ideas and the ideas of philosophers relevant you must not have, as insinuated by Posner, a monumentalistic conception of the past. Schopenhauer's (not Nietzsche's) "ideal of a republic of wise men where one giant calls to another across the desert intervals of time undisturbed by the exited shattering of dwarfs who

[181] *Posner*, Frontiers, p. 163.

[182] *Rosenberg, Alfred*, Der Mythus des 20. Jahrhunderts (The mystification of the 20th century), Berlin 1930. The book was used as important propaganda and schooling material by the Nazi government after Hitler came to power.

[183] *Nietzsche*, Jenseits von Gut und Böse, Vorspiel einer Philosophie der Zukunft, in: Werke Bd. II, S. 566, 578. German text: Leben selbst ist Wille zur Macht –: Die Selbsterhaltung ist nur eine der indirekten und häufigsten Folgen davon.

[184] *Nietzsche*, Also sprach Zarathustra, in: Werke Bd. II, S. 278, 372. German text: Nur, wo Leben ist, da ist auch Wille: aber nicht Wille zum Leben, sondern – so lehre ich Dich – Wille zur Macht!

creep about beneath them", does not deal with or reject the "idolatry of the factual". The message is that there are philosophical ideas, values and insights that remain relevant beyond the disparate events of history. There is no conflict in finding relevant insights in principles that contribute to our civilisation and the recognition of their limited impact on the course of history. There certainly has been an "idolatry of the factual" in order to intoxicate the masses with the sense of power and invincibility; but it is difficult to comprehend why Posner ascribes this attitude to conventional legal thought.[185]

By endorsing Nietzsche's critic of historicism and his aversion to the idolatry of the past, Posner, unaware or careless of context, endorses the idolatry of power. And he fails to notice Nietzsche's own views on philosophy of law, legal history and comparative law. They are the exact opposite of Posner's interpretation. Nietzsche writes:

> "Now to the philosophy of law! This is a science like all moral sciences that is not even out of its infancy ... . And as long as legal theory does not accept a new foundation, namely the foundation of history and the comparison of different laws of different peoples, we are to live with the useless fights among false abstractions that these days present themselves as 'philosophy of law' and all of which are deduced from the character of individuals as they are today. These individuals are, however, such complex beings, particularly with respect to their understanding of legal values, that they permit of the most divergent interpretations".[186]

According to Nietzsche the way to a true understanding of law then is history and comparative law. The methodological affinity of legal history and comparative law has often been recognised. But comparative law is not even registered at the "frontiers" of legal theo-

[185] *Posner*, Frontiers, p. 154.

[186] Author's translation from *Nietzsche, Friedrich*, Aus dem Nachlass der 80er Jahre, in: *Nietzsche, Friedrich*, Werke 1997, Bd. 3 S. 870/71. The German original reads: „Ja die Philosophie des Rechts! Das ist eine Wissenschaft, welche wie die moralische Wissenschaft noch nicht einmal in der Windel liegt.

Und so lange die Rechtswissenschaft sich nicht auf einen neuen Boden stellt, nämlich auf die Historien und die Völkervergleichung wird es bei dem unnützen Kampfe von grundfalschen Abstraktionen verbleiben, welche heute sich als ‚Philosophie des Rechts' vorstellen und die sämtlich vom gegenwärtigen Menschen abgezogen sind. Dieser gegenwärtige Mensch ist aber ein so verwinkeltes Geflecht, auch in Bezug auf seine rechtlichen Wertschätzungen, dass er die verschiedensten Ausdeutungen zulässt."

ry. This is in line with Posner's positivist position that there can be no transfer of scientific insights from one legal system to another and that there are no legal principles of cross-cultural relevance.

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