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## Markets as a Moral Foundation for Contract Law

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# Markets as a Moral Foundation for Contract Law

*Nathan B. Oman\**

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## I. INTRODUCTION

Markets are not natural. Adam Smith noted that mankind has “the propensity to truck, barter, and exchange one thing for another,”<sup>1</sup> but markets require more than mere exchange, which is present not only in all human societies but also among certain primates.<sup>2</sup> Rather, healthy markets consist of the widespread allocation of goods and services through a repeated and ongoing process of impersonal exchange among large groups of people without resort to violent expropriation or other forms of predation.

Consider the example of Russia in the early 1990s. In the wake of the failed coup by hard-line communists, the Soviet Union formally dissolved, and the Russian government faced the daunting task of transitioning from an economy in which goods and services were ostensibly allocated by state fiat to markets.<sup>3</sup> Russian policymakers, acting on the advice of Western economists, opted for a policy of “shock therapy.”<sup>4</sup> Every Russian citizen would be given a share of stock entitling them to some fractional equity ownership of state-owned enterprises.<sup>5</sup> The hope was that simply transferring ownership to private hands would create incentives that would lead to the creation of healthy markets.<sup>6</sup> While the shock therapy did achieve its main political objective of forestalling a return to communism, it was not a startling economic success.<sup>7</sup> In some segments of the Russian economy, healthy markets developed, but criminal and quasi-criminal oligarchs whose wealth rested in large part on extortion and allies within the state came to dominate other sectors.<sup>8</sup>

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1. ADAM SMITH, *THE WEALTH OF NATIONS* 11 (C.J. Bullock ed., Barnes & Noble 2004) (1776).

2. In experiments with humans, chimpanzees demonstrate the ability to trade food, including evidence of a conscious strategy of maximizing their gains from trade. See Louis Lefebvre, *Food Exchange Strategies in an Infant Chimpanzee*, 11 *J. HUM. EVOLUTION* 195 (1982). While chimps have this ability, however, they have not been observed trading in the wild. *Id.* at 201 (“Food exchange can be thus added to the growing list of sophisticated abilities great apes show in captivity but do not use in the wild.”).

3. See generally MARSHALL I. GOLDMAN, *THE PIRATIZATION OF RUSSIA: RUSSIAN REFORM GOES AWRY* 45–70 (2003) (discussing economic conditions in Russia on the eve of privatization).

4. See *id.* at 58–65 (describing the motivations of Yeltsin’s key economic advisors in implementing “shock therapy” for the Russian economy).

5. See *id.* at 86.

6. See *id.*

7. See PREM SHANKAR JHA, *THE PERILOUS ROAD TO THE MARKET: THE POLITICAL ECONOMY OF REFORM IN RUSSIA, INDIA AND CHINA* 36–56 (2002) (discussing the effects of Yeltsin’s “shock therapy” on Russian society).

8. See *id.* at 37 (“The Mafiya controlled prices and rapidly developed an interest in ensuring that increases in supply that would force prices down did not reach the market. . . . It also controlled the entry of new small businesses, and thereby choked the growth of entrepreneurship in the country.”).

Historically, the Russian experience is unsurprising. Commerce and markets on a limited scale, of course, are common across time and space. There was trade in ancient Egypt and ancient China.<sup>9</sup> On the other hand, in many societies impersonal voluntary exchange accounted for a relatively small share of economic activity. Consider, for example, the economic organization of the Roman Empire. To be sure, there was trade and commerce, often on a large scale.<sup>10</sup> On the other hand, subsistence agriculture, slavery, and various forms of expropriation such as tax farming accounted for the bulk of economic activity. In human history, the dominance of economic life by healthy markets has been the exception rather than the rule. Indeed, modern economists have noted that even today most societies are dominated by a social model where “[p]ersonal relationships, who one is and who one knows, form the basis for social organization and constitute the arena for individual interaction, particularly personal relationships among powerful individuals.”<sup>11</sup> In contrast, the

set of changes in the economy that ensure open entry and competition in many markets, free movement of goods and individuals over space and time, the ability to create organizations to pursue economic opportunities, protection of property rights, and prohibitions on the use of violence to obtain resources and goods or to coerce others<sup>12</sup>

is rare both historically and globally.

Foregrounding the contingency of healthy markets has potentially important implications for legal theory, particularly for our thinking about bodies of law such as contracts that are closely associated with markets. An assumption that markets are natural or given focuses attention on the role of law as a regulator, a social mechanism for ferreting out and suppressing markets in their pathological inflection. If, on the other hand, we see markets as fragile and contingent, we focus our attention on a different set of questions, the questions that I seek to discuss in this Article.

Contract law is the quintessential institution of a market economy. Indeed, historically, contract was a late arrival to the common law. For the first several centuries of its existence, the common law focused mainly on issues of personal security—what today we would call torts and criminal law—and the rights and duties associated with property, especially real

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9. See WILLIAM J. BERNSTEIN, *A SPLENDID EXCHANGE: HOW TRADE SHAPED THE WORLD* 20–28 (2008) (discussing international trade in the ancient societies of the Fertile Crescent).

10. See *id.* at 40–42 (discussing trade in the Roman Empire).

11. DOUGLASS C. NORTH, JOHN JOSEPH WALLIS & BARRY R. WEINGAST, *VIOLENCE AND SOCIAL ORDERS: A CONCEPTUAL FRAMEWORK FOR INTERPRETING RECORDED HUMAN HISTORY* 2 (2009).

12. *Id.*

property.<sup>13</sup> It was only in the seventeenth and eighteenth centuries that contract law became the topic of extensive doctrinal elaboration by the courts,<sup>14</sup> and it was only in the nineteenth century that contract reached a state of doctrinal maturity.<sup>15</sup> This does not mean, of course, that there was no legal enforcement of voluntary, executory agreements prior to the early modern period. Roman law recognized a variety of contractual forms, and writs such as debt, covenant, and *assumpsit* existed at common law. Nevertheless, contract did not receive the kind of sustained attention lavished, for example, on the law of real property.

It is not accidental that the rise of judicial attention to contract corresponds with the massive explosion in market activity and economic growth over the same period. Indeed, the period beginning in the eighteenth century marks a kind of big bang for economic growth.<sup>16</sup> After millennia of either stagnant or modest increases in material prosperity, something unprecedented began happening first in the economies of the Netherlands and Britain and then in North America and the rest of northwestern Europe.<sup>17</sup> Economic activity spiked upward and entered a period of sustained, exponential growth that accelerated after the year 1800 and left the inhabitants of these nations wealthier on average than any other societies in the history of the globe.<sup>18</sup> Contract law is a creation of this period.

Despite the close historical connection between the triumph of markets and the rise of contract law, markets play a remarkably small role in contract law theory, particularly those theories we might label as moral or philosophical.<sup>19</sup> Of course, there were contracts and contract law before the economic explosion of the last three hundred years, and in any case, the historical fact that contract law ballooned in importance with the rise of

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13. See THEODORE F.T. PLUCKNETT, *A CONCISE HISTORY OF THE COMMON LAW* 628–32 (Little, Brown & Co. 5th ed. 1956) (1929) (discussing the history of the common law and the origins of contract law).

14. The beginning of this process is traditionally ascribed to the decision of the Court of King's Bench in *Slade's Case*, (1602) 76 Eng. Rep. 1074 (K.B.); 4 Co. Rep. 92b.

15. See generally P.S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* (1979).

16. See DEIRDRE N. MCCLOSKEY, *BOURGEOIS DIGNITY: WHY ECONOMICS CAN'T EXPLAIN THE MODERN WORLD* 1 (2010) ("One hundred dollars as against three: such is the magnitude of modern economic growth.").

17. See *id.* at 7–8 ("In northwestern Europe around 1700 the general opinion shifted in favor of the bourgeoisie, and especially in favor of its marketing and innovating. . . . But for millennia no blade of the hockey stick ensued. When ideology changed, it did." (footnote omitted)).

18. See *id.* at 4 ("As a *share* of all the world's population the world's poverty has been falling not for two decades but for two centuries. A higher and higher share have become since 1800 those \$30- or \$48- or \$137- or \$280-a-day folk, in the top four to six billion.").

19. For example, the index in Stephen Smith's excellent survey of the contemporary philosophy of contract law, *Contract Theory*, does not contain an entry on markets. See STEPHEN A. SMITH, *CONTRACT THEORY* 449 (2004).

markets doesn't mean that there is any necessary connection between markets and the criticism, justification, and interpretation of contract law. Likewise, markets are not entirely absent from contemporary contract law theory. Economic theorists of contract certainly laud markets, and their approach to contract law tends to focus on market participants. Generally, however, the law and economics focus on markets reduces to a single concern: the efficient allocation of resources. Markets, however, are complex social institutions that can serve multiple functions.<sup>20</sup> They do far more than simply allocate resources, and our understanding of their workings and possible social functions cannot be exhausted by the tools of the rational-actor model and efficiency analysis.

In this Article, I hope to show why the *philosophical* indifference of contract theorists to markets is a mistake. I do this by focusing on promissory theories of contract, showing how they could be strengthened by focusing on the role of promises in markets rather than on promissory morality simpliciter. My thesis is that contract law exists primarily to support markets and that the moral and political value of markets as a social institution undergirds its justification. I realize, of course, that the universe of contract theory is hardly exhausted by promissory theories. My focus on promissory theories is pragmatic. I address these theories as a way of illustrating my central thesis, but I understand that ultimately a full discussion of that thesis requires grappling with other theoretical approaches to contract such as consent and transfer theories. That, however, is a task for a different article.

I begin my argument by critiquing the normative foundations of efficiency analysis. This is well-worn ground, but it is worth traversing again as a prelude to the argument that follows. Markets are so often justified as being efficient that it can be difficult for people to think about their value in any other terms. In order to clarify the nature of the claims I am making in this Article, therefore, I want to be very clear that I am not offering a justification for markets based on efficiency. Indeed, when the term "efficiency" is rigorously specified using the tools of welfare economics, it cannot justify markets as they actually exist. Any justification for the unruly reality of markets must lie elsewhere. The next step in my argument is to provide such a justification. Broadly speaking, the good of markets can be understood in three ways. First, markets reinforce a liberal political order. Second, markets generate wealth, which helps to deliver a host of social goods from health care to religious tolerance. Third, I argue that the process of market exchange inculcates a set of virtues that makes us into more peaceful, tolerant, and decent human beings.

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20. See, e.g., Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003) (arguing that economic efficiency should be the sole concern governing firm-to-firm contracts).

Having established the goodness of markets, I next discuss how contract law is justified as supporting markets. I do this by contrasting the support of markets as a justification for contract law with well-known promissory theories, showing how such theories fail at precisely the point where a market-supporting view of contract succeeds. Markets, however, are not an absolute good. At times they operate in ways that we should find normatively troubling. In these situations, markets do not provide a justification for contractual enforcement. Accordingly, I conclude that limitations on freedom of contract such as the rule against immoral contracts, far from being a paternalistic intrusion into the libertarian purity of contract, flow naturally from contract's role as a market-sustaining institution. In short, markets are not a happy by-product of enforcing contracts for other reasons. They are the primary justification for the existence of contract law.

I proceed as follows. In Part II, I address efficiency defenses of the market, showing why they are inadequate and require that we understand the value of markets using tools beyond those that traditional welfare economics and the model of perfect competition provide. In Part III, I discuss noneconomic reasons why markets are politically and morally desirable. In Part IV, I argue that seeing contract law as facilitating markets provides a more coherent normative theory than promissory theories of contract. Part V considers objections to the moral status of markets and how these objections might play out in contract law. Part VI concludes.

## II. THE PROBLEM WITH THE EFFICIENCY DEFENSE OF MARKETS

It is important to understand that focusing on the value of markets is not the same thing as ordinary efficiency analysis. Of course, economists frequently celebrate the virtues of markets. It is thus ironic that economics itself demonstrates the difficulty of defending markets on efficiency grounds. If markets are inhabited by rational actors who face no transaction costs, then neoclassical theory has thoroughly demonstrated that the resulting distribution of resources will be efficient.<sup>21</sup> There will be an incentive to engage in trades that result in Pareto-superior allocations of resources, and all available Pareto-superior moves will, in due course, be made. The result will be a Pareto-optimal distribution. We will have a world in which any deviation from the market allocation will result in at least one person being made worse off. Accordingly, markets are to be desired for their ability to achieve efficient outcomes. It is a beguiling vision, and one that is supported by arguments whose formal validity cannot be seriously

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21. This, roughly stated, is the first fundamental theorem of welfare economics. This theorem states that the competitive or Walrasian equilibrium of a market will be efficient. See generally Kenneth J. Arrow & Gerard Debreu, *Existence of an Equilibrium for a Competitive Economy*, 22 *ECONOMETRICA* 265 (1954) (offering the first formal proof for this claim).

questioned.<sup>22</sup> The problem with this defense of markets is that its assumptions are demonstrably false.

The first assumption is that market participants are rational actors. Economic rationality needn't mean that agents conform to some vision of *homo economicus* in which wealth is the only goal and the accumulation of money is the highest good.<sup>23</sup> For example, there is nothing economically irrational about the actions of Mother Teresa. This is because the demands of economic rationality are purely formal. To be economically rational, one must have preferences that are complete and transitive.<sup>24</sup> For any choice between *A* and *B*, the rational actor must have a preference for *A* or *B*. Furthermore, if *A* is preferred to *B* and *B* is preferred to *C*, then *A* must be preferred to *C*. These preferences must be stable over time, and the agent must act in accordance with them. Economic analysis, however, has nothing to say about the content of *A*, *B*, or *C*. There is nothing irrational about preferring a life of selfless sacrifice in the slums of Calcutta to a life of self-indulgent leisure, so long as it is also true that when self-indulgent leisure is preferred to a life of playing professional chess then selfless sacrifice is also preferred to chess. Thus, the rational-actor model can be saved from crude economic skepticism.

The rational-actor model, however, faces a far deeper challenge from behavioral studies.<sup>25</sup> Rather than attacking a caricature of *homo economicus*, behavioral work suggests that the formal requirements of the rational-actor model do not hold. Most of us, it would seem, do not have complete transitive preferences. There may be gaps between our preferences and our actions. Actual human beings are prone to misperceptions and akrasia. Furthermore, we may be indecisive about what we desire and inconsistent over relatively short periods of time in what we pursue.<sup>26</sup> One minute we want *A* rather than *B*, but the next minute prefer *B* to *A*. On occasion we prefer *A* to *B* and *B* to *C*, but—in the face of the demands of the rational-actor model—we may prefer *C* to *A*.

There are, of course, perfectly respectable reasons to remain sanguine about the power of the rational-actor model in the face of such criticisms. First, most of the behavioral studies occur in carefully structured experimental settings where the surprising results—such as the intransitivity

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22. Kenneth Arrow is generally credited with producing a mathematical proof for the first fundamental theorem. See generally *id.*

23. See ALEXANDER ROSENBERG, PHILOSOPHY OF SOCIAL SCIENCE 65–74 (1988) (discussing the formal requirements of the rational-actor model).

24. *Id.* at 69.

25. See, e.g., Cass R. Sunstein, *Introduction* to BEHAVIORAL LAW & ECONOMICS 1, 1–10 (Cass R. Sunstein ed., 2000) (summarizing research in behavioral law and economics).

26. See Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*, in BEHAVIORAL LAW & ECONOMICS, *supra* note 25, at 211–31.



of preferences—can be altered by very small changes in experimental design.<sup>27</sup> One can plausibly claim, for example, that as scientific conclusions they lack the robustness of the laws of thermodynamics or—for that matter—the almost universally observed inverse relationship between the demand and the price of any good or service.<sup>28</sup> Another response is to note that most economic decisions are made in institutional or social settings that militate against the kind of formal irrationality apparently observed by behavioral critics.<sup>29</sup> For example, when modeling the behavior of firms one might assume economic rationality because competitive forces tend to weed out formal irrationality.<sup>30</sup> These all strike me as fair defenses of the rational-actor model, suggesting that, with caveats, it can still be employed without embarrassment in modeling a great deal of economic behavior.

The deeper problem with an economic defense of markets is the ubiquity of transaction costs. Remember that in order to justify markets as efficient, agents must be rational and face zero transaction costs. There are few markets where the assumption of zero transaction costs, or something like that, holds. Market actors in the real world face ubiquitous information costs, bargaining costs, search costs, and the like. These transaction costs cannot be dismissed as negligible frictions. To grasp why this is so, consider sectors of the economy that exist more or less entirely as a transaction cost. Accountants, for example, exist to solve information costs by providing information about the present value of firms. Lawyers exist to help individuals and firms negotiate the cost of discovering, obeying, and disputing the law or else in negotiating and interpreting the scope of contractual obligations. Brokers of various kinds exist to solve the search costs that willing buyers and sellers otherwise face. And so on. Indeed, one study concluded that roughly forty percent of the entire U.S. economy consisted of private transaction costs.<sup>31</sup> Such costs cannot be dismissed as mere friction contained within the rounding error of economic models. Rather, high transaction costs are the norm.

All of this means that the two key assumptions necessary to defend markets as efficient seldom actually hold true in fact. We simply are not justified in supposing that the allocation of resources resulting from actual markets in the real world is efficient. Indeed, seen in terms of the conditions

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27. See Gregory Mitchell, *Why Law and Economics' Perfect Rationality Should Not Be Traded for Behavioral Law and Economics' Equal Incompetence*, 91 GEO. L.J. 67, 72 (2002) (stating that theories associated with behavioral law and economics "cannot lay claim to empirical validity superior to that of the perfect rationality assumption" of law and economics).

28. See *id.*

29. See *id.* at 74–75.

30. See *id.* at 73–77.

31. See John Joseph Wallis & Douglass C. North, *Measuring the Transaction Sector in the American Economy, 1870–1970*, in LONG-TERM FACTORS IN AMERICAN ECONOMIC GROWTH 95, 121 tbl.3.13 (Stanley L. Engerman & Robert E. Gallman eds., paperback ed. 1992).

for an efficient market, most market activity is actually an unfortunate transaction cost. The process of exchange, shopping, bargaining, persuading, building relationships with customers and suppliers, experimenting with new business models, creating new products, trying new services, and the like are all so much waste. In the theoretical construct of perfect competition, such activities should not exist and goods and services should instantaneously and costlessly converge on an efficient equilibrium point. It is this efficient equilibrium, rather than market activity per se, that is the normative goal of economic theories. In the end, however, any discussion of markets must assume that we are not in the world of perfect competition and zero transaction costs.

This does not, of course, mean that one cannot make efficiency arguments in favor of markets. Nor is it a criticism of economic analysis of the law. The efficiency of markets can still be defended on comparative grounds. Hence, one might acknowledge deviations from the rational-actor model and the ubiquity of transaction costs but still argue that markets are economically preferable to alternative forms of economic organization, especially the allocation of resources by government fiat. This, for example, was the gravamen of Friedrich Hayek's brilliant defense of markets during the so-called socialist economic-calculation debates of the 1930s and 1940s. Hayek did not defend markets as perfectly efficient.<sup>32</sup> Rather, he noted the massive information problems faced by government decision makers and argued that, through the price mechanism, markets were better able to aggregate the decentralized information in society needed for rational decision making.<sup>33</sup>

Likewise, the fact that one cannot ultimately defend real-world markets as efficient using the simple models of neoclassical economics is not necessarily a critique of the efficiency analysis of ordinary law and economics. Indeed, since Ronald Coase, law and economics has assumed that the ubiquity of transaction costs must be the starting point for the economic analysis of legal rules.<sup>34</sup> There is a real sense in which the work of someone like Richard Posner is less a defense of the market than a series of ingenious suggestions as to how market outcomes can be improved by taking transaction costs into account and specifying legal rules that are more efficient in light of those costs.<sup>35</sup> Indeed, the Coase Theorem suggests that if the conditions hold for claiming that a market is efficient, the structure of

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32. See generally Bruce Caldwell, *Hayek and Socialism*, 35 J. ECON. LITERATURE 1856 (1997); Günther K. Chaloupek, *The Austrian Debate on Economic Calculation in a Socialist Economy*, 22 HIST. POL. ECON. 659 (1990).

33. See generally F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945).

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

35. See generally RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (8th ed. 2011).

legal entitlements is generally irrelevant.<sup>36</sup> Law and economics scholarship thus shows us ways in which the legal system might be made marginally more efficient. What that scholarship does not do is provide us with an argument as to why actual markets—as opposed to the frictionless fictions of introductory textbooks—are valuable. One might take the existence of such markets as given and ask how they might be improved so as to be more efficient, but there is no reason why—given a different set of historical accidents—one might not take the hierarchical organized economy of the Roman Empire or some other economic system as given and use law and economics analysis to show how it could be made marginally more efficient.

Even if markets are efficient, the normative credentials of efficiency as a policy goal are open to serious question. When one makes the claim that markets—given certain conditions—are efficient, it is important to understand exactly what is meant by “efficient.” In this claim, what it means for a market to be efficient is that it will result in a Pareto-optimal allocation of resources. There is no reason, however, to suppose that bare Pareto optimality is normatively desirable.<sup>37</sup> The allocation of resources resulting from theft can be Pareto-optimal. If a wealthy glutton steals the last morsel of food from a starving child, the allocation will be efficient so long as the glutton prefers having the morsel of food to not having the morsel of food. Taking the morsel from the glutton and returning it to the child will, after all, result in the glutton being worse off, violating the Pareto requirement. Of course, once the morsel is returned to the child, the restored allocation may itself also be Pareto-optimal. This analysis suggests, however, that the mere fact that a state of affairs is Pareto-optimal tells us relatively little about its ultimate desirability. Certainly, a defense of markets based on their Pareto optimality, without more, has very little to recommend it, even if the implausible assumptions of zero transaction costs and perfect rationality are satisfied.

Finally, it is worth noting that the utilitarian foundations of welfarist justifications for efficiency are open to serious question. The discussion of efficiency above speaks in terms of preferences and their satisfaction. The idea is that the satisfaction of a preference, all else being equal, is a good thing that increases human welfare or is otherwise normatively desirable. The notion of efficiency, however, is indifferent to the substantive content of these preferences. Rather, that notion takes preferences to be exogenous to the analysis, a pre-existing fact about the universe. This approach, however, runs counter to our moral common sense. Ordinarily, we do not regard preferences as matters of moral indifference that present a merely technical

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36. See Coase, *supra* note 34, at 6–8 (noting that in a world of zero transaction costs any initial allocation of an entitlement will result in an efficient final allocation).

37. See Jules L. Coleman, *Risks and Wrongs*, 15 HARV. J.L. & PUB. POL'Y 637, 637–38 (1992).

problem of aggregation and maximization. Rather, we regard some preferences as good and others as bad. The person with a preference for sadistic killing is not merely a person with a taste that happens to have a negative externality. He is a moral monster, and we are right to regard him as such. Likewise, we tend to believe that certain preferences are higher or nobler than others. A person who desires to help or relieve the suffering of others is, for that reason, deserving of praise that is not due to someone with a preference for playing video games. Efficiency analysis, however, provides us with no traction in making such judgments, but rather, requires that we take all preferences as given and unquestionable.

In short, in thinking about the value of the actual markets that we encounter in the real world, traditional economic analysis in its normative guise provides us with less guidance than one might initially assume. At best, actual markets emerge from the argument as a kind of compromised version of a theoretical ideal. Most strikingly, many of the quintessential activities of the market, such as bargaining, exchange, experimentation, and the like, are revealed as so many transaction costs; perhaps inevitable but ultimately wasteful. Economics, whatever its virtues as a theory of social explanation (and I believe it has many virtues) or as a method for prescribing marginal improvements to institutions, does not provide a strong defense of markets in general.

### III. THE NON-EFFICIENCY CASE FOR MARKETS

As mentioned above, markets are most often defended as mechanisms for the efficient allocation of resources. The process of widespread exchange, however, yields greater benefits than conversion on an efficient equilibrium point. Indeed, in many ways efficiency in the abstract sense championed by economic analysis of the law is among the least of the many virtues of markets. These other values can be divided into three basic spheres: politics, wealth, and virtue. These spheres are necessarily related to one another, but for ease of exposition, I will treat each one separately.

#### A. POLITICS

Eighteenth-century writers often spoke of the political benefits of a commercial society.<sup>38</sup> Thinkers, such as Montesquieu and Adam Smith, contrasted the emerging world of commerce with the largely precommercial past.<sup>39</sup> They contrasted commercial society with the ethos of the feudal past,

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38. See ALBERT O. HIRSCHMAN, *THE PASSIONS AND THE INTERESTS: POLITICAL ARGUMENTS FOR CAPITALISM BEFORE ITS TRIUMPH* 70–93 (1977) (discussing eighteenth-century debates over commerce). See generally COMMERCE, CULTURE, AND LIBERTY: READINGS ON CAPITALISM BEFORE ADAM SMITH (Henry C. Clark ed., 2003) (collecting sources on the eighteenth-century debates over commerce).

39. See HIRSCHMAN, *supra* note 38, at 9–12 (discussing “The Idea of Glory and Its Downfall”).

in which bravery, loyalty, obedience to hierarchy, and the like were exalted.<sup>40</sup> For these early evangelists of the market, commerce did much more than make men rich. It made them “gentle,” not simply in the sense of being less violent but also in the sense of being more refined, thoughtful, and tolerant. In commercial society, men were more sociable, the arts and philosophy could flourish more freely, the peace of the commonwealth was less likely to be excited by the violence of religious fanaticism, and true piety could develop without the threat of coercion from a state whose energy was devoted to the cultivation of commerce rather than orthodoxy.<sup>41</sup> To be sure, these theorists worried about the negative effects of commerce. They spoke of the vices of luxury that wealth could bring, but on the whole, they viewed the growth of markets as a beneficent moral force in society.<sup>42</sup>

These arguments can be transposed into the language of modern political philosophy. Much of liberal theory, for example, insists on the need to distinguish between the right—the minimum demands that justice places on each agent to respect the rights of other agents—and the good—the comprehensive systems of beliefs about final moral ends that agents hold.<sup>43</sup> The value of liberal political institutions, on this view, lies in their ability to provide a peaceful *modus vivendi* for those with sharply differing visions of the good. The liberal state should respect the demands of the right while remaining neutral with regard to competing visions of the good. Ironically, however, in pluralistic societies, the market provides a much better example of cooperation among those with competing visions of the good than does politics. Despite the dream of a neutral state whose actions are justified by a thin, public reason, politics as it is actually practiced in liberal societies is frequently bitter, polarizing, and acrimonious. In the marketplace, however, those with sharply competing political, moral, and religious visions

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40. *See id.*

41. *See id.* at 63–66 (discussing “Money-Making as a Calm Passion”); MONTESQUIEU, THE SPIRIT OF THE LAWS bk. XX, ch. 2, at 338 (Anne M. Cohler et al. eds. & trans., Cambridge Univ. Press 1989) (1748) (“The natural effect of commerce is to lead to peace. Two nations that trade with each other become reciprocally dependent; if one has an interest in buying, the other has an interest in selling, and thus all unions are founded on mutual needs.”).

42. *See* 2 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 794 (R.H. Campbell et al. eds., LibertyClassics 1981) (1776) (“In every civilized society, in every society where the distinction of ranks has once been completely established, there have been always two different schemes or systems of morality current at the same time; of which the one may be called the strict or austere; the other the liberal or, if you will, the loose system. . . . In the liberal or loose system, luxury, wanton and even disorderly mirth, the pursuit of pleasure to some degree of intemperance, the breach of chastity, at least in one of the two sexes . . . are generally treated with a good deal of indulgence . . .”).

43. *See* JOHN RAWLS, A THEORY OF JUSTICE 392–96 (rev. ed. 1999) (discussing the distinction between the right and the good); *see also* STEPHEN MULHALL & ADAM SWIFT, LIBERALS AND COMMUNITARIANS 31–33 (1992) (same).

peacefully cooperate.<sup>44</sup> This cooperation is so pervasive that we seldom realize how remarkable it is. Well-functioning markets are perhaps of the single most effective social practice for managing the pluralism of incommensurable beliefs.

Liberal political theory has searched for a solution to the problem of apparently incommensurable and irreducible moral pluralism through some kind of discursive mechanism. For example, the idea of public reason imagines a coercive state, but one whose ability to engage in legitimate collective decisions is sharply limited by the kinds of reasons that may be offered in support of those decisions.<sup>45</sup> In effect, the boundaries of a certain way of talking become the boundaries of legitimate collective action via the state, and the boundaries of the discussion are set in such a way as to manage the pluralism of ultimate moral or political commitments. The problem with this way of managing pluralism is that as a practical matter it requires citizens to engage in an epistemic and rhetorical continence in which their deepest personal convictions and sense of identity are systematically suppressed in public.<sup>46</sup> Regardless of the ultimate rightness of such a strategy, it has not proved especially successful in practice.<sup>47</sup> Modern politics, even in well-functioning liberal democracies, frequently and inevitably features appeals beyond a thin conception of public reason.<sup>48</sup>

Another alternative is to simply limit the reach of the state—and therefore the destructive possibilities of politically clashing moral absolutisms—by carving out a private realm that is to be free of political intrusion. Much of the traditional theory of individual rights is devoted to defining the limits of this protected space. Likewise, much of constitutional theory is devoted to the design of institutions that will prevent the state from growing too large and assertive at the expense of the protected sphere of the individual. Laudable as such efforts are, however, they are insufficient to accomplish the goals to which they are set. Historically, well-specified

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44. See JULES L. COLEMAN, *RISKS AND WRONGS* 5 (1992) (“Markets maximize social interaction without individuals first being required to agree upon fundamental social values or to share a conception of the good or of the constitutive elements of the good life.”).

45. See JOHN RAWLS, *POLITICAL LIBERALISM* 212–54 (1993) (setting forth a defense of the idea of public reason).

46. See STEVEN D. SMITH, *THE DISENCHANTMENT OF SECULAR DISCOURSE* 13–18 (2010) (summarizing the idea of public reason and contrasting it with earlier, more ambitious ideas of reason); see also RAWLS, *supra* note 45, at 216–20 (defending the idea of public reason).

47. See SMITH, *supra* note 46, at 26–27 (“Our modern secular vocabulary purports to render inadmissible notions such as those that animated premodern moral discourse— notions about a purposive cosmos, or a teleological nature stocked with Aristotelian ‘final causes,’ or a providential design. But if our deepest convictions rely on such notions, and if these convictions lose their sense and substance when divorced from such notions, then perhaps we have little choice except to smuggle such notions into the conversation—to introduce them incognito under some sort of secular disguise.”).

48. See *id.* at 27 (“Such smuggling is, I happen to think, ubiquitous in modern public discourse.”).

theories of rights and well-designed political institutions, standing alone, have proven insufficient to prevent either the chaos of clashing moral visions or the capture of the coercive capacity of the state by one totalizing moral vision. Rather, the apparatus of rights and constitutional design must always rest on broader foundation of social practices that facilitate the liberal order.

Markets provide a powerful response to the dilemma of moral pluralism within a liberal order. As Albert Hirschman observed, the pre-classical theorists of the market saw commerce as harnessing people's interests to control their passions.<sup>49</sup> One can think of intense moral convictions as a kind of passion, a reason and a motivation that tends to push a believer towards extreme forms of action. Market participants, however, do not appeal to the passions, convictions, and deepest beliefs of those with whom they deal. As Adam Smith observed, "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."<sup>50</sup> In offering a means by which market participants may advance their interests by cooperating with those whose beliefs they may otherwise despise, markets provide powerful incentives to control the forces that disturb the sleep of liberal theorists. One can see the effectiveness of this approach by considering the relative ease with which those who have sharply differing religious, political, and moral convictions work peacefully with one another as employees of a private corporation or contracting partners in a market exchange. The appeal to the interests, as Hirschman puts it, proves far more powerful than an appeal to the rhetorical abstemiousness of public reason.

Markets also are an effective way of limiting the reach of the state. If rights seek to define the parameters of what the state may legitimately do to its citizens, and if constitutional design seeks to limit the state through its internal architecture, then the market provides a resisting medium in which an expanding state must move if it is to aggrandize itself at the expense of others. Of course, in practice the market is interpenetrated by the state, which provides such basic institutions as protection for private property and contract law. Markets may exist in the absence of such institutions, but they are likely to be far less robust than their formal counterparts.<sup>51</sup> Nevertheless, the market provides at least a semi-autonomous realm in which concerns other than those that drive politics are the dominant motivations. The result is an endlessly complex web of relationships and interests between innumerable private parties that will tend to resist the encroachments of the

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49. See HIRSCHMAN, *supra* note 38, at 31–42 (discussing "Interest' and 'Interests' as Tamers of the Passions").

50. SMITH, *supra* note 1, at 12.

51. See HERNANDO DE SOTO, *THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE* (2000) (discussing the fragility of the informal markets in which the poor of the developing world struggle).

state as its expansion upsets the equilibrium of these relationships. Likewise, in order to foster markets, the state may limit arbitrary and intrusive action for purely instrumental reasons. Robust markets may thus serve to provide part of the social background that can render the formal structure of rights and constitutional protections effective.

The legal history of early Virginia provides an example of how this can be so. The Virginia Company was set up as a profit-making enterprise. Initially, it pursued a strategy of extracting as much labor as possible from colonists through a military-style system of hierarchical command and arbitrary rule.<sup>52</sup> When this approach proved an economic failure, however, the colony shifted to a less hierarchical, more rule-bound regime in order to foster greater investment and commercial activity by providing legal predictability.<sup>53</sup> The result was a move toward a legal system more infused with rule-of-law values, such as legal consistency and respect by the government for the legal rights of its subjects.<sup>54</sup> As William E. Nelson has written:

Tyranny, liberty, and consent are the wrong concepts through which to understand why the legal system of seventeenth-century Virginia changed. Although some of the substantive law changes . . . ultimately may have promoted liberty, there is no evidence that such was their purpose. Profit and the accumulation of wealth, not the attainment of liberty, were the highest aspirations of seventeenth-century Virginians and of the Englishmen who invested in Virginia. It was those aspirations and the need to facilitate the investment that would foster them which drove transformation of the colony's law.<sup>55</sup>

To be sure, no one would hold up seventeenth-century Virginia as a liberal society, particularly as African slavery became deeply entrenched in the economy and legal system of the colony in the second half of the century.<sup>56</sup> Nor am I claiming that markets alone are sufficient to push political institutions toward liberal outcomes. Nevertheless, as the rise of rule-of-law values in seventeenth-century Virginia shows, markets can be an important factor limiting the reach of the state and creating incentives for government officials to conform more closely to liberal ideals.

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52. See 1 WILLIAM E. NELSON, *THE COMMON LAW IN COLONIAL AMERICA: THE CHESAPEAKE AND NEW ENGLAND, 1607–1660*, at 13–22 (2008) (discussing the legal regime of the early Jamestown settlement).

53. See *id.* at 23–47 (discussing the shift in the Virginia legal system after the revocation of the original Virginia Company charter in 1619).

54. See *id.*

55. *Id.* at 23.

56. See DAVID BRION DAVIS, *INHUMAN BONDAGE: THE RISE AND FALL OF SLAVERY IN THE NEW WORLD 131–35* (2006) (discussing the introduction of African slavery to Virginia).



## B. WEALTH

Markets have proven the greatest engine for the creation of wealth in the history of the world. For most of human history, the material condition of mankind has not changed dramatically.<sup>57</sup> While any attempt to measure such things is necessarily fraught with difficulty, our best estimates indicate that global GDP per person did not increase markedly from the time of the Roman Republic to the defeat of the Spanish Armada.<sup>58</sup> In the seventeenth century, however, that began to change. Beginning in the Netherlands and spreading first to England and then later to North America, the rest of Europe, and finally portions of East Asia we began to see, for the first time, sustained and exponential growth.<sup>59</sup> The rate of growth in and of itself was not dramatic—three to five percent per year—but adjusting out the peaks and troughs it continued year in and year out for the next three centuries. To give some sense of what this economic revolution meant, consider for a moment the fact that in the year 1800 the average daily consumption of a relatively prosperous American settler was roughly \$3 per day in current value.<sup>60</sup> After two-hundred years of sustained growth that same figure had multiplied some fifty times to roughly \$150 per day for the average American.<sup>61</sup> The difference between an income of \$3 per day and \$150 per day is the difference between the average citizen of Bangladesh and the average citizen of the United States.<sup>62</sup> The movement of some societies from the first economic condition to the second economic condition is one of the great events in human history.

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57. See MCCLOSKEY, *supra* note 16, at 2 (“Economic history has looked like an ice-hockey stick lying on the ground. It had a long, long horizontal handle at \$3 a day extending through the two-hundred-thousand-year history of *Homo sapiens* to 1800, with little bumps upward on the handle in ancient Rome and the early medieval Arab world and high medieval Europe, with regressions to \$3 afterward—then a wholly unexpected blade, leaping up in the last two out of the two thousand centuries, to \$30 a day and in many places well beyond.”).

58. *See id.*

59. See JOYCE APPLEBY, *THE RELENTLESS REVOLUTION: A HISTORY OF CAPITALISM* 7 (2010) (“[Modern capitalism began] first in England and the Netherlands, next in Western Europe, and then in the American colonies. Outside these areas, capitalism moved next to Eastern Europe and Japan.”).

60. See MCCLOSKEY, *supra* note 16, at 1 (“In 1800 the average human consumed and expected her children and grandchildren and great-grandchildren to go on consuming a mere \$3 a day, give or take a dollar or two.”).

61. *Id.* at 2 (“In the now much richer countries, such as Norway, the average person earns fully forty-five times more than in 1800, a startling \$137 a day, or \$120 for the average person in the United States, or \$90 in Japan.”).

62. *Id.* at 1 (“Two centuries ago the world’s economy stood at the present level of Bangladesh.”).

There is a huge and controversial literature on why this shift took place.<sup>63</sup> I don't purport to have answers to the questions and debates these discussions pose, so I will confine myself to a few observations. First, sustained economic growth does not seem to have been the result of expropriating the wealth of others. For example, some have posited that the massive conquests of non-Western people that began after 1492 account for the economic rise of the West.<sup>64</sup> The problem with this theory is that the timing and geography are wrong.<sup>65</sup> Spanish conquistadors were ravaging the New World for centuries before the economic big bang began in the Netherlands, and often the actual economic consequences of their conquests were negative or a wash at best.<sup>66</sup> For example, the massive importation of precious metals from the New World, far from permanently enriching the Spanish economy, led to widespread inflation in Europe and contributed to the ultimate fiscal collapse of the Spanish monarchy.<sup>67</sup> We must reject the story of wealth-via-expropriation as, at best, incomplete.<sup>68</sup>

Second, the economic explosion of the West cannot be explained in terms of traditional efficiency analysis. Indeed, there is a striking historical irony in the fact that as the intellectual foundations of equilibrium models of economics were being developed by the classical economists in the early nineteenth century, those same economists were remarkably pessimistic about the economic prospects for their society.<sup>69</sup> Neither Malthus, Ricardo,

63. See NATHAN ROSENBERG & L.E. BIRDZELL, JR., *HOW THE WEST GREW RICH: THE ECONOMIC TRANSFORMATION OF THE INDUSTRIAL WORLD* 9–19 (1986) (“The causes of the West’s rise from poverty to wealth have been extensively explored for a century-and-a-half.”).

64. *Id.* at 16 (“Several explanations turn on the relations between Western countries and other, economically less developed, countries. Marxists describe these relations as imperialism . . .”).

65. *Id.* at 18 (“[T]he primary reason for doubting that an adequate explanation for Western growth is to be found in imperialism is the absence of any correlation between the magnitude and timing of Western countries’ economic growth and the magnitude and timing of their participation in imperialism.”).

66. See *id.* (“Imperialist Spain and Portugal did not achieve long-term growth . . .”).

67. See APPLEBY, *supra* note 59, at 46 (“The flood of silver that the conquistadors stole from the Incas and Aztecs precipitated a century-long inflation in Europe.”).

68. See ROSENBERG & BIRDZELL, *supra* note 63, at 17–18 (“The eighteenth- and nineteenth-century history of most imperialist countries makes their economic growth seem more a cause of imperialism, stimulating overseas political adventures in the irresponsible exercise of new-found economic power, than its result.”).

69. Dierdre McCloskey makes the point, thus:

The economists, in other words, did not notice that something entirely new was happening from 1760 or 1780 to 1860. As the demographer Anthony Wrigley put it a while ago, “The classical economists were not merely unconscious of changes going on about them that many now term an industrial revolution: they were in effect committed to a view of the nature of economic development that ruled it out as a possibility.” At the moment . . . that John Stuart Mill came to understand an economy in equilibrium, the economy grew away from the equilibrium.

MCCLOSKEY, *supra* note 16, at 89 (footnote omitted).

nor Mill seem to have been aware of the revolutionary economic transformations through which they were living.<sup>70</sup> They realized that increased efficiency in the allocation of the factors of production would result in only modest and marginal gains before settling into a static equilibrium.<sup>71</sup> Yet, this is precisely what their societies were not doing. Instead, they were experiencing an explosion in economic growth far beyond anything predicted by the equilibrium models of the classical economists.<sup>72</sup>

Third, the process of market exchange itself was a factor in the economic explosion of the West. One way of thinking about this is to look at the process of entrepreneurship.<sup>73</sup> Widespread markets created incentives for people to experiment and innovate because they provided customers for new products and services.<sup>74</sup> Entrepreneurs, in turn, created entirely new categories of goods and services in order to prosper in the market.<sup>75</sup> It is not simply that they found ways of delivering existing goods and services with marginally greater efficiency. Rather, the process of entrepreneurship itself was a mechanism by which entirely new and better ways of living in the world were discovered.<sup>76</sup> Thus, the telephone was not simply a more efficient version of the telegraph, which itself was far more than simply a marginally faster version of the letter. By providing a social space in which entrepreneurship thrived, the rise of widespread markets facilitated this discovery. Hence, while it is true that certain technological factors, such as the harnessing of cheap fossil fuel energy in coal and then oil, contributed to growth, markets were a key part of the social mechanism by which these technological improvements were discovered and implemented.<sup>77</sup>

The value of wealth comes from two sources. The first is in the lessening of material suffering. By virtually any measure of human misery, wealthy

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70. *See id.* at 87 (noting the scorn of Joseph Schumpeter for Malthus, Ricardo, and, in particular, Mill for failing to have any “idea of what the capitalist engine was going to achieve” (quoting JOSEPH A. SCHUMPETER, *HISTORY OF ECONOMIC ANALYSIS* 571 (Elizabeth B. Schumpeter ed., 1954))).

71. *Id.* at 92 (“To speak again to my economist colleagues, they [i.e., the classical economists] all contemplated moving down the marginal product of capital—not its shocking, factor-of-sixteen lurch to the right.”).

72. *Id.* at 86–87 (noting that nineteenth-century economists noted marginal increases in productivity and economic growth, but “did not notice, however, that the change to be explained, 1780–1860, was not 5 or 10 percent but 100 percent, and was on its way to that unprecedented 1,500 percent conservatively measured relative to what it was in the eighteenth century”).

73. *See* James M. Buchanan & Viktor J. Vanberg, *The Market as a Creative Process*, in *THE PHILOSOPHY OF ECONOMICS: AN ANTHOLOGY* 378, 378–98 (Daniel M. Hausman ed., 3d ed. 2008).

74. *See id.* at 389–90.

75. *See id.* at 391.

76. *See id.*

77. *See id.* at 389.

societies are kinder to their inhabitants than impoverished societies.<sup>78</sup> This is manifested in things such as lower infant mortality rates and greater leisure time.<sup>79</sup> Wealth, however, also has other benefits. For example, societies with robust economic growth have lower levels of ethnic and religious conflict.<sup>80</sup> Likewise, they tend to have better treatment for women and minorities.<sup>81</sup> And so on. None of these things is logically related to wealth, let alone to markets. It is possible for poor people to be healthy. It is possible for poor societies to be peaceful and tolerant. Rather, my point is the more modest claim that wealthier societies are strongly correlated with a host of measures of well-being that should sway even those who are unimpressed by the crude piling up of personal fortunes.<sup>82</sup>

### C. VIRTUE

Finally, markets can be justified as inculcators of certain personal virtues. Different activities are conducive to different virtues. Consider an extreme example: war. There is a long tradition of romanticizing warfare, a tradition that has led to more than its fair share of violence and human suffering. Nevertheless, conflict has a way of bringing out certain virtues, such as courage, self-sacrifice, fraternity, and self-discipline. The romantic portrayals of war are aesthetically powerful precisely because they appeal to these virtues. Much of the emotional appeal of war—and despite our appropriate horror of war, there is no denying it has had a very strong emotional appeal through the centuries—lies in the belief that it provides a forum in which these virtues are inculcated and demonstrated. While few poets have been tempted to write epics about the marketplace, the market, like war, inculcates its own set of virtues.

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78. See BENJAMIN M. FRIEDMAN, *THE MORAL CONSEQUENCES OF ECONOMIC GROWTH* 12 (2005) (“Greater affluence means, among many other things, better food, bigger houses, more travel, and improved medical care. It means that more people can afford a better education. It may also mean, as it did in most Western countries during the twentieth century, a shorter workweek, which allows more time for family and friends. Moreover, these material benefits of rising incomes accrue not just to individuals and their families but to communities and even entire countries. Greater affluence can also mean better schools, more parks and museums, and larger concert halls and sports arenas, not to mention more leisure to enjoy these public facilities. A rising average income allows a country to project its national interest abroad, or send a man to the moon.”).

79. *Id.* at 3 (noting that economic growth results in “greater life expectancy, fewer diseases, less infant mortality and malnutrition”).

80. *Id.* at 80 (“What matters is how rising incomes shape the perspective and attitudes of those who earn them, and their families, and how the resulting impact on enough individuals’ attitudes in turn brings about change in a country’s political institutions and social dynamics.”).

81. *Id.* at 79–80 (“It is not hard to see that a strong economy, where opportunities are plentiful and jobs go begging, helps break down social barriers. Bigoted employers may still dislike hiring members of one group or another, but when nobody else is available discrimination most often gives way to the sheer need to get the work done.”).

82. *Id.* at 12.

We can think of war as inculcating certain virtues because success in violent conflict requires a certain set of characteristics. A successful soldier must be brave and disciplined.<sup>83</sup> It is the context in which the soldier's actions occur that requires these virtues. Like war, market activity has a paradigmatic case, but rather than violent conflict, it is the process of exchange. Successful exchange requires that we constantly place our needs and desires in the context of another person's needs and desires. In order to get what we want, we must in some way see to it that the other party gets what he wants. To be sure, this is not an altruistic concern, but it is a kind of concern for the other.

Smith is perhaps the best candidate for a poet of the market. Although most often cast as the founding father of rational-choice economics, Smith spent his life as a moral philosopher.<sup>84</sup> While he was not necessarily a virtue theorist, he was deeply influenced by classical thinkers who emphasized the importance of virtue and character and was tremendously concerned with moral sentiments—what we might think of as the emotional habits of moral life.<sup>85</sup> He saw in commerce a system that tended to systematically punish predation against others and reward peaceful and diligent action.<sup>86</sup>

In this, he mirrored many eighteenth-century theorists, such as Montesquieu, who lauded the effect of commerce upon manners. In Book Twenty of the *Spirit of the Laws*, Montesquieu provides an extended discussion of the moral impact of commerce on individuals and society. "Commerce," he wrote, "cures destructive prejudices, and it is an almost general rule that everywhere there are gentle mores, there is commerce and that everywhere there is commerce, there are gentle mores."<sup>87</sup> In contrast to monarchical or aristocratic regimes, with their emphasis on honor, power, and conquest, commercial society tends to make men tolerant and peaceful. This is Montesquieu's famous *doux commerce* argument. This does not mean, of course, that Montesquieu was indifferent to the moral dangers of commercial society, which he saw as very much a two-edged sword. "Commerce corrupts pure mores, and this was the subject of Plato's complaints," he wrote. "[I]t polishes and softens barbarous mores, as we see every day."<sup>88</sup> Likewise, he deplored the tendency of commercial society to reduce every human activity to monetary exchange:

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83. See, e.g., PLATO, *Laches*, in THE COLLECTED DIALOGUES OF PLATO 123 (Edith Hamilton & Huntington Cairns eds., 1961) (c. 380 B.C.E.) (discussing the nature of courage).

84. See NICHOLAS PHILLIPSON, ADAM SMITH: AN ENLIGHTENED LIFE 120–38, 159–79 (2010) (discussing Adam Smith's career as a moral philosopher).

85. See ADAM SMITH, THE THEORY OF MORAL SENTIMENTS (D.D. Raphael & A.L. Macfie eds., 1976) (1759); see also PHILLIPSON, *supra* note 84, at 138–58 (discussing "The Theory of Moral Sentiments and the Civilizing Powers of Commerce").

86. See SMITH, *supra* note 1; SMITH, *supra* note 85.

87. MONTESQUIEU, *supra* note 41, at 338 (footnote omitted).

88. *Id.* (footnote omitted).

[I]f the spirit of commerce unites nations, it does not unite individuals in the same way. We see that in countries where one is affected only by the spirit of commerce, there is traffic in all human activities and all moral virtues; the smallest things, those required by humanity, are done or given for money.<sup>89</sup>

For Montesquieu, commerce presented a threat to the highest ideals that one might imagine, but tended to have a beneficial effect on humanity as one actually encountered it.

There is empirical evidence in support of Montesquieu's thesis. Experimental studies show that market activity is strongly correlated with higher levels of interpersonal trust.<sup>90</sup> Variations on the prisoner's dilemma allow us to measure the strength of individual commitment to trust and reciprocity.<sup>91</sup> For example, in the so-called ultimatum game there are two players. The experimenters give the first player a sum of money.<sup>92</sup> That player then divides the money between himself and the second player.<sup>93</sup> The second player then chooses whether to accept the division, in which case each player keeps the amount allocated by the first player.<sup>94</sup> If the second player chooses to refuse the offer, then both players get nothing.<sup>95</sup> A simple wealth-maximizing model of human behavior suggests that the first player should offer as little as possible to the second player, and the second player should accept.<sup>96</sup> This result is almost never observed. The amount of money offered by the first player and the threshold below which the second player refuses, however, vary greatly from culture to culture.<sup>97</sup> The simple formal structure of the game allows for cross-cultural comparisons, which reveal that there is an inverse relationship between suspicion and market penetration.<sup>98</sup> The more important commerce is for a society, the higher the levels of observed trust and reciprocity in the ultimatum game.<sup>99</sup> Societies with little market activity—such as those based on subsistence agriculture or

89. *Id.* at 338–39 (footnote omitted).

90. See Joseph Henrich et al., *In Search of Homo Economicus: Behavioral Experiments in 15 Small-Scale Societies*, 91 AM. ECON. REV. 73, 73–78 (2001) (summarizing experiments with the ultimatum game carried out in several different cultural contexts); Joseph Henrich et al., “Economic Man” in *Cross-Cultural Perspective: Behavioral Experiments in 15 Small-Scale Societies*, 28 BEHAV. & BRAIN SCI. 795, 795–855 (2005) [hereinafter Henrich et al., “Economic Man”] (providing a more extensive discussion of the same experiments).

91. See Henrich et al., “Economic Man,” *supra* note 90, at 803.

92. See *id.* at 798.

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at 804.

98. See *id.* at 809.

99. See *id.* at 808.

animal husbandry—show the lowest levels of trust and reciprocity.<sup>100</sup> Of course, it is difficult to tell which way causation flows from these results. Markets could be causing trust or trust could be causing markets to flourish. Regardless, we have good reasons to facilitate market transactions, either to jump start markets and thereby foster activity that will in turn foster trust, or alternatively, fostering markets may act as a multiplier for pre-existing trust, extending its reach and hold over peoples' attitudes.

#### IV. MARKETS AND CONTRACT LAW

Contract law supports markets. This does not mean that markets and contract law are co-extensive. Markets may not be natural, but they do not require law in order to exist. Thriving informal and even illegal markets testify to this fact. Furthermore, throughout human history international trade has thrived even in circumstances in which it was difficult, if not impossible, to get the state to enforce one's agreements. Contract law, however, can strengthen and deepen markets. By limiting opportunism, lowering transaction costs, inculcating moral attitudes conducive to market exchange, and the like, contract law makes widespread exchange between strangers easier and more likely.

While contracts and markets are intimately intertwined, one of the striking features of most moral theories of contract law is their relative indifference to markets. The contemporary moral or philosophical literature on contract law is dominated by promissory theories of contract.<sup>101</sup> Broadly speaking, all of these theories look at contracts as examples of promises and understand the basis of contractual obligation to be related in some fundamental way to the moral obligation to keep a promise.<sup>102</sup> There is, of course, no necessary relationship between promissory morality and the market. We make promises all the time that have little or no relationship to commercial activity. Hence, one can develop an elaborate and complete theory of promising without saying much of anything at all about markets. Likewise, one can develop a promissory theory of contract law without saying much of anything about markets. This is largely what promissory theorists of contract have done. They have had much to say about the duty to keep a promise and the structure of contractual obligation.<sup>103</sup> Their arguments, however, have been largely oblivious to the fact that—along with private property—contract is the central legal institution of a market economy.

I don't mean by this that promissory theorists are ignorant of the obvious fact that most contracts involve commercial activity or that they have ignored this fact in their theories. I do believe, however, that the

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100. *See id.* at 810.

101. *See SMITH, supra* note 19, at 56.

102. *See id.* at 13, 57–58.

103. *See generally* SMITH, *supra* note 19.

relationship between contract law and markets has been taken as accidental, and that the value of markets—as opposed to promise keeping—has played little or no role in their arguments. In this section, I hope to show that this approach is a mistake and that focusing on the moral value of markets, as opposed to the moral value of promising, provides a better way of dealing with three basic problems with which any theory of contract law must deal. The first such question is why the law should concern itself with enforcing promises at all. Not all moral obligations are legally enforced. Why should promises be singled out for legal attention? The second is differentiating between those voluntary commitments that are legally enforced and those that are not. Even if promises should be legally enforced, not all promises are enforced. Why pick some promises for enforcement but not others? The third is the limited availability of specific performance, the remedy that would actually enforce contracts. If we believe that contract law should enforce promissory morality, then the wide availability of money damages seems perverse or, at best, a kind of second-best compromise.

#### A. PROMISSORY THEORIES OF CONTRACT

Section 1 of the Restatement (Second) of Contracts states that “[a] contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.”<sup>104</sup> While some scholars have expressed skepticism as to whether contracts are in fact promises, most judges, practitioners, and scholars accept that a contract consists of a legally enforceable promise.<sup>105</sup> It does not follow from this, however, that most judges, practitioners, and scholars subscribe to a promissory theory of contract law. In other words, one may believe that contracts are made—in part—by making promises without thinking that the moral force of promising provides the normative justification for contract law. For example, law and economics scholars routinely refer to “promisors” and “promisees” in their work, even as they explicitly argue that economic efficiency justifies contract law.<sup>106</sup> Likewise, partisans of reliance-based justifications for contract law, such as Grant Gilmore and Patrick Atiyah, speak of promises made and contracts formed, even though they do not normatively ground contract law in promissory morality.<sup>107</sup>

Charles Fried offered the most unambiguous modern defense of a promissory theory of contract thirty years ago in his book *Contract as*

104. RESTATEMENT (SECOND) OF CONTRACTS § 1 (1981).

105. See generally Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269 (1986); Michael G. Pratt, *Contract: Not Promise*, 35 FLA. ST. U. L. REV. 801 (2008).

106. See, e.g., POSNER, *supra* note 35, at 115–82 (8th ed. 2011) (summarizing economic theories of how contract law creates optimal economic incentives for promisors and promisees).

107. See P.S. ATIYAH, *PROMISES, MORALS, AND LAW* (1981); GRANT GILMORE, *THE DEATH OF CONTRACT* (Ronald K.L. Collins ed., 1995).



*Promise*.<sup>108</sup> For Fried, the relationship between contract and promise is simple and straightforward. When people make promises, they incur a moral obligation to keep those promises.<sup>109</sup> When they fail to live up to these obligations and breach their promises, they treat others with disrespect.<sup>110</sup> Contract is simply the legal reflection of this moral structure. The legal obligations of contract correspond to the moral obligations to keep a promise, and the doctrinal structure of contract is simply the institutional instantiation of the moral structure of promise keeping.<sup>111</sup> Since its publication a generation ago, Fried's theory has attracted few disciples but has generated an enormous amount of discussion.<sup>112</sup> Out of this discussion have come alternative formulations of the promissory approach to contract law.

Consider the work of Seana Shiffrin.<sup>113</sup> Unlike Fried, Shiffrin's theory of contract is not reflective. She does not explicitly claim that contract law does or should reflect some underlying structure of promissory morality. Rather, she offers promissory morality as a kind of limiting principle on legitimate legal and political institutions. The law, she argues, should not encourage its citizens to behave in immoral ways, nor should it undermine a commitment to valuable moral practices.<sup>114</sup> Shiffrin accepts that we have a moral obligation to keep our promises.<sup>115</sup> She also believes that contract law invokes the practice of promising. As discussed in a moment, however, Shiffrin's argument is primarily critical. She believes that contract law as it currently exists fails to comply with her theory of morality as a limiting principle.

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108. See CHARLES FRIED, *CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION* (1981).

109. See *id.* at 13 ("In order that I be as free as possible, that my will have the greatest possible range consistent with the similar will of others, it is necessary that there be a way in which I may commit myself. It is necessary that I be able to make nonoptional a course of conduct that would otherwise be optional for me.").

110. See *id.* at 16 ("To renege is to abuse a confidence he was free to invite or not, and which he intentionally did invite. To abuse that confidence now is like (but only *like*) lying: the abuse of a shared social institution that is intended to invoke the bonds of trust.").

111. See *id.* at 1 ("The promise principle, which in this book I argue is the moral basis of contract law, is that principle by which persons may impose on themselves obligations where none existed before.").

112. The thirtieth anniversary of the publication of Fried's book was marked by a symposium on the work and its influence. The articles produced by the symposium provide a flavor for the sorts of discussions that have been sparked by Fried's book. See generally Symposium, *Contract as Promise at 30: The Future of Contract Theory*, 45 SUFFOLK U. L. REV. 601 (2012).

113. See Seana Shiffrin, *Could Breach of Contract Be Immoral?*, 107 MICH. L. REV. 1551 (2009) [hereinafter Shiffrin, *Immoral?*]; Seana Valentine Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708 (2007) [hereinafter Shiffrin, *Divergence*].

114. See Shiffrin, *Divergence*, *supra* note 113, at 710.

115. See *id.* at 749.

B. WHY ENFORCE MORAL OBLIGATIONS?

The first problem that confronts a promissory theory of contract is the question of why the law should seek to enforce moral obligations at all. This objection can take a strong form or a weak form. The strong form rests on the distinction within liberal philosophy between the right and the good. According to this view, liberal societies must begin with the brute fact of moral pluralism, the absence of widespread agreement about final goods and moral virtue. Accordingly, the law should remain neutral on such matters, allowing each citizen to decide for him or herself questions of personal morality and pursue his or her own vision of the good. The law should confine itself to protecting individual rights, a domain of justice that is conceptually independent of notions of the good. According to the strong objection, promissory morality is a matter of personal virtue and cannot be a legitimate legal concern.<sup>116</sup> This does not mean, of course, that contract law is necessarily illegitimate, only that it cannot be legitimately defended as enforcing the moral obligation to keep a promise.<sup>117</sup>

In its weaker form, this objection needn't invoke a stark liberal divide between the right and the good. Rather than claiming that there is some clearly defined realm of moral demands—the good—that cannot legitimately be the subject of legal rules, one might simply acknowledge that not all moral obligations are legal obligations. This is true even in legal systems that have no liberal scruples about enforcing morality. For example, under classical Islamic law there is no sharp distinction between law and morality, or religion and the state, and there is certainly no objection to coercing moral behavior per se. “You are the best nation ever brought forth to men, bidding to honour, and forbidding dishonour, and believing in God.”<sup>118</sup> Even so, Islamic legal theorists have a five-fold categorization of actions: those that are forbidden, those that are discouraged, those that are indifferent, those that are encouraged, and those that are required.<sup>119</sup> Hence, even in the view of the classical Sharia there are moral obligations that are not also coerced, legal obligations. So long as one does not believe that all moral obligations should become legal obligations—and I am unaware of any legal system that that has ever made such a claim—one must at least explain why promissory moral obligations should also be legal obligations. Merely demonstrating that there is a moral duty to keep a promise does not demonstrate that there should be a corresponding legal

116. See Randy E. Barnett, *Some Problems with Contract as Promise*, 77 CORNELL L. REV. 1022, 1025 (1992).

117. See *id.* at 1024.

118. 1 THE KORAN INTERPRETED 87 (A.J. Arberry trans., Touchstone 1996) (1955).

119. See, e.g., PETE SEDA, ISLAM IS . . . : AN INTRODUCTION TO ISLAM & ITS PRINCIPLES 45 (2002) (providing a popular introduction to Islam). See generally Irshad Abdal-Haqq, *Islamic Law: An Overview of Its Origin and Elements*, 7 J. ISLAMIC L. & CULTURE 27 (2002) (providing a concise summary of Islamic law).

obligation, even if one does not subscribe to a sharp distinction between the right and the good.

To be sure, some promissory theorists seek to answer this question. Fried's response is to locate the obligation to keep a promise in the moral realm of the right rather than the good.<sup>120</sup> His argument is that promise breaking is a breach of trust, an abuse of another person.<sup>121</sup> It is not clear, however, that this claim stands up to closer scrutiny. First, there are other abuses of trust that are not legally prohibited, even though they are often more wrenching than a breach of contract. Consider, for example, the person who discovers that their significant other has been cheating. While such action might be a ground for divorce—and thus legal action—in the case of a married couple, among unmarried couples there may be no legal wrong at all. Second, not all broken promises involve a breach of a trust. Consider the habitual promise breaker whose commitments are never trusted. It would be odd to say that such a person breaches no moral obligation when, as expected, he breaks his promise. This suggests, however, that the wrong of promise breaking is not necessarily an abuse of trust.

Shiffrin likewise seeks to answer this objection. Unlike Fried, her promissory theory of contract is not reflective.<sup>122</sup> As a formal matter, she does not insist that the legal obligations of contract must correspond to the moral obligations of promise.<sup>123</sup> However, in her hands, the side constraint of morality should have a considerable influence on the law of contracts. Because in her view the law cannot encourage its citizens to engage in immoral behavior or undermine moral practices, in practice, she argues that the law of contracts must mirror the morality of promising quite closely.<sup>124</sup> So long as the law of contracts enforces promises, it must do so in a way that coheres strongly with promissory morality.<sup>125</sup> There is, however, something unsatisfying about this formulation, as it does not seek to explain why one would wish to have a law of contracts at all.

If one accepts the social desirability of markets, then the question of why we enforce certain promises becomes much easier. On this view, contract law exists in large part to support markets. We enforce promises not because promissory morality is somehow uniquely deserving of legal enforcement. Rather, we legally enforce promises because doing so sustains

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120. See *supra* note 109.

121. See *id.* at 16.

122. See Shiffrin, *Immoral?*, *supra* note 113, at 1557; Shiffrin, *Divergence*, *supra* note 113, at 709.

123. See Shiffrin, *Immoral?*, *supra* note 113, at 1556; Shiffrin, *Divergence*, *supra* note 113, at 709.

124. See Shiffrin, *Immoral?*, *supra* note 113, at 1568; Shiffrin, *Divergence*, *supra* note 113, at 710–12.

125. See Shiffrin, *Immoral?*, *supra* note 113, at 1557; Shiffrin, *Divergence*, *supra* note 113, at 717.

markets. Our goal is not the maintenance of promissory morality, but the maintenance of markets. Providing legal enforcement of promises does this in at least two ways.

First, it deals with the problem of *ex post* opportunism. In a world of simultaneous exchange, quid is exchanged for pro and there is no need for the enforcement of contracts. When transactions are extended over time, however, there is always the danger that once A has conferred a benefit on B that B will renege and pocket the benefit.<sup>126</sup> Thomas Hobbes summarized the problem:

For he that performeth first, has no assurance the other will performe after; because the bonds of words are too weak to bridle mens ambition, avarice, anger, and other Passions, without the feare of some coërcive Power; which in the condition of meer Nature, where all men are equall, and judges of the justnesse of their own fears, cannot possibly be supposed.<sup>127</sup>

As discussed below, Hobbes was too pessimistic about the possibility of exchange in the absence of law.<sup>128</sup> On the other hand, by empowering disappointed promisees to take action against breaching promisors, the law of contract surely limits the amount of opportunism that we would otherwise expect to observe.<sup>129</sup> More importantly, the availability of formal recourse in the event of breach gives market participants the confidence to engage in transactions that they would otherwise forgo out of fear of exploitation.<sup>130</sup>

Second, the formal enforcement of promises helps to sustain the mutual trust between trading parties that makes formal enforcement itself of secondary importance. To understand what this means, consider an example from Herodotus. He tells of how Carthaginian traders first ventured out of the Mediterranean, beyond the Pillars of Hercules (the Straits of Gibraltar) and into the rougher seas of the Atlantic.<sup>131</sup> Crawling down the coast of Africa, they came to a fertile land, and there engaged in a strange ritual.<sup>132</sup> Going ashore, they would lay their cargo of olive oil and bronze tools on the beach.<sup>133</sup> Then they would retreat to their ships, float off

126. See Nathan B. Oman, *Consent to Retaliation: A Civil Recourse Theory of Contractual Liability*, 96 IOWA L. REV. 529, 546 (2011).

127. THOMAS HOBBS, *LEVIATHAN* 96 (Richard Tuck ed., Cambridge Univ. Press 1991) (1651).

128. See Oman, *supra* note 126, at 545.

129. See *id.* at 551.

130. See *id.* at 560–63.

131. See HERODOTUS, *THE HISTORIES* bk. 4, ch. 42, at 318–19 (George Rawlinson trans., Everyman's Library 1997) (c. 426 B.C.E.) (discussing the expedition of Phoenicians sent to circumnavigate Africa by the Egyptian King Neco).

132. See *id.* at bk. 4, ch. 196, at 381–82 (discussing trading practices by Carthaginians—a Phoenecian group—on the coasts of “Libya,” a region on the Atlantic coast of Africa).

133. See *id.*

shore, and send up smoke signals.<sup>134</sup> A short time later, hoards of people would emerge from the forest, examine the goods left by the Carthaginians, and then lay their own piles of gold on the beach.<sup>135</sup> Done, these people would then retreat back into the forest.<sup>136</sup> Once they were gone, the Carthaginians would return to the shore.<sup>137</sup> If they thought the offered ivory and gold constituted a fair trade, they would leave their goods and take the African commodities aboard their ship.<sup>138</sup> If they thought the offer too low, they would return to their ships with nothing.<sup>139</sup> The people would then emerge from the woods and either take back their gold without touching the Carthaginian goods or else would increase the size of their offering until it was accepted by the traders from the sea.<sup>140</sup> The entire process, according to Herodotus, took place without either side speaking to the other or even knowing their language.<sup>141</sup>

Herodotus's story illustrates that the problem of ex post opportunism can be overcome in some circumstances even without the assistance of formal legal mechanisms.<sup>142</sup> Humanity's inclination to "truck and barter," it would seem, wins out over its instincts for predation. This process, however, requires high levels of mutual trust, and we have numerous examples of societies where such trust is absent.<sup>143</sup> Furthermore, to the extent that such mutual trust and forbearance among those of sharply differing viewpoints is one of the reasons we regard markets as desirable, then it would seem that we face a vicious circle. As Jules Coleman has observed:

Under precisely those circumstances where markets are most desirable from the point of view of social stability, they are most difficult to create and sustain, whereas in those circumstances most conducive to low-cost market interaction, because of their impersonality, markets may well be less desirable forms of social organization.<sup>144</sup>

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134. *See id.*

135. *See id.*

136. *See id.*

137. *See id.*

138. *See id.*

139. *See id.*

140. *See id.*

141. *See id.*

142. *See id.* at 382 ("Neither party deals unfairly by the other: for they themselves never touch the gold till it comes up to the worth of their goods, nor do the natives ever carry off the goods till the gold is taken away.").

143. *See* ROBERT H. BATES, PROSPERITY AND VIOLENCE: THE POLITICAL ECONOMY OF DEVELOPMENT 43-45 (2001) (discussing the breakdown of trust and cooperation among the Neur tribes of East Africa).

144. COLEMAN, *supra* note 44, at 69.

According to Coleman, “the solution is to develop bodies of law that provide resources capable of reducing uncertainty and fostering market cooperation.”<sup>145</sup> Contract does this, according to Coleman, by reducing the risk of ex post defection.<sup>146</sup> As noted above, I have no quarrel with this claim, but I think it is incomplete.

Law can also serve an important didactic function, indicating those actions that society regards as laudable and those that it regards as blameworthy. Such collective norm creation has an effect on behavior, as people seek to conform to collectively approved standards of behavior. Of course, the moral suasion of the law is hardly all-powerful or always justified. The mere fact that some legal sanction is attached to an action does not mean that people will refrain from doing the action, nor does the existence of a legal duty without more command universal respect. Nevertheless, our legal system depends on massive levels of voluntary compliance, compliance that is largely forthcoming from the public when the laws are regarded as legitimate. Hence, if we accept even a weak version of the law’s didactic power, then giving legal sanction to cooperative behavior via contract law will tend to foster norms of mutual performance. Put bluntly, people fail to renege on their agreements not simply because they fear formal legal sanctions, but because they wish to comply with the social norms of good behavior the law of contracts expresses. This law-fostered voluntary compliance, in turn, helps to underwrite the trust on which markets depend. It also provides an expressive reason for enforcing market promises.

There is a variation on this argument based on the power of habit. Those things that we repeatedly do, regardless of our initial reasons, tend to become habitual. Of course, the fact that something is a habit does not mean that we always do it or cannot refrain from doing should we choose. That which is habitual, however, gets done with greater frequency than that which is not habitual. Through formal coercion and social suasion, the law of contracts encourages people to keep their commitments. As they repeatedly do so, however, commitment keeping becomes a habit. Furthermore, there is a self-reinforcing mechanism with habits. Habitual promise keepers are more likely to follow the dictates of the law of contracts, which reinforces its effectiveness and perceived legitimacy. The law of contracts, then, reinforces the habit of commitment keeping.

### C. NOT ALL PROMISES ARE ENFORCED AS CONTRACTS

As the late E. Allan Farnsworth observed, “No legal system has ever been reckless enough to make all promises enforceable.”<sup>147</sup> Any legal system will necessarily pick and choose among the promises that it will recognize as

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145. *Id.*

146. *See id.* at 119–20.

147. E. ALLAN FARNSWORTH, *CONTRACTS* 12 (2d ed. 1990).

legally binding contracts. This necessity, however, presents a problem for promissory theories. If the law is supposed to reflect moral obligations, why does it do so only incompletely? Why do we have some promises that are clearly morally binding but which are not recognized as legally binding contracts?

Fried's discussion of the doctrine of consideration illustrates the problem. In effect, Fried tries to solve this problem by declaring that it doesn't exist.<sup>148</sup> Rather than grapple with the truism articulated by Farnsworth, he argues that the doctrine of consideration does not actually exist. The cases, he insists, are too shot through with inconsistency and circular arguments to serve as a criterion for anything.<sup>149</sup> In effect, he claims that the common law has no answer to the question of which promises the law should enforce.<sup>150</sup> Fried offers this argument as a defense of his promissory theory, and it is easy to see why he would find such a position attractive. It makes it easier to claim that the law reflects the moral obligation to keep a promise. This, however, will not do. Fried is rather too hard on the doctrine of consideration. It is not clear that it is more prone to ambiguity and difficulty than the other doctrines that Fried defends. Furthermore, while it presents a number of difficult marginal cases—as does any doctrine—it offers a fairly straightforward claim: legally enforceable contracts consist of promises made in exchange for something.<sup>151</sup> In the end, Fried's hostility rests less on the internal problems of the consideration doctrine than on his commitment to justifying contractual liability purely on the basis of promissory morality.

Shiffrin does not directly address the question of which promises the law should enforce. On the other hand, she is highly critical of the common law's preference for money damages over specific performance.<sup>152</sup> This rule, she argues, encourages people to treat their commitments as options, a view that she sees as incompatible with the moral obligation to keep a promise.<sup>153</sup> Elsewhere, she goes so far as to argue that the moral wrong involved in breaching a contract is so serious that it should give rise to a claim for

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148. See FRIED, *supra* note 108, at 38 (“My conclusion is rather that the doctrine of consideration offers no coherent alternative basis for the force of contracts, while still treating promise as necessary to it.”).

149. See *id.* (“I conclude that the standard doctrine of consideration, which is illustrated by the preceding ten quite typical common law cases, does not pose a challenge to my conception of contract law as rooted in promise, for the simple reason that that doctrine is too internally inconsistent to offer an alternative at all.”).

150. See *id.* at 37–38 (“I conclude that the life of contract is indeed promise, but this conclusion is not exactly a statement of positive law. There are too many gaps in the common law enforcement of promises to permit so bold a statement.”).

151. See RESTATEMENT (SECOND) OF CONTRACTS § 71 (1981) (setting forth the bargain theory of consideration).

152. See Shiffrin, *Divergence*, *supra* note 113, at 723.

153. See *id.* at 731.

punitive damages on breach claims, damages that cannot be justified based on breach not being “morally wrong.”<sup>154</sup> If the law’s refusal to enforce contracts with a decree of specific performance threatens to undermine the moral practice of promising by treating its obligations with insufficient respect, however, then picking and choosing among promises would also seem to be problematic. In effect, the law declares its indifference to the breach of the kinds of moral obligations that it has elsewhere declared to be worthy of legal recognition. Shiffrin’s theory is not reflective, so it doesn’t require that the law mirror moral obligations. It is, however, deeply concerned about the ability of the law to distort moral practices by using them in ways inconsistent with their underlying moral structure. Thus, without some justifying principle, it seems problematic for the law to enforce only some promises.

If we focus our attention on markets rather than promissory morality, however, there is a ready answer to the challenge. On this view, contract law exists to facilitate markets rather than enforce moral obligations per se. Hence, when asking, “What promises should the law enforce?,” the answer is: “The law should enforce promises when doing so facilitates markets.” On the other hand, when the enforcement of a promise would merely vindicate one’s moral obligation to keep a commitment, unrelated to the market, we have less of a reason to enforce the promise. There is nothing about a market theory of contracts, of course, that precludes the law from recognizing promises unrelated to market activity. However, once one sees contract law as existing primarily to facilitate markets, these become marginal cases requiring special justification.

This approach suggests that the law of contract formation should be structured so as to pick out those promises whose enforcement facilitates market activity. As a first-order approximation, this is what the bargain theory of consideration seeks to do. According to the Restatement (Second) of Contracts, “to constitute consideration, a performance or a return promise must be bargained for” and “a performance or return promise is bargained for if it is sought by the promisor in exchange for his promise and is given by the promisee in exchange for that promise.”<sup>155</sup> In this doctrinal formulation, promises become legally enforceable contracts when there is consideration, and consideration requires that the promise is made in exchange for something else. In short, not all promises are enforced. Rather, only those promises that are part of an exchange are contracts. Exchange, of course, forms the basis for market transactions. Contract law, it would seem, is structured so as to pick out market transactions and, in effect, subsidize them by providing enforcement. Because they are not part of the

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154. See Shiffrin, *Immoral?*, *supra* note 113, at 1551–52.

155. RESTATEMENT (SECOND) OF CONTRACTS § 71 (1981).



market, however, nonexchange promises are not treated as contracts precisely because the purpose of contract law is to sustain markets.

It is useful to distinguish this defense of the doctrine of consideration from others that have been offered for it. Lon Fuller, for example, saw consideration as essentially a formal requirement, one that serves the functions of other formalities such as the seal requirement in the action of covenant.<sup>156</sup> On this view, consideration serves evidentiary, cautionary, and channeling functions.<sup>157</sup> The underlying assumption is that contract law should enforce commitments that are seriously entered into and provide a way of clearly delineating the scope of contractual promises.<sup>158</sup> This is what the consideration doctrine does. Andrew Gold has offered a less pragmatic defense of the consideration doctrine.<sup>159</sup> According to Gold, consideration—rather than serving the practical functions Fuller assigned to it—picks out obligations that are, as a matter of political morality, deserving of legal protection in and of themselves.<sup>160</sup> According to Gold's transfer theory, a contract creates a kind of property interest by the promisee in the promisor's performance.<sup>161</sup> This property interest arises because the exchange relationship marks out the Lockean conditions under which one may acquire a right to something other than one's own person.<sup>162</sup>

Whatever the merits of these theories, they are quite different than the market defense offered by this Article. My claim is not that bargained for promises should be enforced because their bargained for nature gives us assurance of their existence and the seriousness with which they were made. Nor am I claiming that the expectations of performance acquired in a bargained for promise are in themselves as a matter of substantive morality deserving of legal recognition in a way that expectations based on gratuitous promises are not. Rather, my claim is that bargained for promises are part of market transactions, and it is this fact that justifies their enforcement. We enforce them because doing so facilitates markets. Our law is uncomfortable enforcing wholly gratuitous promises because their enforcement has nothing to do with markets.<sup>163</sup>

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156. See Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 799 (1941).

157. *Id.* at 799–801.

158. See *id.* at 800–01.

159. See Andrew S. Gold, *A Property Theory of Contract*, 103 NW. U. L. REV. 1 (2009).

160. See *id.* at 44.

161. See *id.* at 5.

162. See *id.* at 5 & nn.17–18.

163. Hence the ambivalent attitude of the common law of contracts toward gratuitous gift promises. Compare *Ricketts v. Scothorn*, 77 N.W. 365 (Neb. 1898) (enforcing a gift promise under the doctrine of promissory estoppel), with *Kirksey v. Kirksey*, 8 Ala. 131 (1845) (refusing to enforce a gratuitous promise to convey a piece of land to a relative). See also Melvin Aron Eisenberg, *The World of Contract and the World of Gift*, 85 CALIF. L. REV. 821 (1997) (discussing the common law's hostility to enforcing gift promises).

There are, of course, well-known objections to the doctrine of consideration, objections that can be couched in terms of the market arguments made here. For example, the doctrine of bargained for consideration creates difficulties in cases of contract modification.<sup>164</sup> Hence, if midway through the performance of a contract the parties encounter an unanticipated problem, it is difficult to create a legally binding modification. The pre-existing duty rule will vitiate many modifications because they will not involve any new bargain.<sup>165</sup> A market-focused view of contract would counsel in favor of allowing such modifications when doing so facilitates market transactions, even if there is no formal bargain. This is because the virtue of the bargain theory lies in the way in which it picks out market transactions, not in any inherent and exclusive value in bargains per se. Not all market transactions, however, are bargains for some new value. Hence, for example, the Uniform Commercial Code's rule abolishing the consideration requirement for modification of sales contracts makes perfect sense.<sup>166</sup> These are market transactions, and in the absence of fraud or other problems, modifications should be enforced even if there is no new bargain.

#### D. CONTRACT LAW REMEDIES DON'T ALWAYS ENFORCE PROMISES

The final problem is that, at least in the common law of contracts, the main remedy for breach of contract is not the enforcement of the promise. This claim is true in two senses. First, the law of contracts does not "enforce" contracts in the sense of requiring a breaching party to perform via an order of specific performance.<sup>167</sup> Rather, the dominant remedy under the common law is the award of money damages.<sup>168</sup> Second, the law of contracts does not "enforce" contracts in the sense of insuring that breaches of contract are sanctioned by the state.<sup>169</sup> Rather, contract law is a species of private law, which means that rather than enforcing primary obligations it empowers wronged parties to act against those that have breached their obligations.<sup>170</sup> If a potential plaintiff chooses not to sue, however, the law

164. See, e.g., *Stilk v. Myrick*, (1809) 170 Eng. Rep. 1168 (C.P.); *Alaska Packers' Ass'n v. Domenico*, 117 F. 99 (9th Cir. 1902).

165. See RESTATEMENT (SECOND) OF CONTRACTS § 73 (1981) ("Performance of a legal duty owed to a promisor which is neither doubtful nor the subject of honest dispute is not consideration . . ."); see also *id.* at illus. 4.

166. See U.C.C. § 2-209(1) (1990) ("An agreement modifying a contract within this Article needs no consideration to be binding.").

167. See RESTATEMENT (SECOND) OF CONTRACTS § 359(1) ("Specific performance or an injunction will not be ordered if damages would be adequate to protect the expectation interest of the injured party.").

168. See *id.* § 346(1) ("The injured party has a right to damages . . .").

169. See Oman, *supra* note 126, at 532-34.

170. See Nathan B. Oman, *Why There Is No Duty To Pay Damages: Powers, Duties, and Private Law*, 39 FLA. ST. U. L. REV. 137 (2011).

does nothing to “enforce” the promissory obligation inherent in the contract.<sup>171</sup>

Fried has claimed that the link between what he calls the promise principle and expectation damages is “palpable.”<sup>172</sup> The appeal to the self-evidence of money damages, however, falls flat for a number of reasons.<sup>173</sup> First, in some circumstances, the common law will award specific performance rather than money damages, and in most civil law countries, specific performance is the default remedy. Why isn’t this remedy’s connection with the promise principle more “palpable”? Second, it is unclear why the moral obligation to keep a promise requires remedies in the event of breach. Why not punish promise breakers in the same way that we punish thieves? It is unclear why the moral obligation to keep a promise commits us to some remedial scheme rather than punishment or some other response.

Other promissory theorists have struggled with the issue of remedies. Shiffrin has been the harshest recent critic of money damages for breach of contract.<sup>174</sup> She takes particular aim at the theory of efficient breach, which sees contract law as a licensing breach so long as the breaching party is willing to pay damages.<sup>175</sup> Such an approach is unacceptable, she argues, for at least two reasons. First, it encourages citizens to behave in morally reprehensible ways, breaking their promises without a good excuse.<sup>176</sup> Second, by encouraging such flouting of promissory obligations, it undermines the practice of promising itself.<sup>177</sup> Accordingly, Shiffrin argues that the law should switch the default remedy to specific performance or, perhaps, should sanction deliberate breach of contract with punitive damages.<sup>178</sup>

To be sure, there have been sophisticated attempts to reconcile the award of money damages with promissory theories of contract. One possibility is that all contracts happen to be disjunctive promises to either perform or pay damages.<sup>179</sup> This is the approach suggested by some economic theorists, who insist that in a fully specified contract this is precisely what the parties would have explicitly agreed to.<sup>180</sup> Fried has

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171. See Oman, *supra* note 126, at 560.

172. See FRIED, *supra* note 108, at 21.

173. For a fuller critique of Fried’s arguments on this point, see Nathan B. Oman, *Promise and Private Law*, 45 SUFFOLK U. L. REV. 935 (2012).

174. See Shiffrin, *Divergence*, *supra* note 113, at 722–24.

175. See *id.* at 730.

176. See *id.* at 731–32.

177. See *id.* at 732–33.

178. See *id.* at 734; see also Shiffrin, *Immoral?*, *supra* note 113, at 1551–52.

179. See Steven Shavell, Essay, *Is Breach of Contract Immoral?*, 56 EMORY L.J. 439, 457 (2006).

180. See *id.*

recently indicated that he holds to something like this view.<sup>181</sup> This argument faces two problems. First, it rests on a contingent and debatable claim about the content of contractual promises.<sup>182</sup> Second, it is inconsistent with the pleading requirements and doctrinal structure of the common law of contracts, which does not acknowledge the payment of damages as a substitute for performance.<sup>183</sup> Instead, damages, rather than forming part of the obligations of a contract, are conceptualized as a remedy in the face of the breach of those obligations. Jody Kraus has accepted this point and argued that it is possible to specify—as a matter of promissory morality—not only one’s obligations under a promise but also one’s remedial obligations in the event of the failure to keep those obligations.<sup>184</sup> This, however, remains a highly controversial claim about the nature of promissory morality. It is certainly plausible to suppose that while promissory morality gives agents control over the content of their primary moral obligations flowing from a promise, it does not give agents power over the moral consequences of their own immoral behavior in breaking a promise.

The persistence of money damages presents a theoretical difficulty because the assumption of promissory theories is that contract law exists to vindicate promissory obligations. On the other hand, if we see contract law as existing to facilitate markets, then this difficulty disappears. Even if we accept the Restatement’s formulation of contracts as “a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty,”<sup>185</sup> it doesn’t follow that contract law is joined at the hip to promissory morality. Rather, contract law invokes promising not for its own sake but because by attending to promises it can facilitate markets. On this view, promises are instrumentally, rather than inherently, valuable. They are recognized and enforced only in so far as that recognition and enforcement facilitates markets.

While markets are not natural, they do not depend on law for their existence. Thriving markets in illegal commodities such as drugs, sex, and pirated Hello Kitty bags demonstrate this fact. Contract law and other market-sustaining legal regimes do not create markets. Rather, they strengthen pre-existing practices. While courts often speak of enforcing a contract, more commonly they are concerned with a slightly different concept, namely liability. The term itself is suggestive. Liability refers to

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181. Charles Fried seemed to adopt this position during his remarks at a recent Suffolk University Law School conference on the thirtieth anniversary of the publication of *Contract as Promise*. Charles Fried, *Contract as Promise at 30: Closing Remarks* (Mar. 25, 2011) (downloaded using iTunes).

182. See Shiffrin, *Immoral?*, *supra* note 113, at 1557.

183. See generally Oman, *supra* note 170.

184. See Jody S. Kraus, *The Correspondence of Contract and Promise*, 109 COLUM. L. REV. 1603, 1627–34 (2009).

185. RESTATEMENT (SECOND) OF CONTRACTS § 1 (1981).

vulnerability rather than coercion or obligation per se. To be liable is to be exposed to attack from others. Hobbes famously suggested that in the state of nature life was “nasty, brutish, and short.”<sup>186</sup> Anarchic systems, however, are shot through with mechanisms for maintaining order and cooperation in the absence of the state.<sup>187</sup> The idea of liability is key to understanding these practices.

According to Hobbes, the problem with the state of nature is its ubiquitous vulnerability. “Hereby it is manifest, that during the time men live without a common Power to keep them all in awe, they are in that condition which is called Warre; and such a warre, as is of every man, against every man.”<sup>188</sup> Unprotected from predation by others, “there is no place for Industry; because the fruit thereof is uncertain . . . and . . . worst of all, continuall feare, and danger of violent death; And the life of man, solitary, poore, nasty, brutish, and short.”<sup>189</sup> The solution to this problem, according to Hobbes, is Leviathan, an omnipotent state that can suppress all private predation and guarantee security to all. And therein lies the problem.<sup>190</sup>

Vulnerability has a way of making people cautious toward others. People who are open to attack tend not to be predatory.<sup>191</sup> It is only when one becomes relatively invulnerable that predation becomes an optimal strategy. Consider the recurrent pattern in human history of mobile, horse-mounted raiders attacking relatively immobile agriculturalists.<sup>192</sup> The predators in this scenario are predators precisely because they can easily run away when attacked and are thus less vulnerable than their victims. The Cold War debate over anti-ballistic missile systems hinged on the same issue.<sup>193</sup> The fear was that a country that was invulnerable to nuclear attack was far more likely to become a nuclear aggressor.<sup>194</sup>

In contrast, consider the practice of giving a hostage as part of a treaty. The purpose of exchanging hostages was to make the parties to the treaty permanently vulnerable to one another.<sup>195</sup> It was this very vulnerability that

186. HOBBS, *supra* note 127, at 89.

187. *See* Oman, *supra* note 126, at 545.

188. HOBBS, *supra* note 127, at 88.

189. *Id.* at 89.

190. *See* Oman, *supra* note 126, at 544–51 (arguing that cooperation can be undermined by systems and situations that render contracting parties invulnerable to one another).

191. *See id.* at 533.

192. *See id.* at 547.

193. *See* JOHN LEWIS GADDIS, *THE COLD WAR: A NEW HISTORY* 81 (2005) (discussing the debates over ballistic-missile defense).

194. *See id.* (noting that the 1972 Anti-Ballistic Missile Treaty “was the first formal acknowledgment, by both sides, of Churchill’s—and Eisenhower’s—idea that the vulnerability that came with the prospect of instant annihilation could become the basis for a stable, long-term, Soviet-American relationship”).

195. *See* Oman, *supra* note 126, at 548.

acted as the spur to good behavior.<sup>196</sup> Modern game theory provides a similar insight.<sup>197</sup> When the prisoner's dilemma is played as a one-shot game, the optimal strategy is to defect, in part because the players in the game have no way of sanctioning those that defect.<sup>198</sup> On the other hand, if the game is played in successive rounds, the parties become vulnerable to one another.<sup>199</sup> If you defect in this round, then I can punish you in the next round by defecting. A strategy of cooperation coupled with tit-for-tat retaliation emerges.<sup>200</sup> The vulnerability of the parties fosters cooperation and trust.<sup>201</sup>

Contractual liability fosters cooperation by making promisors vulnerable within a framework that otherwise protects them from predation. It balances the conflicting needs of being secure from attack and avoiding the invulnerability that can undermine cooperation. The central moral obligation associated with promising is the obligation to do what one has promised. The most natural legal analog to this moral obligation is the principle of *pacta sunt servada*. This is not, however, what the law of contracts does. Rather, it provides disappointed promisees with a way of retaliating against those that break their promises. Contract law makes people vulnerable, liable. It allows tit-for-tat and, in effect, makes the promisor's non-exempt assets a hostage to his performance. Rather than coercing the performance of a moral obligation to keep one's promises, contract law is oriented toward reaping the benefits of the state of nature—the way its ubiquitous vulnerability makes sanctioning those that renege on their agreements easy—while avoiding the very pathologies which that vulnerability creates. The result is a legal institution that extends the reach of the pre-legal dynamics that make markets possible.

## V. CRITICISMS AND LIMITATIONS

Thus far, the structure of this Article's argument has necessarily led me to take a celebratory stance towards markets. I believe that such a stance is justified. In broad historical terms, markets have been an enormously beneficent influence on human societies. Commerce, on balance, makes our polities more peaceful, stable, and humane. Its practice tends to make us into better people. That said, however, it would be the rankest kind of Panglossianism to assume that markets are always positive in either their outcomes or their operation. Accordingly, in this section we turn to some of the central criticisms that can be leveled at markets. The first is that markets

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196. *See id.*

197. *See id.* at 549.

198. *See id.*

199. *See id.*

200. *See id.*

201. *See id.*

result in distributive outcomes that cannot be normatively justified. The second is that markets are heterogeneous and can sometimes turn pathological. While I do not believe that either of these objections justifies rejecting the ultimately positive assessment of markets I have offered thus far, there is some merit to both of them.

I do not, however, believe that these objections are fatal to the central thesis of this Article, namely that contract law is best thought of as existing to support markets because markets are themselves normatively desirable. Even if one qualifies one's support of markets by acknowledging their normative limitations, they can continue to justify contract law so long as we acknowledge that contract law must be limited so as not to support markets in their pathological inflection.

#### A. *DISTRIBUTIVE JUSTICE*

Aristotle claimed that distributive justice represents a geometric principle.<sup>202</sup> On first reading, the reference to mathematics seems out of place, but the philosopher was making an important point about the structure of justice. In claiming that distributive justice is geometric, he was not offering a substantive theory of justice. Rather, he was making a claim about what is at issue in the concept of distributive justice. At its heart, Aristotle insisted, justice is about a ratio, the ratio between an individual's possession of some morally relevant characteristic and that individual's share of the desirable things of life.<sup>203</sup> A distribution is just when this ratio is the same for all of the morally relevant members of a society.<sup>204</sup> For example, suppose that one subscribes to a racist theory of distributive justice, whereby the desirable things of life should be granted in equal shares to those of the favored race and denied to those of all other races. Now as a substantive matter, such a theory of justice is false and evil. It is nevertheless identifiable as a distributive theory. The proper ratio between the theory-relevant characteristic—race—and the good things of life is maintained for each individual.

Markets distribute desirable social goods. Indeed, this is one of their primary functions. A well-worn criticism of markets states that they do so in distributively unjust ways. Stated in Aristotelian terms, there is no plausible moral characteristic such that the ratio between that characteristic and the distribution of the desirable things of life effected by the market holds true for all members of society. To put some flesh on this abstraction, consider the case of Carlos Slim Helu, the head of Telmex, the Mexican telecom

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202. See ARISTOTLE, *NICHOMACHEAN ETHICS* 95–96 (F.H. Peters trans., Barnes & Noble 2004) (c. 384 B.C.E.) (“We see then that which is just is in some sort proportionate.”).

203. See *id.* (“That which is just, then, requires that there be four terms at least, and that the ratio between the terms and the same.”).

204. See *id.*

giant, who was, according to *Forbes*, the richest person on the planet in 2012, with a net worth of \$69 billion.<sup>205</sup> Helu's yearly income is roughly \$18.5 billion, while the median per capita income in Mexico is roughly \$14,800 per year.<sup>206</sup> In other words, Helu's income is over 1,250,000 times greater than that of his average countryman. It would be very difficult, however, to imagine any morally relevant characteristic that a person possesses in such vast quantities relative to others. When markets create such disparities—and admittedly in Helu's case his wealth was amassed thanks to significant intervention by the Mexican state—then they are distributionally unjust.

The distributive attack on markets, however, generally goes beyond mere skepticism about the possibility of a theory of justice defending market distributions. Rather, the critique almost always comes from egalitarians who believe that, at least as a first approximation, the desirable things of life should be distributed equally to all. Of course, sophisticated egalitarians do not advocate anything approaching absolute equality, but they do tend to believe that deviations from an equal distribution are suspect and require special justification. John Rawls, for example, argued that some of the inequities of a market system may be justified because they are necessary to incentivize the creation of wealth, but such inequities can be maintained only so long as they benefit the least well-off members of society.<sup>207</sup> Understood in these terms, the market is presumptively unjust, which would suggest that standing alone it cannot operate as a moral justification.

There are essentially two ways that this line of argument can be met. The first approach is to offer a libertarian defense of markets. On this view, markets are in fact distributionally just, or at least presumptively so. Robert Nozick offered the most famous modern version of this argument.<sup>208</sup> Rejecting what he called "patterned" theories of distributive justice, Nozick argued that one cannot judge any distribution as just by simply observing its correspondence with some ideal. Rather, he argued that any distribution is potentially just as long as it is the result of a series of past transactions that are voluntary.<sup>209</sup> Put in Aristotelian terms, the morally relevant category to which distributions are to be related is a particular sort of historical

205. See *The World's Billionaires: Carlos Slim Helu & Family*, FORBES, <http://www.forbes.com/profile/carlos-slim-helu/> (last visited Sept. 18, 2012).

206. See *Moguls: Carlos Slim Helu Is World's Richest Man*, DAILY BEAST (Mar. 10, 2010, 2:28 PM), <http://www.thedailybeast.com/cheats/2010/03/10/carlos-slim-helu-is-worlds-richest-man.html>; *The World Fact Book: Mexico*, CENT. INTELLIGENCE AGENCY, <https://www.cia.gov/library/publications/the-world-factbook/geos/mx.html> (last updated Sept. 10, 2012). This number represents per capita GDP, which is simply GDP divided by population. Because many members of the population are not wage earners—such as children, women working in the home, etc.—average income for wage earners is probably somewhat higher. None of this, however, is relevant to the argument in the text.

207. See RAWLS, *supra* note 43.

208. See ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 155–60 (1974).

209. See *id.* at 155–56.



pedigree. Hence, in evaluating the justice of Helu's wealth relative to that of his countrymen, what should arouse moral concern is not the size of Helu's holdings but the means by which he acquired them.<sup>210</sup> Provided that the markets in question conform to Nozick's conditions of voluntary alienation of entitlements and respect for individual rights, then the distributions they produce are by definition just.<sup>211</sup>

There is also an older, libertarian defense of the justice of market distribution based on the idea of desert. For example, John Bates Clark, an American economist writing at the end of the nineteenth century, argued that in a competitive market all economic inputs—labor, land, and capital—would be paid according to their marginal productivity.<sup>212</sup> The resulting distributions were just because each person received an amount equal to his contribution. “To every man his product, his whole product and nothing but his product,” Clark explained.<sup>213</sup>

One needn't accept these libertarian arguments, however, in order to defend markets from the distributional attack. This is fortunate because whatever their merits in the abstract, both arguments place very demanding conditions on markets, conditions that in all likelihood cannot be met in the real world. Setting aside the very difficult question of voluntariness, given the historical and contemporary ubiquity of various forms of expropriation, it is unlikely that the exacting historical conditions necessary for Nozick's theory can be met.<sup>214</sup> Likewise, even if Clark's economic analysis is correct and perfectly competitive markets give to each person the marginal value of their productive contributions, it is still true—as I argued above—that the conditions for perfectly competitive markets are seldom, if ever, realized in the real world.

Other defenses of markets, however, are available. Consider the second theorem of welfare economics. As noted above, the first theorem states that the final distribution of goods and services in a competitive market will be

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210. *See id.* at 28–29.

211. *See id.* at 29.

212. *See* BARBARA H. FRIED, *THE PROGRESSIVE ASSAULT ON LAISSEZ FAIRE: ROBERT HALE AND THE FIRST LAW AND ECONOMICS MOVEMENT 1–2* (1998) (describing Clark's economic and moral theories). Clark defended his claims most fully in JOHN BATES CLARK, *THE DISTRIBUTION OF WEALTH* (Augustus M. Kelley rprt. 1965) (1899).

213. *See* FRIED, *supra* note 212, at 2 (quoting John Bates Clark, *The Law of Wages and Interest*, 1 ANNALS AM. ACAD. POL. & SOC. SCI. 43, 44 (1890)) (internal quotation marks omitted).

214. The issue of what counts as a voluntary transfer is conceptually difficult. As critics of laissez faire have long argued, the seemingly voluntary transactions of the market can be characterized as coercive. *See id.* at 29–70 (discussing “The Empty Idea of Liberty”). To his credit, Robert Nozick has offered one of the most sophisticated modern expositions of the problems associated with the idea of voluntariness, as well as his own theory of what counts as a voluntary transaction. *See generally* ROBERT NOZICK, *SOCRATIC PUZZLES 15–44* (1997) (containing Nozick's “study of coercion”).

Pareto-optimal and will result from a series of Pareto-superior moves.<sup>215</sup> The second theorem is a corollary to it, namely that any final, Pareto-optimal distribution can be achieved in an efficient market by manipulating the initial distribution of goods and services.<sup>216</sup> It seems plausible to suppose that any reasonable theory of distributive justice will defend a Pareto-optimal distribution. This does not mean, of course, that Pareto optimality is itself a theory of distributive justice. Many distributionally unjust outcomes could be Pareto-optimal. I only mean to suggest that Pareto optimality is a necessary, but not a sufficient, condition for a fair distribution. This is, of course, a very weak constraint on distributional theories. It means only that we cannot regard a change in distribution that leaves at least one person better off while leaving no one worse off as an injustice.<sup>217</sup> If this is correct, then the second theorem suggests that in an efficient market *any* reasonably just distribution may be achieved, so long as the initial entitlements are properly adjusted ex ante.

Of course this ex ante argument requires that we have perfectly efficient markets, or alternatively, markets that are sufficiently efficient to result in Pareto-optimal distributions. This condition may not be met. It is, however, possible to make distributional adjustments ex post to market results in order to reach desired outcomes. This is a variation of an argument that is habitually made by efficiency proponents of the market. They argue, in effect, that markets should be ordered so as to maximize joint profit, even if one believes that the resulting distribution will be perverse as a matter of justice. This is because it is always possible after the fact to redistribute wealth via taxes and transfer payments.

In the real world, the distinction between ex ante and ex post manipulation of entitlements breaks down. This is because social outcomes are never determined in a neat three-step process of (1) ex ante distribution; (2) market activity; and (3) ex post redistribution. Rather, market processes and their alternatives are continuous. In effect, step 2 is constant, and any action at step 1 could be recharacterized as a step 3 action and vice versa. Consider state-provided public education. The education could be thought of as altering the initial ex ante distribution of each actor, in effect giving each adult additional resources at the starting line of economic life. Alternatively, public education can be seen as a transfer of

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215. See JOHN LEACH, *A COURSE IN PUBLIC ECONOMICS* 35 (2004) (setting forth the first theorem of welfare economics).

216. See *id.* ("Second theorem: Each Pareto optimal allocation is the competitive allocation under some distribution of the endowed goods.").

217. Strictly speaking, this may be an even weaker condition than it appears. To be Pareto-superior, a new distribution would need to not only not leave any person worse off in material terms (i.e., poorer) but also not be disapproved by any one for any other reason. See generally AMARTYA SEN, *The Impossibility of a Paretian Liberal*, in *CHOICE, WELFARE AND MEASUREMENT* 285, 285-90 (1982).

income from wealthy households in the form of taxes to poorer households in the form of a free service, in effect an *ex post* redistribution. This fuzziness needn't concern us much if our goal is some just distribution different than the one that the market would otherwise produce. Instead, it is enough to say that markets needn't be distributionally perverse—even to those that reject the libertarian argument for the inherent justness of market distributions—so long as they are accompanied by various other forms of distribution that ameliorate their effects.

The question that remains is what impact, if any, the distributive justice critique of markets should have on the central thesis of this Article. My answer is: very little. If one subscribes to the libertarian defenses sketched above, then the distributive outcomes of markets are *per se* just. My thesis, however, does not require the defense of such a strong claim. While I do celebrate the virtues of markets, I am not defending capitalist anarchy in this Article. My claim is not that markets provide the sole legitimate means of social or political organization or that they provide a justification for all of our legal and political institutions. Rather, my claim is that markets provide the best justification for contract law. This is admittedly an important legal institution, but it is ultimately one among many. Hence, for my thesis to survive the distributional critique of markets, all that is necessary is to show that markets are consistent with most reasonable theories of distributive justice. For the reasons sketched above, I believe this is a burden that can be easily met.

*B. HETEROGENEITY AND THE PROBLEM OF PATHOLOGICAL MARKETS*

Not all markets are the same. One of the effects of modern economics, especially neo-classical price theory, is to homogenize our view of markets.<sup>218</sup> In place of the heterogeneity of actual markets, economics tends to flatten out the differences between different kinds of markets.<sup>219</sup> In place of the manifest differences between, for example, international securities markets, the market for locally grown produce, and the market for professional labor, economics presents iterations on the central theme of prices moving along supply and demand curves toward an efficient market-clearing price.<sup>220</sup>

Classical economists from Adam Smith to Karl Marx, however, tended to emphasize the heterogeneity of markets. Smith famously described the benefits of specialization and the division of labor using the example of a pin factory.<sup>221</sup> He also worried, however, about the effects of the change from a labor market dominated by individual craftsmen to a market

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218. See DEBRA SATZ, *WHY SOME THINGS SHOULD NOT BE FOR SALE: THE MORAL LIMITS OF MARKETS* 44–49 (2010) (discussing “Heterogeneous Markets”).

219. See *id.*

220. See *id.* at 17–21 (discussing market efficiency).

221. See *id.* at 44–45 (discussing Adam Smith’s analysis of the effects of specialization on laborers).

dominated by factory workers performing simple and repetitive tasks.<sup>222</sup> Smith's concern was that working lives devoid of the complex tasks faced by craftsmen would tend to deaden the intellectual facilities of workers, rendering them unable to meet the demands of citizenship.<sup>223</sup> It was a theme that Marx picked up on in his famous thesis about the alienation of the worker from the product of his labor and its baleful effects on human happiness.<sup>224</sup> The simplifying and homogenizing approach of modern economics has yielded considerable analytical insights. Modern price theory provides a much better model of how value is created in transactions, the price at which contracts are made, and the way that price distributes value than do, for example, the clumsy labor theories of value that Smith and Marx employed. The earlier theories, however, draw attention to the way in which markets can turn pathological, representing an inversion of Montesquieu's *doux commerce* thesis.

Markets can turn pathological in at least two ways. First, markets may be structured around the production and distribution of goods and services that are in some way evil. Consider, for example, a market in child sex. For a variety of reasons, we should regard child prostitution as evil. The necessarily dependent status of children renders child prostitution markets even more prone to violence and abuse than adult prostitution markets. Child prostitution sexualizes children long before they have the emotional capacity to deal with sexuality. Other examples of markets in evil goods or services abound.

A variation on this objection notes that there are certain things that, while not inherently evil, become undesirable when traded in a market. Sex is the quintessential example. While some have no per se objection to prostitution so long as it is fully voluntary and unaccompanied by abuse, most people believe that there is something inherently wrong about trading sex for money and money for sex. This belief, however, needn't imply that sex engaged in outside of the context of a market transaction is wrong. Margaret Radin has argued that the law should adopt a market inalienability rule, refusing to enforce contracts involving the purchase or sale of goods or services that implicate core matters of identity.<sup>225</sup> In other cases, we might worry that market transactions will crowd out alternative and desirable

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222. *See id.*

223. *See id.*

224. *See* Karl Marx, *Economic and Philosophic Manuscripts of 1844*, in THE MARX-ENGELS READER 66, 96 (Robert C. Tucker ed., 2d ed. 1978) (discussing the idea of a worker's alienation from the product of his labor).

225. *See* Margaret Jane Radin, *Market-Inalienability*, 100 HARV. L. REV. 1849 (1987) (setting forth the argument that certain entitlements should not be alienated within a market); *cf. In re Baby M*, 537 A.2d 1227 (N.J. 1988), *superseded by statute*, N.J. Stat. Ann. § 9:3-46 (West 2002), *as recognized in In re Adoption of Children by G.P.B.*, 736 A.2d 1277 (N.J. 1999) (refusing to enforce a surrogacy contract).

means of enforcement.<sup>226</sup> Similarly, for example, some have claimed that paying for blood actually reduces the supply of blood donations because it crowds out voluntary donations.<sup>227</sup>

The second way that a market might be evil is if the process of exchange in the market degrades its participants in some way, even if the good or service traded in the market is not itself evil. Sometimes the response may be frankly paternalistic. In *Lochner v. New York*, the state placed restrictions on the working hours of bakers not because markets in bread were purveying an evil commodity, but because either disparities in bargaining power or an inability to perceive their true interests led bakers to work longer hours than the state determined to be safe.<sup>228</sup> Alternatively, one might object to the way a market alters or reinforces certain social structures. For example, one might object to a market in indentured servitude because it would tend to lead to a stratified and status-bound society of servants and masters.<sup>229</sup>

My object here is not to evaluate the merits of any of the specific arguments as to why a market is pathological. Rather, let us assume—as seems to me eminently reasonable—that the set of such pathological markets is not empty but also does not include all markets. What then follows for the core claim of this Article that contract law is justified by the moral desirability of markets? The answer is that it must be qualified. Not all markets are morally desirable. There are healthy markets and pathological markets. Contract law, however, is not institutionally well suited to suppress pathological markets. This is a task better performed—if it is to be performed at all—by criminal law or regulatory authorities. However, if contract law's justification rests in the desirability of markets, then there is no justification under this theory for enforcing the contracts supporting pathological markets. Doctrinally, this basic intuition is reflected in the rule that contracts may be void as violating public policy. Thus, for example,

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226. See Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377 (2010) (arguing that formal contract enforcement may crowd out informal mechanisms of organization).

227. See RICHARD M. TITMUS, *THE GIFT RELATIONSHIP: FROM HUMAN BLOOD TO SOCIAL POLICY* (1971) (arguing that payments for blood donation undermine the propensity to donate).

228. See *Lochner v. New York*, 198 U.S. 45, 58–63 (1905), *overruled in part by* *Ferguson v. Skrupa*, 372 U.S. 728 (1963) (discussing the state's interest in restricting the working hours for New York bakers).

229. See Nathan B. Oman, *Specific Performance and the Thirteenth Amendment*, 93 MINN. L. REV. 2020 (2009) (arguing that the Thirteenth Amendment prohibits employers from dominating employees via the enforcement of contractual obligations); see also James Gray Pope, *Contract, Race, and Freedom of Labor in the Constitutional Law of "Involuntary Servitude,"* 119 YALE L.J. 1474 (2010) (arguing that the Thirteenth Amendment's prohibition on involuntary servitude serves to guarantee egalitarian labor relationships).

contracts to pay bribes,<sup>230</sup> contracts for certain kinds of disfavored medical procedures,<sup>231</sup> contracts to pay gambling debts,<sup>232</sup> and contracts to commit a tort<sup>233</sup> will not be enforced.

It is worth noting here that the market-based justification for contract deals with public-policy limitations on freedom of contract better than autonomy approaches like the promissory theories discussed above. For autonomy theories, public-policy exceptions represent a messy intrusion of foreign values into contract law. By refusing to enforce voluntary commitments, the law makes a kind of ad hoc compromise with the libertarian purity of contract. From a market perspective, however, such limitations flow naturally from the basic normative justification for contract law. In effect, contract law runs out at the point where its normative justification runs out. Our goal is not respect for personal autonomy per se but the moral goods provided by markets. When the enforcement of contracts fails to provide those goods, the justification for enforcing the contract also fails.

### C. CONTRACT LAW AND PRIMA FACIE JUSTIFICATION

The limitations on the justificatory power of markets discussed in the previous two sections illustrate an important issue. Contract law is a residual or background category of law. By this I mean that it constitutes a kind of global default rule governing obligations arising from voluntary transactions. This does not mean, of course, that it applies to all voluntary transactions. Indeed, the central thesis of this Article is that, as a market-sustaining institution, we have reasons for confining the reach of contract law to market transactions. Rather, by “residual or background” I mean that contract law deals with a transaction unless some other body of law displaces it. Hence, for most market transactions, contract law is both logically and historically prior to the other bodies of law governing those transactions. Consider the example of employment contracts. Prior to the rise of modern employment law in the 1960s, the law of contracts governed most

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230. See *Sirkin v. Fourteenth St. Store*, 108 N.Y.S. 830, 834 (App. Div. 1908) (“I think nothing will be more effective in stopping the growth and spread of this corrupting and now criminal custom [of commercial bribery] than a decision that the courts will refuse their aid to a guilty vendor or vendee . . .”).

231. See *In re Baby M*, 537 A.2d 1227, 1234 (N.J. 1988), *superseded by statute*, N.J. Stat. Ann. § 9:3-46 (West 2002), *as recognized in In re Adoption of Children by G.P.B.*, 736 A.2d 1277 (N.J. 1999) (holding that surrogacy contracts violated the public policy of New Jersey and could not be enforced). *But see Johnson v. Calvert*, 851 P.2d 776, 778 (Cal. 1993) (en banc) (holding that surrogacy contracts did not violate public policy).

232. See *Cudahy Junior Chamber of Commerce v. Quirk*, 165 N.W.2d 116, 118 (Wis. 1969) (refusing to enforce a wagering contract). *But see FARNSWORTH*, *supra* note 147, at 351 n.4 (noting that under English common law gaming contracts were generally enforceable).

233. See *Sayres v. Decker Auto. Co.*, 145 N.E. 744, 745 (N.Y. 1924) (holding that a contract to give a false bill of sale in order to defraud a third party was not enforceable).

employment relationships. With the passage of the 1964 Civil Rights Act<sup>234</sup> and various other statutes designed to govern employment relations, however, contract law was displaced on certain issues. Contract, however, continues to operate in the interstices of employment law, providing the default rules when the more specialized body of law is silent.

Contract's status as a background body of law raises a number of interesting questions. First, there is the question of whether there are special reasons for favoring the more general principles of contract law over the more context-specific bodies of law such as employment law or the like.<sup>235</sup> Secondly, and for purposes of this Article more importantly, a defense of contract law needn't provide a defense of contract law as the best regime to govern all transactions. Rather, it need only provide a prima facie defense of contract law. To be sure, the more robust one's belief in the beneficent force of relatively unfettered markets, the more likely one is going to be suspicious of bodies of law that seek to displace market-sustaining regimes, such as contract law with more regulatory bodies of law.

While I am sympathetic to criticisms of much of our current regulatory apparatus, however, nothing in the argument that I have offered in this Article requires such sympathy. In order for markets to justify contract law, it is enough that one is persuaded that markets are sufficiently valuable to provide a prima facie reason for legal support and that one is further persuaded that contract law does in fact provide such support. The fact that one believes that in some situations markets ought not to be supported does not defeat the basic thesis. It only means that in those circumstances we lack a reason for having contract law, and its support for the market in question ought to be withdrawn.

Once it is recognized that contract law provides a set of background rules and that what is needed is a prima facie justification for the law, the case for viewing contract as a market-sustaining institution becomes stronger. Contractual liability is relatively easy to avoid by simply refusing to

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234. Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 241 (codified as amended at 42 U.S.C. § 1981 (2006)). Of particular importance is Subchapter VI, Equal Employment Opportunities. 42 U.S.C. §§ 200e to -e-17.

235. Compare Nathan B. Oman, *A Pragmatic Defense of Contract Law*, 98 GEO. L.J. 77, 90-91 (2009) (arguing that the generality of contract law solves public choice and information problems faced by more specialized bodies of law), with BRIAN H. BIX, *CONTRACT LAW: RULES, THEORY, AND CONTEXT* (2012) (criticizing contract theorists for focusing too much on the generality of contract law). See also Brian H. Bix, *Mahr Agreements: Contracting in the Shadow of Family Law (and Religious Law)—A Comment on Oman's Article*, 1 WAKE FOREST L. REV. ONLINE 61, 63-64 (2011), [http://wakeforestlawreview.com/wp-content/uploads/2011/05/Forum\\_Bix.pdf](http://wakeforestlawreview.com/wp-content/uploads/2011/05/Forum_Bix.pdf) (arguing that general contract law is poorly situated to police mahr agreements); Nathan B. Oman, *Bargaining in the Shadow of God's Law: Islamic Mahr Contracts and the Perils of Legal Specialization*, 45 WAKE FOREST L. REV. 579, 581-82 (2010) (arguing that the general law of contracts deals with Islamic marriage contracts better than the more specialized rules developed for prenuptial agreements); Nathan B. Oman, *How To Judge Shari'a Contracts: A Guide to Islamic Marriage Agreements in American Courts*, 2011 UTAH L. REV. 287, 319-31 (same).

engage in contracts. For that reason, it is not a body of law that is well suited for controlling or regulating behavior.<sup>236</sup> This phenomenon is compounded by the fact that contract law's reaction to undesirable contracts is relatively anemic. For example, rather than trying to suppress prostitution by punishing those who seek to purchase sex, contract law simply refuses to recognize meretricious contracts. Only through verbal and conceptual gymnastics, however, can this response be seen as a punishment or a sanction against prostitution. Rather, it is a withdrawing of support from that market. Instead of suppressing pathological markets, contract law tends to simply run out, refusing to act one way or the other. Such a stance is entirely consistent with the role of contract law as a market-supporting institution, and it is the way in which the value of markets provides a *prima facie* justification for contract.

The argument offered in this Article is not libertarian. It is laudatory of markets and provides reasons for celebrating and protecting them. It is not, however, offered as a brief for radical free-market politics or anarcho-capitalism. It may be consistent with such ideologies, but to say that markets are good is not to say that they are always good or that they are the only good. Rather, this Article is offered as a brief for contract law, a body of rules that provides a default regime supporting markets, but a regime that may be pushed aside when we decide that particular markets are not desirable. My goal is not to provide a set of arguments specifying the structure of society as a whole, only a set of arguments specifying the basic domain of contract law.

## VI. CONCLUSION

Markets provide the moral foundations for contract law. The widespread process of exchange does more than efficiently allocate resources. Indeed, it is far from clear that real-world markets result in the formally efficient allocation of resources. Markets do, however, perform a host of other morally valuable functions. They allow for widespread cooperation among those with often violently different religious and moral beliefs. They generate wealth, which not only decreases material suffering but is positively correlated with such desirable social outcomes as religious tolerance, better treatment of women and racial minorities, and greater concern for the natural world. The claim here is not that wealth is either a sufficient or a necessary condition for these outcomes. Rather, it is the more modest argument that wealth often shifts society in these directions and that, to the extent that markets facilitate this process even in part, they are to be desired. Finally, markets inculcate certain habits of mind and behavior that are to be desired. Given the benefits that flow from markets, we have

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236. *But see* Jean Braucher, *Contract Versus Contractarianism: The Regulatory Role of Contract Law*, 47 WASH. & LEE L. REV. 697, 699 (1990) (arguing that contract law serves to control and regulate contracting parties).



good reason for creating bodies of law that serve to sustain and strengthen markets. This is what contract law does.

Looking at markets rather than directly at personal moral obligations, such as the duty to keep a promise, allows us to better navigate some basic theoretical problems that any system of contract law will face. It gives us an answer as to why promissory obligations are picked out from the universe of moral obligations for legal enforcement. They are favored not because we want to facilitate promise keeping but because doing so facilitates markets. It also gives us guidance as to which promises we want to enforce and the remedial structure of that enforcement. In each case, focusing on the moral obligation to keep a promise leads to confusion, while looking at markets as the goal of contract law provides a better guide to legal structure. Finally, the fact that in some circumstances markets can be pathological does not undermine this Article's central thesis. It only means that in those areas we lack a reason for supporting markets through contract law, and accordingly, the law should be limited. In short, markets should be placed at the center of the justification of contract law. Contract is the law of the market.