Law and power in a world with no transaction costs: an essay on the legitimating function of the Coasian “narrative”
Francesco Denozza

Abstract
This paper examines the possible legitimating function (understood as the ability to provide an appropriate framework for developing rational arguments in support of legal principles and rules) of the Coasian “narrative”. The thesis presented in this paper is that a Coasian world of a "human" type (a world that does not exist, but is conceivable, without breaking the physical and psychological laws that govern our real world) is not an acceptable world. In order to imagine a world devoid of the defects of a “human” Coasian world, we should think of a world of "divine" type, populated not by human beings, but by God-like creatures. A world that anyone can model at her pleasure, and that can provide rational legitimacy to nothing.

The paper then argues that the Coasian narrative ignores the “dispositional” nature of legal power, and hides the distinction between influence and power. If these theoretical limits are appropriately removed, the centrality of the notion of (“human”) transaction costs loses legitimacy and appears subordinate to the primary goal of limiting the power that some private individuals can exert on other individuals.

1. The “legitimating” function of the Coasian narrative.

This paper focuses on the possible “legitimating” function of what I would call the “Coasian narrative”.¹

For “legitimating” function I understand in the present context the ability of providing reasonable arguments to support the legitimacy of a set of institutions, and grounds for considering legitimate a given theory on how to build institutions and rules. It is therefore intended not in the legal sense of “making lawful”, but in the sense of “providing legitimacy”.

In fact the paper seeks to answer the question whether the Coasian narrative is able to make legitimate a specific way of framing the legal problems connected with the assignment of rights to private subjects and to suggest appropriate criteria for evaluating the different possible solutions of those problems.

I understand a legitimating function as less demanding than a normative function. The latter implies a model able to provide precise indications and to suggest

¹ I understand the “Coasian narrative” as a set of beliefs and convictions whose implications are wider, and more generic, than those strictly derivable from the literal interpretation of Coase’s
unequivocal choices (however difficult might be the identification of the right choice in the real world). The former implies instead a narrative which provides a framework for developing rational, but disputable, arguments.

In this vein, the subject of this study is not the Coase theorem and the problem of its validity, but the set of principles and of ethical and political prescriptions that are built on, and around, this piece of knowledge, and that aim to perform the function of a (local, but surely very ambitious) narrative, able to allow our society on the one hand, to define its criteria of competence and, on the other, to evaluate according to those criteria what is performed or can be performed within it.\(^2\)

The reasons for examining the Coase theorem not from the viewpoint of its truth and its objective features, but from a subjective and evaluative point of view, are obviously connected to the legitimating function that the Coasian world and the connected narrative, perform (largely beyond Coase’s intentions\(^3\)) in a substantial part of the law and economics movement. Putting aside all possible discussions concerning the different approaches that coexist in that movement, it seems to me that its core is inseparable from the legacy of the Coase’ lesson.

Therefore the targets of this essay are not just the interpretations that use the Coase theorem as a mechanical device able to provide immediate solution to every problem of social choice, but also the more flexible interpretations that acknowledge the ubiquitous presence (in the real world) of high transaction costs and recommend a careful analysis of the relevant circumstances of each single case. At least up to the point that both start from the idea that reduction of transaction costs, and approximation to the results the parties would have reached through bargaining absent transaction costs, are the most important goals legal rules should pursue, rigid and flexible interpretations both inevitably use the reference to the Coasian narrative as a legitimating device, in the sense that the founding arguments eventually justifying the resulting assignments of rights and duties, institutions and practices, stem in both cases


\(^3\) In fact, in the work of Coase there is a constant concern for giving precise and well defined sense and scope to his intellectual discoveries. He usually underlines the fact that a world without transaction costs is “unrealistic” (see e.g. R.H. COASE, The Firm, The market and The Law, University of Chicago Press, 1988, p.114; R.H. COASE, Essays on Economics and Economists, University of Chicago Press,1994, p.11, “...I tend to regard the Coase Theorem as a stepping stone on the way to an analysis of an economy with positive transaction costs. The significance to me of the Coase Theorem is that it undermines the Pigovian system.....My conclusion: Let us study the world of positive transaction costs”). He explicitly refused the parenthood of the concept of “Coasian world” (Id., The Firm, p. 274).

On the difference between the Coase’s thought and what I called the Coasian narrative, see especially S.G. MEDEMA, Through a Glass Darkly or Just Wearing Dark Glasses? Posin,
from regarding social arrangements as means to reproduce in the real world at least some (if not all) the positive features of a Coasian world.

In this perspective the fact that a Coasian world does not exist is not as such a possible obstacle to the performance of a legitimating function, as the fact that a state of nature or a social contract never existed is not an obstacle to the legitimating function those concepts perform in the doctrines of Hobbes, Rousseau or Rawls. What counts is the nature of the imagined world. As we will see, the relevant question is whether the imagined world is a world governed by the same physical and psychological laws that govern our real world, or a world which can be conceived only by subverting the laws which characterize the human external and internal nature.

So we face two different questions. On one hand, we can ask whether the Coasian world, even if it does not exist, is a world in any case conceivable as a possible “human” world. On the other hand, there is the question whether it is a world in which collective action problems are correctly solved and benefits for collective activity appropriately provided and distributed. In a word: is it a world worth living in?

In my view, the answer to the latter question defines the ability of the Coasian narrative to perform a legitimating function. The answer to the former defines the kind of legitimacy the Coasian narrative might be able to provide. Let us dig deeper into the different profiles of the two questions.

2. Two categories of legitimacy distinguished.

In order to define the kind of legitimacy that can be provided by a given narrative, we can resort, coloring it with an evaluative connotation, to the conceptual framework underpinning the distinction between different types of legitimate authority elaborated by Max Weber. I would focus not on the problem (especially considered by Max Weber) of defining legitimacy and its sources, but on the types of arguments that can induce those involved in a power relationship, to believe that power is legitimate. In this perspective, and therefore with a rather peculiar meaning, I will use the notions of rational and traditional legitimacy and contrast them from the point of view of the narratives by which each can be supported.

I have already underlined that the fact, as such considered, that the Coasian world does not exist, may not constitute an obstacle to considering it as a narrative able to provide legitimating criteria for the real world. As I have also underlined, many

---


arguments are provided through the reference to worlds or to processes that do not, and did not, exist, as the state of nature or the social contract.

I think that a distinction must however be made, between a world that albeit inexistent may be conceived as possible, taking for granted the main features of our real world, and a world which is conceivable only by imagining physical or psychological conditions not allowed by the natural laws which govern our world. Whereas the reference to the former can provide rational arguments for legitimating a given institution or system of domination, the reference to the latter can provide only arguments akin to that supported by the belief in the sanctity of tradition or in the moral value of attempting to gain a perfect status, which is however acknowledged as unattainable in our real world.

I think that we could apply to those different kinds of imagined world, the distinction (inspired by Weber, but largely adapted, as we saw, to the context of our discussion) between authority legitimated by rationality, (interpreted as a belief in legitimacy having “an immanent relation to truth”\(^5\)) and authority legitimated by tradition.

In my opinion, I repeat, arguments provided by the reference to an imaginary, but possible world, may be used to demonstrate the rational character of an entire system or of a single rule. The reference to a world that cannot be conceived as possible, may provide only arguments akin to that resting upon belief in the sacredness of settled traditions. Arguments which in our post-metaphysical world \(^6\) have a very limited force.

As we shall see the question whether the Coasian world must be classified in the first or in the second category, whether it can provide rational or only traditional-like legitimacy, is strictly linked to a better definition of what we intend for transaction costs, and to a consequent better definition of what we conceive as a Coasian world.

We shall examine this question later.

3- The ability to perform a legitimating function.

Coming to the question whether a Coasian world is a world in which collective action problems are correctly solved and benefits for collective activity appropriately provided and distributed, it is evident that this question is not of a nature of allowing indisputable answers. The notions of correctness and appropriateness are amply exposed to the risk of being filled with different contents by different people. Thus, what is deemed correct and appropriate by an individual, may appear to another as

incorrect and inappropriate. However, claims of correctness and appropriateness are just the claims “that we advance with norms of action or of evaluation”. Thus, I argue that they are pertinent claims, when referred to a Coasian world, interpreted as a possible legitimating device of a set of norms.

Correctness and appropriateness of a set of norms and institutions, depend on the system of values on which they are based and on the level of coherence they are able to reach in putting those values in practice.

Thus the first question is: what system of values governs a Coasian world? Obviously the answer depends on the way we define a Coasian world (it is well known that is not such an easy task as the following reasoning will confirm).

As a first approximation we can conceive a Coasian world as a world in which the law can limit itself to fix the prerequisites (especially, an exact definition of property rights) for the continued existence of a reproduction process exclusively based on voluntary exchanges. The Coasian world so defined is a set of norms and institutions (individual rights on each and every available resource, enforceable contracts and freedom of exchange, are the main elements that characterize it) plus another ambiguous element, absence of transaction costs (ambiguous because, as we will see, it is not clear whether absence of transaction costs is a physical or a social property of this world).

In a Coasian world two main values are satisfied at the maximum possible level. The first is efficiency, that in this context can be considered as a value since here it is intended as the maximization of the overall welfare. Thus, not as a means or as a set of means, but as an end in itself, which claims appreciation for its own sake and not for its ability to secure other ends.

The second relevant value is liberty. In a Coasian world each individual is endowed with a domain in which he/she can freely dispose of himself/herself and of a given amount of resources, no matter the effects that his/her decisions can have on third parties.

People disturbed by the decisions of anyone else can use the resources at their disposal in order to convince the others to change their decisions and to dispose of their resources in a less disturbing way. The final result will be a world in which everyone can push for a use of the available resources in the way that maximize his or her satisfaction, with the only constraints stemming from the free exploitation of the same option by every other individual.

6 J.HABERMAS, Between Facts and Norms, English translation, Polity Press, 1996, p.443,
7 Id., supra note 5, at 10.
The main value with which the two values of efficiency and liberty notoriously conflict is that of equality, or, more generally, that of a fair distribution of the available resources. The potential conflict among those values is in fact the leit-motiv of all disputes about the moral validity of the economic analysis of law.

The Coasian narrative suggests a solution, by severing two perspectives. The allocative point of view, which considers only the effects that a choice to assign given resources may have on the overall welfare, and the distributive point of view, which considers the assignment of the resources according to fairness criteria. The distinction allows a hierarchical ordering of the two perspectives. The order is that the distributional concerns must be postponed every time they conflict with efficiency goals. However, this sacrifice may not remain without its rewards. Having obtained the biggest possible pie, thanks to the sacrifice of the interests of some individuals, the society can dispose of more resources that it can periodically employ in endeavoring to redress the situations that may occasionally appear particularly unfair.

Moreover we can assume an equal distribution of initial resources. Nothing in the Coasian narrative excludes that the transactions take place between parties provided with an equal endowment of resources. In this situation, even a lawmaker tormented by anxieties of distributive justice could adopt an abstentionist policy, limiting its interventions to few occasional actions aimed at correcting specific distortions.

To summarize: the possible virtues of a Coasian world are the maximization of both the individual liberty (all transfers of goods take place only through agreements among their holders, and the lawmaker’s intervention is confined to very rare and special occasions) and of the overall welfare (all the transfers of goods are by definition welfare enhancing). As to the distributive concerns, the possible sacrifices of the individuals who, being destitute of rights, are compelled to “buy” from other individuals the conducts that they are not entitled to impose, may be considered as functional to, and likewise justified by, the goal of reaching a more efficient use of the available resources. What is more, distributional concerns may be in any case attenuated by a fair initial distribution of the resources and by sporadic interventions of the legislator. Therefore, if we were to assume that a Coasian world is a world in which efficiency and liberty are maximized up to the optimum, and if we accept the said compromise between- on the one hand- efficiency and liberty operating as main values and -on the other hand- fairness operating as a subordinated, but not totally dismissed,

---

value, then we can consider the Coasian world as an ideal, capable of legitimating every choice of our real lawmaker heading to steer our real world to approximate the Coasian one.

4- What could happen in a “human Coasian world”?

As we saw, the core of the juridical insight of the Coasian narrative, is that a world with well defined individual rights on every available resource and no transaction costs can be effectively regulated by agreements between the holders of such rights without the need for legislative action other than those necessary for the initial definition of rights.

Using an example that is quite different from those used by Coase, but equally classic, we can isolate a part of this world imagining a lake used jointly by a factory for the discharge of water used in its production processes and by riparian owners for bathing. As is well known, in this kind of world, and still assuming that there are no transaction costs, the law-giver could limit itself to define the rights on the use of all the lake water leaving the factory owner and the riparian owners free to bargain among themselves the concrete use each can make of the lake water. As is also known, according to a widespread opinion, only the exact definition of the rights in question would be essential, while irrelevant, in allocative terms, would be the choice of the subjects to whom the rights are assigned. Repeating things now very familiar, the intuition in this regard is that if the utility of the clean water to the bathers is greater than that obtained by the factory, they will refuse to allow the factory to pollute (if they are the holder of the right on the use of the water) or they will pay the factory to not pollute, if the factory owner is the holder of the right on the water. In both cases, the resources will always be used in a way that maximizes the overall welfare. Obviously in the latter hypothesis bathers will be a little poorer (and the owner of the factory a little richer) than they would have been if the right had been assigned to the bathers from the outset (this is the obvious effect of the initial distribution of rights). This is an effect whose existence is difficult to dispute⁹, but which can be eliminated or at least attenuated -as we have already underlined-by an egalitarian assignment of the original rights.

Suppose that in the process of the original assignment, the right to discharge into the lake is clearly assigned to the factory and that the pollution generated by the factory’s discharge of waste water is below the level that, according to the preferences of the riparian owners, could induce them to make an offer to the factory

---

⁹ See however Coase’s remarks on this point in The Firm, supra note 3, at 170.
The use of the lake by the factory owner, and the bathers, according to their respective preferences, in the most efficient way.

Suppose now that an inventor-discoverer may be the same factory owner-discovers a new technique that allows for production at lower costs, but that involves much higher levels of pollution (obviously the example was not chosen by pure chance: technology changes are just the kind of events that can put the definition of rights “under continuous pressure to change”\(^{10}\)).

The question whether such occurrence (the unforeseen invention of a new technique) may in itself undermine the assumption of zero transaction costs will be examined later. For now, let us explore what may happen in the world I described before (a world characterized by the fact that individuals can freely contract for each other’s rights) and that I would provisionally qualify as a “human Coasian world”.

In this world, the factory owner will offer the inventor a price, for the use of the invented technique, at maximum equal to the costs it will save with the use of the new technology. The bathers will try to convince the inventor not to sell the technique to the factory owner and to this end they will offer an amount of money corresponding to the benefits they derive from the opportunity of swimming in clean water.

Let us assume that this sum is greater than that the owner of the factory is able to offer. The result of the free bargaining among all the interested parties will be the non-adoption of the new technology. This result is certainly efficient. The trend of the deals shows that the new technique produces costs for the bathers that are higher than the costs it would be able to save when used by the factory.

From a distributive point of view the result raises rather less enthusiasm. The inventor receives a reward for having invented a socially harmful, useless, technique, whilst the bathers have to pay a fee (to the inventor or to the factory owner) to continue doing what before they were doing for free.

If this result is (as indeed seems to me) not desirable, the possible options are two. The first is a lawmaker's intervention limiting the right of the factory, by preventing pollution beyond a definite level. In this case, the owner of the factory is not able to compensate the bathers, the new technique remains equally unemployed and there is no transfer of wealth.

The second alternative is that the lawmaker intervenes by taxing the inventor and subsidizing the bathers. It follows a distribution that in the real world would be very

expensive and in a Coasian world would be completely free, but in both cases of decidedly questionable rationality.

I think this simple example demonstrates two things. The first thing it demonstrates is that in a human Coasian world significant transfers of wealth may occur that are in no way connected to the increasing of the overall welfare. In our example the wealth available to the society after the dealing is identical to that existing before the trading day. The difference is simply that some have become richer whilst others have become poorer.

Secondly, a world organized on the basis of an initial attribution of rights and free negotiations between private rights-holders, with no intervention by the lawmaker, produces results whose acceptability is highly questionable. To prevent the gigantic, and socially unnecessary, transfers of wealth that could occur in a society of this kind, continuous intervention is needed. The lawmaker faces every moment the choice between creating and assigning new rights in relation to new possibilities for action created by innovation, or to correct the distributional distortion produced by the combined effect of innovation and original allocations.

In the first case, the attraction exerted by a model in which the results are the fruit of a game where all participate on an equal footing, disappears. The game in question is indeed similar to a chess game in which the "value" (the possibility of movement) of each piece is continuously changing.

In the second alternative (distributive interventions) the attraction of a system tending to be self-sufficient, able to eliminate the external interventions or to limit them to a few exceptional cases, simply disappears. In fact, the event hypothesized in the lake example exhibits no particular element of exceptionalness, but is rather representative of a type of events occurring continuously.

We may yet again resort to the lake example and analyze it from another point of view.

Imagine two universes: one, in which the right to discharge is assigned to the factory owner, and another, identical to the first, except for the fact that the right is assigned to the bathers.

Supposing that the bathers have resources to invest in building recreation facilities. In the first universe, reasonably concerned of having no right to clean water, they decide to use the resources to have fun in other ways. In the second universe, aware of the strength of their right, they decide instead to invest in the lakeshore.

Imagine that in both universes the same technique is invented, that allows to save production costs, but entails a greater pollution. It is obvious that for equal magnitude
of production costs savings and levels of pollution, the new technique has in universe 1 very different chances of being put in use than the ones the same technique has to be employed in universe 2. A very likely outcome is that the technique will be adopted in the universe 1, where bathers do not assess the purity of the lake waters as much as to offer the factory owner an amount greater than the value of production costs saved, but it will not be adopted in universe 2, where the savings in production costs - however identical to what occurred in universe 1 - are not such that the owner of the factory can offer bathers a certain amount able to convince them to renounce the use of the lake.

This example suggests some reflections too. A first consideration is that the outcomes in the two universes are both efficient, each in the context of its universe, but certainly they do not characterize two fungible worlds. By generalizing the events described in the example, we can imagine two worlds, one characterized by the adoption of inexpensive techniques and lakes polluted, the other characterized by the use of more expensive techniques and clean waters. Even putting aside the distributional effects (the greater or lesser welfare of the factory owner and/or buyers of its products in comparison to greater or lesser welfare of bathers), no reason seems to exist that demonstrates that one of the two universes is more efficient or more legitimate than the other.

A second point which deserves to be noted, is that the difference between the two original results depends on the resources held, and the choices made, by the holders of the right. What happens here is particularly significant from the point of view of a legal review of the two situations. The point is that the market is not a locus in which simple negative freedoms (the possibility of use of one's resources without interference of the State or of other private individuals) coexist, but is a locus in which active powers conflict with each other. Therefore, when the law assigns property rights, coupled with freedom of contract, it does not assign only the possibility (negative freedom) of enjoying the things every individual owns. It assigns also a power, the power of changing the legal and the effective reality. The power to continually create new rules and thereby new limits to the freedoms of others. In our example, the legal power granted to bathers to build infrastructure on the lake that others must respect, and to recruit lifeguards, attendants, waiters, and so on, gives them the opportunity of modifying, in a legally protected way, not only the legal, but also the factual reality. This is with the consequence that the undertaking of a given activity (in our example, the spreading of a new technology) may be made more expensive for third parties (the

---

11 The point has been elaborated especially by E. DICIOTTI, Il mercato delle libertà, Il Mulino,
owner of the factory) and for the whole society. In other words, the fact that we all will eventually live in a polluted world where goods cost little, and not in a clean world where goods cost more, comes to depend on the initial assignments of power and the use that the holders decide to make of their powers.

5- “Human” and “divine” Coasian worlds distinguished.

Of course, we can easily imagine worlds more Coasian than the world we referred to in the previous paragraph. We can imagine a world in which the lawmaker is able to foresee all the possible inventions and, more in general, all the possible changes of every individual and social condition, and to dictate rules applicable to every future situation, not only real, but also hypothetical (so to inform the contracting parties of what could be the law in every possible circumstance).

We can also imagine a world with markets for all possible future goods “distinguished by their physical characteristics, by their place and date of delivery, and also by the state of the world” or with insurance market for each date-event pair.12 We can obviously imagine a world in which the factory owner may bribe the riparian owners in order to convince them not to invest on the lake shores, the riparian owners may bribe the inventor in order to convince him not to invent a more polluting technique, the inventor may bribe the factory owner in order to gain a commitment to adopt her future invention, and so one.

Putting aside the question whether it is worth living in a world in which we all must be continuously careful of bribing the right person at the right moment, the problem is that in both solutions (foreseeing lawmaker and complete markets for careful contracting parties) we have to imagine a world populated by divine creatures capable of foreseeing exactly each and every possible state of the future world and the probabilities of each one of them taking place. Otherwise, every, even the smallest, error of prediction can in fact prevent the attainment of the best results.

A world in which everything can be foreseen is a world without innovation in the sense we are accustomed to. It is in fact a world without time. It seems to me a world of eternity that only Souls and God-like creatures are able to inhabit.

In any case, a world where certain phenomena whose elimination is physically impossible in any imaginable universe are deleted, cannot sustain a narrative able to provide rational arguments. At most it can provide a sort of legitimacy that is unacceptable in our post-metaphysical world.


So, going back to the notion of transaction costs, we can distinguish between what we can call “human” transaction costs and what we can call “divine” transaction costs. In the former category we can put the transaction costs whose elimination is conceivable (even if in fact not completely attainable) in a world governed by the same physical and psychological laws that govern the universe which we actually live in. In the latter, we can put the transaction costs that could disappear only in a world governed by different laws, whose content every one can establish according to preference.

The possibility that unforeseen events occur, the consequences of which agents are unable to assess, and sometimes even to imagine in advance, must therefore be accepted as one of the characteristics of any imaginable universe, including a “human Coasian” world.

A “divine Coasian” world is also imaginable as is a Christians’ or Muslims’ Heaven (more or less vaguely). I do not think however that those efforts of imagination are useful in the present context. It may be that imagining a “divine” Coasian world results in utility elsewhere, but surely not in legitimating the institutions of our secularized world.

6-Failures of the “human-Coasian” world.

Having distinguished two kinds of Coasians worlds, my thesis, in the light of the arguments discussed in the preceding paragraphs, is that a “human Coasian” world is a world in which the coherent fulfillment of the system of values which has been indicated as the basis of its potential legitimating function, is not obtained. I maintain therefore that the possible legitimating strength of the Coasian narrative is very low.

Many of the arguments that motivate this judgment have already been illustrated in the previous paragraphs. A few points deserve to be underlined here, especially with reference to the values that were indicated as possibly able to make the Cosian world a world worth living in.

As we have already seen, the main values whose achievement should positively qualify a Coasian world, are efficiency, liberty and a peculiar compromise between these values and the value of equality or fairness.

As to the question of efficiency, a fundamental difficulty impairs the same possibility of considering it as a value. The fact is that efficiency, interpreted as the maximal feasible satisfaction of the preferences of all relevant individuals, is a “local” concept, which has a (more or less precise) content only in a context in which the relevant individuals and their preferences are precisely defined. On a more general level,
the concept loses its content, especially as the preferences become indeterminate and
the same identification of the relevant individuals may become uncertain. The
preferences become indeterminate not for empirical difficulties in the ascertainment
what the preferences of the concerned people actually are, but because beyond a given
level of complexity the preferences become difficult to define even for the single
individual. Let's pose the question whether the Roman empire was more efficient than
the Mongol empire or if there is any truth the reverse. The question immediately
appears to be a ridiculous one, even after we have successfully established that the
relevant viewpoint is that of the Romans, the Mongols or ours.

The point necessitates closer examination, though for the sake of the present
argument this generic reference to the problem of defining “efficiency” may be
sufficient.

With this general remark in mind, we can go back to the problem of the two
universes, respectively with clean or polluted waters, and with the usage of more or less
expensive techniques. The fact that a human Coasian world can indifferently develop
in either direction without any reason provided for preferring either one, is in my view
sufficient enough for excluding that the Coasian narrative may perform a serious
legitimating function. It is not capable of keeping the promise of a better tomorrow,
for the simple reason that it is not able to determine what our tomorrow will be and has
no criteria for establishing which tomorrow should be appreciated as the best.

As to the hierarchy of the values, and the compromise between efficiency and
fairness, we have seen that in a human Coasian world a lot of events may determine
distributions wholly independent on improvements of the overall efficiency of the
system.

Coming to the question of liberty, interpreted as the possibility of a collective
self-government via voluntary exchanges with the intervention of the lawmaker
confined, in essence, to the initial assignment of rights, I have already noted that the
promise cannot be kept. An acceptable human Coasian world requires a constant
legislative intervention, to correct distributions devoid of any meaning, and / or to
update the original allocation of rights to resources. It follows that the relations
between the parties are continuously modified by the law. The results of free bargaining
are therefore deprived of a possible procedural legitimacy provided by their being the
result of a process of free bargaining taking place within rules of the game established
once and for all in advance.

The last, and probably the most important, point is that liberty cannot be
considered only from the viewpoint of the possible intrusions of the lawmaker in the
private spheres of the individuals. We know that another, even more odious, limit to individual liberty exists: the power a private individual can exert over other private individuals. This is an incumbent problem even in a human Coasean world, as we have already seen when we underlined that the evolution towards a universe of type 1 or of type 2 depends on the exercise of the power assigned to some individuals rather than to others. This is a main theme, and we shall explore it more closely in the last part of the paper.

7- Private power and the role of the transaction costs.

Through previous arguments the conclusion follows that the Coasian narrative is unable to perform the function of providing rational arguments in favor of the way the problems of the assignment of rights are framed by the economic analysis of law movement. It cannot perform this function on a global level, as it is not able to keep its promises pertaining to the system of values that could be fulfilled by moving towards, or by mimicking the main features of, a “human” Coasian world.

I would pose now a residual question and explore the problem as to whether the Coasian narrative can perform the more limited function of identifying a variable, the “human” transaction costs, as the most important among the obstacles which, in the majority of situations we face in our real world, are able to prevent the attainment of the best possible results.

Having established that the elimination of all “human” transaction costs is not the path towards the promised Eden, we can ask ourselves whether it is at least the best way to improve our life in this valley of tears.

In less mystical words, we can now pose the question whether “human” transaction costs (the only costs that can be eliminated by human actions) deserve the prominent position they enjoy in the Coasian tradition of the law and economics movement.

As is well known, and as we have already underlined, in the Coasian tradition, transaction costs are considered paramount because they may prevent the interested parties from bargaining to the efficient solution. Absent transaction costs, it is assumed, the parties will always negotiate an agreement that maximizes the social product. Thus, the indications suggested by the legal interpreters of the Coase’s thought: legal rules should be designed to assign legal entitlements so that transaction costs are minimized and where they cannot be reduced, legal rules should dictate a solution that achieves the result that the parties would have reached through bargaining.
In the previous paragraphs we examined the normative profile of that prescription and endeavored to demonstrate that there is a lack of a solid foundation. A “human” Coasian world is not a place worth living in. Therefore, even if it were possible, there is no rational argument in favor of trying to approximate the real world to the Coasian world.

Now I will examine another, more limited (but practically more relevant) question, in which normative problems are intertwined with empirical and pragmatic aspects. The question is whether it is correct and appropriate to start our framing of the legal problems posed by human (or at least human-economic) relationships with an analysis of the phenomena transaction costs refer to. It is no longer a matter of great narratives. It is rather a local problem, a simple problem of how to build a research project and of identifying the main factors that affect the solution of the problems we face. Correctness and appropriateness remain debatable judgments (we are still treating a problem of legitimacy, not a problem of absolute truths). The difference is that here they depend not on comprehensive narratives, but on empirical evidence and practical judgments of convenience.

In our case, the problem is whether transaction costs are the only or main (both in terms of empirical assessments and of judgments of value) impediments to efficient solutions and therefore the variable on which we have to concentrate our attention.

My thesis is that the most important factor we have to consider in solving the problems of human cooperation are not the phenomena connected to the notion of transaction costs, but the phenomena connected to the notion of power and to the problems of its distribution.

This is far from being an original idea. Leaving aside other important doctrines, the asymmetries in resource ownership (and the consequent asymmetries of power) are considered as the main factor affecting the process of genesis of social institutions in the so-called bargaining thesis. Asymmetries of resources ownership are also considered as a very relevant variable in the literature on economic development and on strategic bargaining between parties unequally endowed.13

---


Obviously the existence of power asymmetries cannot be contested. In fact the dissent with followers of the Coasian tradition is not on this point (existence of power asymmetries) but on the effects that power relationships can have on the allocation of the resources. In particular, the central question is whether power distribution can affect the allocation of the resources and whether power asymmetries may prevent the parties from reaching the agreements that could maximize the aggregate benefit of their joint activity.

The argument that power asymmetries could prevent the reaching of efficient agreements is based on the idea that rational self-interested individuals “will prefer a contract that maximizes their individual benefits over a contract that maximizes aggregate benefits”\(^{16}\). They will prefer a bigger slice of a smaller pie to a smaller slice of a bigger pie.

In the Coasian tradition the reply to this argument is as usually based on the assumption of zero transaction costs. Absent transaction costs, the distributive consequences of every deal can be established by the parties and, therefore, nothing prevents the weaker party from offering to the stronger one any distribution of the benefits of the deal that can satisfy the stronger party’s desires. In this context, a greater aggregate benefit that can be divided according any criteria whatsoever the parties agree upon, will produce, by definition, at least one share greater than the largest of shares in which a smaller aggregate benefit can be divided.

The problem seems to lay as always in the presence of transaction costs that could prevent side payments to the most powerful party or may in general reduce the range of the alternatives “such that there is no sufficient correspondence between efficiency and distributional advantage to offset the effects of individual self-interest on the selection of a particular rule”\(^{17}\).

If this were the case, if in fact the elimination of transaction costs impeding side payments is in some contexts (international State relationships, certain kinds of political bargaining, etc.) impossible, then the validity of the Coase theorem, and of the whole conception of the process of institutional development which is connected with the Coase's lesson\(^ {18}\) should be limited to the social contexts in which contracts occur.


\(^{17}\) Id., at 117.

\(^{18}\) The so called contract theory, developed especially by D.C.NORTH, *Institutions, Institutional*
between actors of equal power or in which arbitrary asymmetries of power among the actors are neutralized. This is in fact the thesis proposed by the adherents to the bargaining theory.

It is worth noting that in the literature briefly examined just a moment ago, the possible relevance of power relationships is still dependent on the existence of transaction costs, notably the transaction costs able to prevent the securing of side payments in favor of the more powerful parties (and on the following difficulty of convincing them to accept agreements which, as such considered -lacking side payments- may entail results that they consider unsatisfactory).

In this vein, we are still concerned with a problem of possible elimination of transaction costs (at least if we decide to call transaction costs the difficulties of establishing credible commitments in favor of the most powerful parties of the bargain). Given that these costs are theoretically eliminable (in our terminology they are “human”, not “divine” transaction costs) the controversy ends up in the empirical dispute about whether transaction costs of this kind (that able to prevent side payments) are more or less widespread and more or less easily removable.

Both (the followers of the contract theory and its critics), share the conviction that power positions can be transferred like any other good. They dissent only on the practical recurrence of the conditions that can prevent the powerful from accepting a social arrangement that however efficient may entail a decrease in her power. In this perspective, transaction costs are the governing variable even in the presence of power asymmetries. Absent transaction costs, power relationships could be neutralized in every situation, and they would cease to perform a relevant role.

Instead, I would like to explore a different perspective in which power relationships may affect the results of a bargaining process in a way which is fully independent on the existence of transaction costs that make side payments unfeasible, and is instead strictly connected to the essential features of the notion of power, and to the empirical attributes of its forms of concretization.

At the empirical level, I maintain that power relationships are able to hinder (“fetter”, in the Marxian language) the development of the system even where transaction costs (of course, we speak of “human” transactions costs, that are the only that can be eliminated in the real world) are absent.


19 J.KNIGHT, Models, note16, at 95. In a different perspective the priority of creating fair contexts in which rules and contracts can work efficiently is argued in F.DENOZZA, supra note 8.
At the level of value judgments, I maintain that problems concerning power distribution deserve much more consideration than the phenomena connected to the transaction costs do.

As we have seen, the main idea shared by the different theories previously examined, is that power does not matter, because it may be sold and bought like everything else. If individual A by exploiting her power in a given way can cause individual B a harm bigger than the benefit for herself, B can simply pay A a sum of money to induce her to use her power in a different way. This is a classical Coasian bargain, and the reference to anything we have called “power” (instead of resorting to the more usual language in which what is exchanged is called resource, property, right or in any akin way) seems unable to change the frame and the results of the reasoning.

The point deserves a closer examination. I will argue that in the Coasian narrative problems of power distribution are concealed by some conceptual vagueness which confuses power with influence, and ignores the distinction between the power interpreted as a dispositional concept and the power interpreted as the concrete exercise of this dispositional attitude.

The indifference predicated in the Coasian narrative between the assignment of the right to one or another of the two parties of a possible transaction, and the consequent faith in the centrality of transaction costs (up to the point that the same choice of the assignee of the right is conceived as a function of the constellation of transaction costs existing in any given situation), follows just from the confusion between power and influence.

Going back to the example of the lake, let's imagine that the lake is used by a factory and by a fishery and that the latter has to decide whether to invest in improving its activity in front of the possibility that in the future a new technique creates for the factory the opportunity of exploiting the lake in a way not compatible with fishing. In the classical Coasian version of the evolution of this situation, the right holder is offered by the other party a sum of money in order to prevent her from taking the course of action that may interfere with the other party's projects. Thus, either the fishermen offer the factory owner a compensation for the commitment to not modify the technique she is using in her factory, or the factory owner offers the fishermen a compensation for waiving to invest. In both cases the sort of the lake depends on the comparison between the amount of the offered compensation and on the profits the right holder expects from the future activity he is asked to surrender.

In a “divine” Coasian world, the reservation price of the right holder and the compensation offered by the other party reflect exactly the reciprocal expected
profits. The fate of the lake is therefore decided by the relationship between the magnitudes of these two variables. The party with higher expected profits will invariably conquer the right of using the lake, and the system will invariably produce the maximal feasible amount of gains. Power does not matter.

If we consider a “human” Coasian world in which the parties are absolutely free to contract with no cost, but are not able to exactly foresee the future, the terms of the problem change. In fact, between the two parties a difference exists, that is neglected in the Coasian narrative and deserves consideration. One of the two parties, the right holder, can effect the result, in the sense that she can determine the result by simply deciding not to assume any commitment. The other party can only affect the result, via the incidence her offerings, of rewarding in different measure the different conducts of the right holder, may have on the decision taken by the latter. If the reward offered for the “correct” conduct (the conduct of the right holder that maximizes the joint gain of the two parties and of the whole society) is considered by the right holder insufficient for whatever reason, there is no way whatsoever to compel her to take the “correct” decision.

This difference is concealed in the Coasian narrative by one simple move, that of considering only two (totally de-socialized) parties in a context in which both are constrained to act according to a given rule (that of maximizing one's immediate gain). In this situation power, that is the ability to act according to one's will and not according to a given rule, simply disappears.

We can however easily imagine a different situation in which the right holder faces different counterparts each making an offer of a magnitude determined in accordance with her forecast for the level of her future profits. If one, or some, of the offering parties make a mistake in deciding the “right” amount of the offer, this does not matter if at least one makes the right offer. But if the right holder is mistaken (if she is expecting a totally “wrong” offer) there is no way of reaching the “right” result. This makes a big difference between individuals who have power and individuals who can only try to influence the decisions of the powerful.

Other problems in the Coasian narrative arise from failing to distinguish between the sale of a single, concrete, exercise of a given power, and the sale of the power position as such. I contend that whilst the former (the single concrete exercise of a given power) may be treated as a thing that can be more or less easily evaluated and transferred, the latter exhibits some peculiarities that are in my view able to prevent

---

efficient agreements in a way that is much more disturbing than the way transaction costs do.

The Coasian narrative fails to appreciate the distinction between power positions, with their dispositional attitude,21 and acts of exercise of power, still by the usual move of presenting two parties, detached from the rest of the society in which they live, and engaged in a single deal, with payouts and rules of the game fully specified in advance, once and for all. In this context there is no difference between power as such considered and a single exercise of power.

Contrary to the possible appearances, it is a fully static situation with a pie whose size is given, in the sense that everyone knows what the maximum size that can be obtained is, and the recipe that allows the achievement of this result. In such a static world, power relationships can be easily neutralized simply because they, in a sense, do not exist at all.

8- Variations and expansions.

Power as a dispositional attitude is distinguishable from the single acts of its exercise only when we consider an indeterminate future which the powerful has the opportunity to influence, if not to model, in her own interest.22 Power becomes a relevant variable when we are confronted with a world, as is the world we live in, in which the problem is not only, and may be neither mainly, that of producing goods with given resources, but that of reproducing the society as a whole.

That of reproducing not only the main aspects of society’s economic life, but also its particular form of social organization (in Marxian terminology, its “production-relations”).

The fact that we are considering economic power, thus a power which arises from the control over things mediated by property rights, should not hide the difference between the value of things as such considered, and the value of the power conferred by the ability of controlling them. The evaluation of a power position depends in fact on the exact forecast of the complete set of the opportunities of its exploitation.

In a narrative in which attention is paid only to the property rights of the parties, something important is missing. In fact, property rights can be imagined in a way almost completely independent from the historical characteristics of the society in which they exist.

---

21 Id, at 14.
22 “Power should be understood as the capacity of one or several classes to realize their specific interests” N. POULANTZAS, State, Power, Socialism, English translation, Verso, 2000, p.147.
Many attributes of the property right have remained unchanged since the Roman law up to the present. This does not imply that we can consider the actual position of all property holders as immutable and always equal to itself in the endless course of the centuries.

The point is that even where the structure of the property right does not change, what may change is the level of social power enjoyed by the right holder. The level of social power conferred by the property right depends much less on the legal structure of the right, than on the social and practical conditions of the context in which the right can be exercised. An apple harvest may confer to its owner very different levels of power. It depends if the property holder is a member of a capitalist society or of a feudal society if a competitive market for apples exists, or she is the only owner of apples in the world.

Let us consider for example a power position like that enjoyed by a monopolist. Monopolist's customers may in hypothesis bribe the monopolist in order to induce him to practice competitive prices.23

But what about the sale of the monopolistic position as such? A part of the value of a monopoly is obviously measured by the future discounted profits that the monopolist will be able to earn in a definite time (the time the monopoly will presumably last) rebus sic stantibus, that is, in a future imagined as a projection of the given situation. I believe however that we have to add to this value that of the chance the monopolist has (and the firm in a competitive market does not) of modeling some of the future characteristics of the market, for example by choosing to develop one instead of another technology, one or another level of compatibility of the product in question with other products, and so forth.24

The first difficulty in imagining this chance bought and sold like any ordinary commodity stems from the fact that its value depends on the gains that the holder of the power will be able to collect from a series of acts of exercise of her power that cannot be defined in advance and that will vary according to future concrete unforeseeable circumstances. If markets for each of these circumstances are missing

---

23 I am not able to understand whether this was the hypothesis contemplated by G. STIGLER, The Law and Economics of Public Policy: A Plea to the Scholars, 1 Journal of Legal Studies, 1972, 12, approved by R.H.COASE, The Firm, at 158.

24 This point is usually neglected by ultra-liberal thinkers. For them economic power “is simply the right under freedom to refuse to make an exchange. Every man has this power. Every man has the same right to refuse to make a proffered exchange” M. N. ROTHBARD, Man, Economy, State (the scholar’s Edition with Power and Market). Ludwig von Mises Institute, 2004, p.1327. On the contrary, the essence of economic power is the ability to define the status of futures worlds and the conditions in which future exchanges shall occur.
“individuals must make guesses about opportunity costs”\textsuperscript{25}. The point is that the “guess” of the powerful counts much more than the guess of the powerless.

Another difficulty to the creation of a market for power arises from the fact that its future exercise may affect different people in different ways according to the unforeseeable circumstances and the contingent decisions of the power holder. In the case, for instance, of the monopoly power, the way in which the exercise of the power will affect different categories of consumers and of competitors, depends on the evaluations the monopolist will make of what is more in her interest in each set of the different circumstances she will face in the future. Therefore, determining in advance how much the future exercise of a given power will affect each potentially interested individual, is almost impossible, making thereby impossible the calculus of the price each individual might be willing to offer for inducing the powerful to relinquish whole or part of her power.

To sum up, my thesis is that power, interpreted as a disposition distinct from the single acts in which it is exercised, cannot be treated as a commodity which can be bought and sold in an appropriate market, due to the practical and theoretical difficulties of establishing its value.

Obviously, everything can be the object of a sale or of a barter. In fact, power positions are usually sold, often together with the material or immaterial resources whose possession the power position stems from, as in the case of the sale of firms with monopoly power. The point, however, is that when power positions are at stake, no guarantee exists that the transactions possible in a “human” Coasian world invariably constitute true steps along the path towards the maximization of the overall welfare. If it is true that in order to have complete markets and “for the first theorem to apply, goods must be distinguished by their physical characteristics, by their place and date of delivery, as well as by the state of the world”\textsuperscript{26} and if the value of a simple thing as a booked taxi changes according to the status of the weather at the moment expected for its use (the same taxi being presumably more valuable if raining than if sunny\textsuperscript{27}), it is not so easy to imagine markets able to give the “correct” price to a complex “thing” like a power position.

\textbf{9- Conclusions.}


\textsuperscript{26} Id. at.43.

\textsuperscript{27} Ibidem.
Finally, let us come to the question whether transaction costs are a correct and appropriate starting point from which to examine the problems of human relationships.

Transaction costs may obviously impair the possibility for a party to affect the decisions of another party. They can prevent the party without power from making an offer (contract) or from making a threat (lawsuit) in order to convince the powerful party to act in a “rational” way. I contend, however, that much more important than the transaction costs, which disturb the relationships between powerless and powerful individuals, is the social context which determines who is the powerless and who is the powerful. This does not mean that transaction costs are irrelevant. They may prevent workers from creating a valid countervailing power to the power of employers; they may prevent consumers from coordinating their actions against monopolistic firms, and so on.

Eventually, they may prevent us not only from reaching a better result chosen among given possible outcomes, but from making feasible new possible outcomes in which “some are helped and no one is harmed”\(^2\).

What I contend, however, is that transaction costs (especially as are usually conceived of) are not the most important factor in determining unacceptable results.

Coming a bit more closely to the real problems we face in our real world, the point is that we are often confronted with power positions which (for a lot of different reasons) we are not able to dismantle. Think about the monopolistic power enjoyed by a lot of firms, or to the power of people managing giant corporations. As to the latter, consider that in every theoretical construction (from Berle&Means to the agency problem narrative) and in every corporate governance model (from the Angle-Saxon to the Rhenish to the Latin), beyond all beyond all differences, an element exists that does not vary. In all these real models, and in all these theoretical constructions, despite their differences, we are confronted with the same problem: the existence of a power position (the discretionary power of the managers, be they owners, partial owners, syndicated owners, professional managers and so on) that we cannot dismantle, and the need to balance this power with a countervailing power, we are everywhere in search of\(^2\), be it the banks, the minority shareholders, the financial market and so on.


\(^2\) Not only “macro” countervailing powers in the Galbraith's vein, (whose importance, far from being undermined, has been on the contrary enhanced by the globalization of the market, see G. AMATO, Antitrust and the Bounds of Power. The Dilemma of Liberal Democracy in the History of the Market, Hart Publishing, 1997, It.translation Il potere e l’antitrust, Il Mulino, 1998,
I contend that having established that in a “divine” Coasian world a simple, “complete”, contract could solve any problem, is neither helpful, nor an appropriate starting point. If the objective is that of inventing an “organization that might make us all better off” 30, then the main problem lies not in what can prevent contracts between powerful and powerless people, but the way in which power is allocated. The latter is the legitimate starting point.

30 G.CALABRESI, supra note 28.