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LAW AND ECONOMICS

JOHN R. COMMONS

Of the five elementary concepts or principles of economic theory, at least four are functional also to the science of law, namely, Scarcity, Futurity, Custom and Sovereignty. A fifth concept of economics, Efficiency, connects that science with the physical sciences.

Scarcity, for the economist, shows itself in the so-called "law of supply and demand," or rather in the functional relations of the three variables, Supply, Demand and Price, since a change originating in the dimensions of any one of these variables of scarcity is followed by changes in the dimensions of the other two. But Scarcity, also, for the jurist is fundamental to his concept of property, since the only significance of any sometimes alleged right of property attaching to objects whose quantity is unlimited in supply and can therefore be used by all persons, like air or sunlight, is in their appurtenance to objects whose quantity is limited in supply and can, therefore, be excluded from use by other persons, like radio stations and land space. Neither proprietors nor courts can get jurisdiction over objects unlimited in supply.

Having the same foundation in the Principle of Scarcity, the question arises, why have not the two sciences of law and economics been treated as one and been advanced together? In our Anglo-American universities they have been separated, but on the continent of Europe we know that they are more closely united. One reason is the priority of England in inventions and manufactures, which attracted the pioneer English economists towards the physical sciences of production of wealth, and they based their theories mainly on that division of economics which has to do with man's control over the forces of nature, namely, Efficiency, under the name of Productivity.

Another reason is the influence of Jeremy Bentham in his criticism of Blackstone. Bentham asserted that Blackstone's reliance upon custom and the common law was a reliance on mere "ancestor wisdom" supported by "authority," and he set up, in its stead, the pains and pleasures of individuals supported by "reason" as the foundation of legal, ethical and economic science.¹ This view fitted in precisely with the extreme individualism of English economists and made it possible for them to assume that the largest production of wealth through the selfishness of individuals was equivalent to the ethical principle of the maximum happiness of all. Great productivity was great happiness. Ricardo, the founder of English economic theory, one hundred years

¹"Fragment on Government," 1 *Bentham's Works* (1843) 221; "Book of Fallacies," 2 *ibid.* 375.

ago, accepted Bentham's rendering, and hence custom was apparently eliminated from English economics, so that it came to be based on "happiness" and "reason" instead of "custom" and "authority."

But economists did take for granted the largest contribution which custom had made to economics, namely, the custom of private property, so that English economic theory was worked out on the three principles of productivity, selfishness and property. It was this "classical" theory of economics, thus propounded by Bentham and Ricardo, that split afterwards into the socialism of Marx and the anarchism of Proudhon.

In more recent times, that is within the past forty years, economists have begun to incorporate into their theories contributions from three sources, Sociology, Trade Unionism and Public Regulation, which run counter to, or at least transcend, much of the inferences drawn from either Bentham's individualistic pains and pleasures or the supposed identity of efficiency and happiness, and which turn out to be the part played by Blackstone's custom upon economic life.

However, this economic concept of custom is a considerable enlargement upon what I understand Blackstone and the lawyers to mean by custom. They identify custom with the common law, whereas, from the economist's approach, the common law is a special case of Darwin's "artificial selection," by the courts in this instance, of what are deemed to be good customs, and the rejection and penalization by the courts of what are deemed to be bad customs. Thus the practices of trade unions may be deemed to be bad customs, but the similar practices of business men may be said to be good customs. The economist, or sociologist, takes all customs into account, and the word Custom, in his usage, may be said to have the three meanings of Habit, Common Practices and Common Law. Habit is the practices of individuals which may or may not conform to the common practices of those with whom he is associated. Common practices are the pressure of opinion and the exclusion from intercourse by the associates of the individual which thereby require him to conform if he would live and prosper. And the common law is the protection by the courts, by means of the physical penalties and immunities of government, of approved practices and the exclusion of disapproved practices.

From this point of view it can be seen, I believe, how close is the relation between Economics and Law. Economics becomes the Common Practices of feudal lords, of the early guilds, of agricultural communities, of merchants, manufacturers, business men, of workingmen, professional men and others, in their daily transactions with each other by way of creating and obtaining an income from the earth and from each other. And the Common Law evolves in proportion as the courts decide disputes in accordance with the common practices of these several classes deemed to be good and proper.

Perhaps this notion does a little violence to a certain notion that the

common law is the primitive custom of England, as suggested in the distinction between the common law and the law merchant. But the law merchant was simply one section of the approved common practices of business men, first enforced in their own courts and then enforced, with enlargements or restraints, in the common law courts. These latter courts have been taking over these business practices during something more than three hundred years, and out of them they have developed by "artificial selection" the modern concepts of incorporeal and intangible property, additional to the primitive concepts of corporeal property pertaining to the early common law. Incorporeal property is the legal enforcement of approved contracts; and "intangible" property has come to be distinguished, especially in the public utility and labor cases, as the "exchange-value," or "purchasing power," of any and all property upon the markets, such as the exchange-value of the intangible good-will of a business as well as the exchange-value of the physical plant and inventory, or the exchange-value of labor on the labor markets, or the purchasing power of credit on the money markets, and these purchasing powers constitute the business man's "assets" and the laborer's wages which are their intangible property. The two concepts of incorporeal and intangible property are merely two kinds of business customs, the one referring to creditor and debtor transactions, the other to seller and buyer transactions, as distinguished from the older customs of feudalism and the early common law which referred mainly to lands, physical chattels and personal services, before the great development of modern wholesale markets.

It was often with difficulty that the common-law courts could be induced to take over the practices of business men, an illustrious example being the rejection by Lord Chief Justice Holt, in 1702, of the negotiability—that is, the "intangibility" in the recent sense of the word—of the goldsmiths' notes, the foundation of modern banking, on the ground, in part, that these particular business men in London were presumptuously trying "to make a law to bind all that did deal with them."² A similar difficulty is observable during the past hundred years, after the courts had fully accepted the good practices of business men as normal, when it attempted to have them recognize also the practices of associations of workingmen. Workingmen have set up their own courts endeavoring to enforce their own customs, and, in many cases, they have set up jointly with their employers so-called arbitration boards, which are industrial courts. Here it is found that nearly always the disputes turn, directly or indirectly, on the fitness of certain shop rules designed to protect the workers in their jobs, and thus, in effect, to create a kind of property right in the job. Anyone who goes through the hundreds of labor cases reported from the courts

² *Buller v. Crips* (1702, K. B.) 6 Mod. 29, 87 Eng. Rep. 793.

of Australia will find that those courts have actually taken over the shop rules of the workers, and these common practices have become the common law of Australia. Here we find the creation by the courts of a new kind of intangible property, the job, and the process of its creation, by artificial selection, is almost an identical repetition of the process in English and American history of creating the incorporeal and intangible properties of business men, by way of taking over and enforcing their good practices, customs, or rules, formerly enforced in their own way in their own private courts of the guilds, the law merchant and in the *pie poudre* courts of the markets and fairs.

Thus the science of economics, which is a science of the good and bad habits and common practices of farmers, landlords, business men, workingmen and others in their mutual adjustments to scarcity of resources and in their competitions and conflicts imposed upon them by that scarcity, is a science of the fundamental concepts on which the science of law is also grounded.

But there is a reverse action wherein the science of economics is being grounded, in recent times, on concepts derived from the common law, quite contrary to Jeremy Bentham. This turns on the question, What is the ultimate unit which furnishes to economics its starting point? Economists have sometimes been apologetic, sometimes defiant, sometimes cynical, towards the criticism that they have based the whole of their economic theory on the selfishness of the individual regardless of the interests of others. In order to offset this animadversion some of them have at times made a fresh start in the field of ethics or law, as a kind of addendum, and there has resulted an irreconcilable dualism of the two principles of the individual and the society. But the courts, being directly in contact with the practices of business and compelled to decide disputes arising out of those practices, have built up both a method of approach and a joint concept of the individual and society which completely transcend this dualism and give us a starting point that is both individual and social.

The method of approach referred to, is that of a conflict between two persons, the plaintiff and defendant, who stand, through the doctrines of precedent and equal protection of the law, as representatives of two opposing classes of people. The court always begins with two conflicting persons, instead of one selfish person, and with the common practices of two opposing classes of persons instead of a mass of disconnected individuals, as the economists had done in imitation of Jeremy Bentham. This conflict of interests, then, is transcended by applying a rule or custom that has been found to be good, in that it lies in the direction of what is believed at the time to be the common interest of individuals and classes within the same group or society. The court begins with a transaction, where economists, following Bentham, begin with individuals. Thus the method of approach is both individualistic

and socialistic, and would seem to afford a point of conciliation between the great antagonistic schools of economic thought, the "classical" economists led by Ricardo, the socialists led by Marx, and the anarchists led by Proudhon.

Growing out of this point of approach and in order to do justice to the parties in view of the relations and obligations previously assumed, the courts have built up the joint concept of individual and society, above referred to, namely a "going concern" which acts as a unit, though composed of individuals, and is endowed with many of the legal attributes attached to individuals. They have thus converted the economists' "individual" into a set of relations, habits, transactions, or customs, of associated individuals. When we look at the matter objectively and without the subjective bias of our individualistic pleasures and habits, we must perceive that the true unit of economic theory is not an individual but a going concern composed of individuals in their many transactions of principal and agent, superior and inferior, employer and employee, seller and customer, creditor and debtor, bailor and bailee, patron and client, etc. Each individual in society, for the purposes of economic theory, comes to the surface as a member, a participant, a "citizen," in several of these going concerns, shifting from one to another and performing the work of certain jobs, or positions, or other set of transactions, in each particular concern for the time being, the supreme concern being the political one which attempts to monopolize the physical coercive power of society.

Here, it seems to me, the analysis made by Professor Hohfeld,³ of legal rights, duties, liberties and exposures, is of universal application to all going concerns. His is practically an analysis of the way in which the common practices of any going concern control the individual members of that concern and hold them to the conduct necessary to preserve the existence of the concern. For, as stated by Professor Corbin,⁴ these rules affirm what the individual member may expect that he "can, cannot, may, must or must not do," in so far as the superior interests of the concern are deemed to be at stake. These principles are just as applicable to the shop rules of an industrial concern, or to the ethical rules of a family or any of the many cultural concerns, as they are to the supreme political concern. The differences reside mainly in the sanctions brought to bear upon the individual and in the technical meanings and more elaborate manipulation of the words as used by the lawyers. In the political concerns the sanctions are physical coercion or physical immunity, and in the others the sanctions are wages, rents, interest, profits, jobs and other economic or cultural gains or losses. Where, as, in Australia, the shop rules of industrial concerns

³ Hohfeld, *Fundamental Legal Conceptions* (1923); Commons, *Legal Foundations of Capitalism* (1924) 91.

⁴ Corbin, *Legal Analysis and Terminology* (1919) 29 YALE LAW JOURNAL, 163.

are taken over by the courts, then the legal sanction of threatened violence is added to the economic sanction of threatened poverty, with such differences in interpretation as may be deemed fitting by the courts.

It will be seen that this concept of a going concern, with its common practices and common law, changes very greatly the several concepts of the individual, of the state, and of property entertained by Benthamistic economists. Instead of a passive "globule of desire" following the parallelogram of physical forces which bear down upon him, as Veblen⁵ would say, it substitutes an active person associated with others and participating in and controlled by the practices common to all. And it makes of the state itself a much less dominant coercive and arbitrary power than that conceived by the classical economists, the socialists and the anarchists. For it interjects between the state and the individual a complex of habits, practices, opinions, promises and customs which are both a substitute for state action and a highly intractable force which even the most powerful state cannot override, or will not if its officials care to hold their jobs.

This gives a very different idea about property. It corrects the anarchistic doctrine of the early economists that private property is an original, natural and inalienable right that cannot be taken away by the state, as well as the socialistic, and even occasional lawyer's doctrine, that property is the mere creature of sovereignty and can be changed in whatever way the sovereign may command. In place of these mechanical and coercive doctrines is substituted the concept of property as a complex set of acquired rights, of imposed duties, and of permitted liberties and exposures, derived from a great variety of customs which landlords, guilds, business men and laboring men have been influential enough to get the courts to authorize; and further, that these fundamental social relations of rights, duties, liberties and exposures, are grounded, not on the state, but in the daily habits, practices and customs of the people. I take it this is the grand contribution which the science of law gives to the science of economics. It introduces Custom into economic theory where, without it, there is no bridge between the anarchistic sovereignty of the pleasures of the individual and the socialistic sovereignty of the commands of Legislatures and Soviets.

The modern importance of this concept is very great, for it underlies all the legislation of the past thirty or more years, regulating the employment of labor, regulating public utilities, regulating competitive business and regulating the banking business. If the individual is supreme there can be no regulation—if the state is supreme, there can be no freedom. But if, between the two, is the regulative power of custom, then the choice lies only between good customs and bad customs,

⁵ Veblen, *The Place of Science in Modern Civilization* (1919) 73.

both of them already to be found in the world about us, and it is this that gives to economic science that ethical theory which its leaders have always sought or assumed, the theory of Reasonable Value. For reasonable value is none other than that valuation which arises from good practices of business and industry, distinguished from the anarchistic or socialistic, or dictatorial, or arbitrary, or destructive, practices, not conforming to the consensus of those who are deemed to be reasonable men, in that they conform to the custom of the time and place. Here the word "reasonable," means, not Bentham's meaning of intellect, but Blackstone's meaning of custom.

The other concept referred to above—Futurity—is common to the sciences of economics and law, as distinguished from the physical sciences. When economists based their theories on analogies to physical sciences, from which the Principle of Efficiency is derived, they pictured human conduct as a resultant of physical forces which pushed mankind forward from the past into the present. The individual was subject to "natural" laws which he could not overrule. The so-called "law of supply and demand," derived from the Principle of Scarcity, was a physical force of this kind. And correspondingly, the concept of Time, in the physical sciences, is that of a flow of events proceeding inevitably from antecedent to consequent. But when we look at the human will, or rather human Willingness, as the force with which economic science has to do, in contrast to the physical forces of gravitation, electricity, mechanics, and so on, then we find that it is the hopes and fears, the expectations and cautions, the foresight and impatience, respecting the future that determine what shall be done in the present. We have, both in economics and in law, many terms indicating this futuristic aspect of Time, such as motive, intent, purpose, wants, desires, security, investment, property, assets, liabilities, interest, capital—in fact, the concept of Value itself, on which economic theory, as well as legal theory, turns, is a synthesis of all these other concepts of futurity, and, as such, is always a concept of the present importance of things and persons and classes of persons in view of their expected uses and behavior in the immediate or remote future.

It is, indeed, this Principle of Futurity that changes the early economists' concept of human nature from that of a passive resultant of forces to that of an active originator, or rather chooser, of forces. Needless to say, the science of law, which studies the rules laid down for the guidance of conduct, is also a science wherein that ultimate mystery, Time, reveals itself as Future Time. But it has been only within the past forty years, through the insight of the late Minister of Finance of Austria, Böhm-Bawerk,⁶ that Future Time has been given a truly functional position in economic theory as one of the variables

⁶ Böhm-Bawerk, *Positive Theory of Capital* (1891) *passim*.

which determine the dimensions of the other variables, Efficiency and Scarcity. This was a noble contribution to economic theory and evidently furnishes another link uniting law and economics, though Böhm-Bawerk himself did not carry it forward to that conclusion. This was doubtless because his concept of objects of property was that of "corporeal" property, equivalent to the physical or materialistic "capital" of economic theory in its earlier stages.⁷ But when economic theory passes over to the "incorporeal" property (the creditor and debtor relation) and to the "intangible" property (the seller and buyer relation) of the law, then Böhm-Bawerk's Futurity is none other than the very attribute of Time whose expected outgo and income determine, both in law and in economics, the present value of going concerns and workers' jobs.

The interdependence of these five variable dimensions of human willingness, namely, Efficiency, Scarcity, Futurity, Custom and Sovereignty, may be seen concretely in the concept of "capital," which is both an economic and a legal concept. Different economists and different schools of economists have differed widely as to which of the first four variables they should select to represent "capital," though the concept is really that of the interaction of all five. At one time capital was the quantity of labor devoted to production. At another it was the accumulation, from the past, of physical products devoted to future production. At another it was the money which purchases commodities and labor. At another it is the capitalization in the present of expected net earning power in the future. If we put these various ideas together, all of the implied in the concept of Capital, we find that "capital," which is a modern concept, is the incorporeal and intangible properties of the law that have been recognized conformably to the customs of business. Incorporeal property (the creditor and debtor transaction) is created and becomes intangible property (the seller and buyer transaction) on the so-called money market, and a rate of interest or discount at the banks is the price paid by the debtor for that scarce service of a quantity of purchasing power loaned or hired during a lapse of time between the present when physical goods and labor services are purchased, and the future when their products will be sold and the purchasing power returned to the lender. It is the exchange-value of this incorporeal property, Credit, that constitutes this purchasing power, and it is this purchasing power which is intangible property or assets, yielding to the business man a legal control over commodities and the products of labor, through contracts and alienations, during the physical process of production and transportation.

Hence the prices paid, by means of this purchasing power, are paid, not for commodities and services, but for legal control over commodities

⁷ Compare his *Rechte und Verhältnisse* (1881) *passim*.

and services. The distinction may be seen by comparing primitive markets with modern capitalistic markets. In the primitive markets of the fairs and *pie poudre* courts both the physical control and the legal control went together. A seller handed over a physical product to the buyer and the law read into the act a transfer of legal control. But with modern wholesale business, under the direction of modern business concerns, after the desuetude of common law and legislative rules against forestalling, regrating and engrossing, the transfer of legal control is widely separated from the transfer of physical control. The legal control moves on from business man to business man in accordance with the customs of the credit system, while the physical control moves on from employee to employee under the commands of business men. The business practices determine the place and date of transfer of legal control, and the prices agreed upon in the markets always are fixed as the price paid for legal control specified or implied by the two dimensions of space and time. "Futures" have a price as well as "spots," and a "delivered" price is different from a "mill-base" price.⁸ Each is the exchange value of incorporeal and intangible habits, customs, practices and promises of business men, approved by the courts and guided by the legislatures and constitutions, and directed towards the control of commodities and services. Thus the concept of Capital, so fundamental in modern economic theory, is that of the inter-action of the five variables that measure and determine the activity of all economic concerns, namely, the Efficiency of labor and management, the relative Scarcity of things and services at specified times and places, the Futurity of a flow and a lapse of time, the legalized Customs of business men and the sovereignty of the State. A change originating in any one of these five dimensions of human Willingness is followed by changes in the dimensions of the others.

Other illustrations might be given of the fundamental unity of law and economics, for example, Value. This puzzling term has passed through many vicissitudes in economic theory and has recently become the outstanding term in psychology and ethics, as distinguished from the former pre-eminence of pleasures, pains and Bentham's so-called "reason." The law contributes still another variation, the concept of "reasonable value." Practically and objectively, the various meanings, as employed in law and economics, may be contrasted as Efficiency values, Scarcity values and Ethical values. All three of these meanings imply Futurity. Efficiency has to do with the increase in quantity of output in the form of products or services, compared with the quantity of input in the form of man-power. But the significance of efficiency does not lie in the mere physical products but in their physical qualities

⁸ Commons, *The Delivered Price Practice in the Steel Market* (1924) 14 AM. ECON. REV. 505.

and powers which are useful. While an increase of efficiency is increasing the quantity of commodities it is increasing, in exactly the same amount, the quantity of useful physical qualities or powers, sometimes known as "use-values" or "uses," or merely "usefulness," belonging to commodities, such as the nutritive qualities of wheat, the tractive powers of automobiles, and so on. These useful qualities and powers are the Efficiency Values of industry.

But scarcity values operate in exactly the opposite direction. An *increase* in the quantity of wheat, or the quantity of automobiles (other things remaining equal), *diminishes* their scarcity values, that is, their prices, although *increasing* the total amount of their efficiency values. And a *decrease* in the quantity of wheat or automobiles *increases* their scarcity values or prices by *diminishing* the quantity of efficiency values, or useful qualities. Now it is the engineer, the technologist, the labor manager, the laborer, who increases the efficiency values by *enlarging* output, but it is the business man, or rather the business function of all men, which maintains or increases the scarcity values by *withholding* output. The technologist is a specialist in efficiency, the business man a specialist in scarcity. The technological function of the will adapts itself to, and thus enlarges its control of, the forces of nature, but the business function of the will adapts itself to, and thus enlarges its control of, the forces of demand, supply and price.

This difference is really the difference between corporeal and "intangible" property, under the modern meaning of the latter term as distinguished from "incorporeal" property. Corporeal property refers to the physical forces of nature; intangible property is the business man's assets, or purchasing power, on the markets, that is, the exchange values, or rather scarcity values, of his corporeal, incorporeal, and even intangible property, depending upon their relative scarcities on the commodity markets, the labor markets and the money markets.

When next a dispute arises as to the prices, that is, the scarcity values, of commodities or services, in the hundreds of cases continually coming before the courts, the question may arise as to what is the "reasonable value," that is, the *ethical scarcity* value, under the circumstances, of that commodity, or service, or contribution to the common fund obtained as taxes, and so on. Herein the court, or the market commission, or the public utility commission, or the tax commission, or the arbitration board in labor cases, must take into account all of the five variable functions of Willingness already mentioned. It must consider the inducements to Efficiency, the circumstances of Scarcity at the time and place, the expectations of the Future, the good and bad practices of the two parties, as well as the good and bad Common Practices of similar persons under similar conditions and the legislative acts of sovereignty. These considerations are none other than the five interdependent functions of

the human will which make up the science of economics, and the Reasonable Value of the law is therefore the summing up of the whole science of economics.

I have spoken of law and economics as two "sciences." If they are strictly sciences, as distinguished from the theories or hypotheses with which all sciences start, then they must have units of measurement by means of which to test their theories by experiment and to enable the different investigators and practitioners to speak the same quantitative language. Words give us theories, but numbers give us sciences. The science of economics, unlike the physical sciences, has two systems of measurements, a quantity measurement and a scarcity measurement, while the law adds the measurement of "reasonableness." The quantity measurements are derived from the physical sciences and apply to such dimensions as length, volume, weight, work, time and efficiency. But the scarcity dimensions are derived from the markets, and apply to the dimensions of supply, demand and price. In America the lawful scarcity unit is the dollar, and the prices of all things on the markets are determined by their relative scarcities compared with each other and with the relative scarcity of the dollars themselves. The quantity measurement and the scarcity measurement always go together. Cloth is 50 cents per yard, wheat is \$1.00 per bushel, and, in the "greenback" period, even the physical dollar unit of 23.22 grains of gold was as high as \$2.00 measured in terms of the legal tender scarcity unit. It was the decisions of the highest court in the Legal Tender Cases that changed the scarcity unit from corporeal property measured by weight and fineness to that incorporeal and intangible property, the promises of government which have a certain amount of purchasing power upon the markets. A tender of this paper money is considered to be a liquidation of indebtedness in all disputes that might come before the courts, and hence almost every business man and working man, in all sales, purchases and promises upon the markets, employs this incorporeal and intangible unit of measurement rather than the gold or silver unit.

Herein we have a special and extreme case of what seems to be the general principle underlying the concept of "reasonable value." Considering all the circumstances of all the people of the nation, the highest court decided, in effect, that it was reasonable for lower courts to employ, in deciding disputes, a unit of measurement which the people, through their representatives, had agreed upon. The principle is not so very different from that underlying the establishment of all units of measurement, whether of weight, length, coins, or other dimensions. They began as local customs, then were standardized into a common law for all the courts by royal decree or legislative act. In all cases the standards of measurements proceed from a consensus of opinion. The opinion may be mistaken in the light of history or logic, but, in the light of that which works reasonably well, under all the circumstances and in

the opinion of those selected to decide because they are deemed to be reasonable men according to the custom of the time and place, such as a jury, a court, a public utility commission, an arbitration board, a legislature or similar body, Reasonable Value, when measured, is that degree of economic power through control of relative scarcities, which individuals may be permitted to exercise conformably to the habits, common practices, common law and common policies of the time and place.

If, in addition to the common law, we include statute law, as is needful for a complete idea of the unity of law and economics, then statute law, including constitutional law, the alleged seat of sovereignty, is rather a kind of organizing and experimenting with the efficiencies, scarcities, customs and expectations of the people, sometimes expediting them, sometimes inhibiting them. And the unity of law and economics, emerging, as it does, out of the same mysterious force, the Human Will, on which each science is grounded, becomes the interaction of Efficiency which creates a national output of human services, Scarcity which distributes the services as prices and income, Futurity which makes them valuable, Custom which regulates them, and Legislation which organizes and experiments upon them.