

The Impact of Contract Law on the Economy: Less Than Meets the Eye?
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We assume that contract law plays an important role in a market economy, but we may over-estimate its significance. A study of the Peruvian economy recently has been the focus of scholarly discussion in the United States. An entire symposium in the *Yale Law Journal*,² the lead article and a lengthy comment in the *Law & Society Review*,³ and an article in *Social & Legal Studies*⁴ all have focused on norms and sanctions in underground or second economies. All of these articles have considered in some detail Hernando de Soto's *The Other Path*.⁵ De Soto's study of Peru has come to stand for second economies in all of Latin America, Africa and much of Asia.

The Other Path contains several distinct elements. De Soto describes the practices of Peruvians in housing, retailing and transportation transactions, many of which violate Peruvian law. He explains why such transactions succeed even though they stand apart from the official legal system. Finally, there is a prescription for a "revolution" that would encourage and focus the entrepreneurial energy of the popular classes in Peruvian society toward greater prosperity. In essence, *The Other Path* advocated by de Soto is deregulation and the "rule of law," so beloved by international monetary organizations.⁶

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² See Symposium: The Informal Economy, 103 Yale Law Journal 2119-2436 (1994). See, particularly, Arthur J. Jacobson, *The Other Path of the Law*, 103 Yale Law Journal 2213 (1994).

³ See Jane Kaufman Winn, *Law and Relational Practices in Taiwan*, 28 Law & Society Review 193 (1994); Frank K. Upham, *Comment--Speculations on Legal Informality: On Winn's "Relational Practices and the Marginalization of Law,"* 28 Law & Society Review 233, 236-237 (1994).

⁴ See Lauren Benton, *Beyond Legal Pluralism: Towards a New Approach to Law in the Informal Sector*, 3 Social & Legal Studies 223 (1994).

⁵ Hernando De Soto, *The Other Path: The Invisible Revolution in the Third World* (1989). De Soto's title, of course, suggests a contrast with "The Shining Path," a radical Marxist revolution advocated by other Peruvians. See David Scott Palmer (ed.), *Shining Path of Peru* (1992).

⁶ Udo Reifner remarks: "While in former times capitalist nations used priests, soldiers and merchants to convince less developed peoples to adhere to their system, we can now rely on the convincing forces of IMF, World Bank, BERD and other financial institutions where nations cue up to be accepted as members." Reifner, *The Vikings and the Romans--Contract Law and Social Economy* 6 (Paper presented at the Conference on Perspectives of Critical Contract Law, Tuusula, Finland, May 7 to 10, 1992).

De Soto calls for deregulation to legalize the practices of those who now participate in a second economy. Most significantly for this paper, de Soto calls for the courts to enforce the contracts of those now in the second economy to encourage planning and risk taking. He found that those in the informal sector use inefficient tactics to insure performance of agreements. They create and maintain trust, dealing primarily with family members, and fashioning long-term continuing relationships. De Soto argues that these practices impose unnecessary transaction costs on traders. He advocates legally enforceable contracts so traders can rely on the legal system to increase the likelihood of performance and remedy defaults rather than on family loyalties and friendship. He writes as if legally enforceable contracts, standing alone, would make trust and the sanctions of long-term continuing relationships unnecessary in a modern economy. In other words, only a impersonal market is efficient.⁷

This paper will consider the role of contract law in market economies, particularly that of the United States because I know more about it than others.⁸ Much of my research has involved interviewing business people and their lawyers about their practices, collecting standard form contracts, and analyzing the context of contracts cases brought before courts. Thus, I will offer an empirical perspective on contract in modern economies.

I. The Received Model of the Role of Contract in Market Economies.

De Soto's argument about contract law's role is familiar. In Western culture there is a classic model of the functions of legally enforceable contract. This model rests on common but inconsistent assumptions. One version of the story suggests that in a state of nature we are all selfish, and we are forced to cooperate to gain economic rewards. Law supports our needed interdependence by coercing us to honor our agreements with others. Ideally, it should make no difference whether we perform or breach a contract because legal action will redress any harm resulting from breach. We get performance or a judgment, and one is as good as the other in a world where we can transform everything into a monetary equivalent.

The historical story of contract's development is similar. We began by trading within real communities. Capitalism then destroys community, and we became alienated strangers. We might like to act to help others, but we risk becoming exploited fools. The legal system then supplied a synthetic community based on rights and duties enforced by courts. We can risk acting cooperatively because the law will discipline those who act opportunistically.

The classical model also rests on many assumptions about the behavior of bargainers: They plan, perform and resolve disputes guided by their legal rights. Bargainers know that they must state all their rights and duties in a detailed contract because they can expect performance

⁷ Although I am critical of de Soto's claims for contract law, I do not want to be misunderstood as being critical of so much that I admire in *The Other Path*. It is a great book, and I would support many, if not most, of his policy recommendations.

⁸ See Stewart Macaulay, Non-Contractual Relations in Business: A Preliminary Study, 28 *American Sociological Review* 55 (1963); Stewart Macaulay, Elegant Models, Empirical Pictures, and the Complexities of Contract, 11 *Law & Society Review* 507 (1977); Stewart Macaulay, An Empirical View of Contract, 1985 *Wisconsin Law Review* 465.

only to the letter of their agreement. Indeed, if parties fail to plan and specify everything, they are at fault. They are responsible for their own injury when they fail to receive what they expected from the bargain. It is assumed that contract law is a body of clear rules that help traders plan and perform contracts. Bargainers know, or can learn, the formal steps necessary to create a legally enforceable contract. A bargainer always knows or can learn what a court would do in case of a dispute, and bargainers make contracts and perform them in light of this knowledge. Contract law also provides default rules to minimize transaction costs. Unless bargainers want other terms, they can rely on the law to fill in standard provisions. This avoids the costs of negotiating about all possible contingencies. Finally, the classic model assumes that, directly or indirectly, contract litigation is a primary means of determining breach, providing remedies and resolving disputes.

This classic model has an illustrious history. We find traces of it in Shakespeare's *The Merchant of Venice*. As you will recall, Antonio has breached a contract, and, under its terms, he owes Shylock a pound of flesh. Several characters look for a way out, but others argue that the economy of Venice depends on the certain and predictable enforcement of contracts. Even Antonio himself rejects a suggestion that the judge should not enforce such a bargain. He says that if the course of the law is denied, it will "impeach the justice of the state." This will harm the "trade and profit of the city." Of course, Shakespeare finds a way out of the dilemma, but remember that it involves at least claiming to enforce the letter of the contract.

We also find traces of the classic model of the role of contract in the writings of the great sociologist Max Weber. Weber argued that capitalism and increasing "formal rationality" go together. David Trubek⁹ tells us that Weber thought only a formal system of law can be predictable. Law seeking substantive ends leads to particularistic decisions. Such decisions make it impossible for business people to know in advance the right answers to legal questions. Formal justice, Weber argues, enhances individual opportunities, promotes self-determination and helps assure individual freedom. Trubek notes that Weber also argues, perhaps paradoxically, that formal thought in law may actually defeat the intent of transacting parties, and benefit those with power and wealth. In fact, Weber suggested that completely formal thought may be impossible.

⁹ David M. Trubek, *Reconstructing Max Weber's Sociology of Law*, 37 *Stanford Law Review* 919 (1985). See, also, David M. Trubek, *Max Weber's Tragic Modernism and the Study of Law in Society*, 20 *Law & Society Review* 573 (1986).

II. An Empirical Appraisal of the Classic Model.

How well does this classic model of the role of contract law fit an empirical picture of the law in action? It is not all wrong, but it certainly is an overstatement.¹⁰ Contrary to de Soto's position, and that of others who celebrate contract law, formal law may not be able to reduce transaction costs by placing great reliance on rights and courts.

The North American story is complex. Sometimes something approaching the classic model tracks well with the empirical picture. In certain situations, business people do engage in elaborate planning, performance and dispute resolution in light of contract law. Typically, lawyers control or influence these transactions. They may involve, for example, the sale of a major building, transfers of the control of a corporation or the licensing of intellectual property. The risks and amounts involved warrant elaborate written contracts and formal behavior. The parties' lawyers will take care to dot all the "i"s and cross all the "t"s.

Even the most carefully planned transactions may go wrong. When business people face disputes, sometimes they litigate to final judgment. Some losers appeal these decisions. In some of these cases, we get an appellate opinion applying the Uniform Commercial Code or the common law of contract as envisioned in the classical contract model. Often transactions that provoke judicial opinions involve a power imbalance. A franchisee, such as a local Ford dealer, may be suing a franchisor, such as the Ford Motor Company. A small supplier may sue a large corporate buyer. Appellate opinions often reveal a weaker party attempting to gain the power of the law to offset its lack of market power. But as Galanter tells us usually "the haves come out ahead" before the legal system.¹¹

Other disputes that go to court may involve attempts to salvage something from a near-disaster. Our Wisconsin Business Disputes Research Project has found that during the last few decades, there has been a marked increase in contract litigation involving the largest corporations in the United States. The great economic dislocations of the recent past have melted the relational glue that held transactions together. Long-term continuing relationships have

¹⁰ Roberto Mangabeira Unger in *Law in Modern Society: Toward a Criticism of Social Theory* 12-13 (1976), remarks:

By tightening or relaxing the strictness of the premises, by making them more or less complex and therefore more or less faithful to the social reality we want to apprehend, we are able to control the balance between simplicity of explanation and descriptive fidelity.

The more we lean toward the former [simplicity], the greater the danger that our inferences will fail to apply to any world in which we are actually interested. The more we tend to the latter [descriptive fidelity], the higher the risk that our conjectures will degenerate into a series of propositions so qualified and complicated that we are just as well off with our commonsense impressions. Whether simplicity or faithfulness to fact is emphasized will depend on the particular purpose for which we choose between them.

¹¹ Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 *Law & Society Review* 95 (1974).

collapsed. One party may be on verge of declaring or actually in bankruptcy. Moreover, modern economic transactions often involve great sums of money that neither party can afford to lose without a fight.

However, in other situations where transactions have failed, the role of contract law is muted or absent. Instead of relying on contract law alone, business people often turn to legally guaranteed security interests in property. My colleague, the great legal historian Willard Hurst, celebrates the role of lawyers as social inventors in 19th century America. Lawyers, he says, "contrived or adapted institutions (the corporation), tools (the equipment trust certificate), and patterns of action (the reorganization of corporate financial structure or the fashioning of a price structure for a national market)." ¹² Hurst views these social inventions as critical for the economic development of the United States. We can analyze these social inventions as contracts, but usually they involve much more than a simple contract. If, for example, an airline fails to pay for a Boeing 747, Boeing can seek damages. However, it also can take back title and possession of the aircraft through legal procedures. Of course, the value of repossessing goods is uncertain. If the used aircraft market is weak, recovering a 747 airplane may benefit Boeing very little. However, reselling the 747 after repossession may not be the most important goal of Boeing. The threat of losing the use of the aircraft may be a powerful incentive for an airline to pay or renegotiate its arrangement with Boeing.

Having said all this, however, very often the classic model is far from the reality of United States business. This is particularly true in transactions involving manufacturing firms. Often business people do not plan transactions in detail. As part of closing a deal, sometimes they fill in blank lines on standardized forms that contain numerous printed clauses. However, often signing such forms is only an empty part of a ceremony. No one negotiating the contract has read or understands the standard provisions printed on the form. The parties file the documents away and forget them. They perform to business and engineering standards rather than legal ones captured in contract documents. Sometimes form provisions are important. Often the goal of a large corporation that uses them is to ward off results that otherwise the law would impose. The corporation wants to be sure that those with whom it deals have no legally protected rights and cannot sue the corporation. Freedom of contract becomes freedom to have no legally enforceable contract. For example, in the automobile industry manufacturers often deal with suppliers on documents called blanket orders. They are documents with extremely flexible quantity and price provisions. The manufacturers make no commitment to buy a specified quantity of parts or components or they make a commitment that they can "cancel for convenience." The position of the parties is not that envisioned in the classic model of contract law. The contract document offers guidance rather than a fixed commitment.

Even where the parties are more or less equal, business people usually seek to avoid disputes or settle those that occur without reference to rights and the threat of legal proceedings. Instead of rights, they talk of solving problems and seeing the other's position. They continuously modify contracts during performance to adapt to changes in the market. Buyers may agree to pay more than the contract price when the seller's costs drastically increase. Sellers will accept cancellation or postponement of some or all of an order when buyers cannot use the

¹² J. Willard Hurst, *The Growth of American Law: The Law Makers* 337 (1950).

items they bought. The parties may modify the product itself to cut costs or adapt it to market demand. If a product does not work satisfactorily, both firms work to fix it. Engineers from both seller and buyer may devote a great deal of time to diagnose problems and remedy them. Deadlines for delivery often, if not usually, are target dates rather than absolute requirements. Buyers may accept even long delays as a cost of doing business, particularly if a seller has an excuse recognized by business custom.

Why does business so often operate inconsistently with the classic model of the place of contract law in the economy? Most simply, business seldom needs contract law. Even when informal measures are not enough, the benefits of contract law seldom outweigh its very high costs. Business seldom needs formal contract law because transactions rest on trust, power, the sanctions of long-term continuing relations or some blend of these factors. These are the same factors that de Soto finds important in holding together the informal sector in Peru. He sees them as inefficient transaction costs and prescribes legally enforceable contracts instead. North American business people would disagree. Undoubtedly, there are costs in creating trust or dealing only with those with whom you have long-term continuing relationships. Nonetheless, these may be necessary costs because formal impersonal contract is too weak a reed to support business transactions. It cannot substitute for trust, power and long-term continuing relationships that keep both the first and second economies going.

The relevance of formal contract turns on the nature of the transaction. Arthur Okun speaks of "auction" and "consumer" markets.¹³ Economists usually like auction markets where price competition for fungible goods should bring all the benefits promised by their theories. For example, both American and United Airlines fly many times a day from Chicago to New York. Their aircraft are the same or very similar. There is little difference in the food they serve or the way they handle baggage. Both have been in business since the 1930s and have experienced pilots and good safety records. Most people are likely to see all other things as equal, and so their decision about which airline to fly will turn on which offers the lowest price. This competitive pressure also pushes both airlines to avoid disputes with customers and to exert great effort to resolve any that arise. Both value their reputation, and they will avoid litigation with customers in all but unusual situations.

Consumer markets are different. Goods and services are not standardized, and the customer cannot be sure that more than one supplier will offer what it needs. If anything should go wrong, the buyer probably cannot find reasonable substitutes on the market that can be delivered on time. The product may require continuing maintenance and spare parts over time. The buyer's personnel may have to learn how to use the supplier's goods, and they would have to be retrained to use a competitor's product. Often, as well, suppliers know that there are few customers. Sales people will be under great pressure not to lose "their accounts." In such transactions, long-term continuing relations offer a potent sanction--neither party can afford to lose the other. In these situations people do not assert their rights. Rather, they seek to keep the other content with the relationship by resolving problems or offering attractive compromises.

¹³ Arthur Okun, *Prices and Quantities: A Macroeconomic Analysis* (1981). Okun says that consumer markets are often held together by an "invisible handshake."

The second reason for the nonuse of contract law is that the costs of litigation outweigh its potential benefits in all but a few situations. One cost is what the German sociologist Niklas Luhmann calls crossing "thematization thresholds."¹⁴ We use distinct vocabularies to talk about transactions with others. If we talk in terms of trust, cooperation and mutual advantage, we invite a response in those terms. Compromise is appropriate; conflict is not. If, however, we talk of legal rights, we are asking for a fight. I am right and you are wrong. I am innocent but you are at fault. You have breached your promise and broken your word. Or, in other words, there is a law of physics that says lawyers attract lawyers, and courts attract lawyers. Luhmann says: "it takes a certain amount of courage to openly confront the other with the question of whether he is in the right. The comfortable consensus that can normally be assumed in living and acting together will be shattered."

The costs of using contract law may be more tangible and economic. Contract litigation in the United States often is an expensive game of chance. When others fail to perform, aggrieved parties cannot be sure that they will win a contract lawsuit. Many potential litigants must conclude that they cannot afford to roll the dice. First, United States contract law is not predictable and certain. Much of it rests on hard-to-apply qualitative standards. For example, it asks whether there has been "a material failure of performance." It asks whether the other party has "substantially performed." It asks whether the aggrieved party's response to the other's default has "waived" exact performance of the contract. It asks whether the default was excused because it was caused by "the occurrence of a contingency, the nonoccurrence of which was a basic assumption of the contract." Of course, we can image clear cases under any of these rules, but in reality many situations will only produce equally cogent arguments for both sides.

Contract litigation also often turns on hard-to-prove facts. Justifiable expectations may be dashed on the burden of proof, the parol evidence rule and the statute of frauds. Furthermore, clauses commonly buried in form contracts may block legal protection of the actual expectations of the parties. In theory, contract terms are a matter of free choice, but, in practice, many times such provisions enter a contract by subterfuge via a form contract. Business people often sign documents without reading and understanding all the terms and conditions. The lawyers who draft such documents are well aware of this. Sellers' forms usually disclaim all consequential damages, limit buyer's remedies to replacement and repair of defective goods, and excuse or suspend performance when it becomes difficult because of any event listed in a long menu of contingencies. Buyers' forms may allow them to cancel a contract for convenience, paying only the seller's actual out of pocket expenses. Standard forms can contain trick clauses designed to deter successful vindication of the weaker party's rights. For example, a standard form may provide that litigation must take place in a state far from the weaker party's place of business. It may provide for arbitration by an arbitrator certain to favor the stronger party. It may require a buyer to give written notice of all claimed defects within an unreasonably short period after delivery. Such forms may disclaim responsibility for the statements of agents--these are "license to lie" clauses. Sometimes courts will overturn such clauses; other judges will refuse to do so, writing opinions based on a rich fantasy about choice and the responsibility to read, understand and negotiate away such provisions in situations where few people would think to do so.

¹⁴ Niklas Luhmann, *Communication About Law in Interaction Systems*, in K. Knorr-Cetina and A.V. Circourel, eds., *Advances in Social Theory and Methodology* (1981).

Moreover, courts in the United States will seldom put aggrieved parties in the position they would have been in had their contracts been performed--even when they win their lawsuit. United States contract law is a misrepresented product. The primary remedy will be damages because courts seldom award specific performance of contracts except in real estate transactions. Various policies limit money damages in United States law. Contract damages, for example, must be foreseeable and proved with reasonable certainty. The monetary equivalent of a performance in the future always will be difficult to prove.

Even more important, a successful plaintiff may get an award of damages, but she must deduct the costs of winning the suit from her net recovery. Absent statutes to the contrary, successful plaintiffs in the United States legal system must pay their own lawyer's fees. Lawyers seldom agree to accept contingent fees in contract litigation. Moreover, the costs awarded to a victorious plaintiff may not include the full fees for the experts necessary to establish damages. Furthermore, collection of the damages awarded in a judgment may be uncertain. An insolvent party often fails to perform its contract. A judgment is not cash; the winner must try to execute it against resources that the losing party may not have. Indeed, filing a law suit may lead the defendant or its other creditors to file bankruptcy. If this happens, usually a party aggrieved by the other's breach can only hope to recover at best some percentage of its total claim, and it risks recovering nothing. The weaker party may use the chance of declaring bankruptcy as a bargaining tool against its creditors as it demands to settle claims for a small fraction of the amounts due.

Our understanding of other market economies suggests that what I found in North America is a broader phenomenon. Studies in Great Britain,¹⁵ France¹⁶ and several Scandinavian countries¹⁷ find similar patterns of the use and nonuse of contract law in planning, performance and dispute resolution. Also, we must remember the highly developed and successful Asian economies when we consider the role of contract law. There is little contract litigation in most Asian societies. In these societies we find a number of features at least analogous to what de Soto found in the Peruvian informal sector.¹⁸ Business contracts rest on trust. People prefer to

¹⁵ See Hugh Beale and Anthony Dugdale, *Contracts Between Businessmen*, 2 *British Journal of Law & Society* 45 (1975).

¹⁶ See Edward H. Lorenz, *Flexible Production Systems and the Social Construction of Trust*, 21 *Politics & Society* 307 (1993).

¹⁷ See Britt-Mari Blegvad, *Commercial Relations, Contract, and Litigation in Denmark: A Discussion of Macaulay's Theories*, 24 *Law & Society Review* 397 (1990).

¹⁸ Compare De Soto, *The Other Path* 163-165 (1989) where he argues that such relational sanctions and trust are high cost and inadequate for modern development. Perhaps the Peruvian and the, say, Taiwanese situations described by Winn, *supra*, note 3, differ. Nonetheless, we can point to remarkable economic success that rests on just the mechanisms that de Soto finds inefficient and inadequate.

For studies about squatter settlements in Hong Kong that describe similar practices but offer a very different analysis from that of de Soto, see Alan Smart, *The Informal Regulation of Illegal Economic Activities: Comparisons Between the Squatter Property Market and Organized Crime*, 16 *International Journal of the Sociology of Law* 91 (1988); Alan Smart, *Invisible Real*

deal within the long-term continuing relationships of an extended family. Often a written contract is but a starting point for negotiations as the parties perform the arrangement and deal with changed circumstances. Okke Braadbaart, after studying vegetable marketing in Java, points out: "Personal relationships often develop between representatives of firms cooperating closely over a longer period. These ties are of strategic value in recurrent crisis management."¹⁹

International trade flourishes despite the lack of formal contract law as such. International contracts can channel disputes to courts in such places as London or to arbitration systems in major centers around the world. However, when it is sufficiently profitable, international trade takes place even where courts and arbitration are absent. Often lawyers and others work to build "self-enforcing" structures that substitute for legal enforcement of contracts. In Erich Schanze's words: "the theory of self-enforcement implies that in the course of the anticipated project life, breach by one party will be prevented by the fact that in any stage of the investment process the ongoing 'working relationship' makes the parties to the agreement better off than breaching."²⁰ Today, in Russia and the other countries of the former Soviet Union a working formal law of contract is largely absent. Nonetheless, a market economy is developing and many multinational corporations are present. Indeed, in 1992, the New York Times ran an article with the title: "The Art of a Russian Deal: Ad-Libbing Contract Law."²¹ It reported that in Russia deals turn on mutual benefit and trust. Besides mutual benefit and trust, transactions in the former Soviet Union often involving paying off what the Russians call their "Mafia"²² or hiring private guards for protection.²³ If relationships break down, the attitude is "we've made

Estate: Investigations into the Squatter Property Market, 10 *International Journal of Urban and Regional Research* 29 (1986); Alan Smart, *The Squatter Property Market in Hong Kong*, 5 *Critique of Anthropology* 23 (1985).

The classic study of a squatter settlement and its production of other-than-state law is, of course, Boaventura de Sousa Santos, *The Law of the Oppressed: The Construction and Reproduction of Legality in Pasargada*, 12 *Law & Society Review* 5 (1977).

¹⁹ Okke Braadbaart, *Business Contracts in Javanese Vegetable Marketing*, 53 *Human Organization* 143, 144 (1994).

²⁰ Erich Schanze, *Regulation by Consensus: The Practice of International Investment Agreements*, 144 *Journal of Institutional and Theoretical Economics (JITE)* 152, 166 (1988). See, also, Erich Schanze, *Constructive Jurisprudence in Mining Agreements: Institutional Innovation and Practical Drawbacks*, in Gunther Jaenicke, Christian Kirchner, Hans-Joachim Mertens, Eckard Rehbinder, and Erich Schanze, eds., *International Mining Investment: Legal and Economic Perspectives* 161 (1988); Terence Daintith, *Mining Agreements as Regulatory Schemes*, in the same book; Terence Daintith, *The Design and Performance of Long-Term Contracts*, in Terence Daintith and Gunther Teubner, eds., *Contract and Organisation: Legal Analysis in the Light of Economic and Social Theory* 164 (1986); Wolfgang Streek and Philippe G. Schmitter, *Community, Market, State--and Associations? The Prospective Contribution of Interest Governance to Social Order*, 1 *European Sociological Review* 119 (1985).

²¹ Louis Uchitelle, *The Art of a Russian Deal: Ad-Libbing Contract Law*, *N.Y. Times*, Jan. 17, 1992, at A1, cols 3-4.

²² See Stephen Handelman, *The Russian "Mafiya"*, 73 *Foreign Affairs* 83 (1994).

²³ Michael Specter, *U.S. Business and the Russian Mob: Some Hire Guards: Others Tough It Out*, *N.Y. Times*, July 8, 1994, at C1, cols. 3-5.

money in the interim, and if the deal stops, O.K." Or as one American lawyer working in Moscow put it: "We'll dance together until the music stops."

We can conclude, then, that a strong functioning system of legally enforceable contracts is not essential to a market economy. Indeed, de Soto's story about the informal and often illegal sectors of the Peruvian economy illustrates that. Minimizing risks, trust and long-term continuing relations will support much business activity.²⁴ De Soto, however, sees these steps as transaction costs and advocates legally enforceable contracts as a way of reducing them. Business people around the world, nonetheless, seldom rely on contract law alone to support business transactions. Yet what does contract law contribute to a market economy?

III. The Contribution of Contract Law.

The major contributions of contract law may be more symbolic than instrumental. Contract law in most countries with market economies stands for the idea that people should perform their commitments unless they have a very good excuse. It, thus, reinforces norms that are common in all business communities. However, once we accept this, we still must ask how contract law communicates its message to a relevant audience. Lawyers learn contract law in law school, and as they read statutes and judicial opinions, they renew their appreciation of the law's lessons. Business people and the general public seldom read statutes and legal decisions, and so we can suspect that the symbolic contribution of this body of law is at best indirect and subtle. Occasionally, newspapers cover important contracts litigation, and business people gossip about those who sue and are sued. Lawyers may tell clients entertaining "war stories," that also suggest the lawyers' importance in warding off litigation risks.

Perhaps it is enough that business people see contract disputes and litigation as trouble they should avoid whenever possible. Invoking formal contract procedures involves turning control of events over to lawyers. It diverts business people from profitable and enjoyable activities. There is always the risk of unfavorable publicity. Even if a charge of breaching a contract is groundless, others in the business community might wonder about what had happened. Insofar as avoiding trouble exerts influence, it would serve as one of many things pushing for performance of contracts or reaching satisfactory compromises of disputes. Contract law also may exert influence when people *think* that they know what a court would do even when their lawyers would see doubts and questions. Udo Reifner suggests: "Law in market societies is a useful lie because the economy needs to reduce complexity to be able to give answers where they are needed."²⁵

Contract doctrine also may provide a vocabulary for negotiation. The contract litigation process may function as a bargaining arena. For example, a letter from a lawyer for one party written in terms reflecting the law may open a process for resolving a dispute that the parties

²⁴ cf. Edward H. Lorenz, Flexible Production Systems and the Social Construction of Trust, 21 Politics & Society 307 (1993).

²⁵ Udo Reifner, The Vikings and the Romans--Contract Law and Social Economy 5 (Paper presented at the Conference on Perspectives of Critical Contract Law in Tuusula, Finland, May 7 to 10, 1992).

could not handle by cooperation and compromise. While talking legal rights may have costs, it usually is better than refusing to perform because of self-interest. At least in the United States, our judges more and more have become involved in settling disputes rather than trying lawsuits. One of our federal judges became known for bringing the top executives of both parties into his chambers and refusing to allow their lawyers to be present. The judge then sought to persuade these business people to resolve the dispute among themselves rather than litigate. In several noted cases he was successful. While his action is atypical, it is far from unique.

IV. Conclusions.

What should we make of my skepticism about de Soto's enthusiasm for legally enforceable contracts? Perhaps we should reform the contract system so it comes closer to fulfilling the functions claimed for it in the classic model. We could refashion the rules to be simple, clear and formal. We would abandon rules that rested on qualitative concepts such as "substantial performance," "unconscionability," and "reasonable notice." We might award specific performance more often or accept estimates of loss as sufficiently certain proof. We could change our rules so the losing party paid a significant amount of the winner's lawyer's fees. The goal would be to make contract law something that more business people would want to use more often. Many countries have attempted this in specific areas. Often law-makers remove transactions from the general area of contract and create special bodies of law when they seek to offset inequalities of market power. For example, in the United States, many states have consumer protection or unfair and deceptive trade practices acts that provide incentives to sue and advantageous remedies.²⁶ These statutes often provide for lawyers fees to be paid by a defendant to a successful plaintiff and double or triple damages.

Our economies might be better off, however, if we sought to recognize and legitimate compromise rather than rights vindication as the goal of the legal system. Perhaps we should take what we can call the Dr. Pangloss position: the high cost barriers and uncertain payoffs of our legal system are part of the best of all possible worlds. People will litigate only important cases that involve significant sums of money or issues of principle. Otherwise, the functioning legal system gives people strong incentives to share losses, consider the interests of the other side, and work out solutions by agreeing to deal in the future. Possible breach of contract litigation serves as a vague threat affecting but not controlling behavior in most cases. Undoubtedly, this solution requires parties to build trust and create long-term continuing relations. They will have to take security or create self-enforcing contracts. As de Soto points out, these are transaction costs. However, they may be cheaper or more acceptable as judged by various norms than anything the law can provide.

Indeed, we must remember that market economies exist despite, in Max Weber's terms, substantively rational contract law with uncertain remedies. We can remember that Shakespeare, in *The Merchant of Venice* had Portia find a way to deny Shylock his pound of flesh. In form,

²⁶ Lawrence M. Friedman, *Contract Law in America* (1965), argues that United States legal history teaches that whenever problems become important they are removed from the common law of contract by a statute. Thus, the common law of contract is, largely, law for problems too new or unimportant to have their own statute.

she just enforced Antonio's promise. In substance, she denied Shylock legal enforcement of his actual expectations. As a result, *Shylock v. Antonio* may have deterred others from claiming a pound of flesh as their remedy for breach of contract. (Some rational maximizers, of course, might provide in their contract that they could take all necessary blood as well as a pound of flesh). Shakespeare, however, never tells us whether Portia's sophisticated or sophist treatment of Shylock's contract undermined the economy of Venice. Somehow, I suspect that it did not.