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*, the lead article and a lengthy comment in the *Law & Society Review*, and an article in *Social & Legal Studies* 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*.
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
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.
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.\textsuperscript{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

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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
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
The second reason for the nonuse of contract law is that the costs of litigation outweigh the potential benefits in all but a few situations. One cost is what the German sociologist Niklas
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.
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
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. De Soto, however, sees these steps as transaction costs and advocates legally enforceable contracts as a way of reducing them.
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...
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,