

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

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Abstract

This paper discusses the possible legitimating function (understood as the ability to provide an appropriate framework for the development of rational arguments supporting legal principles and rules) of the Coasian “narrative”. I argue that the Coasian narrative is inadequate to provide *rational* legitimacy to the theoretical roots of the economic analysis of law movement. The argument starts with the distinction between transaction costs that could be eliminated even if at times their elimination would be impossible or too expensive (“social transaction costs”) and transaction costs that could disappear only in a world ruled by physical laws different from the laws that govern the real world (“natural transaction costs”). The thesis presented in this paper is that a Coasian world of a “human” kind (defined as a world- conceivable without breaking the physical and psychological laws that govern our real world - in which social transaction costs are absent, but natural transaction costs are present) is not a place worth living in. In order for us to imagine a world devoid of the defects of a “human” Coasian world, we should imagine a “divine” kind of world, populated by God-like creatures and not by human beings. A world that everyone can model at his/her own pleasure, and that can provide rational legitimacy to nothing.

This paper goes on to argue 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 transaction costs loses legitimacy and appears subordinate with regard to the primary goal of limiting the power that certain private individuals can exert over others.

1.Introduction.

This paper focuses on the possible “legitimizing” function of what I would call the “Coasian narrative”. This expression (Coasian narrative) as employed in the present context, refers especially to the use of the Coase’s thought in the construction of the theoretical references underpinning most of the arguments elaborated by the economic analysis of law movement. The Coasian narrative is therefore constituted of as a set of beliefs and convictions with wider and more general implications than those strictly derivable from the literal interpretation of the works of Coase.¹

In the Coasian narrative the Coasian world (defined as a world with no transaction costs) is imagined as the uncontested reign of efficiency and individual freedom and liberty, an Eden in need of little law and substantially no lawmakers², in which individuals can always establish agreements apt at self-regulating their lives. Even if it is widely recognized that this state of perfection is practically unobtainable³, the reference to the Coasian world supports the thesis that the analysis of the transaction costs that are in fact present in the real world (the things that keep us apart from the Eden) and their possible elimination, should be the basis and likewise the goal of any legal proposal, be it aimed at creating new a law or at interpreting the existing

¹ See infra note 4 and accompanying text.

² “According to the Coase Theorem, there is no continuing need for government under these conditions [zero transaction costs]. Like the deist god, the government retires from the scene after creating some rights over externalities, and efficiency is achieved regardless of what rights were created” R.COOPER, *The Cost of Coase*, XI *Journal of Legal Studies*,19 (1982).

³ The existence of market at zero transaction costs is considered by Coase himself a “very unrealistic assumption” R.H.COASE, *The Problem of Social Cost*, in Coase, *The Firm the Market and the Law*,, University of Chicago Press, 1988, p.114

one. In this sense the reference to the Coasian world performs the function of legitimating the main arguments used by the adherents to the economic analysis of law movement.

In this paper I argue that the Coasian narrative's ability to perform a legitimating function is generally quite low and of no value whatsoever as far as providing a *rational* legitimacy is concerned. I furthermore argue that the assumption - so widespread in the economic analysis of law movement- that the transaction costs should be the main subject and starting point of every legal analysis is completely misdirected.

I shall commence my argument with the distinction between two kinds of transaction costs: transaction costs that theoretically could be eliminated, even if at times their elimination would be impossible or too expensive (e.g. the transaction costs stemming from one party's lack of information owned by the other party of the transaction) and transaction costs that could disappear only in a world ruled by physical and psychical laws different from the laws that govern the real world (e.g. transaction costs stemming from lack of information which no human being owns and could own). Let us call the former "social transaction costs" and the latter "natural transaction costs".

Consequently, we can disentangle the ambiguity of the recurrent statement that a world with no transaction costs does not exist, by distinguishing between a non-existent, but quite possible, world, and a world conceivable only through imagining an external or internal nature that is completely different from that of the real world. Let us call the former a "human Coasian world" and the latter a "divine Coasian world".

My point is that a human Coasian world (a world in which social transaction costs are eliminated but natural transaction costs are present) not only does it not exhibit the positive qualities usually attributed to the Coasian world, it is a world not worth living in. The relationship between a divine Coasian world and a human Coasian world is not

that of a progressive approximation to the achievement of the values allegedly governing a Coasian world. From a perspective that is centered on values, rather than on analytical properties, there is no ideal path that commences in the real world, is then improved in a human Coasian world and is later brought to perfection in a divine Coasian world. The human Coasian world simply does not fulfill- not even partially- the promises of a divine Coasian world.

The conclusion of the first part of this paper is that either reference be made to the human Coasian world, then no legitimacy can be provided by evoking this world's image, due to the fact that it is not a world worth living in; or reference be made to a divine Coasian world, then no *rational* legitimacy can be provided by evoking the image of a world not only non-existent but unconceivable within the natural laws governing the real universe.

In the second part of the paper I argue that once the reference to a divine Coasian world has been dismissed, then the assumption of human or social transaction costs as a starting point for every legal analysis lacks any legitimacy. Power asymmetries are the legitimate starting point, as they are the main factors -even in a market-based economy- that shape human relationships.

2 .The “legitimizing” function and the Coasian narrative.

For “legitimizing” function I understand in the present context the ability to provide reasonable arguments supporting 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 in the sense of “providing legitimacy” and not in the legal sense of “making lawful”.

In fact the paper seeks to answer the question whether the Coasian narrative is able to 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 to those problems.

It is my understanding that a legitimating function is less demanding than a normative function. The latter implies a model capable of providing precise indications and of suggesting unequivocal choices (however difficult the identification of the right choice in the real world might be). The former implies instead a narrative which provides a framework for developing rational, though 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 likewise the ethical and political prescriptions (built on, and around, this piece of knowledge) that aim at carrying out the function of a (local, but surely quite ambitious) narrative, allowing 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.”⁴

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 intentions⁵) in a substantial

⁴ J-F LYOTARD, *The Postmodern Condition: A Report on Knowledge*, English translation, Manchester University Press, 1984, p. 20.

⁵ The lack of exact correspondence between the Coase’s thought and its reception in the economic analysis of law movement is widely recognized. See e.g. S.G. MEDEMA, *Through a Glass Darkly or Just Wearing Dark Glasses? Posin, Coase and the Coase Theorem*, 62 *Tenn. L. Rev.* 1041 (1995); D. CAMPBELL-S.PICCIOTTO, *Exploring the Interaction between Law and Economics: the Limits of Formalism*, 18 *Legal Studies*, 249 (1998), underline “the very questionable nature of the way in which the work of Ronald Coase has been taken up by those who claim to be his followers...”

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

part of the economic analysis of law movement. Putting aside all possible discussions concerning the different approaches that coexist in such movement, it seems to me that its core is inseparable from the legacy of the Coase' lesson.

Therefore this paper's targets are not just the interpretations using the Coase theorem as a mechanical device capable of providing an immediate solution to every social choice problem, 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 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 with regard 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 does count is the nature of the imagined world. As we shall see, the relevant question is whether the imagined world is a world governed by the same physical and psychological laws that govern the real world, or a world which can only

study the world of positive transaction costs"). He explicitly refused the parenthood of the concept of "Coasian world" (Id., *The Firm*, p. 274).

be conceived by subverting the laws which characterize the human external and internal nature.

Therefore we face two different questions. On the one hand, we may ask ourselves whether the Coasian world, even if non-existent, is a world conceivable anyway 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 short: is it a world worth living in ?

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

3.The ability to perform a legitimating function.

Commencing with the question on whether the Coasian narrative is capable of performing a legitimating function, we noted that it depends on whether a Coasian world is a world in which collective action problems are correctly solved and benefits for collective activity appropriately provided and distributed. We readily recognize that the question does not permit 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”⁶. This, I argue, is the reason for considering them as pertinent claims, when referred to a Coasian world, interpreted as a possible legitimating device of a set of principles and rules.

⁶ J.HABERMAS, *Legitimation Crisis*, English translation, Polity Press, 1988, p. 10.

Correctness and appropriateness of rules and institutions, depend, in turn, on the system of values on which they are based and likewise on the level of coherence they are able to reach in putting those values into practice.

Thus the first question is: what system of values governs a Coasian world? Obviously the answer depends on how we define a Coasian world .

As a first approximation we can imagine a Coasian world as a world in which the law can limit itself to fix the prerequisites (in particular , 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 rules 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 the 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 therefore 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 maximizes

his or her satisfaction, with the only constraints stemming from the free exploitation of the same option by every other individual.

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 concerning the moral validity of the economic analysis of law.

The Coasian narrative suggests a solution, through the severing of 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 come into conflict with efficiency goals⁷. However, this sacrifice may not remain without its rewards. Having obtained the biggest possible pie, due 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 unfair⁸.

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

⁷ The point is especially elaborated by . L.Kaplow and S. Shavell, '*Fairness Versus Welfare*', 114 *Harvard Law Review* (2001) p. 961.

⁸ On the problems raised by this distribution in two stages, s. F. DENOZZA, *Fairness and Welfare: are they really competing values?* In *Legal Orderings and Economic Institutions*, edited by Fabrizio Cafaggi, Antonio Nicita and Ugo Pagano, Routledge Siena Studies in Political Economy, Routledge, 2007, at 159.

by anxieties of distributive justice could adopt an abstentionist attitude, limiting its interventions to few occasional actions aimed at correcting specific distortions.

In summary: the possible virtues of a Coasian world are the maximization of both the individual liberty (all transfers of goods only take place through agreements amongst 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, though not totally dismissed, value, then we can consider the Coasian world as an ideal, capable of legitimating each and every choice of the real lawmaker heading to steer the real world to approximate the Coasian one.

4. Legitimacy: two distinguished kinds of legitimacy

In the previous paragraph we defined the conditions that the Coasian narrative necessitates in order to carry out a legitimating function. Now we can go back to the question concerning the kind of legitimacy that can be provided by the Coasian narrative.

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 Weber⁹.

Max Weber especially considered the problem that concerned the definition of legitimacy, considered as an empirical fact, and the classification of its possible sources. I would instead focus 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, does 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.

However, I believe that a distinction must be made, between a world that, albeit inexistent, may be conceived as possible, taking for granted the main features of the 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 worlds, the distinction (inspired by Weber, but largely adapted, as we saw, to the context of our

⁹ M. WEBER, *Economy and Society*, English translation, University of California Press, 1978, s.212 ff.

discussion) between authority legitimated by rationality (an authority based on belief - having “an immanent relation to truth”¹⁰- in a rationally sustainable legitimacy) and authority legitimated through tradition.

I would like to repeat that in my opinion 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 world¹¹ have a very limited force¹²

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 further examine this question later.

5.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.

¹⁰ J.HABERMAS, *Legitimation Crisis*, English translation, Polity Press, 1988, p.97.

¹¹ J.HABERMAS, *Between Facts and Norms*, English translation, Polity Press, 1996, p.443.

¹² As I have already underlined, the focus here is not on the analytical truth of the so-called Coase's theorem. The recognized utility of the reference to a non-existent world from an analytical viewpoint (as to a frictionless world in mechanical physique) does not contrast with the scant ability (argued in the text) for this kind of reference to provide rational justifications regarding the choice of acceptable institutions and rules. The truth of the Pythagorean theorem is not a sufficient, or even good, argument for accepting the mystic philosophy of the Pythagoreans.

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 lawmaker 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. Irrelevant, from the allocative viewpoint, 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 dispute¹³, 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 owner so as to induce her to stop polluting. Consequently, the lake is used by the

¹³ See, however, Coase's remarks on this point in *The Firm*, supra note 3, at 170.

factory and by the bathers, according to their respective preferences, in the most efficient way.

Supposing now that an inventor- may be the same factory owner- discovers a new technique that permits production at a lower cost, but 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”¹⁴).

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 could happen in the world I have just described (a world characterized by the fact that individuals can freely contract for each other’s rights) and that I would 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 she will save using 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 amongst 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 they were doing before for free .

If this result is (as indeed seems to me) not desirable, there are two possible options. The first is a lawmaker's intervention limiting the right of the factory, by preventing pollution beyond a definite level. In this case, the factory owner would not be 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. The prevention of the gigantic, and socially unnecessary, transfers of wealth that could occur in this kind of society necessitates continuous intervention. 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 created by the combined effect of innovation and original allocations of rights.

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

¹⁴ R. BARTLETT, *Economics and Power*, Cambridge University Press, 1989, p.157.

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 (the invention, which creates the conditions for a possible lawmaker's intervention) 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.

Suppose 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 entailed levels of pollution, the new technique has in universe 1 very different chances of being put to 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 certain reflections too. A first consideration is that the outcomes in the two universes are both efficient, each in the context of its universe, but they certainly 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 polluted lakes, 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 or of the buyers of the factory's products in comparison to greater or lesser welfare of the 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 results depends on the resources held, and the choices made, by the holders of the right. As we saw, the simple fact of the assignment of a right can influence the decisions of the subjects concerned. In our example, bathers' decision to build or not to build recreation facilities on the lake shore. Moreover, and more important, the decisions of the right holders taken at $t-1$ influence in turn the decisions that all the interested subjects will take at $t-2$. In our example, the decisions taken by the bathers, before the invention of the new technique, affect each party's convenience in the use of the invented technique, the results of the related deals, and eventually effect the adoption or the rejection of the new technology.

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 only assign the possibility (negative freedom) of enjoying the things every individual owns, it also assigns 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 others¹⁵.

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 factory owner) 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. From this point of view 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, does not stand.¹⁶

6. “Human” and “divine” Coasian worlds distinguished.

¹⁵ The point has been elaborated especially by E. DICIOTTI, *Il mercato delle libertà*, Il Mulino, 2006, p.52. See also L.FERRAJOLI, *Principia iuris*, II, Laterza, 2007, p.253.

¹⁶ The incidence - illustrated in the example of the lake - that different legal rules can have on the use of future and unforeseen inventions, is one of the many possible illustrations of the possible existence of different competitive equilibria corresponding to different distributions of wealth. D.H.REGAN, *The problem of social cost revisited*, in 15 *The Journal of Law and Economics*, 433 (1972) underlines that “Even granting then that the allocation before the change of legal rule was efficient, and that the allocation after the change must also be efficient, there is no reason to assume they must be the same, if the change of legal rule effected a redistribution of wealth, as there is every reason to suppose it did”

We can add that rules affect not only the distribution of wealth, but the distribution of the legal powers whose exploitation can determine what outcomes of future deals will be efficient and what will be inefficient.

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 generally, all the possible changes to each and every individual and social conditions, as well as 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 pair¹⁷. 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 her 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 forth.

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.

¹⁷ D.M. NEWBERY, *Missing Markets: Consequences and Remedies*, in *The Economics of Missing Markets Information and Games*, edited by F. Hahn, Clarendon Press, 1989, at 211, ff.

In any case, a world where certain phenomena, whose elimination is physically impossible in any imaginable universe, are deleted, cannot sustain a narrative capable of providing rational arguments. At most it can provide a sort of “traditional” 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 “social” transaction costs and what we can call “natural” transaction costs. In the former category we can put the transaction costs whose elimination is conceivable (though not completely attainable) even 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,¹⁸ must therefore be accepted as one of the characteristics of any imaginable universe, including a “human Coasian” world.

A “divine Coasian ” world is also more or less vaguely imaginable. 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 .

7. 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

¹⁸ On the relationships between fundamental uncertainty and transaction costs, examined in the perspective of the theories on the emergence of firms, S.P.DUNN, *Fundamental Uncertainty and the Firm in the Long Run*, 12 *Review of Political Economy*, 419 (2000).

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 Coasian 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 us pose for instance the question whether the Roman Empire was more efficient than the Mongol Empire or if the opposite is true. 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 opinion sufficient enough to exclude 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 cannot 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 various events may determine distributions wholly independent on improvements of the overall efficiency of the system.

Coming to the question of freedom and 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 underlined 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 advance¹⁹.

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

¹⁹ On this point see F. PARISI, *Private Property and Social Costs*, 2 *European Journal of Law*

individuals. This is an incumbent problem even in a human Coasian 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.

8. 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 social transaction costs, as the most important amongst the obstacles which, in the majority of situations we face in the real world, are able to prevent the attainment of the best possible results. Having established that the elimination of all social 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 social transaction costs (the only costs that can be eliminated by human actions) deserve the prominent position they enjoy in the Coasian tradition of the economic analysis of law 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

and Economics, 149 (1995) at 157.

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, there is no rational argument in favor of trying to approximate the real world to the Coasian world (even if it were possible).

Now I shall examine another, more limited (though 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.

9. Power asymmetries in the bargaining thesis and in the Coasian narrative.

The attitude of power relationships to affect the bargaining process, and its results, has been extensively examined as a possible factor which could prevent rational actors from reaching in every transaction the most efficient result²⁰ Leaving aside other important doctrines (asymmetries of resources ownership are deemed a very relevant variable in the literature on economic development²¹ and on strategic bargaining between parties unequally endowed²²) the asymmetries in resource ownership (and the consequent asymmetries of power) are especially considered in the so-called “bargaining thesis” which regards them as the main factor affecting the process of genesis of social institutions.²³

²⁰ See e.g. R.COOPER, *The Cost of Coase*, XI *Journal of Legal Studies*,19 (1982),at 15. . D.H.REGAN, *The problem of social cost revisited*, 15 *The Journal of Law and Economics*, 433 (1972)

²¹ D. ACEMOGLU, *Why Not a Political Coase Theorem? Social Conflict, Commitment and Politics*, in *Journal of Comparative Economics*, Vol. 31, No. 4, December 2003,Available at : SSRN <http://.com/abstract=545463>

²² R.G.RAJAN-L.ZINGALES, *The Tyranny of Inequality.*, (May 1999). CRSP Working Paper No. 423 available at SSRN: <http://ssrn.com/abstract=206508>.

²³ Developed especially by J. KNIGHT, *Institutions and Social Conflict*, Cambridge University Press, 1992; J.KNIGHT- J.JOHNSON, *On the Priority of Democracy: A Pragmatist Approach to Political-Economic Institutions and the Burden of Justification*, in 101 *American Political Science Review*, 53 (2007): “On this account, social institutions are a by-product of strategic conflict over substantive social outcomes. The mechanism of selection among the possible institutional alternatives is bargaining among the actors over the various alternatives. Institutional development is a contest among actors to establish rules that structure outcomes to those equilibria most favorable for them.”

Obviously the existence of power asymmetries cannot be contested. In fact the dissent of the proponents of the bargaining thesis with the 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”²⁴. 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 usual 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 the shares in which a smaller aggregate benefit can be divided.

The problem seems to concern (as always) the presence of transaction costs that could prevent side payments to the more powerful party or may generally reduce the range of the alternatives “such that there is no sufficient correspondence between

²⁴ J.KNIGHT, *Models, Interpretations, and Theories: Constructing Explanations of Institutional Emergence and Change*, in *Explaining Social Institutions*, edited by J. Knight and I. Sened, The University of Michigan Press, 1998, at 113.

efficiency and distributional advantage to offset the effects of individual self-interest on the selection of a particular rule”²⁵.

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 ²⁶ should be limited to the social contexts in which contracts occur between actors of equal power or in which arbitrary asymmetries of power amongst the actors are neutralized.²⁷ 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 “social”, not “natural” transaction costs) the controversy ends up in the empirical

²⁵ Id., at 117.

²⁶ The so called contract theory, developed especially by D.C.NORTH, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press,1990. Id. *A Transaction Cost Theory of Politics*, in 3 *The Journal of Theoretical Politics*, 1991,355.

²⁷ 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.

dispute about whether transaction costs of this kind (capable of preventing side payments) are more or less widespread and more or less easily removable.

To sum up, 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 social transactions costs, that are the only that can be eliminated in the real world) are absent.

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.

10- Power and its theoretical and practical properties. Power v. Influence.

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.²⁸ If individual A by exploiting her power in a given way can cause

²⁸ The difficulties in the conceiving of power as a commodity is explored, from a different

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 episodic 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 us 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 an opportunity for the factory to exploit the lake in a way that is not compatible with fishing. In the classical Coasian version of the evolution of this situation, the other interested party offers the right holder a sum of money in order to prevent her be from taking the course of action that may interfere with the other party's projects. Thus, either the fishermen offer the factory owner a

viewpoint by, U. Pagano *Is power an economic good ? Notes on Social Scarcity and the Economics of Positional Goods*. in S. Bowles, N. Franzini and U. Pagano (eds) *The politics and Economics of Power*, Routledge, London ,1999, p.53.

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 fate of the lake depends on the comparison between the amount of the compensation offered and on the profits the right holder expects from the future activity she 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 destiny 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 instead 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.²⁹ 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 make 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).

²⁹ The difference is especially stressed by P. MORRISS, *Power, A philosophical analysis*, second

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.

The difference becomes especially relevant if we consider a factor as important as uncertainty, a factor which is absent in the divine Coasian world, but is inevitably present in the real world and in any conceivable human Coasian world³⁰.

In presence of absolute uncertainty, and lacking markets able to give a price to any future event, “individuals must make guesses about opportunity costs”³¹ The point is that the “guess” of the powerful counts much more than the guess of the powerless. The efficiency of the results of the dealings depends much more on the prevision capacities of the former than on that of the latter.

In a perspective concerned with problems of legitimacy this point cannot be considered as irrelevant. We may even accept of entrusting our destiny (the attainment of the most efficient results) to the random ability, of the concerned

edition, Manchester University Press, 2002,p.29.

³⁰ “In a world without uncertainty, the notion of power dissolves and loses much of its importance” M. LAVOIE, *Foundations of Post Keynesian Economic Analysis*, Aldershot, Edward Elgar, 1992, at 100. V.MONVOISIN - L.-P. ROCHON, *Economic Power and the Real World, A Post-Keynesian Analysis of Power*, 35 *Int. Journal of Political Economy*, 5 (2006-7) at12 “Hence the absence of power in neoclassical theory is reached by eliminating two important concepts: social conflict and uncertainty.”

³¹ A. PRZEWORSKI, *States and Markets*, Cambridge University Press, 2003, p. 49.

individuals, to foresee the “right” developments of the given situation (and therefore to establish an “efficient” price for every possible transaction). There is, instead, no rational reason for entrusting our future to the interested predictions of the powerful.

11. Power as a dispositional attitude.

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 something that can be more or less easily evaluated and transferred, the latter exhibits some peculiarities that are in my opinion 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 attitude³², and episodic acts of exercise of power. The cause of this confusion resides again in 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.

The Coasian is in fact a fully static world with a pie whose size is given, and in which 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.

³² P. MORRISS, *Power, A philosophical analysis*, second edition, Manchester University Press, 2002,p.14. S LUKES, *Power: A Radical View*, second edition, Basingstoke: Palgrave Macmillan, p. 109. D.H.WRONG, *Power..Its Forms,Bases,and Uses*, Transaction Publishers, New Brunswick-London,second printing,1997,p.6. S.R. CLEGG, *Frameworks of Power*, SAGE Publications, 1989,p.83.

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 interest³³. 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 the resources available in any given instant, 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"). A form which must adapt itself to the changing conditions of the capitalist development and continuously invent new practices, institutions and rules compatible both with the preservation of its basic structure and with the further development of the productive forces.

The dispositional attitude of the power can be fully appreciated only in the perspective of a dynamic world facing an uncertain future and struggling with the imperative of both maintaining and transforming its particular form of social organization in front of continuously changing conditions.

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. Many attributes of the property rights have remained unchanged

³³ "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.

since the Roman law up to the present day. 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 rights 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 on the social and economic situation of the property holder : whether she is a member of a capitalist society or of a feudal society, whether a competitive market for apples exists, or she is the only owner of apples in the world, etc.

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 prices³⁴. As is well known, the amount of harm suffered by the costumers who decide to buy at the monopolistic price plus the harm suffered by customers who decide to resort to the second best alternative, is bigger than the profit earned by the monopolist. Therefore the costumers, assuming zero transaction costs, can bribe the monopolist in order to induce her to practice competitive prices.

³⁴ On this subject (monopolies in a world with no transaction costs) se G. STIGLER, *The Law and Economics of Public Policy: A Plea to the Scholars*, 1 *Journal of Legal Studies*, 12 (1972): in a world with no transaction costs “Monopolies would be compensated to act like competitors..” (this statement is approved by R.H.COASE, *The Firm*, at 158) . G. CALABRESI, *Transaction Costs, Resource Allocation, and Liability Rules: A Comment*, 11 *J. Law and Econ.*,67, at 70 (1968) “Assuming no transaction costs, those who lose from the relative underproduction of monopolies could bribe the monopolists to produce more”. C. J. DAHLAN, *The Problem of Externalities*, 22 *J.Law and Econ.*,141 (1979), at 142, underlines that monopoly and public goods can be treated as subcategories of externalities. F. PARISI, *Private Property and Social Costs*, 2 *European Journal of Law and Economics*,149 (1995) at 156.

But what about the sale of the monopolistic position as such? Is it possible to conceive of a situation in which customers are able to institute a system of free competition by buying the monopoly position as such ?

I argue that the possibility of the monopoly position as such being sold, is much more difficult to imagine. In fact, the value of the monopoly position for the monopolist is composed of at least two addenda: the profits that can be earned in any single episodic exploitation of monopolistic power, plus the value of the possibility of increasing these profits by, for example, reducing the production costs. The first addendum corresponds to the difference between monopolistic and competitive prices and, as we have just noted, the existing (in the given moment considered) customers are interested in bribing the monopolist in order to convince her to practice competitive prices. As to the second addendum, the problem is: what is the price of the possibility of increasing profits in ways that are barred to firms acting on competitive markets and who are the individuals willing to pay for it? I think that the great difficulties in answering to this question are rather evident.

It is already difficult to measure the part of the value of a monopoly consisting of the (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. Much more difficult is the estimation of the value of the chance the monopolist has (and the firm in a competitive market does not) of converting into profit any gain in productivity and 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 forth³⁵.

³⁵ This point is usually neglected by ultra-liberal or libertarian 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,

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.

Another difficulty concerning 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.

In summary, 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. These difficulties may be relevant when the goal is

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. "Contracts by their nature are no longer simply private relationships that leave others' rights and duties unaffected; they become publicly enforceable agreements altering others' rights and obligations. Contracts impose upon others duties to recognize and respect contractual terms, and upon governments duties of coercive enforceability." S. FREEMAN, *Illiberal Libertarian : Why Libertarianism Is Not a Liberal View*, 30 *Philosophy and Public Affairs*, 105 (2001) at132.

the transfer of a power position from one to another individual. They become almost insurmountable when the goal is the sale of a power position in view of its dissolution.

Obviously, almost everything can be the object of a sale or of a barter.³⁶ In fact, power positions are usually transferred 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 what is at stake is not the transfer of a position of power from an individual to another, but the sale of the power position as such (in the sense that the power is not transferred but eliminated) the probability of dealings reaching efficient results is, in a human Coasian world, very low. It is difficult to identify the parties interested to the deal and it is even more difficult for each party to establish the price. This is the reason why power positions are often transferred but seldom eliminated by free and consensual bargaining³⁷.

Power, interpreted as a dispositional attitude, is a “thing” that is in fact composed by an almost innumerable set of different elements, as we saw in the case of the monopoly power, whose value depends on a large amount of different future events, markets for which do not exist in the real world and are difficult to conceive even in a human Coasian world.³⁸ If the value of a simple thing as a booked taxi

³⁶ Even if “Nothing like a free market of power has ever existed or will exist” B.BARNES, *The Nature of Power*, Polity press, 1988, p.87.

³⁷ As noted by K.MARX, *Grundrisse*, trans. Martin Nicolaus (New York: Vintage,1973) p.303, “...I may well separate capital from a given individual capitalist, and it can be transferred to another. But in losing capital, he loses the quality of being capitalist. The capital is indeed separable from the individual capitalist, but not from the capitalist, who as such confront the worker”.

³⁸ 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” A. PRZEWORSKI, *States and Markets*, Cambridge University Press, 2003, 43. A thing which is unattainable in a human Coasian world.

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 sunny³⁹), it is not so easy to imagine markets able to give the “correct” price to a complex “thing” like a power position.

12- Conclusions.

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 the social context determining who is the powerless and who is the powerful, is much more important than the transaction costs, that disturb the relationships between powerless and powerful individuals. 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 forth.

Eventually, they might prevent us from not only reaching a better result chosen among given possible outcomes, but also *from making feasible new possible outcomes* in which “some are helped and no one is harmed”⁴⁰.

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

³⁹ Ibidem.

⁴⁰ G. CALABRESI, *The Pointless of Pareto: Carrying Coase Further*, 100 *Yale L.J.*,1211 (1991).

Coming a bit more closely to the real problems we face in the real world, take for instance the case regarding the discipline of financial markets, and especially the part concerning the relationships between investors and financial intermediaries. Transactions between investors and financial intermediaries are usually analyzed in terms of information asymmetries, consequent market failure and need of a regulation capable of restoring the functioning of the market. Instead, it is rather evident that the main factor which in fact affects these kinds of transactions, is not the information asymmetry, but the production relations of the “financial industry”, characterized by countless situations in which the intermediaries’ interests conflict with the interests of their clients. Lacking these conflicts of interest, one could trust the impartiality of the advisor- intermediary and no complex (and often confused) special protection such as that established e.g. by the MIFID European directive would be necessary.

In this vein I maintain that in this case, as in many important other cases, the “legitimate” starting point for a correct analysis should be the power relationships that define the context in which the transactions take place and not the single transaction.

More in general, the point is that we are often confronted with power positions which (for many reasons) we are not able to dismantle. The organization of the financial industry, together with all its conflicts of interests we just recalled, is a perfect example of a set of intertwined powers that are considered not modifiable due to their alleged ability to induce efficiency. But one can bring to mind the monopolistic power enjoyed by many firms, or likewise the power of people managing giant corporations.

As to the latter, one may consider that in every theoretical construction (from Berle&Means to the agency problem narrative) and in every corporate governance model (from the Anglo-Saxon to the Rhenish to the Latin) 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 forth) that we cannot dismantle, and the necessity to balance this power with a countervailing power, we search everywhere for ⁴¹, be it the banks, the minority shareholders, the financial market and so on.

I contend that having established that in a divine Coasian world a simple, “complete”, contract could solve all problems, is neither helpful, nor an appropriate starting point. If the objective is that of inventing an “organization that might make us all better off” ⁴², then the main problem lies not in what can prevent contracts between powerful and powerless people, but in the way in which power is allocated. The latter is in my opinion the legitimate starting point.

⁴¹ 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, p.117) but also “local” countervailing powers, able to limit the discretion of the power holder.

⁴² G.CALABRESI, *supra* note 28.