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AFTERWORD: THE RATIONAL CHOICE APPROACH TO LEGAL RULES

JULES L. COLEMAN*

Much of the work in law and economics continues to exploit the insight of Ronald Coase, who recognized that under conditions of full information, rationality and zero transaction costs, any assignment of legal rights will be efficient. Different initial allocation decisions could affect the distribution of wealth, but not its ultimate efficiency.¹ This insight, however, has had two detrimental implications for legal research, neither of them Coase's fault.

The first involves the analytic separation of the efficiency of legal rules from their distributive consequences. It may have appeared useful at one time to distinguish the efficiency of legal rules from their distributive dimension. However, it was never analytically possible, nor is it now normatively defensible to do so. This conclusion is unavoidable once we come to see legal rules as collective goods which rational actors impose in order to secure gains otherwise unobtainable.

The second involves the idea that the possibility of private negotiations depends on zero or at least trivial transaction costs. The assumption is that other than trivial transaction costs lead to market failure. Market failure in turn calls for legal intervention which is intended to replicate the outcome of a hypothetical costless market. When this idea is accepted, legal rules can be understood in either of two ways: (1) as necessary to establish a framework within which efficient negotiations under conditions of low transaction costs can occur; or (2) as necessary to rectify for market failures which occur when transaction costs are nontrivial. This view of legal rules, however, and of rational intervention generally, as a response to transaction costs, is not analytically satisfying and needs to be replaced by a more sophisticated understanding of the relationship between transaction costs and what I and others have recently called *endogenous transaction resources*.²

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1. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960). It is a further question whether alternative assignments of rights yield the same or different efficient equilibria.

2. Coleman, Heckathorn & Maser, *A Rational Bargaining Approach to Default and Disclosure Rules in Contract*, 12 HARV. J.L. & PUB. POL'Y 639 (1989); J. Coleman, *Rational Risks and Rectifiable Wrongs* (Cambridge University Press, forthcoming).

In this essay, I will present arguments which rectify these two unfortunate misunderstandings of Coase's basic insight.

I. RATIONAL CHOICE

In economic analysis, a set of *property rights* is necessary to make possible the gains from trade. That process, securing the gains from trade, is itself made possible by the existence of *property rules*. It is well known, however, that under certain conditions that often prevail, fully rational and voluntary action yields a suboptimal or inefficient equilibrium. One way to phrase the problem is, that under conditions of perfect competition, rational actors, non-cooperatively pursuing individually rational strategies secure optimal outcomes in the core. When conditions of perfect competition are not realized, independent actions, based entirely on individually utility maximizing strategies, will yield suboptimal or inefficient outcomes. This gap between the competitive equilibrium securable under ideal circumstances and the inefficient outcome secured under less than ideal circumstances is a *surplus*. Under conditions that regularly prevail, that surplus is unobtainable by individuals acting on the basis of purely individually rational strategies. Thus, in order to obtain those gains, individuals must abandon action based entirely on individually rational strategies and pursue a jointly maximizing strategy. Formally, such strategies are referred to as "cooperative." The surplus is, therefore, usefully characterized as a "cooperative surplus." Thus, rational cooperation is aimed at capturing the cooperative surplus, that is, the difference between the suboptimal equilibrium of failed competition and the optimal equilibrium of perfect competition. Cooperation can be more or less successful to the extent that it captures these gains.

The same story can be framed in the idiom of economic efficiency and market failure. The suboptimal equilibrium secured as a consequence of individually rational strategies under certain conditions constitutes a *market failure*. Within the traditional law-and-economics literature, that failure is to be rectified by the imposition of some legal rule. The objective of the legal rule is to induce an allocation of resources which would have resulted if the conditions which created the market failure had never occurred. Thus, we get the view that within the market or economic paradigm, the purpose of legal rules is to mimic efficient markets by producing Pareto optimal outcomes. Of course, a variety of possible Pareto optimal outcomes are feasible and enforceable, differing from one another in their distributional components. However, that aspect of them is distinct from their efficiency, and otherwise not central to

them, and thus best dealt with in some other way—perhaps by consulting a philosopher.

Within the rational choice framework, legal rules are elements in a scheme of rational cooperation. The traditional economic analysis, which focuses entirely on the efficiency of perfect competition and the inefficiency of market failure, blinds us to the ways in which the distributive and productive dimensions of legal and political constraints are united in rational cooperation. To clarify this point, let's return to the characterization of the problem in game theoretic terms.

Under conditions of perfect competition, rational actors maximize their utility within the restraints imposed by the utility of others. Each does as well as he or she might given the utility of others. Thus, under conditions of perfect competition, a rational actor will not willingly impose any constraints on his utility maximizing behavior. Constraints curtail self-interested action. Therefore, because a purely self-interested person, under perfect competition, does as well as he or she might given the utility of others, a person who self-imposed such constraints would necessarily do less well than she would in the absence of such constraints.³

Legal rules are constraints. Thus, under conditions of perfect competition, legal rules, other than those which may be necessary to make competition possible (property rights) are *irrational*. Constraints are rational for all actors only under conditions of market failure. As a result, legal rules are rational for all agents only under conditions of market failure. Within the rational choice perspective, rational cooperation is a response to market failure.⁴ Market failure, in turn, is simply the failure of agents acting on purely individually maximizing strategies to secure a Pareto optimal or collectively rational outcome.

Legal rules are a species of rational constraints—the components of a scheme of rational cooperation. Constraints cannot be rational for all actors if they are entirely *redistributive* in character. Such constraints improve the welfare of some only at the expense of others. Consequently, a set of legal rules designed to move resources along the Pareto frontier from one optimal outcome to another could not be rational for each agent. Thus, the view that law or politics is entirely redistributive, in this sense, is incompatible with the rational choice perspective.

In order to be rational, legal constraints must also have a *productive*

3. See D. GAUTHIER, *MORALS BY AGREEMENT* (1986); Coleman, *Competition and Cooperation*, 98 *ETHICS* 76 (1987); Kraus and Coleman, *Morality and the Theory of Rational Choice*, 97 *ETHICS* 715 (1987).

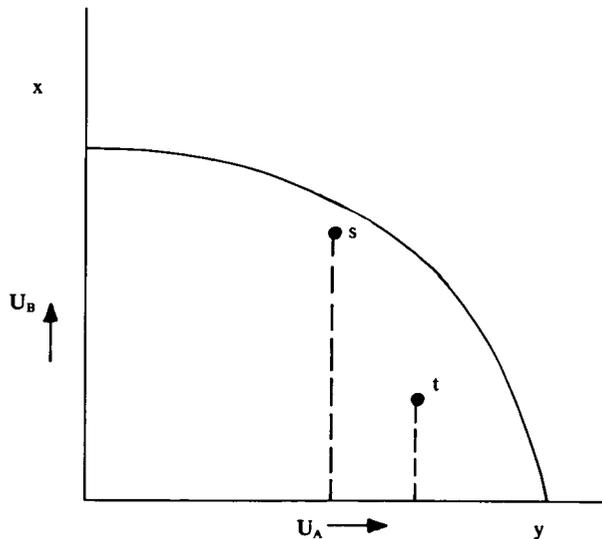
4. But see J. COLEMAN, *supra* note 2.

dimension. This follows directly from my previous argument. Legal rules are rational constraints, and rational constraints cannot be entirely redistributive. Therefore, in order to be rational, legal rules must also have a productive dimension—but what does that mean?

Constraints are productive only if they increase people's welfare, utility or well-being. They must, in some sense, make people better off. Thinking about this in Pareto terms, it can be rational for individuals to impose constraints on themselves only if doing so moves them towards the Pareto frontier. Think of it this way. Such constraints cannot be rational if individuals are already located on the frontier. They can be rational, therefore, only if people are within the frontier. From within the frontier, constraints cannot be rational if they move individuals further from the frontier or along some curve with the same slope as the frontier. Moving further away may make everyone worse off, while moving along the same curve makes some better off only at the expense of others, and while desirable, therefore, for some, *not* rational for all.⁵

Only movement in the direction of (and ultimately to) the frontier can be rational for all agents. Thus, constraints are rational only if they constitute Pareto improvements for all agents. Because legal rules are constraints, they can be rational only to the extent they constitute Pareto

5. Further movement away from the frontier need not make everyone worse off. This is easily illustrated by the following graph.



Line x, y represents the frontier. Suppose A and B find themselves at s . A movement to t is a move away from the frontier, but it is one that makes A better off than she is at s . The crucial point is that no such move can render everyone (A and B) better off.

improvements for all agents. In this sense, productivity is a precondition of rational legal constraint. This is what it means to say that rational constraints must be rational for all agents.

With one difference, the foregoing analysis of legal rules within the rational choice perspective squares exactly with the traditional economic analysis of them. In the traditional economic analysis, legal rules rectify market failures by encouraging efficient or Pareto optimal allocations of resources. This is another way of saying that legal rules must have a productive dimension. The one difference is that within the rational choice perspective, legal rules must be both collectively and *individually* rational. Collective rationality is simply Pareto optimality, so the difference between traditional economic analysis and the rational choice perspective is the individual rationality condition. The individual rationality condition imposes the constraint that legal rules be mutually advantageous in a way in which the collective rationality or Pareto optimality condition does not.

Readers familiar with my previous conceptual work on economic analysis might be led into thinking that I am drawing attention to the difference between Pareto superiority and Pareto optimality. In other words, that by committing itself to the individual rationality condition, the rational choice perspective requires legal rules to be both Pareto optimal and Pareto superior to the status quo or inefficient equilibrium. At one time I would have drawn the same conclusion, but there is an important difference between Pareto superiority and individual rationality that I want to emphasize. However, that discussion needs to be postponed a moment while we return to the basic argument.

To refresh your memory, here's where the argument stands. My claim so far is that from a rational choice perspective, within which I believe any defensible form of economic analysis must ultimately be embedded, legal rules, understood as rational constraints, must be productive in the sense prescribed by both the collective and individual rationality conditions.

Economic analysis countenances a role for distributive considerations, but views any concerns for distribution as exogenous to the structure of the problem and as logically distinct from the productive or efficiency dimension of it. Such a view is precisely what the rational choice framework denies.

From any equilibria within the Pareto frontier, the frontier can be reached only as the result of a cooperative scheme. Cooperation exists in a set of constraints which rational individuals could agree to and with

which it would be rational for each to comply. There are a large number of feasible cooperative schemes capable in theory of securing the frontier and which could plausibly obtain the compliance of rational agents. These schemes do not differ from one another with respect to their productive dimension—they are all “efficient.” From the point of view of classical economic theory, because they are all collectively rational or Pareto optimal, they are all equally defensible. The choice among them cannot be a matter of economics, and thus we get the natural dichotomy between “efficiency” and “equity” which gets picked up in our normal understanding of the Coase Theorem and expressed as the difference between a rule’s efficiency and its distributional properties.

From the rational choice perspective, this dichotomy cannot be sustained. Constraints equally capable of securing the frontier differ from one another in the ways in which they distribute the benefits and burdens of cooperation. Cooperation, if it is to be defensible, must be reconstructible as the outcome of a rational choice by the parties whose behavior and well-being is to be affected by it. This requires the parties to agree upon a division of the benefits and burdens of cooperation. For them, the problem of cooperation is necessarily both distributive and productive. Failure to agree upon a division of the cooperative gains *means* no cooperation; that is, failure to obtain the frontier. It’s not only that there are various and different distributive consequences of legal rules, but as long as legal rules are seen as rational constraints for mutual advantage—as they must be within the rational choice perspective—the very possibility of mutual advantage depends on reaching an agreement as to the distribution of advantage. The marriage of productivity and distribution is the bond that makes rational cooperation possible.

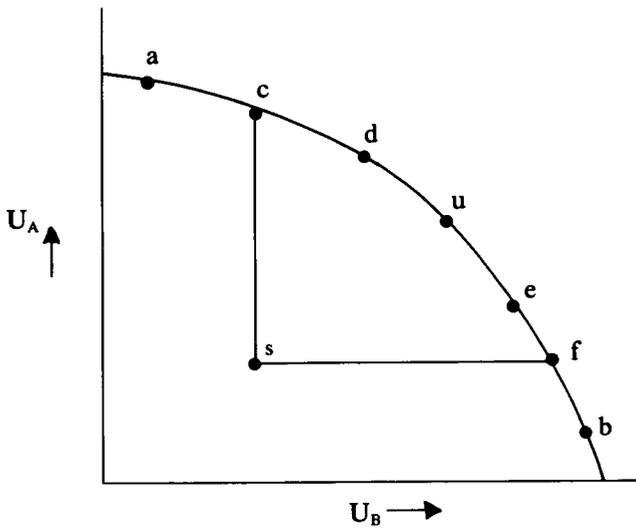
Once we *embed* the claim that the law ought to promote efficiency or rectify market failure in a political or moral theory which makes that claim plausible or defensible, that is, the rational choice framework, the normative significance of the analytic distinction between efficiency and distribution evaporates.

Legal rules are responses to market failings. Within a rational choice framework (in which economics is ultimately embedded), inefficiency creates an opportunity for rational cooperation. Rational cooperation exists in agreement to and compliance with a set of constraints on individually maximizing strategies. A large number of such constraints, which differ from one another in their distributive dimension, can in theory produce efficient outcomes. Rational cooperation requires an agreement upon a set of such constraints. Thus, rational cooperation requires

the merger of the distributive with the productive aspects of legal practice.

Let's now make several distinctions more precise, and in doing so, we will deepen our understanding of the role of legal rules within a rational choice perspective, and in the process more fully appreciate the diversity of legal practice as a form of rational cooperation. Our discussion will be enhanced by analyzing a very simple graph.

FIGURE 1: RATIONAL COOPERATION



Suppose s represents a suboptimal equilibrium. Points a, c, d, u, e, f and b are all Pareto optimal. Points b and a are not Pareto superior to s . At b , A is worse off than she is at s ; at a , B is worse off than he is at s . On the other hand, when at s and faced with a choice among the alternatives on the frontier, choice b is *individually* rational for B , and choice a is individually rational for A . This is the difference between Pareto superiority and individual rationality mentioned above. A and B can obtain the frontier only if they can agree upon which point on it to accept. These points all represent the outcomes of alternative constraints which differ from one another on distributive grounds. That choice is not distinct from the problem of rational cooperation either when A and B face it *ex ante* or when we reconstruct that choice *ex post*.

It is quite common to view rational cooperation as a prisoner's dilemma problem and to understand market failure which gives rise to it in the same way. But this graph shows why it is a mistake to view market failures on the model of a prisoner's dilemma. In its standard formula-

tion, the payoffs of a prisoner's dilemma are *given*.⁶ There are no negotiations over the gains from cooperation. In a typical market failure, however, there are various ways of rectifying the failure which differ from one another in their distributive dimension. For similar reasons, conceiving of rational cooperation generally as a prisoner's dilemma problem—as have political theorists since Hobbes—is to once again ignore its central distributive aspect.

More importantly, to see legal rules as schemes of cooperation designed to solve a prisoner's dilemma is to focus entirely on the role such rules play in eliminating the rationality of choosing defection payoffs (*a* and *b* in Figure 1) and therefore in making the "contract curve" (choices *c*, *d*, *u*, *e*, and *f* in Figure 1) enforceable. Such a view ignores the distributive aspects of cooperation—the choice of *a* contract among alternatives on the contract curve—and in so doing, ignores the roles legal rules play in pursuing and enforcing distributive claims and in encouraging negotiations.⁷

Once we recognize the centrality of distribution to rational coopera-

6. A classic example of a prisoner's dilemma serves to illustrate my point. Assume two prisoners are faced with the following alternatives: if either of them confesses while the other does not, the confessor will be sentenced only to two years in prison, while the other will be sentenced to 12; if neither confesses, they will both be sentenced to four years; and if both confess, each will be sentenced to 10 years. When deciding whether to confess, each prisoner reasons as follows: "It will be to my advantage to confess regardless of what the other prisoner does: if he confesses, and I don't, I will get 12 years, while if I do confess, I will only get 10; similarly, if he does not confess, and I also do not confess, I will get four years, while if I do confess, I will only get two. Thus, regardless of whether he does or doesn't confess, in either case, I'm better off confessing." Because they each go through the same reasoning process, they both confess, and each gets 10 years in prison; whereas if neither had confessed, each would have received only four years. Thus, each would have been better off if neither had confessed. Although each realized this while deciding whether to confess, they also realized that they were better off confessing no matter what the other did, and so each confessed. R. NOZICK, *PHILOSOPHICAL EXPLANATIONS* 542 (1981).

7. Thus, there are two central distinctions between the theory of law as rational cooperation and the economic analysis of it. The first difference is that the Pareto optimality or economic efficiency exhausts the concerns of "economics" in legal practices on the economic model, whereas the rational choice framework emphasizes both the individual and the collective rationality conditions. The difference is important, since only the latter provides a theory of motivation, that is, an explanation of why individuals faced with a suboptimal outcome would seek some form of third party assistance, e.g., a legal rule. Such a rule promises (*ex ante*, at least) to make individuals better off. But it is this theory of motivation which explains why people cooperate and why cooperation is so difficult. The principle of individual rationality that motivates cooperation also motivates defections from cooperative schemes. This is represented in Figure 1 in that payoff *a* is individually rational for *A*, but involves defection, not cooperation. Payoff *b* is individually rational for *B*, but again *b* is not a cooperative outcome. Thus, rational cooperation has a prisoner's dilemma element. That is not all there is to it, however, for once the theory of human motivation is taken seriously, we must countenance a second difference between classical law-and-economics and the rational choice framework. Classical law-and-economics appreciates the distributive consequences of legal rules, but does not appreciate concerns for distributive rationality as a component of the motivation to cooperate. Thus, in economic analysis, distributional concerns arise once the frontier is secured and they are then dealt with outside the economic framework. In the rational choice framework, distributional issues

tion, we can no longer treat the distributive aspect of legal rules, in the way Coase's interpreters—including an earlier version of me—have, that is, as exogenous to the structure of the problem to which legal rules purport to be solutions.

II. TRANSACTION RESOURCES

In some contexts, the distributive considerations will be considerably less significant to rational cooperation than they will be under other circumstances. The difference depends on what I call the environment—as opposed to the logical structure—of the problem. Let me explain. In doing so I will try to correct one other mistake which grows out of the Coasean literature: namely, the view that *ex ante* exchange is plausible whenever transaction costs are low, and impossible otherwise.

Both of these points can be usefully developed by looking at the practice of contracting.⁸ Imagine two people seeking to reach an enforceable agreement in the absence of any state-like agency with the authority to enforce their agreement. Their process has two logically distinct elements: *contracting* and *safeguarding*. Contracting consists of specifying the terms of the agreement; safeguarding is the process by which those terms are protected against the strategic or noncompliant behavior of others and/or one another.

Contracting has three logically distinct phases. *First*, the parties try to identify if gains exist which they can obtain by contract. To do this they have to be able to identify the status quo and something like the ordinary contract curve. (Neither enterprise is trivial, nor uncontrovers-

arise in determining whether individuals can rationally cooperate in order to secure the frontier and the problems are analyzed as part of the very same framework of rational (economic) decision.

No doubt modern economic theorists have loosely tried to link the traditional efficiency analysis with the theory of rational choice by arguing, for example, that an efficient set of liability rules is that which rational parties would have bargained to. A careful reading of this sort of analysis will show, however, that invariably the author is just dressing up the collective rationality condition in rational choice garb. Not even lip service is given to the distributive dimension of the problem while mere lip service is all that is given to the individual rationality condition. In other words, the bargaining model is introduced, not as a way of giving expression to the problems of division and individual rationality, but as a vehicle for highlighting the collective rationality or Pareto optimality condition—which, like division and individual rationality, is an element of rational bargaining. The way I prefer to structure the problem facing rational actors is as a bargaining problem embedded in a prisoner's dilemma. Only in this way are the conditions of division and individual rationality given their proper weight in a theory of rational cooperation. And within the market failure theory of law, within which economic analysis of law operates, legal rules are rational constraints, that is, the components of a scheme of rational cooperation. To focus on the Pareto optimality condition as expressing the full demands of economic analysis is to miss entirely the relationship between law and rational cooperation more generally. To accept that connection is, however, to abandon the separation of efficiency from distribution forever.

8. The following arguments draw heavily on Coleman, Heckathorn & Maser, *supra* note 2.

sial, especially since what counts as the status quo often has a controversial moral or normative dimension.) *Second*, the parties, having identified the gains, must agree upon a division of them. This involves the process of bargaining. It is for this reason that I see the distributive aspects of rational cooperation (which after all involves forms of explicit or implicit contracting) as being internal to the structure of the problem—and not distinct from it. *Third*, the parties must render their agreement enforceable.

Each phase of contracting appeals to different dimensions of rationality. The first phase—the cooperation or coordination phase—in which the existence of a cooperative surplus is identified, involves the collective rationality (or Pareto optimality) condition. The second phase—the distribution phase—in which a division of the benefits of cooperation is reached, involves a principle of concession or bargaining rationality. Finally, the third phase—the compliance or monitoring phase—in which each individual seeks to protect him or herself against the other's free-riding or defection, involves the principle of individual rationality.

Safeguarding is the process by which the actors attempt to insure that an agreement, once reached, is enforced. The actors are concerned that the distribution to which they have agreed is maintained, and that the possibility of mutual advantage does not evaporate. Safeguarding is necessary whenever uncertainty exists, and in the absence of third parties who reduce uncertainty by providing information or monitoring services, it requires individuals to invest their own resources in securing the transaction.

The truth is that individuals in general have such resources. Let's refer to these as transaction resources. Let's continue to refer to those facts about an environment that threaten the success of negotiations as transaction costs. Then, it follows that the need for third party enforcement or legal rules is *not* a function of the extent of transaction costs, but instead a function of the relationship between transaction costs and transaction resources.

Rational individuals are prepared to incur at least some costs to eliminate uncertainty. Such costs are the most important kind of transaction cost. The costs which individuals are prepared to incur fall into three categories: (1) search, (2) division, (3) monitoring. Because each contractor wants information about his prospects for contracting, each will have an incentive to incur some *search costs*. Search costs are invested in order to enable each contractor to answer the question: Are there gains to be had?

Bargaining requires concessions. Concessions depend on each party's best hope alternative and what he or she will be unwilling to accept. In order for bargaining ultimately to succeed, each individual must be willing to incur some costs in order to obtain the relevant information. These are division costs.

Finally, each individual wants to determine the likelihood of defection and its consequences. Only then can each hope to construct an enforceable agreement. Therefore, each individual is prepared to incur certain monitoring costs.

The analytic nature of the problem is becoming clearer. First, individuals have an incentive to incur costs or, alternatively, to expend some resources. In almost all circumstances, individuals have some such resources. Their motivation for expending resources is to reduce uncertainty and thereby induce optimal contracting. This is the process of safeguarding.

Safeguarding does not presuppose either the absence of transaction costs or the presence of the state as a safeguard—quite the contrary. There are always transaction resources and the role of the state is to be explained, not assumed.

The degree to which the expenditure of transaction resources is necessary is a function of the scope of uncertainty. The extent of uncertainty is itself a function of the environment within which contracting occurs. Let's note some of the factors affecting uncertainty. *Group size* can increase uncertainty. Large groups can obscure the possibility of gains, increase uncertainties about acceptable divisions, and increase the costs of monitoring. *Heterogeneity* can increase bargaining problems and monitoring. Just think how much easier it is to reach and enforce agreements among totally like-minded individuals than it would be to do so among individuals who have virtually no attributes, principles or values in common. *Distance* and *time* increase uncertainty, especially in monitoring. Finally, *instability* or *transience* in the nature of the relationship increases uncertainty. To see this, just consider how repeat play and reputational effects reduce uncertainty.

I mention these examples not just to show how the environment in which contracting occurs can increase the costs of safeguarding by increasing uncertainty, but also to show how the environment can create transaction resources upon which the parties can draw. Closely knit communities defined by shared values and commitments may permit contracting to occur successfully without the use of third parties simply because the environment is so rich in transaction resources. Information

in such communities travels quickly and accurately. Reputation works in similar ways. Defection is easily discerned and punished. A person contracting in *that* environment has resources upon which to draw that Marco Polo clearly lacked when he first sought trading partners in the Far East.

Analogous considerations apply among contractors in competitive markets. Highly competitive markets provide reasonably low cost safeguards to defection and reduce divisional uncertainty by narrowing the bargaining range. Thus, for a wide class of contracting situations, law is a relatively high price to pay for safeguards that might otherwise be available and endogenous to the environment in which the contract occurs.

I say that the existence of legal rules may in some circumstances be a high price to pay to safeguard a contract among rational actors. The reason is that legal rules represent the contribution of third parties. Third parties cannot be presumed willing to provide this service costlessly. In any event, what in the absence of the "state" is a two party contracting problem, becomes, in its presence, a three party problem. That fact alone increases search, division and defection problems. Are there gains for all parties? How are the gains to be distributed? For example, if the state is a monopoly while the other parties are internal competitors (over distributive shares), there is reason to believe the state will secure all the economic rents. Finally, who will monitor the monitors? On the model developed here, legal rules are exogenous transaction resources to which rational actors might legitimately appeal to resolve problems that arise in safeguarding contracts. Thus, legal rules are *never* taken as given. Their explanation depends on their relative costs and benefits especially in comparison with endogenous transaction resources upon which the parties can draw.

In another paper,⁹ and in the book to which I referred earlier,¹⁰ I develop the idea presented here in more analytically precise ways. My object here is only to introduce the importance of endogenous transaction resources as essential to our understanding of Coase's original insight.

Coase himself was never guilty of the mistake which I have attributed to all of the Chicago stylè law-and-economics that self-consciously sees its origins in his work. Transaction costs are a black box that needs to be filled in. It is distinctly unhelpful always to reconstruct a legal rule

9. Coleman, Heckathorn & Maser, *supra* note 2.

10. J. Coleman, *supra* note 2.

as a solution to a market failure caused by transaction costs. Instead, I urge the following perspective. First, identify the standard or typical *context* within which the problem is embedded. Second, identify the factors in the environment that contribute to uncertainty and those factors which constitute the pool of resources upon which parties in those circumstances might typically draw. Third, see whether the central problem which the legal rule addresses (given the context) is one of *coordination*, *division* or *defection* uncertainty. Only in this way is the view of law as a response to transaction costs meaningful and informative, for only then can we understand which sort of transaction cost is involved and which sort of endogenous transaction resource is in inadequate supply.

Let me end with two brief remarks. The first ties together claims made in both parts of this paper. At the conclusion of the first part, I said that within the rational choice perspective, the distributive dimension of legal rules is as central as their productive dimension, and that traditional law-and-economics has too easily set these elements of rational cooperation apart. So there is an apparent straightforward difference between what traditional economic analysis on the one hand and rational choice theory on the other would predict about legal practice. The rational choice approach would appear to predict that a greater concern for distributional dimensions of social interaction would appear in our legal practices of rational constraint than might the economic analysis. Thus, whenever the best analysis of a legal rule or practice ignores or downplays distributive concerns, my analysis would appear to be in trouble, or there had better be an explanation of the practice consistent with my theory.

Let's look at the practice of contracting as a test case. The economic analysis of contracting downplays the significance of distributional concerns, yet if contracting is a scheme of rational cooperation, and if distribution is at its core, how could this be? The answer, I believe, is once again to look at the context in which most commercial contracting occurs. In the analysis outlined here, rational contractors appeal to third parties as safeguards against contract failure when the transaction resources endogenous to their environment are inadequate to the task. Thus, contract rules would be especially concerned about distributional matters *only if* a significant degree of uncertainty regarding potential divisions existed among contractors in the typical commercial or sales contract setting and could not be overcome by the contractors drawing upon those endogenous transaction resources available to them. As it happens, most such contracts are embedded in competitive markets among repeat

players. The bargaining range is, therefore, narrowed considerably by context, and the ability of any one party successfully to be an advantage taker is reduced accordingly. The competitiveness of the market and the information necessarily accumulated by repeat players reduces both the bargaining range and the attractiveness of defection payoffs. The market in which the contract is embedded *is* the low cost safeguard against unfair division and defection, thus reducing the role for legal rules, in particular, for legal rules primarily concerned to effect a "distribution" of the gains from contracting. That is an *outline* of the beginning of the sort of explanation the rational choice approach would provide to account for the fact that so little of contract law is given over to distributional matters, even though contracting is a form of rational cooperation with distributional questions at its core. Thus, the economic and rational choice perspectives may reach the same conclusion about the role of distributive considerations in ordinary contracts, but for different reasons. Moreover, unlike economic analysis, the rational choice approach downplays but does not downgrade the significance of one's interest in distributive fairness.

Finally, if the analysis outlined here and developed elsewhere is plausible, then many cases in contracts also have less to do with creating safeguards against defection (or breach) than we might otherwise think. For if a typical contract is embedded in a competitive market, the lowest cost safeguard to defection is the existence of alternatives. Many cases that come to a court framed as breach or defection cases actually raise coordination problems. In ongoing relationships, what the parties are really asking a court to do is to specify some rule or convention to reduce uncertainty and thereby to enable future individuals to contract within a framework whose boundaries are more precisely determined. Put another way, once we appreciate the context in which much rational contracting occurs, we realize that the parties who call upon courts are not asking for the imposition of an efficient rule, but for the imposition of *any* rule that will reduce uncertainty. For such a rule facilitates rational contracting, the long term consequences of which will be efficient. Efficiency derives from the ongoing nature of the practice once a convention is established; it is not necessarily what rational parties demand from legal rules themselves.

I do not want to deny that courts often and correctly seek legal rules that are efficient as compared to ones which may not be. My point is the more modest one, that once we force ourselves to take seriously the contexts in which the need for exogenous resources may arise, we will realize that, at least in some cases which involve competitive markets and repeat

play, the role of legal rules is simply one of providing salience that enables conventions to emerge. This is not to downplay the significance of legal rules to the efficient allocation of resources, but to redirect our attention to the way in which legal rules contribute to efficient resource allocation.