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CONTRACT LAW AND THE AUSTRIAN SCHOOL OF ECONOMICS

*CHRISTOPHER T. WONNELL**

INTRODUCTION

BECAUSE both contract law and economic theory are concerned in large part with marketplace phenomena,[1] it is important to consider what effects developments in economic thought may have on contract law. One such development is the revival of interest in the Austrian school of economics[2] on the part of the economics profession.[3] The basic tenets of the Austrian tradition, articulated in more detail below,[4] include an emphasis on the division of knowledge among market participants,[5] a theory of competition and of the market as a continuing process of learning and adaptation rather than an equilibrium state[6] and a com-

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1. *See* L. Friedman, Contract Law in America 20 (1965) ("The law of contract is . . . roughly coextensive with the free market. Liberal nineteenth-century economics fits in neatly with the law of contracts so viewed."); Kronman & Posner, *Introduction: Economic Theory and Contract Law*, in The Economics of Contract Law 1 (A. Kronman & R. Posner eds. 1979) ("Since buying and selling . . . are quintessentially economic activities, it would seem that economics should have something useful to say to students of contract law.").

2. For a good summary of the development and tenets of the Austrian School, see *Economic Thought: The Austrian School*, 4 Int'l Ency. Soc. Sci. 458 (1968).

The Austrian tradition dates back to the publication of Carl Menger's Grundsatze in 1871. The Grundsatze was not translated into English for many years, but indirectly influenced English economists through the work of, among others, Friederich Wieser and Eugen Bohm-Bawerk. *See, e.g.*, E. Bohm-Bawerk, The Positive Theory of Capital xxvii-xxviii (1971) (first edition published in 1891); F. Wieser, Natural Value xxxiii (1971) (first edition published in 1893). This influence is recounted in the preface to the English version of Menger's book. *See* C. Menger, Principles of Economics 37-40 (1950).

3. *See* Kirzner, *Introduction*, in Method, Process, and Austrian Economics 1 (I. Kirzner ed. 1982) [hereinafter cited as Austrian Economics]; Roche, *The Relevance of Friedrich A. Hayek*, in Essays on Hayek 1 (F. Machlup ed. 1976).

4. See *infra* Part II.

5. *See, e.g.*, Hayek, *The Use of Knowledge in Society*, 35 Am. Econ. Rev. 519, 519 (1945) [hereinafter cited as Hayek I], *reprinted in* F. Hayek, Individualism and Economic Order 50-54 (1948); Hayek, *Economics and Knowledge*, 4 Economica 33, 49-53 (1937) [hereinafter cited as Hayek II], *reprinted in* F. Hayek, *supra*, at 77; Loasby, *Economics of Dispersed and Incomplete Information*, in Austrian Economics, *supra* note 3, at 114-15. See *infra* Part II.A.

6. *See, e.g.*, C. Menger, *supra* note 2, at 74 ("Nothing is more certain than that the degree of economic progress of mankind will still, in future epochs, be commensurate with the degree of progress of human knowledge."); Littlechild, *Equilibrium and the Market Process*, in Austrian Economics, *supra* note 3, at 86 (For the Austrian, "the market is a process. The state of the market is continually changing. The market process is

mitment to a radical methodological individualism and subjectivism.[7]

The thesis of this Article is that the Austrian school of economics has much to contribute to contract law, and in particular to the recurring tension between freedom of contract and the idea that a party should be excused from contractual duties because of her insufficient knowledge, foresight or bargaining power. This problem area includes, of course, the idea that a court will not weigh the adequacy of consideration,[8] as well as the competing concept of unconscionability.[9] Also included are the doctrine of impossibility[10] and the closely related doctrine of mistake.[11]

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characterized by profits and losses as the judgments made by entrepreneurs turn out to be correct or incorrect."). See *infra* Part II.B.

7. *See* L. Mises, Human Action 143 (2d ed. 1963) ("Society is the outcome of conscious and purposeful behavior."); 1 M. Rothbard, Man, Economy, and State 2 (1962) ("Only individuals have ends, and can act to attain them."); Lachmann, *Methodological Individualism and the Market Economy*, in Roads to Freedom—Essays in Honour of Friederich A. von Hayek 91-92 (E. Streissler ed. 1969), *reprinted in* L. Lachmann, Capital, Expectations, and the Market Process 152 (1977) ("We now have to consider the significance of [individual plans] for the methodology of the social sciences. It seems to us that they provide the justification for 'methodological individualism' . . . .") (footnote omitted). See *infra* Part II.C. For an example of a subjectivist critique, although one which operates within both the Keynesian and Austrian traditions, see G. Shackle, Epistemics and Economics (1972).

8. J. Calamari & J. Perillo, The Law of Contracts § 4-3, at 136-37 (2d ed. 1977); Braucher, *Freedom of Contract and the Second Restatement*, 78 Yale L.J. 598, 600 (1969); *see* Black Indus., Inc. v. Bush, 110 F. Supp. 801, 805 (D.N.J. 1953) ("relative values of the consideration in a contract between business men dealing at arm's length without fraud will not affect the validity of the contract").

9. *See* U.C.C. § 2-302 (1978) (courts may modify or refuse to enforce unconscionable contract); Restatement (Second) of Contracts § 208 (1979) (same) [hereinafter cited as Second Restatement]. The unconscionability section of the Uniform Commercial Code (UCC) "is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable." U.C.C. § 2-302 official comment 1 (1978). For an enlightening discussion of the definition of "unconscionable," see Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & Econ. 293 (1975).

10. Impossibility or impracticability claims typically involve some assertion that performance itself has become more costly, burdensome or impossible. *See, e.g.*, Ontario Deciduous Fruit-Growers' Ass'n v. Cutting Fruit-Packing Co., 134 Cal. 21, 24, 66 P. 28, 29 (1901) (party excused from delivery of specific crop of peaches when drought destroyed the crop); Taylor v. Caldwell, 122 Eng. Rep. 309, 312-15 (K.B. 1863) (fire in music hall excused performance of agreement to lease hall); U.C.C. § 2-615 (1978) (failure of performance by a party to contract not breach if performance made impracticable by occurrence of contingency the nonoccurrence of which was basic assumption of contracting parties); Second Restatement, *supra* note 9, § 261 (same). Both the Uniform Commercial Code and the Second Restatement use the term "impossibility" to encompass "impracticability." *See* U.C.C. § 2-615 (1978); Second Restatement, *supra* note 9, ch. 11. This Article will do the same.

Frustration of purpose involves a claim that, although performance may be no more costly than anticipated, it has been rendered pointless by the intervention of some event. J. Calamari & J. Perillo, *supra* note 8, § 13-10, at 495; *see, e.g.*, Doherty v. Monroe Eckstein Brewing Co., 198 A.D. 708, 710-12, 191 N.Y.S. 59, 61-62 (1921) (purpose of lease for saloon frustrated by Prohibition); Krell v. Henry, 2 K.B. 740 (C.A. 1903) (purpose of contract to lease building in order to enable lessee to view royal procession was frustrated when the procession was canceled).

11. Where both parties share a common assumption about a vital fact upon which they based their bargain and that assumption is false, the transaction

One caveat is appropriate at the outset of this Article. In light of the way in which law is presently taught, abstract discussion of any legal doctrine is likely to evoke images of standard casebook illustrations—"hard cases" with stark fact situations that test the limits of legal principles. Thus, the unconscionability doctrine creates images of door-to-door salesmen selling $300 refrigerators to welfare recipients for over $1200,[12] and the impossibility doctrine suggests the problem of holding a party to a contract to lease a music hall that has since burned to the ground.[13] It is not clear that Austrian, or any other, economics has much to contribute to resolving such aberrational cases.

Unconscionability and impossibility claims have, however, been pressed in circumstances touching more closely on the ordinary workings of the market economy. In general, courts have thus far hesitated to limit the principle of freedom of contract in such cases. This Article asks whether such hesitation is justified. That is, should it be unconscionable for a creditor to accelerate the balance of a debt on default,[14] for a bank to set off debts of a depositor against his account,[15] for a secured creditor to insist that a debtor not sell collateral without the prior consent of the creditor[16] or for a seller to keep a security interest in previously purchased goods where payments are applied first to the items purchased first?[17] Should contractual performance be held impossible when costs have risen fifty-eight percent,[18] when one party becomes insolvent or bankrupt,[19] when the necessary labor for performance becomes scarce[20] or when a party to a commercial lease is unable to obtain needed

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may be avoided if because of the mistake a quite different exchange of values occurs from the exchange of values the parties contemplated unless the risk is otherwise allocated by agreement, custom or law.

J. Calamari & J. Perillo, *supra* note 8, § 9-26, at 300 (footnote omitted); *see* G. Palmer, Mistake and Unjust Enrichment 13-17 (1962); Second Restatement, *supra* note 9, § 152.

12. *See* Jones v. Star Credit Corp., 59 Misc. 2d 189, 190, 298 N.Y.S.2d 264, 264-65 (Sup. Ct. 1969).

13. Taylor v. Caldwell, 122 Eng. Rep. 309 (K.B. 1863).

14. *See* Simon v. New Hampshire Sav. Bank, 112 N.H. 372, 375, 296 A.2d 913, 916 (1972) (holding no); King v. South Jersey Nat'l Bank, 66 N.J. 161, 169, 330 A.2d 1, 5 (1974) (same). *But see* Fontaine v. Industrial Nat'l Bank, 111 R.I. 6, 11-12, 298 A.2d 521, 523-24 (1973) (acceleration without prior notice is unconscionable).

15. *See* Greene v. Citizens & S. Bank, 134 Ga. App. 73, 76, 213 S.E.2d 175, 177-78 (1975) (holding no).

16. *See* O'Brien v. Larson, 11 Wash. App. 52, 53-58, 521 P.2d 228, 229-32 (1974) (holding no).

17. *See* Singer Co. v. Gardner, 65 N.J. 403, 410-14, 323 A.2d 457, 462-63 (1974) (holding no). *But see* Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 450 (D.C. Cir. 1965) (consumer contract that did not close off first debt first may be unconscionable).

18. *See* Northern Corp. v. Chugach Elec. Ass'n, 518 P.2d 76, 82 (contract excused where contemplated ice holding method proved not commercially feasible), *vacated*, 523 P.2d 1243 (Alaska 1974).

19. *See* Bloor v. Falstaff Brewing Corp., 454 F. Supp. 258, 267-70 (S.D.N.Y 1978) (holding no), *aff'd*, 601 F.2d 609 (2d Cir. 1979). *But see* Howard v. Nicholson, 556 S.W.2d 477, 483-84 (Mo. App. 1977) (impossible where bankruptcy of prospective commercial tenants was not contemplated by parties).

financing?[21]

In a sense, neither economic theory nor principles of contract law unequivocally answer these concrete questions, because both disciplines are essentially abstract.[22] Rather, the inquiry of economics and contract law concerns the general circumstances under which it is appropriate to leave the allocation of concrete rights and duties to the parties. Of course, any assertion of "appropriateness" requires normative as well as positive[23] analysis. The law-and-economics school can be criticized for its tendency to argue policy conclusions directly from its cause-and-effect analysis, while assuming the unspoken norm that economic efficiency is a desirable goal. The difference between neoclassical economics[24] and the Austrian school, however, concerns positive analysis, not the desirability of particular ends. This Article seeks to contribute solely to the positive economic analysis of the effects of alternative legal rules. Of course, if one is indifferent to efficiency and the creation or destruction of wealth, the positive analysis may be of little interest. No such pretense of indifference is maintained here, for it is assumed without much argument[25] that efficiency is in fact a good thing.[26] The positive analysis, however, is logically independent of this ethical assumption, and therefore should be useful to those who, for ethical reasons, may disagree with certain suggestions of appropriate policy contained in this Article.

Part I presents the approach of traditional neoclassical economics to the problems of contract law. Part II then describes at some length the major assumptions of the Austrian school and how they differ from the

20. *See* Hudson v. D & V Mason Contractors, Inc., 252 A.2d 166, 169 (Del. Super. 1969) (holding no).

21. *See* Marcovich Land Corp. v. J.J. Newberry Co., 413 N.E.2d 935, 942-44 (Ind. App. 1980) (holding no).

22. *See* L. Friedman, *supra* note 1, at 20-21 ("Contract law is abstraction—what is left in the law relating to agreements when all particularities of person and subject-matter are removed . . . . Liberal nineteenth-century economics . . . too, had the abstracting habit."). Friedman's thesis, however, is that law as a whole has become less abstract in this century. *See id.* at 215.

23. "Positive economics is in principle independent of any particular ethical position or normative judgments. As Keynes says, it deals with 'what is,' not with 'what ought to be.' " M. Friedman, Essays in Positive Economics 4 (1953).

24. "Neoclassical economics" is a term given to an economic tradition dating from the "marginal revolution" against classical economics in the 1870's. *See* Hausman, *Introduction*, in The Philosophy of Economics 33 (D. Hausman ed. 1984). The classical economists held that the price of a good is determined by its cost of production. *See* C. Menger, *supra* note 2, at 149. The marginal revolution was a product of the independent discovery by William Stanley Jevons in England, Carl Menger in Austria and Leon Walras in France that the causal sequence is in fact the reverse—that the price of resources was determined by the amount consumers would pay for goods produced from those resources. *See* Hausman, *supra*, at 33.

25. A few words in defense of efficiency as an ethical concern are presented in the Conclusion of this Article.

26. For a discussion of the normative status of efficiency, see Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 Hofstra L. Rev. 509, 526-48 (1980); Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 Hofstra L. Rev. 487, 502-06 (1980).

neoclassical approach. No prior knowledge of Austrian economics is assumed. Indeed it is best to delay consideration of the Austrian tenets until the neoclassical paradigm to which the Austrians are responding is itself explained. Part III analyzes several major problems of contract doctrine from an Austrian perspective and argues that many of the "assumptions" made in neoclassical economic models not only are unnecessary for the idea of freedom of contract, but in fact tend to mask some of the most important reasons for maintaining that freedom. The Conclusion presents some directions for contract law and policy that would, under Austrian economics, be desirable.

I. THE APPROACH OF NEOCLASSICAL ECONOMICS

A. *The "Victimless Crimes" Theory of Contract*

A good place to start the economic analysis of contract law is with the following contention of Professor Richard Epstein:

> [The] general regime of freedom of contract can be defended from two points of view. One defense is utilitarian. So long as the tort law protects the interests of strangers to the agreement, its enforcement will tend to maximize the welfare of the parties to it, and therefore the good of society as a whole. The alternative defense is on libertarian grounds. One of the first functions of the law is to guarantee to individuals a sphere of influence in which they will be able to operate, without having to justify themselves to the state or to third parties: if one individual is entitled to do within the confines of the tort law what he pleases with what he owns, then two individuals who operate with those same constraints should have the same right with respect to their mutual affairs against the rest of the world.[27]

Economic analysis is concerned with only the "utilitarian," or at least consequentialist, argument for freedom of contract. Epstein's consequentialist argument might be characterized as a "victimless crimes" theory of contract—because no third party is hurt, no one can complain. But this clearly will not do. If X and Y enter into a contract, the most obvious victims of the contract are X's competitors for Y's service and Y's competitors for X's service. The injuries that result from such fair competition are not generally compensable in tort actions.[28] In Epstein's libertarian argument, of course, one might say that X's competitors have no right to Y's services and thus no third party's *rights* have been victimized by the contract. From the perspective of the consequentialist argument, however, this contention begs the question about the appropriate assignment of rights because under Epstein's libertarian argument the appropriate assignment of rights is whatever the parties to a contract

27. Epstein, *supra* note 9, at 293-94 (footnote omitted).

28. *See* W. Prosser & W. Keeton, Prosser and Keeton on Torts 1012 (5th ed. 1984). Of course, a contract might generate other forms of externalities that would be covered by tort law. Such coverage is necessary to ensure that firms consider the full marginal social costs of their behavior.

decide. The challenge of the economic theory of contracts is to explain how freedom of contract can be beneficial even though the doctrine diverts resources from alternative uses.

Epstein's theory does suggest the important truth that contracts can simultaneously benefit both contracting parties. Economists have, of course, been making this point since the time of Adam Smith.[29] But because the core materials of our legal system are appellate opinions that depict contracting parties as adversaries, the argument bears repetition in the legal context. A contract can, of course, be in the ex ante[30] interest of both parties and nevertheless lead to litigation. For example, one party may partially perform first, and thus leave the other party with no further incentive to comply with the contract.[31] Alternatively, the parties may have rationally placed a risk on the superior risk-bearer,[32] but once the feared loss accrues, the risk-bearer has an incentive to escape the contract.[33] Even if one focuses solely on the ex ante status of the parties to the contract, it is certainly not clear that all contracts are victimless—one of the parties may have been mistaken about her true interests. This possibility is discussed in detail later in the Article.[34]

B. *The Efficiency of Market Prices Under Perfect Competition*

Because contract law cannot be defended as having no victims, the real question becomes why the victimizing of the contracting parties' competitors (broadly construed to include anyone else with whom the other party could have contracted) is defensible. Traditional neoclassical economics offers an explanation. X chooses to contract with Y rather than some Y_1, and Y chooses to contract with X rather than some X_1, because X and Y are somehow in a position to offer better price or other contract

29. M. Friedman & R. Friedman, Free to Choose 39 (1980) ("Ever since Adam Smith there has been virtual unanimity among economists, whatever their ideological position on other issues, that international free trade is in the best interest of the trading countries and of the world.").

30. On the importance of ex ante analysis of legal problems, see Easterbrook, *The Court and the Economic System*, 98 Harv. L. Rev. 4, 10-12 (1984).

31. In Groves v. John Wunder Co., 205 Minn. 163, 286 N.W. 235 (1939), Wunder, the lessee, refused to restore mined property to its original condition after the lessor Groves had fully performed. *Id.* at 165, 286 N.W. at 236. "[F]rom the outset, on Groves' part the contract was executed except for [lessees'] right to continue using the property for the stated term." *Id.* at 164-65, 286 N.W. at 235-36. There was no indication that Wunder had any use for the right to further use the property, so it is not surprising that Wunder saw no further need to comply with the contract.

32. On the criteria that influence proper allocations of contractual risks, see Posner & Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. Legal Stud. 83, 89-90 (1977), *reprinted in* The Economics of Contract Law, *supra* note 1, at 122-23.

33. *See* Pacific Allied v. Century Steel Prods., Inc., 162 Cal. App. 2d 70, 72-74, 327 P.2d 547, 549-50 (1958) (defendant agreed to reimburse plaintiff for labor costs in experimenting with installing defendant's steel forms, but defendant refused to pay when project required extensive labor costs).

34. See *infra* notes 105-75, 190-201 and accompanying text.

terms[35] than are X_r and Y_r.[36] Resources are thus allocated in accordance with governing prices, but the question remains whether those prices themselves efficiently allocate resources.

The well-known answer of neoclassical economics is that prices will allocate resources efficiently given assumptions that collectively have come to be called "perfect competition." Perfect competition exists when all sellers in an industry produce a homogeneous product, each market has so many buyers and sellers that no single person's actions can affect the market price, all resources are perfectly mobile and thus can be switched readily from one use to another and consumers, firms and resource owners have complete knowledge of all relevant facts.[37] Although the legal literature has sometimes acknowledged the neoclassical conclusion that freely-set prices efficiently allocate resources, such literature rarely indicates why perfect competition ensures this result.[38] Yet without knowing the *reason* freedom of contract would be efficient under perfect competition, it is impossible to say to what extent real world deviations from the assumptions of perfect competition would introduce serious inefficiencies into the contracting process.

Both neoclassical and Austrian economists emphasize that market prices force firms to consider the real costs[39] production imposes by the diversion of scarce resources. In a perfectly competitive economy, the owners of land, labor and capital would know exactly where they could command the highest return and would move to that use instantaneously. Firms where those resources could make the largest contribution toward valuable consumer goods would be in a position to offer the resource owners the highest returns and under perfectly competitive conditions would be forced to do so.[40] As a result, each expanding firm's cost of production increases by the amount it must pay the owners of re-

35. Hereafter, in keeping with the neoclassical tradition, the terms of trade will simply be called "prices," although other contractual terms are included in the term. Subsequent sections of the Article will discuss important differences between prices and other contract terms. See *infra* notes 190-201 and accompanying text.

36. This conclusion assumes the neoclassical conception of "economic man" who rationally maximizes his utility (satisfaction of his desires) subject to his budget constraints. G. Stigler, The Theory of Price 46 (3d ed. 1966).

37. *See* E. Mansfield, Principles of Microeconomics 204 (4th ed. 1983); Eisenberg, *The Bargain Principle and Its Limits*, 95 Harv. L. Rev. 741, 746 (1982).

38. For example, Professor Eisenberg has noted that under perfect competition price tends to equal marginal cost, but he did not fully explain why that result is efficient. *See* Eisenberg, *supra* note 37, at 746-47.

39. In a perfectly competitive economy, each firm produces at a level of output where its marginal cost—the cost of producing an additional unit of output plus a profit—equals the governing price. *See* E. Mansfield, *supra* note 37, at 206. This behavior enhances efficiency. The production of any good entails real costs, since it diverts scarce inputs such as land, labor and capital away from the production of other goods. *See* F. Wieser, *supra* note 2, at 173. For example, consumers may value an additional 100 units of some good X at $500, but that does not mean that the production of those 100 units would be efficient if the result were to divert resources away from the production of goods Y and Z that consumers value at $700.

40. *See* F. Wieser, *supra* note 2, at 70-71.

sources in order to induce them away from other uses. Because perfectly competitive firms maximize profits by setting marginal cost equal to the price of their product, consumers receive only those goods for which they are willing to pay enough to divert resources from other uses.[41]

It is now possible to supplement Professor Epstein's neoclassical defense of freedom of contract: Contracts may have victims, but under the assumptions of perfect competition, contracts are efficient because they move resources to the production of those goods that consumers value most highly.

C. *The Problem of Unrealistic Assumptions*

The problem with the above reasoning, of course, is that the assumptions of the perfect competition model are unrealistic. Commentators in contract law have been quick to use this argument to support judicial intervention into the terms of contracts: "[I]f the assumption of a perfectly competitive market is relaxed, the stage is set for invoking limits on the bargain principle based on the quality of the underlying bargain."[42] Particular criticism has been directed to the assumptions that firms are so numerous that none can influence the market price[43] and that all market actors have perfect information.[44]

Neoclassical economists themselves are of course under no illusion that the assumptions of their model accurately describe real markets.[45] Rather, their defense of the model is based on a methodological theory generally attributed to an article by Milton Friedman. Friedman argued

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41. In economic jargon, marginal-cost pricing is efficient because it ensures that the "marginal rate of transformation" of any two goods—the rate at which one good can be "transformed" into another by shifting inputs—is equal to the "marginal rate of substitution"—the rate at which consumers would be willing to substitute one good for another. *See* C. Ferguson & J. Gould, Microeconomic Theory 452-53 (4th ed. 1975).

42. Eisenberg, *supra* note 37, at 748; *see* Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, With Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 Md. L. Rev. 563, 580-83 (1982) (criticizing freedom of contract as incoherent and therefore incapable of determining outcomes).

43. With the decline of the free enterprise system due to the innate trend of competitive capitalism towards monopoly, the meaning of contract has changed radically. . . . Standard contracts in particular could thus become effective instruments in the hands of powerful industrial and commercial overlords enabling them to impose a new feudal order of their own making upon a vast host of vassals.

Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 Colum. L. Rev. 629, 640 (1943).

44. "[W]hen consumers simply misperceive risks, efficiency might be enhanced by imposing a nondisclaimable duty on the manufacturer." Note, *Efficiency and a Rule of "Free Contract": A Critique of Two Models of Law and Economics*, 97 Harv. L. Rev. 978, 984 (1984).

45. *See, e.g.*, M. Friedman, *supra* note 23, at 15 (perfect competition is "false image of reality"); E. Mansfield, *supra* note 37, at 204 ("No industry in the real world, now or in the past, satisfies all these conditions completely; thus no industry is perfectly competitive. Some agricultural markets may be reasonably close, but even they do not meet all the requirements.").

that a model should be assessed by its explanatory and predictive power rather than by the truth of its assumptions.[46] Because any model must be simpler than reality to be useful,[47] the question is not whether the assumptions are accurate, but whether it has predictive power.[48] Even at this level, however, it is clear that many markets cannot satisfy the stringent requirements of perfect competition; it is doubtful that prospective insureds, for example, behave as if they had full knowledge of the terms of the insurer's contract.

Once one accepts that the market is imperfectly competitive, one must ask whether courts or other public agencies should remove the remaining imperfections in contracts.[49] Indeed, neoclassical economics finds it hard to assert that even the complete elimination of freedom of contract would necessarily be inefficient, because planners could ensure efficient resource allocation by setting "shadow prices" that individuals could be ordered to observe.[50] If neoclassical economics cannot state unequivocally that the total abolition of freedom of contract would be inefficient, the economic case for defending free contract against minor reforms remains problematic.

II. THE AUSTRIAN CRITIQUE

In a sense, it is misleading to speak of an Austrian "school" of economics in flat contradistinction to the neoclassical school. Such a description creates images of bitter conflicts on fundamental assumptions and warring paradigms. The Austrian economists, however, share the neoclassical premise that the prices of resources are determined by their contribution to valued final products.[51] Moreover, the image of conflict-

46. *See* M. Friedman, *supra* note 23, at 15-16.

47. *See* E. Mansfield, *supra* note 37, at 23.

48. Friedman offers an example of predicting a shot by an expert billiard player. He suggests that good predictions might be reached by assuming that the player makes lightning calculations in his mind of the angles revealed by geometric measurements, ball speed, etc. Even though one does not believe billiard players actually make such calculations, one assumes that unless they were in some way able to make the shot as if they made such calculation, they would not in fact be expert billiard players. *See* M. Friedman, *supra* note 23, at 21.

49. If the goal is prices equal to marginal costs, but due to certain monopolistic elements in the market the prices in contracts slightly exceed marginal costs, one might argue that a court should make the necessary contractual revisions. See *supra* notes 42-44 and accompanying text.

50. Neoclassical economics thus has trouble with more radical critiques of freedom of contract such as those emanating from representatives of the Critical Legal Studies (CLS) movement. *See, e.g.*, Kennedy, *supra* note 42, at 564 n.3; Unger, *The Critical Legal Studies Movement*, 96 Harv. L. Rev. 561, 627 (1983). Although CLS has been unclear about its positive program, a major element of its critique concerns the unequal allocation of wealth and power in a market society and contract law's alleged contribution to that inequality. *See* Kennedy, *supra* note 42, at 629-31.

51. See *infra* notes 64-69 and accompanying text. In fact, Carl Menger, the founder of the Austrian school, was also one of the three founders of neoclassical economics. *See* Hayek, *The Place of Menger's Grundsatze in the History of Economic Thought*, in Carl Menger and the Austrian School of Economics 2 (J. Hicks & W. Weber eds. 1973).

ing "schools" would suggest that neoclassical economists have fought vigorously against the Austrian critique, but in large measure they have not.[52] The sense in which Austrian economics constitutes a separate "school" is that it opposes the emphasis that neoclassical economists have placed on relatively unimportant features of an actual economy.[53] In particular, the Austrian school has emphasized the importance of a division of knowledge among market participants,[54] the growth of the knowledge in a market process[55] and the methodological functions and limits of economic analysis.[56]

A. *The Division of Knowledge Among Market Participants*

The Austrian critique begins with the premise that efficiency requires the use of vast quantities of knowledge that exist in no single place but only in the separate minds of millions of individuals.[57] The neoclassical assumption of perfect knowledge on the part of the actors or the economist herself[58] ignores this fundamental fact. F. A. Hayek, probably the best known Austrian economist, stated:

> It is difficult to defend economists against the charge that for some 40 to 50 years they have been discussing competition on assumptions that, *if* they were true of the real world, would make it wholly uninteresting and useless. If anyone really knew all about what economic theory calls the *data*, competition would indeed be a very wasteful method of securing adjustment to these facts.[59]

If knowledge consisted merely of scientific laws knowable in principle by anyone, that knowledge might be obtained by a sufficiently determined group of planners—perhaps judges assisted by expert witnesses. The problem, however, is that so much of what is needed to allocate resources efficiently is knowledge not of the abstract regularities of natural science or social science, but of the concrete particulars of time and place, such as knowledge of available labor supplies, machinery, farmland or unused stocks of goods.[60] Worse yet, contrary to the simplifying assumptions of neoclassical models, the concrete phenomena are not generic categories like "land," "labor" and "capital," but highly specific parcels and subparcels of land, particular people and occupational classes, individual

52. The text overstates the similarities in some respects unrelated to this Article. For example, the Austrian theories of capital and the business cycle differ sharply from those of mainstream economists. *See* L. Lachmann, *supra* note 7, at 267-86.

53. See *infra* notes 59-99 and accompanying text.

54. See *infra* Part II.A.

55. See *infra* Part II.B.

56. See *infra* Part II.C.

57. *See* Hayek I, *supra* note 5, at 519-20, *reprinted in* F. Hayek, *supra* note 5, at 77-78; Loasby, *supra* note 5, at 114.

58. See *supra* text accompanying note 37.

59. F. Hayek, *Competition as a Discovery Procedure*, in The Essence of Hayek 254 (C. Nishiyama & K. Leube eds. 1984) (emphasis in original).

60. *See* Hayek I, *supra* note 5, at 521-22 *reprinted in* F. Hayek, *supra* note 5, at 79-81.

machines and buildings that all differ in endless economically relevant dimensions.[61]

Furthermore, efficient allocation requires a particular type of data detailing the extent to which commodities can be substituted for each other in production or consumption.[62] Thus, rational decisionmaking requires not only that the particularities of each resource be considered in isolation, but also how well highly specific resources can be transformed into others or substituted for others. Ludwig Mises, a leading figure in the Austrian school, stressed the magnitude of this problem, remarking that "the present state of technological knowledge makes it possible to produce almost anything out of almost everything."[63]

The key Austrian point is not simply the existence of this complexity, but that market institutions operate to make that complexity manageable.[64] The market works by giving each individual an incentive to use the concrete information that she possesses and by conveying knowledge (or, more precisely, substitutes for knowledge) of the relative scarcity of all other resources of which the person has no direct knowledge in the form of market prices and other contract terms.[65] In this way each individual can act as if she knew the myriad alternative uses for the products she uses as well as each one of their component resources, and to employ those products only if her use is one of the most efficient possible.[66] If

61. *See id.* at 522, *reprinted in* F. Hayek, *supra* note 5, at 80; Hayek, *Socialist Calculation II: The State of the Debate*, in Collectivist Economic Planning: Critical Studies on the Possibility of Socialism (F. Hayek ed. 1935), *reprinted in* F. Hayek, *supra* note 5, at 153-54; *see also* L. Mises, *supra* note 7, at 699 ("The director does not simply have to deal with coal as such, but with thousands and thousands of pits already in operation in various places, and with the possibilities for digging new pits, with the various methods of mining in each of them, with the different qualities of the coal in various deposits, with the various methods for utilizing the coal for the production of heat, power, and a great number of derivatives.").

62. See *supra* note 41.

63. L. Mises, *supra* note 7, at 699.

Thomas Sowell, a supporter of the Austrian tradition, has noted that "the Soviet machine tool industry alone produces about 125,000 products, involving an estimated 15,000,000,000 possible relations." T. Sowell, Knowledge and Decisions 220 (1980). Sowell particularly emphasizes the problem of determining rates of substitution through any nonmarket process, since these rates require a knowledge of "subjective patterns of trade-off that are nowhere articulated, not even to the individual himself." *Id.* at 217-18 (emphasis omitted). Sowell offers the following example:

> I might *think* that, if faced with the stark prospect of bankruptcy, I would rather sell my automobile than my furniture, or sacrifice the refrigerator rather than the stove, but unless and until such a moment comes, I will never *know* even my own trade-offs, much less anybody else's. There is no way for such information to be fed into a computer, when no one has such information in the first place.

Id. at 218 (emphasis in original).

64. *See* Hayek I, *supra* note 5, at 526-27, *reprinted in* F. Hayek, *supra* note 5, at 86-87.

65. *Id.* at 526, *reprinted in* F. Hayek, *supra* note 5, at 86 ("We must look at the price system as such a mechanism for communicating information if we want to understand its real function . . . .").

66. *See id.* at 527, *reprinted in* F. Hayek, *supra* note 5, at 87 ("The marvel is that in a

there were no market prices, some single mind would have to know the concrete information on which efficiency depends.

Mises' principal argument is that large-scale economic planning is possible only because economic calculations based on prices are possible.[67] For example, without such calculations it would be impossible for a corporation, court or planning agency to choose rationally between two technologically feasible methods of producing a product, one of which employed inputs in quantities 10a + 86b + 31c + 80d + 41e + 8f + 90g and the other in quantities 27a + 11b + 90c + 30d + 60e + 10f + 70g. Without the common denominator of money prices, one simply cannot say which of the two (or, more likely, hundreds of) processes employs "less" of society's resources—imposes less cost in the form of valuable foregone alternatives—and is thus more efficient. As Mises stated: "The paradox of 'planning' is that it cannot plan, because of the absence of economic calculation. What is called a planned economy is no economy at all. It is just a system of groping around in the dark."[68]

To summarize the Austrian argument, a market price embodies the knowledge of vast numbers of people regarding available supplies of the concrete good, its highly specific actual and potential resources and alternative uses of those resources, as well as the requirements for that good and for its highly specific possible substitutes. The Austrians make no assertion that market prices are the most efficient prices conceivable, but however imperfect those prices are, they still embody wisdom many orders of magnitude greater than any one mind could possess.[69]

B. *The Growth of Knowledge and the Competitive Process*

The previous section discussed the Austrian view that a core economic problem is to find a way to make efficient use of the knowledge that already exists but only in a diffuse form among millions of people. Equally important to the Austrian analysis is the importance of the growth of

case like that of a scarcity of one raw material, without an order being issued, without more than perhaps a handful of people knowing the cause, tens of thousands of people whose identity could not be ascertained by months of investigation, are made to use the material or its products more sparingly; i.e., they move in the right direction.").

67. L. Mises, *supra* note 7, at 700. If one mind could know simultaneously all existing production methods, all potential production methods and the relative importance of all the different ends, the calculation problem might be soluble with the use of simultaneous equations. The problem is precisely that such data is diffuse, and that without prices one who lacks substantially comprehensive knowledge cannot make efficient use of the knowledge she does possess. For an excellent summary of the socialist calculation debate, and a thorough demonstration that the Lange-Lerner trial-and-error approach constitutes no solution once the dynamic characteristics of the market generate significant changes that must be entrepreneurially predicted, see D. Lavoie, Rivalry and Central Planning 125-32 (1985).

68. L. Mises, *supra* note 8, at 700.

69. *See* C. Menger, *supra* note 2, at 74; Hayek I, *supra* note 5, at 527-28, *reprinted in* F. Hayek, *supra* note 5, at 88-89.

knowledge beyond that which exists at any one point in time.[70] The static models of neoclassical economics assume away the important element of time, and with it the problems of uncertainty and learning.[71] The first illustration of this aspect of the Austrian critique, although perhaps not one on which Austrian writers have been particularly clear or consistent, concerns "economic man"—the ready-made figure assumed in neoclassical models.[72] It is true that the Austrian economists assume a very thin conception of "rational" conduct that involves some element of purposefulness,[73] but the neoclassical conception of a human being as a walking set of consistent indifference curves is rejected by the Austrian school.

On the contrary, the Austrian school recognizes that people are not necessarily "rational" in the sense assumed by neoclassical economists, but rather that rationality is a trait one can learn (or unlearn) over time. However, no guarantee exists that such learning will in fact take place, or that people will not regress into irrationality. Nevertheless, the Austri-

70. *See* C. Menger, *supra* note 2, at 74; Hayek I, *supra* note 5, at 526-27, *reprinted in* F. Hayek, *supra* note 5, at 86-87.

71. See *supra* text accompanying note 37. This is true even of neoclassical "comparative statics" models, which seek to compare two equally timeless stationary states. *See* G. Shackle, *supra* note 7, at 271.

72. See *supra* note 36.

73. Rizzo, *Mises and Lakatos: A Reformulation of Austrian Methodology*, in Austrian Economics, *supra* note 3, at 57 ("The fundamental presupposition of Austrian economics is that man acts or, equivalently, that he engages in purposeful behavior."); *see* L. Mises, *supra* note 7, at 355-56 ("the activities of enterprising men, the promoters and speculators, eager to profit from discrepancies in the price structure, tend toward eradicating such discrepancies").

Hayek has argued that the neoclassical assumption had not been made until the later classical economists did so:

> Even such a celebrated figment as the "economic man" was not an original part of the British evolutionary tradition. It would be only a slight exaggeration to say that, in the view of those British philosophers, man was by nature lazy and indolent, improvident and wasteful, and that it was only by the force of circumstances that he could be made to behave economically or would learn carefully to adjust his means to his ends. The *homo oeconomicus* was explicitly introduced, with much else that belongs to the rationalist rather than to the evolutionary tradition, only by the younger Mill.

F. Hayek, The Constitution of Liberty 61 (1960).

Carl Menger also pointed out that the weakly assumed "rational" or "purposeful" person was fully capable of conduct that in ordinary discourse might be considered irrational:

> Even individuals whose economic activity is conducted rationally, and who therefore certainly endeavor to recognize the true importance of satisfactions in order to gain an accurate foundation for their economic activity, are subject to error. Error is inseparable from all human knowledge.
>
> Men are especially prone to let themselves be misled into overestimating the importance of satisfactions that give intense momentary pleasure but contribute only fleetingly to their well-being, and so into underestimating the importance of satisfactions on which a less intensive but longer enduring well-being depends.

C. Menger, *supra* note 2, at 148.

ans believe that individuals will become more rational over time *if* social institutions allow them to experience the consequences of their economic actions:

> If we allow men freedom because we presume them to be reasonable beings, we also must make it worth their while to act as reasonable beings by letting them bear the consequences of their decisions. . . . The assigning of responsibility thus presupposes the capacity on men's part for rational action, and it aims at making them act more rationally than they would otherwise. It presupposes a certain minimum capacity in them for learning and foresight, for being guided by a knowledge of the consequences of their action. It is no objection to argue that reason in fact plays only a small part in determining human action, since the aim is to make that little go as far as possible.[74]

A second illustration of the neoclassical tendency to ignore the dynamic effects of time is their neglect of entrepreneurship.[75] The simplest idea embodied in the concept of entrepreneurship is that of arbitrage—perceiving that different prices for the "same good" exist in different places and engaging in an essentially instantaneous transfer.[76] Thus the neoclassical assumption that the price is everywhere the same for the same good is in the Austrian scheme not an assumption but a tendency of a market process.[77] In other words, the market system provides an incentive for individuals to make the condition *increasingly* true over time.[78]

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74. F. Hayek, *supra* note 73, at 76-77. Thomas Sowell's recent critique of Marxism stresses its failure to appreciate this feature of the market economy, *see* T. Sowell, Marxism 190 (1985) ("As a theoretical system, Marxian economics begins the story of production in the middle—with firms, capital, and management already in existence *somehow*, and needing only the addition of labor to get production started. From that point on, output is a function of labor input, given all the other factors *somehow* already assembled, coordinated, and directed toward a particular economic purpose.") (emphasis in original); but this is a failure that Marxism shares with mainstream neoclassical theory. Kirzner attributes the neoclassical neglect of the entrepreneurial role to its "preoccupation with final equilibrium positions." Kirzner, *supra* note 3, at 4. The Austrian entrepreneur is not the technological inventor of Schumpeter's conception; she is not the party who causes the supply curves to shift, but the party who realizes that they have shifted. *Id.*

75. *See* I. Kirzner, Perception, Opportunity and Profit 53 (1979) ("It is by now fairly well recognized that the mainstream of [neoclassical] microeconomics has, particularly since its decisive absorption of Walrasian influence, assumed a form in which scope for the entrepreneurial role is conspicuous by its absence.").

76. Leff, *The Leff Dictionary of Law: A Fragment*, 94 Yale L.J. 1855, 2050-51 (1985).

77. *See* L. Mises, *supra* note 7, at 355-56 ("[T]he activities of enterprising men . . . tend toward eradicating . . . discrepancies [in the market] and thereby also toward blotting out the sources of entrepreneurial profit and loss. [The economist] shows how this process would finally result in the establishment of [market equilibrium]."); Hayek II, *supra* note 5, at 44, *reprinted in* F. Hayek, *supra* note 5, at 45 (a tendency toward equilibrium "can hardly mean anything but that, under certain conditions, the knowledge and intentions of the different members of society are supposed to come more and more into agreement").

78. In this connection, it is important to note the essentially subjective character of a "good" in the Austrian (and, for that matter, in the neoclassical) conception. *See* C.

In addition, the role of the entrepreneur goes beyond low-risk, virtually instantaneous arbitrage. Entrepreneurial profit can be earned by perceiving lines of investment where market prices are in disequilibrium[79]—where the entrepreneur judges that the expected selling price of a product she can offer for sale in the future will more than cover the present costs of producing the product.[80] Thus, the entrepreneur's most important functions, which neoclassical economics overlooks because it generally neglects the time element, are to perceive present market conditions, imagine alternative future market conditions, make judgments about the existence of likely incongruities in the market over time and create futures that exploit (and, in the process, mitigate) those incongruities.[81] It does not "just happen" that factories are built that five years later produce products consumers want to buy at a profit to the manufacturer.

The lack of a role for entrepreneurship in the neoclassical theory of competition and the market is an aspect of the more general Austrian

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Menger, *supra* note 2, at 52. The same physical item—a block of ice or a load of cement—may be a totally different good, depending on whether it is winter or summer and how far the good is from the people who need it. The market system rewards equalization of the price of each "good" subjectively defined. Thomas Sowell has written:

> [I]t may be apparent that a given physical object has a value that varies greatly according to the location of that object in time and space, and according to the risks associated with it. Otherwise people would not go to the trouble and expense of transporting things, or insuring them, or buying them on credit with interest charges. Indeed, no exchanges of goods (for other goods or for money) would ever take place, unless the same physical things had different values to different people. Yet the opposite view—that a given physical object is always a given value—has had a profound effect on human history. Over the centuries, highly diverse consequences have followed from a belief in the invariable value of a physical object—a belief that can be characterized as "the physical fallacy."

T. Sowell, *supra* note 63, at 67.

The problem is that individuals not subject to the incentives of the market process, such as judges, may be tempted to see inefficiencies wherever the same *physical* item sells for different prices in different places or times. For example, the middleman in a transaction is commonly seen to be cheating people because he buys goods for one price and sells them at a higher price. *See id.* at 68. This recurrent difficulty with intervention is explored in *infra* notes 168-69 and accompanying text.

79. See *infra* notes 168-75 and accompanying text.

80. *See* High, *Alertness and Judgment: Comment on Kirzner*, in Austrian Economics, *supra* note 3, at 161; Kirzner, *Uncertainty, Discovery, and Human Action: A Study of the Entrepreneurial Profile of the Misesian System*, in Austrian Economics, *supra* note 3, at 141.

81. For example, the entrepreneur may take advantage of an existing monopoly condition. According to one Austrian interpretation, "[a]ll markets begin with monopoly and move toward being more and more competitive." O'Driscoll, *Monopoly in Theory and Practice*, in Austrian Economics, *supra* note 3, at 207. Profit opportunities exist initially in starting a new market, such as for a new or differentiated product or a new productive process. Once others discover the market, profit opportunities exist in imitating the newly proven process without charging as high a price: "The monopolist's very method of exploiting his power—undersupplying the market—is the source of his own demise." *Id.* Of course, long before monopoly profits could be totally eroded and "perfect competition" reestablished, it is likely that someone will create yet another product that can for a time be monopolized. *See* L. Lachmann, *supra* note 7, at 145.

critique. The Austrian school economist Israel Kirzner describes this point:

> A characteristic feature of the Austrian approach to economic theory is its emphasis on the market as a *process*, rather than as a configuration of prices, qualities, and quantities that are consistent with each other in that they produce a market equilibrium situation. This feature of Austrian economics is closely bound up with dissatisfaction with the general use made of the concept of perfect competition.[82]

For example, neoclassical economics assumes that costs are "given," and thus that one can state meaningfully whether a firm is producing above or below marginal cost.[83] To the Austrians, it is only through the market process of persistent searching by individuals for low-cost methods of production that such data can be discovered.[84] Neoclassical economics assumes that goods are homogeneous, when in fact it is only through persistent attempts to "improve" or "differentiate" a product that one *specific* version of the product comes to occupy most of the market.[85] The perfect competition model of neoclassical economics assumes away all personal relationships[86] and thus misses the central importance of the development of reputations or goodwill on the part of people who provide services about which uninformed consumers know they are ignorant.[87] Finally, the static models of neoclassical economics see no solution to monopoly except to posit the empirically problematic assertion that expanding firms will eventually encounter diseconomies of scale.[88] Austrian economists see monopoly or oligopoly in an open economy as an important stage in a process of learning and adaptation. They trust the competitive process to minimize monopolistic abuses over time, because the driving forces of the learning process are the entrepreneurial

82. *See* I. Kirzner, *supra* note 75, at 3-5 (emphasis in original).

83. See *supra* text accompanying note 37.

84. *See* Address by Hayek, *The Meaning of Competition* (May 20, 1946), *reprinted in* F. Hayek, *supra* note 5, at 95-96; Kirzner, *supra* note 80, at 141.

85. *See* Address by Hayek, *supra* note 84, *reprinted in* F. Hayek, *supra* note 5, at 96.

86. *See* G. Stigler, The Theory of Competitive Price 24 (1942) ("Economic relationships are never perfectly competitive if they involve any personal relationship between economic units.").

87. *See* Address by Hayek, *supra* note 84, *reprinted in* F. Hayek, *supra* note 5, at 97 ("[C]ompetition is in a large measure competition for reputation or good will. . . . The function of competition is here precisely to teach us *who* will serve us well: which grocer or travel agency, which department store or hotel, which doctor or solicitor. . . .") (emphasis in original).

88. Austrian economists do not deny that it is possible for a market to exist with minimal prospects for the development of substitute or differentiated products, better technological processes or cost-saving insights, and that such a market might be characterized by a technology that could produce a natural monopoly. *See* L. Lachmann, *supra* note 7, at 144 ("It has always been known that perfect competition is incompatible with increasing returns."). However, neoclassical economists place their principal hope for competition on the empirically problematic assertion, *see* F. Scherer, Industrial Market Structure and Economic Performance 86 (1980), that diseconomies of scale will cause marginal costs to begin to rise as the firm becomes larger, *see* E. Mansfield, *supra* note 37, at 187.

talents and knowledge that themselves are so difficult to monopolize.[89]

C. *The Methodology of the Austrian School*

As noted earlier, neoclassical economists do not contend that the assumptions of their models, about which the Austrians are so critical, are realistic, but rather that they help predict and explain reality.[90] Accordingly, much of the Austrian critique is methodological. The Austrian school of economics is committed to the principle of methodological individualism. As stated by the Austrian school economist Ludwig Lachmann: "Methodological individualism . . . means simply that we shall not be satisfied with any type of explanation of social phenomena which does not lead us ultimately to a human plan."[91] Note what is *not* implied by this methodology. It is emphatically not a "conspiracy" theory because social phenomena are often the unintended effects of the interaction of numerous individual plans.[92] Nor does it suggest that individual plans themselves are not influenced or even determined by other social phenomena or that the autonomous individual is in any sense prior to the social system.[93] Indeed, Hayek has devoted a large part of his later work to refuting the argument that human values and reason are independent of the social process.[94] Nevertheless, the Austrians insist that complex social phenomena must somehow be traced to their probable sources in individual human minds, whether or not further analysis could explain certain aspects of the minds themselves.[95]

This methodological approach leads the Austrians to differ sharply with Milton Friedman's view that the goal of economics is to construct

89. *See* L. Lachmann, *supra* note 7, at 145.

90. See *supra* notes 45-50 and accompanying text.

91. L. Lachmann, *supra* note 7, at 154.

92. For an example of the problem with conspiracy theory, see T. Sowell, *supra* note 63, at 196.

93. *See* Address by Hayek, *The Origins and Effects of Our Morals—A Problem for Science* (November 1, 1983), *reprinted in* The Essence of Hayek, *supra* note 59, at 318-19. It is particularly important to note this fact because the Institutional school of economics has used the contrary view as a straw man in its criticism of mainstream, and, by implication, Austrian, economics. *See* Dugger, *Methodological Differences Between Institutional and Neoclassical Economics*, in The Philosophy of Economics, *supra* note 24, at 314-15.

94. *See, e.g.*, F. Hayek, The Counter-Revolution of Science 34 (1952); Address by Hayek, *supra* note 93, *reprinted in* The Essence of Hayek, *supra* note 59, at 318-19.

95. This methodological individualism is mandated by the nature of the social sciences. Social science—a study of regularities in social phenomena—is possible only so far as one can understand, through introspection and empathy, the *meaning* that individuals attach to particular phenomena. *See* L. Lachmann, The Legacy of Max Weber 31 (1971). Austrian economics opposes attempts to establish that social "wholes" exhibit regularities independent from any plausible conception of individual values and knowledge. *See id.* Wholes are sufficiently complex that their direct study can mislead. For example, observation may show the price of farmland relative to urban real estate values declining over a certain period of time, but many thousands of influences may be responsible for this, any one of which may be absent in a future period. Only patient reconstruction of the individual elements that combine to determine prices can lead to an explanation.

theories that produce verifiable predictions from admittedly false premises.[96] Indeed, some Austrian school economists—notably Ludwig Mises and Murray Rothbard—take the diametrically opposed view that the laws of economics follow deductively from the true premise that people act purposefully.[97] They contend that if the conclusions of economic models are the products of sound logical deductions from incontestable premises, those conclusions must be true and cannot be contradicted by experience.[98]

Although this contention may go too far for most Austrian school economists,[99] it does illustrate the conflict between Milton Friedman's position on the relative importance of realistic assumptions and predictive power in economic models and the corresponding Austrian view. The conflict, however, should not be overstated. The Austrians do not believe that the individual human beings of their models must possess all the richness of a real human personality. Disregard of the traits that are not expected to influence economic decisions in any major or systematic way is appropriate in the interest of manageable theory construction.[100]

The Austrian approach leads to a theory of logical deduction from simple and hard-to-contest premises about individual economic actors with limited knowledge, but one that fails to predict quantitative conclusions of the kind policy makers often want.[101] The Austrian theorists criticize the overly mathematical character of neoclassical economics, in particular its pretense of giving quantitative conclusions that are in fact beyond the competence of social science.[102] The result is too often that regularities are accepted because they are quantifiable rather than because they can be defended as theoretically sound, deriving ultimately from intelligible human plans.[103]

III. AUSTRIAN ECONOMICS AND CONTRACT LAW

The Austrian critique of neoclassical economics, if accepted, tends to

96. See *supra* notes 47-48 and accompanying text.

97. *See* L. Mises, *supra* note 8, at 38-44; 1 M. Rothbard, *supra* note 7, at 9.

98. *See* L. Mises, *supra* note 8, at 38-44; 1 M. Rothbard, *supra* note 7, at 9.

99. *See* Rizzo, *supra* note 73, at 64-65 (observations *may* disprove premises).

100. In choosing which traits to disregard, experience is an important guide. For example, a failure of rent controls strictly enforced for ten years to produce a shortage of housing in one city might be explainable, but a repeated failure of such shortages to appear would suggest that something is probably wrong with either the assumptions or the logic of the model. *See* Address of Hayek, *The Pretence of Knowledge* (Dec. 11, 1974), *reprinted in* The Essence of Hayek, *supra* note 59, at 268-69.

101. *See id., reprinted in* The Essence of Hayek, *supra* note 59, at 269-70.

102. *See id., reprinted in* The Essence of Hayek, *supra* note 59, at 571. Quantitatively precise predictions would require perfect foresight, and an assertion that the scientist can *know* all the causes of a person's behavior in advance. *See* G. Shackle, *supra* note 7, at 349-51.

103. The Austrians are thus particularly critical of macroeconomic "theories" like the Phillips Curve, which derive from quantitative observations of inflation and unemployment rates over time rather than from microeconomic foundations. *See* Address of Hayek, *supra* note 100, *reprinted in* The Essence of Hayek, *supra* note 59, at 267-72.

alter the *raison d'etre* of the free market and freedom of contract. In general terms, freedom of contract is no longer defended because it produces perfect efficiency. Rather, freedom of contract produces more efficient outcomes than does judicial or legislative intervention, and outcomes that are increasingly efficient over time. This general point can be illustrated with the specific contract ideas of impossibility, mistake and unconscionability.

A. *Impossibility and Mistake*

1. Impossibility and the Entrepreneur

Under section 261 of the Second Restatement of Contracts, a party's performance under a contract will be excused if such performance "is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made," unless the language of the contract or the circumstances indicate that he assumed the risk of the occurrence of the event.[104] The issue considered here is whether and under what circumstances the discharge of a contract on the ground of impracticability is efficient.

The doctrine of impossibility does not arise if the parties agreed that one party would assume a risk, but only when the risk is unforeseen or unprovided for.[105] Unfortunately, contracting parties are often not clear about their intentions, and the contract may simply fix some terms, saying nothing about whether the contract will remain enforceable given various contingencies. When parties are silent about the allocation of specific risks, Professors Posner and Rosenfield have argued that the court should allocate the risk to the superior ex ante risk-bearer.[106] If the risk were preventable, the better risk-bearer might be the party who was better able to prevent the risk from occurring.[107] But even if neither party could have prevented the risk, one party may still be the better risk-bearer because she was better able to insure against the risk, either by buying market insurance or by self-insuring.[108] The party who could have better insured against the risk may be the one who could have better estimated the probability and impact of the loss or it may be the one who had greater ability to diversify away a known risk.[109]

From the point of view of the Austrian school, the Posner and Rosen-

104. Second Restatement, *supra* note 9, § 261 & comment C.

105. Posner & Rosenfield, *supra* note 32, at 90, *reprinted in* The Economics of Contract Law, *supra* note 1, at 122-23 ("Of course, if the parties have expressly assigned the risk to one of them, there is no occasion to inquire which is the superior risk bearer.").

106. *See id., reprinted in* The Economics of Contract Law, *supra* note 1, at 122.

107. *Id., reprinted in* The Economics of Contract Law, *supra* note 1, at 123.

108. *Id.* at 90-91, *reprinted in* The Economics of Contract Law, *supra* note 1, at 123 ("The promisor may be the superior insurer. If so, his inability to prevent the risk from materializing should not operate to discharge him from the contract, any more than an insurance company's inability to prevent a fire on the premises of the insured should excuse it from its liability to make good the damage caused by the fire.").

109. *Id.* at 92, *reprinted in* The Economics of Contract Law, *supra* note 1, at 124-25.

field analysis fails to recognize the phenomenon of entrepreneurship. Posner and Rosenfield consider the impossibility problem to arise when an unprovided-for contingency makes performance uneconomical.[110] This problem, however, could develop in at least three different ways:

1. The parties both assumed that the risk would not arise, and no entrepreneurial perceptiveness reasonably could have contradicted either party's assumption;
2. One party's lack of entrepreneurial perceptiveness caused her to assume the risk would not arise, while the other's entrepreneurial perceptiveness caused her to realize that it might in fact arise;
3. The parties both assumed the risk would not arise, but entrepreneurial perceptiveness on the part of one or both parties reasonably could have contradicted that party's assumption.

Austrian economics might have very little to contribute to resolving a case such as *Taylor v. Caldwell*,[111] which involved the question of whether a contract to lease a music hall was discharged when the music hall burned to the ground.[112] The case falls within the first category listed above; although a fire is perhaps not utterly unforeseeable, it is surely difficult to attribute the loss to any reasonable conception of lack of entrepreneurial perceptiveness. But suppose that the problem is that costs in a particular industry have risen by fifty-eight percent.[113] When a change of this nature causes one party to suffer losses and the other to reap gains, the question of which of the three categories of interpretation explains the parties' failure to allocate the risk may become important. To an Austrian economist, entrepreneurial judgment and perceptiveness concerning costs are important, because they are a necessary precondition for efficient resource allocation.[114] To allow a party to escape performance under a contract because she failed to foresee a rise in costs when the other party did fails to compensate the knowledgeable party for perceptiveness. Such perceptiveness and judgment do not occur by accident; they occur only because those who fail to perceive the economic situation suffer the consequences of their failure,[115] while those who do

110. *Id.* at 90, *reprinted in* The Economics of Contract Law, *supra* note 1, at 122.

111. 122 Eng. Rep. 309 (K.B. 1863).

112. *See id.* at 312.

113. *See* Iowa Elec. Light & Power Co. v. Atlas Corp., 467 F. Supp. 129, 139-40 (W.D. Iowa 1978), *rev'd on other grounds*, 603 F.2d 1301 (8th Cir. 1979), *cert. denied*, 445 U.S. 911 (1980).

114. See *supra* notes 80-81 and accompanying text.

115. It would be a mistake to regard the idea of "entrepreneurial perceptiveness" as an all-or-nothing state of mind that a contracting party either possesses in full or lacks entirely. For example, neither party may have believed costs would rise 58%, but if party *A* believed that they would fall by 10% while party *B* judged that they would rise by 20%, *A* inhibits and *B* advances efficient resource allocation.

This is not an assertion of blameworthiness or fault on *A*'s part. In this context, entrepreneurship is no different than other inputs; rewarding naturally gifted restaurant chefs, for example, contributes to efficient resource allocation as well, but this is certainly not a commentary on the moral worth of inferior chefs. *See* Harsanyi, *Rule Utilitarianism, Equality, and Justice*, 2 Soc. Phil. & Policy 115, 124 (1985).

perceive it reap the benefits of their entrepreneurial judgment.[116]

The Austrian theory of impossibility clearly conflicts with that of Posner and Rosenfield. Those two authors argue that when a contract becomes uneconomical because of the occurrence of some event, the loss should be placed on the party who ex ante was better able to foresee and insure against that risk.[117] Posner and Rosenfield presumably would regard proof that one party in fact did perceive the risk as damning evidence that the party was in a better position to reduce the risk by insurance or otherwise.[118] Moreover, the idea of placing the risk on the better risk-spreader implies that the party who accurately perceived some incongruity will be deprived of the fruits of that perception if she is capable of diversifying away some of the other party's loss.[119] This clearly is not a theory calculated to encourage entrepreneurship, and Austrian economists would sympathize with it only in cases like *Taylor v. Caldwell* where entrepreneurial activity plays a minor role.

Indeed, further analysis shows that the entire Austrian conception of contract differs from that of neoclassical economists. Professors Kronman and Posner believe the justification for contracts is that both parties ex ante benefit from them.[120] A mistake or subsequent change in circumstances may destroy that mutual benefit, and any such result should, according to Kronman and Posner, be rectified by allocating the risk of that mistake or subsequent change to the party to whom it would have been allocated if both parties had been fully perceptive and informed.[121] The Austrians, by contrast, regard entrepreneurial perceptiveness as an essential skill to be encouraged, and their defense of contract is not that both parties necessarily benefit ex ante from every contract but that over the long run the system of contracting encourages the full use of human knowledge.[122]

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116. See *supra* note 72.

117. See *supra* notes 105-10 and accompanying text.

118. It is true that Posner and Rosenfield disclaim interest in the question of which party is in a better position ex post to bear the loss, as opposed to which party ex ante could have better prevented it. *See* Posner & Rosenfield, *supra* note 32, at 113, *reprinted in* The Economics of Contract Law, *supra* note 1, at 135-36. Logically, therefore, Posner and Rosenfield should not want to punish the party who did in fact perceive the risk, but the party who was ex ante in a better position to do so. Posner and Rosenfield, however, do not discuss the problem of entrepreneurial perception, and it does not seem that litigants in an impossibility case before Judge Posner would be well-advised to deny that they were in a position to exercise entrepreneurial judgment.

119. *Id.* at 106, *reprinted in* The Economics of Contract Law, *supra* note 1, at 130-31.

120. *See* Kronman & Posner, *supra* note 1, at 1-3.

121. *See id.* at 4 ("An important function of contract law is to enforce the parties' agreed-upon allocation of risk. A related function is to reduce the costs of the exchange process by supplying a standard set of risk-allocation terms for use by contracting parties. . . . If the parties are satisfied with the way in which the rule allocates the risk of that contingency, they have no need to incur the expense of writing their own risk-allocation rule into the contract.").

122. *See* I. Kirzner, *supra* note 75, at 215-17.

2. Duty to Disclose Knowledge

Professor Kronman has discussed the question of whether a contracting party who possesses some factual knowledge unavailable to the other party is under a duty to disclose it before contracting.[123] He concludes that such a duty should not be imposed if that knowledge were acquired through deliberate and costly effort, because those efforts must be encouraged.[124] If the knowledge was acquired without such a conscious effort, however, Kronman suggests that the law should imply a duty to disclose the factual information.[125]

Entrepreneurship does not, however, involve merely incurring the costs of becoming informed; it also involves *perceiving* opportunities for useful knowledge acquisition, knowledge that may itself be inexpensive to acquire once one realizes that acquiring it is valuable.[126] Moreover, the entrepreneur may acquire all her facts by casual means, but be able to use those facts to form creative insights that others lacking entrepreneurial judgment would not have had.[127] Alertness, imagination, creativity and judgment are far from being ubiquitous human traits, and it is arbitrary to reward such eminently useful economic skills only when by coincidence they happen to be coupled with highly costly acquisitions of knowledge.

Thus, an Austrian perspective on the problem of disclosure of facts and the defense of mistake requires that the phenomenon of entrepreneurship be taken seriously. The question becomes whether there are any circumstances in which gains from entrepreneurial perceptiveness should be confiscated by use of the doctrines of mistake or impossibility. In the "leading" case of *Laidlaw v. Organ*,[128] only one party to a tobacco

123. *See* Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. Legal Stud. 1 (1978). This problem is often discussed under the rubric of the defense of mistake.

124. *See id.* at 33.

125. *See id.*

Although Kronman's theory concerns the doctrine of mistake rather than impossibility, the same considerations apply when one party accurately perceived a future development but elected not to disclose the forecast before contracting. Indeed, with regard to the factor of entrepreneurship considered here, the doctrines of mistake and impossibility can be considered together, because both concepts involve an attempt by one party to excuse herself from a contractual duty by citing her failure to perceive some fact which was a basic assumption upon which she contracted. *Compare* Second Restatement, *supra* note 9, § 153 (rule regarding mistake) *with id.* § 261 (rule regarding impossibility).

126. *See* I. Kirzner, *supra* note 75, at 32.

127. *See* High, *supra* note 80, at 167. High criticized Kirzner's early work for limiting the entrepreneurial role to one of alertness, ignoring the problem of uncertainty about the future. Kirzner answered by including within the idea of alertness the alertness to circumstances that might suggest future changes. *See* Kirzner, *supra* note 80, at 148-51. High replies that this conception of entrepreneurship is still too narrow since it ignores the need for judgment: "Alertness is the mental quality of being on the lookout for something new; judgment is the mental process of assigning relevance to those things we already know." High, *supra* note 80, at 167.

128. 15 U.S. (2 Wheat.) 178 (1817).

contract was aware that a peace treaty had just been signed ending the War of 1812 and with it the naval blockade that was holding down the market price of tobacco.[129] In holding that the knowledgeable party was not required to disclose this information, Chief Justice Marshall stated:

> The question in this case is, whether the intelligence of extrinsic circumstances, which might influence the price of the commodity, and which was exclusively within the knowledge of the vendee, ought to have been communicated by him to the vendor? The court is of opinion that he was not bound to communicate it. It would be difficult to circumscribe the contrary doctrine within proper limits, where the means of intelligence are equally accessible to both parties. But at the same time, each party must take care not to say or do anything tending to impose upon the other.[130]

Consistent with his analysis of the need to reward costly searches for information, Professor Kronman argues that the question of whether the contract in *Laidlaw* should have been discharged turns on whether the knowledgeable party acquired news of the treaty as a result of a deliberate (and therefore presumably costly) search for such news.[131] However, in *Laidlaw* another consideration seems much more important. The problem in this case is that information about the treaty, whether or not deliberately obtained, was certain to reach the market very soon, probably within hours. The question thus is whether the marginal encouragement to entrepreneurial skills of this character is important enough to outweigh the static effect of locking in a tobacco contract at an unrealistic price.[132] The Austrian perspective is sympathetic with Justice Marshall's fear that courts might be unable to identify cases in which information was entrepreneurially significant, and thus the result may be defensible because of the need for a manageable bright-line test. Nevertheless, the case does present a particularly compelling fact situation for considering the entrepreneurial element a matter of secondary importance.

It would appear, moreover, that the case for enforcement of the contract in *Laidlaw v. Organ* would have been much stronger under facts different than those Kronman considers vital. Suppose, for example, that six months prior to the end of the war, the party in *Laidlaw* had a personal conversation with a friend, during which the friend, who was familiar with the treaty negotiations, told the party that the war should end within the year. Although the party made no deliberate search for that information, suppose further that the party perceived that the end of the war would raise the price of tobacco, and accordingly began entering

129. *See id.* at 183.

130. *Id.* at 195 (dictum).

131. *See* Kronman, *supra* note 123, at 15-16, *reprinted in* The Economics of Contract Law, *supra* note 1, at 119-20.

132. In other markets, such as that for securities, "beating the market" by minutes or hours may be an important market function, but the reward of entrepreneurship arises from the repeated character of such revaluations.

long-term purchase contracts. These contracts should not be dischargeable when the war ends; the expectation of such a holding would discourage potentially perceptive parties from acting on their perceptions by buying and thus moving the market price in the correct direction—in this case, upward.

Thus, the Austrian theory does not argue for complete abolition of the contract defenses of mistake and impossibility. In some cases, the contribution to the process of developing entrepreneurship may be sufficiently slight to warrant discharge. Nevertheless, the Austrian theory does suggest that there is considerable merit to Chief Justice Marshall's dictum in *Laidlaw*, even if the facts of the case may present one of the rare instances in which that dictum was *not* applicable.

Undoubtedly there is an intuition that someone who profits because she perceives a better use for the owner's property than the owner herself perceives, but chooses not to tell the owner that better use prior to purchasing the property, is behaving less than honorably. Yet the question remains whether contract law is going to regard entrepreneurship as a ready-made gift from the Heavens or as a factor of production that must command a price. To the Austrians, conduct of this character is not fraud, but is rather creation of value, because the same physical item may have much greater value in the hands of one who perceives a use for it than in the hands of one who does not.[133]

B. *Standard Form Contracts*

One of the embarrassments to the ideal of freedom of contract is the omnipresent standard form.[134] Ironically, as numerous authors have noted, the phenomenon of standard forms also can be viewed as the product of failing to adhere to the principles of freedom of contract.[135] After all, the law for some reason has chosen to give legal force to terms on which it cannot be said *either* that the parties' minds subjectively met or that a reasonable objective third party would have believed those minds had met.[136] Because this conclusion may be controversial where both parties are commercial institutions that may employ their own forms, the analysis here will be limited to the noncommercial context where one party employs a standard form to which the other is expected to assent if she wants the transaction to take place.

The view that standard forms manifest freedom of contract rather than

133. *See* I. Kirzner, *supra* note 75, at 216-17.

134. *See* Slawson, *The New Meaning of Contract: The Transformation of Contract Law by Standard Forms*, 46 U. Pitt. L. Rev. 21, 28-29 (1984).

135. *See, e.g.*, Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 Harv. L. Rev. 1174, 1180-83 (1983); Slawson, *Mass Contracts: Lawful Fraud in California*, 48 S. Cal. L. Rev. 1, 4, 11 (1974). *See generally* Goldberg, *Institutional Change and the Quasi-Invisible Hand*, 17 J.L. & Econ. 461 (1974).

136. *See* Slawson, *supra* note 134, at 27 ("businesses know full well that their forms will not generally be read, let alone understood").

violate it may derive from a tendency to view the market as a particular set of institutions. For example, Professor Rakoff backs away from advocating the wholesale invalidation of invisible standard form clauses because he fears the loss of autonomy by independent institutions.[137] The Austrian conception of the market as a *process*, rather than any particular set of institutions, requires that an institution continue to prove itself against alternative institutions under the market process.[138]

As noted earlier, the Austrians tend to regard market prices as embodying vast amounts of highly diffuse knowledge about relative scarcities that is unavailable to any one particular source such as a court.[139] Such supraindividual wisdom, however, certainly cannot be claimed for contract terms conceived by one party, drafted to the limit of the allowable law and slipped past numerous parties on the other side who could not justify the time it would take them to review the document carefully. In the language of efficiency, consumers have difficulty making their "marginal rates of substitution" between any two products equal to the "price ratio,"[140] because they cannot figure out the "prices" of those products—the contractual terms on which the products are offered. The Austrian perspective, therefore, disfavors the enforcement of the invisible terms in standard forms, at least in the context of transactions involving individual consumers.

Having said this, however, it does not follow that nothing could be worse than standard forms. The temptation is to exaggerate the harm done by standard forms in the interest of promoting a desirable reform in the law of contracts. The risk of this approach, however, is that one may come to see any system that allows contractual freedom by weak parties as partaking somewhat of the problems of standard forms, and conclude that the safe course, at least for terms other than price, is to make all duties nondisclaimable.[141] From the perspective of the Austrian school, this would be a serious mistake.

As examples of the tendency to exaggerate the harm done by standard forms, one can cite passages from the otherwise outstanding contributions to the subject by Professors Slawson and Rakoff. Slawson, for example, has stated:

> The mass contractor has been put in the position of setting the terms of

137. *See* Rakoff, *supra* note 135, at 1242-43.

138. *See* T. Sowell, *supra* note 63, at 41.

139. See *supra* notes 57-69 and accompanying text.

140. *See* C. Ferguson & J. Gould, *supra* note 41, at 453 (Efficiency requires that all consumers set their marginal rate of substitution between any two commodities equal to the marginal rates of other consumers, so that all consumers at the margin, say, would be willing to part with their last steak in return for two additional pounds of hamburger. This is because if their marginal rates differed, an exchange could make them both better off. Perfect competition achieves this result by use of a uniform price ratio that all consumers set equal to their marginal rate of substitution.).

141. For a ringing defense of nondisclaimable duties that does not seem to exempt even price terms from its enthusiasm, see Kennedy, *supra* note 42, at 648-49.

> what we may still call a contract essentially as he may please. The only limitation on his power presently is the minor and practically ineffectual limitation placed on it by the courts. . . . The limitation which used to exist by virtue of the consumer's ability to refuse to contract on terms to which he did not consent has been lost.[142]

Slawson then estimates that in one industry in one state alone—insurance in California—consumers are being overcharged hundreds of millions of dollars per year in this manner.[143]

Professor Rakoff presents the problem in equally stark terms:

> When contracts of adhesion become commonplace, even the individual who reads and understands is, and may well perceive himself to be, essentially helpless. The consumer's experience of modern commercial life is one not of freedom in the full sense posited by traditional contract law, but rather one of submission to organizational domination, leavened by the ability to choose the organization by which he will be dominated.[144]

To an Austrian school economist, these passages lack an appreciation of goodwill.[145] Once one leaves the neoclassical world where human beings and human relations are absent, competition becomes very largely a matter of competition among people.[146] Consumers are probably quite ignorant of the terms of each standard form, but at the same time they are reasonably likely to know they are ignorant.[147] Such knowledge makes contracting with strangers or with people who try to overreach at every available opportunity highly risky, and if consumers are risk-averse they will demand risk premiums to compensate for that risk.[148] Avoiding those risk premiums becomes an incentive to develop a reputation for trustworthiness.

Given the serious imperfections in the market for consumer information about the users of standard forms, the constraint of reputation is hardly enough to undo all the harm of standard forms.[149] Nevertheless, the idea that the mass contractor can impose terms (not simply put them into a document but insist on them in disputes with the consumer) "essentially as he may please" even if the consumer feels a "helpless" victim of "organizational domination" would surely surprise many experienced

142. Slawson, *supra* note 134, at 53.

143. *Id.* at 1. Although it is not clear, this figure may include losses from inadequate damage measures as well as harsh standard form terms. *See id.*

144. Rakoff, *supra* note 135, at 1229 (footnote omitted).

145. In fairness, Rakoff does acknowledge this phenomenon, and Slawson may as well, but is not clear how that acknowledgement squares with the statements quoted in the text. *See id.* at 1228 ("businessmen concerned with fostering goodwill do not always stand on a document that was from the beginning overdrafted by lawyers").

146. See *supra* notes 86-87 and accompanying text.

147. *See* Gerner & Bryant, *Appliance Warranties as a Market Signal?*, 15 J. Consumer Aff. 75, 78-79 (1981).

148. *See* R. Posner, Economic Analysis of Law 75 (2d ed. 1977).

149. *See* Goldberg, *supra* note 135, at 485-86.

businesspeople.[150] To whatever extent goodwill does operate, moreover, its effects will tend to be systematic rather than random. The worst generators of bad will presumably would be those clauses that surprise and seriously disappoint the consumer. Particularly vulnerable would be the most inefficient clauses—those that impose large burdens on the consumer with little corresponding benefit to the producer.[151]

Finally, the Austrian economists would stress that the profit opportunities generated by harsh form clauses provide an incentive for entrepreneurs to enter the market and thereby depress prices.[152] Such entrepreneurial activity also would not eliminate the harm of standard forms, because better informed consumers might prefer a contractual package consisting of higher prices but more favorable additional terms.[153] Nevertheless, any assertion that harsh form clauses are costing consumers "hundreds of millions" of dollars must consider as an offset to such losses the gains consumers receive in the form of lower prices.

As noted above, these observations are emphatically not intended as a defense of standard forms in the consumer context.[154] Rather, they are intended to place the problem in perspective, so that remedial cures are not worse than the disease. The next section of this Article discuss the serious problems that Austrian economists see in the use of nondisclaimable duties.[155] The remainder of this section is concerned with the question of how the problem of the standard form might be remedied without using such nondisclaimable duties.

In the discussion of impossibility, the Austrian perspective was a rather hard-boiled view that people learn important lessons from their inaccurate entrepreneurial judgment.[156] But no such harshness is justified here. The market process requires that parties be aware of the terms on which they are contracting. Professor Unger has drawn the important distinction:

> The problem arises constantly from an ambiguity in the expectancies that contract law is supposed to protect: the expectancy may be an

150. *See* R. Posner, *supra* note 148, at 66-67 (concern for reputation would protect voluntary exchange system in absence of contract).

151. *See id.* at 86-88. This is true even if the seller were a monopolist, because both the monopolist and the fully informed consumer would benefit by removing the senseless, inefficient clause and adjusting the price term accordingly. *See* Kennedy, *supra* note 42, at 608.

152. See *supra* notes 75-76 and accompanying text.

153. *See* Rakoff, *supra* note 135, at 1227-31.

154. See *supra* notes 139-40 and accompanying text.

In the commercial context, a strong argument has been made for the enforcement of form terms even when one of the entities was unaware of the form clauses. In such a context, the standardized terms that come to prevail from general alertness to contract clauses are likely to be more efficient than terms a court might itself impose "off the rack." *See* Baird & Weisberg, *Rules, Standards, and the Battle of the Forms: A Reassessment of § 2-207*, 68 Va. L. Rev. 1217, 1249-51 (1982).

155. See *infra* Part III.C.

156. See *supra* Part III.A.

> interest either in a certain performance or in the exchange value that this performance embodies. Even when the performance consists in a payment of money, the ambiguity does not disappear. Money itself matters for its value in exchange, and this value may be subject to radical and unexpected dislocations.[157]

The Austrian perspective inclines strongly toward protecting only the expectancy of a certain performance, recognizing both that the value of that performance depends on information about alternatives to which only an individual is privy[158] and that efficiency requires that individuals learn the value of their actions.[159] Ignorance of the external world and ignorance of contract terms, however, are two very different problems—the former is an inherent problem that any economic system must try to alleviate while the latter becomes a problem only when the legal system has chosen to give effect to unseen contract terms.[160]

Thus, while the Austrian view of impossibility is that ignorance and entrepreneurial passivity regarding the outside world should be discouraged, in the area of standard contracts it is only when there *is* knowledge together with active "entrepreneurial" judgment that the legal system should recognize contractual terms as binding. The sphere of binding terms in any contract, for example, would include the core "reasonable expectations" of the consumer regarding the deal she has struck.[161] In addition to these core terms, it might be reasonable to expect consumers to read and appreciate a small number of plainly visible, comprehensible contract clauses that modify or limit those core terms.

Beyond this the contract should include enforceable terms only when the consumer makes an active "entrepreneurial" choice in deciding to include the terms. Experience suggests that merely making certain terms conspicuous or forcing consumers to separately sign a long document in numerous places accomplishes very little in making consent real.[162] By contrast, when consumers are forced to make active judgments ("Do you want this note to be at 12⅞% interest with a $1000 penalty for prepayment or at 13⅛% with no penalty for prepayment?"), provided the number of judgments is not so large as to be bewildering, the assumption of consent seems more realistic. As the next section of this Article indicates, the risk of imposing seriously mistaken nondisclaimable duties is sufficiently large that a court should be extremely hesitant to invalidate

157. Unger, *supra* note 50, at 627-28.

158. See *supra* notes 57-69 and accompanying text.

159. See *supra* notes 70-78 and accompanying text.

160. This is not to say that the ideas of a "duty to read" or of the objective theory of contracts should play no role in contract law; undoubtedly the other party should be expected to have read at least a few core terms. The problem is that traditional contract law has drawn the duty to read far too broadly.

161. For the interesting perspective that reasonable expectations *are* the contract, see Slawson, *supra* note 134, at 23. As the text notes, however, the Austrians would be inclined *not* to construe "reasonable expectations" to include the expected *value* of a given performance.

162. *Id.* at 26.

such active consumer choices.[163]

C. *Other Unconscionability Problems*

The standard form presents enough peculiarities to be studied in a separate section, but the general problem of unconscionability arises in at least three other settings. The first of those settings involves contractual parties who entered transactions on price terms inferior to those generally prevailing in the market. The second involves contractual parties who contend that the price terms of their contract are unfair, not because they are inferior to the market price, but because the market price is itself monopolistic or unfair. The third setting involves contractual parties who contend that certain nonprice terms of their contract are unfair and should be replaced by court-imposed nondisclaimable terms.

1. Contracting at Terms Inferior to the Market Price

It has been shown that the poor pay more for goods and services than the affluent, but commentators differ on the cause of this phenomenon.[164] Some have argued that the phenomenon represents merchant exploitation of consumers who do not fit the neoclassical conception of rational economic agents[165] while others attribute the higher prices to real cost differences.[166] Faced with this uncertainty about the reason the poor pay more, courts must decide whether to hold contracts entered into by the

163. See *infra* Part III.C.3.

164. One author describes the phenomenon as follows:

> Because of their dissimilarity to the ideal consumers of modern economics and legislation, the poor pay prices for food, rent, medicine and durables almost always exceeding those paid by the more affluent, and usually exceeding those needed to yield a fair return on the businessman's investment . . . . The low income consumer pays between 5 per cent and 10 per cent more for the same groceries purchased in his own neighborhood than does a middle income consumer . . . . Some other stores, such as co-operatives or private stores selling in particularly high volume have prices more than 15 per cent below those predominating in the low income areas. Low income neighborhood stores usually price [consumer] durables 50 per cent to 100 per cent above the going rate in more affluent areas, employing markups of 300 or 400 per cent and giving commissions running as high as 100 per cent of the value of the goods.

Note, *Consumer Legislation and the Poor*, 76 Yale L.J. 745, 755-57 (1967) (footnotes omitted).

165. *See id.* at 749-54. According to the author, the poor often do not believe in comparative shopping, they buy goods for status reasons, they are shy and unwilling to deal with strangers outside their neighborhood and they are uneducated about their alternatives and unmotivated to learn more about them. *See id.*

166. As one study noted:

> Despite their substantially higher prices, net profit on sales for low-income market retailers was only slightly higher and net profit return on net worth was considerably lower when compared to general market retailers. It appears that salaries and commissions, bad debt losses, and other expenses are substantially higher for low-income market retailers.

Federal Trade Commission, Economic Report of Installment Credit and Retail Sales in the District of Columbia 39 (1968).

poor on terms inferior to those paid by the nonpoor unconscionable.[167] The Austrian school of economics can make three important contributions to this debate. The first concerns the subjective character of a "good" and the need to avoid the fallacy of assuming that a good can be defined by its physical properties alone.[168] The "same" consumer durables sold in two different stores may be entirely different goods in an economic sense if one store is more conveniently located for relatively immobile consumers or is more willing to sell the durable to uncertain credit risks. If the court required approximate parity of the physical item's price in the two stores, it could create a disincentive to producing the "good" consisting of the high-priced durable plus the attendant services.[169]

A second consideration is that the Austrian school does not make the neoclassical assumption that consumers are rational;[170] it asserts instead that rationality is a trait learned over time.[171] Thus, to the Austrians, the problem is twofold. Because the knowledge needed to make efficient economic decisions is diffuse, the court will find it extremely difficult to distinguish rational choices made under a particular set of financial constraints from truly irrational action.[172] Moreover, even if the court in a rough way could isolate and rectify the irrational economic decisions, its doing so would tend to inhibit the only lasting method of protecting consumers—for consumers to learn increasingly rational, and thus efficient, behavior over time.[173]

The most important Austrian contribution, however, is to stress the qualitative difference between the risk of serious if not catastrophic judicial mistakes in this area as compared to the more limited risk of merchant overcharges. The essential difference is that overcharges ex-

167. Professors White and Summers offer the following suggestion:

> A reasonable alternative . . . would be for the court to allow . . . a *prima facie* case either by showing a markup of two or three times, or by showing that the price at which the product was sold was two or three times greater than at least one other available price—in the ghetto or elsewhere . . . . After the buyer makes out his *prima facie* case, then the plaintiff-merchant would be permitted under 2-302(2) to rebut the buyer's case by showing that his net return or net profit was not excessive.

J. White & R. Summers, Uniform Commercial Code 159-60 (2d ed. 1980) (emphasis in the original).

168. See *supra* notes 77-78 and accompanying text.

169. This has been the experience with Robinson-Patman laws, which tend to cause incongruities by prohibiting differences between what are in fact different markets. *See* T. Sowell, *supra* note 63, at 209-12.

170. See *supra* note 36 and accompanying text.

171. See *supra* Part II.B.

172. On the mistakes government has made by incorrectly assuming that racial minorities behaved irrationally, see T. Sowell, Markets and Minorities 108-21 (1981).

173. *See* T. Sowell, *supra* note 63, at 110-11 (discussing the idea of effective feedback). Of course, given the present distribution of legal services, the number of invalidations to be expected may be too small to have much effect on feedback. It would not seem appropriate, however, to have legal rights that would be unacceptable as soon as large numbers of people began to assert them.

hibit self-correcting proclivities that judicial decisions do not. Suppose a merchant attempted to justify to a court a one hundred percent markup on consumer durables in poor areas, arguing that the costs of doing business there were higher. An important feature of the Austrian critique is that government officials have great difficulty in accurately measuring costs in a particular industry.[174] If the court rejects the merchant's defense and turns out to be wrong, whole segments of the economy of the poor may disappear. By contrast, if the overcharge really was unjustified by costs yet the court allowed the overcharge anyway, entrepreneurs would at least have an incentive to direct further resources into poor areas until the overcharges were to some extent eroded.[175] Of course, when door-to-door sales people or other merchants have obviously procured a sale by questionable means, a declaration of unconscionability is eminently sensible. The three Austrian arguments are directed against a finding of unconscionability on the basis of an alleged price disparity alone.

2. Contracting at Monopolistic Market Prices and Wages

Another area of unconscionability concerns claims that a contract should be set aside, not because one party failed to understand its terms or because the contract was made at a price inferior to the market price, but because the market price is itself monopolistic or unfair.[176] A great deal of serious overstatement has pervaded legal commentary on this issue. Consider, for example, the following treatment of the subject by Professor Unger:

> Gross inequalities of bargaining power . . . are all too common in the current forms of market economy, a fact shown not only by the dealings between individual consumers and large corporate enterprises, but also by the huge disparities of scale and market influence among enterprises themselves. Thus, the doctrine of economic duress must serve as a roving commission to correct the most egregious and overt forms of an omnipresent type of disparity. But the unproven assumption of the doctrine is that the amount of corrective intervention needed to keep a contractual regime from becoming a power order will not be so great that it destroys the vitality of decentralized decisionmaking through

174. *See id.* at 169 ("The costs of an industry are difficult—if not impossible—for third parties to determine. . . . [C]osts are foregone options—and options are always *prospective*. . . . Government regulations and their estimates of 'cost' are based on objective statistical data on actual outlays.") (emphasis in original). If such "overcharges" in the ghetto are not aberrational but systematic and common, it is extremely likely that the court's factual premise is indeed wrong.

175. *See* J. Buchanan & G. Tullock, The Calculus of Consent 36-38 (1962) (contrasting market and political relationships by noting that the former encourage more rational decisionmaking by punishing irrational choices).

176. On the distinction between "procedural" and "substantive" unconscionability, see Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. Pa. L. Rev. 485, 487 (1967).

contract.[177]

From the Austrian perspective, of course, perfect competition is nowhere to be found. But if "gross inequalities" and "huge disparities" were indeed "omnipresent," profitable opportunities for competitors would have been created and long ago seized. The principal fallacy of Unger's argument is the emphasis it places on "bargaining."[178] From the time of Carl Menger, Austrians have stressed that competition provides an alternative to bargaining and that the range of indeterminacy where bargaining is necessary tends to narrow as competition becomes more vigorous.[179] Indeed, competition is *particularly* necessary where one party will inevitably be a weak bargainer. In the area of labor relations, for example, an argument often made against freedom of contract is that employers can negotiate by out-waiting employees who need their wages for food and housing.[180] In fact, what this argument tends to establish is the helplessness of workers under any system that depends on *bargaining* with employers. To the Austrians, this argument misses the fact that the essential dynamic of the market process is not bargaining[181] but the continuous creation of new profit opportunities followed by the competitive erosion of those opportunities.[182] In the case of labor, for example, one entrepreneur perceives the opportunity to increase profits by employing capital and other resources to raise the productivity of labor, and the resulting gap between the workers' new marginal product and their wages creates additional profit opportunities for other entrepreneurs who compete for that now underpaid labor.[183]

Of course, the Austrians do not contend that these adjustments occur in the instantaneous manner hypothesized by neoclassical models. Labor and other markets may be characterized by slow adjustments, impediments to new entry[184] and serious informational problems in the discovery of new opportunities.[185] One's instinctive reaction to these problems

177. Unger, *supra* note 50, at 629.

178. For criticism of the concept of "bargaining power," see Kennedy, *supra* note 42, at 615-17; Rakoff, *supra* note 135, at 1192-94.

179. *See* L. Lachmann, *supra* note 95, at 84; C. Menger, *supra* note 2, at 196-97.

180. *See* Unger, *supra* note 50, at 630 ("If labor were not allowed to organize and to bargain collectively, the disparity between the contract model and economic reality would remain immense and unmistakable in a central aspect of social life. It would then be clear that the only kind of correction capable of distinguishing contract from subjugation would be one that effectively abolished contract by policing all of the terms or correcting all of the outcomes.").

181. *See* L. Lachmann, *supra* note 95, at 84 ("In fact, the competitive price sysem by its very existence sets fairly narrow limits to the area within which wage-rates could be determined by bargaining.").

182. See *supra* notes 81-89 and accompanying text.

183. *See* M. Friedman & R. Friedman, *supra* note 29, at 246.

184. On the problem of governmentally created barriers, and an argument for holding them unconstitutional, see Wonnell, *Economic Due Process and the Preservation of Competition*, 11 Hastings Const. L.Q. 91 (1983).

185. On the significance of consumer ignorance of market opportunities, see Eisenberg, *supra* note 37, at 781.

is that judicial revision of unfair monopolistic contracts is at least justified in the interim before the market can restore efficient competitive pricing. From the Austrian perspective, however, this interim approach suffers from two fundamental defects. The first is that it assumes a court can come reasonably close to approximating the true competitive price, a preposterous assumption from the Austrian perspective.[186] Prices, even seriously imperfect ones, nevertheless embody the wisdom of millions of market participants, acting on their widely diffused knowledge of the scarcity of that good, its potential substitutes in production and consumption and the scarcity of each resource needed to produce the good and the thousands of alternative uses for each such resource.

The second problem is that even if by some miracle the court correctly perceived that the contract price was *X* percent above or below the competitive price, from a dynamic perspective the intervention still would be unjustified. Supracompetitive prices play two important roles in the Austrian conception of the market process: the expectation of supracompetitive profits is the motivating force of the creative entrepreneur[187] and the existence of such profits once created signals the market to direct more resources toward the industry in question.[188] Thus, even if the court could correctly identify and expunge the "monopoly" element in every contract price, its doing so would stifle the market process on which progressive increases in efficiency depend.[189]

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186. See *supra* notes 57-69 and accompanying text.

187. See *supra* note 81.

188. *See* Hayek I, *supra* note 5, at 526, *reprinted in* F. Hayek, *supra* note 5, at 86.

189. In general, the courts have been extremely hesitant to hold the price term of a contract unconscionable when the contract price simply reflected the market price. Mobile Am. Corp. v. Howard, 307 So. 2d 507 (Fla. App. 1975) deserves to become a true "leading case" in this area. The plaintiff corporation sought to replevy a mobile home, and the defendant argued that the installment sales contract charged an unconscionable interest rate of 11.75%. *See id.* at 507. The trial court accepted the defense, but the appellate court reversed:

> [W]e find no case which even comes close to declaring an interest rate of 11.75% on an installment sales contract "unconscionable." Indeed, most cases finding unconscionability do so by considering terms other than price. Of those cases dealing with price at all, most require, *in addition* to a grossly excessive price, some element of nondisclosure, fraud, overreaching or a manifestly unequal bargaining position. Only a few courts have indicated that an excessive price disparity may be sufficient of itself under [the unconscionability provision of the Uniform Commercial Code], but such cases involved *grossly* excessive prices and finance charges considering average market conditions. In any case, no such comparison was made in the trial court's judgment here appealed from and it is common knowledge, to which judges are no less privy, that an 11.75% annual percentage rate is within the limits prevalent in the current status of the installment sales market.

Id. at 507-08 (emphasis in original).

This excellent decision should not be clouded by the court's reference to possible discharge when a "manifestly unequal bargaining position" exists. It is extremely unlikely that the mobile home purchasers were able to "bargain" the corporate seller down from, say, 14% to 11.75% interest. Competition, not altruism or bargaining, caused lenders to offer an interest rate below 14%.

3. Contracting at Harsh Nonprice Terms and the Nondisclaimable Duty

Price and nonprice terms of a contract differ in two ways. First, price terms are uniquely visible and comprehensible. Even in consumer contracts, it is generally a fair assumption that both parties know what the price term is and what it means. Second, nonprice terms typically impose a cost on one party different from the value they confer on the other. A price of $5000 means a loss to the consumer and a gain to the producer of $5000. By contrast, a consumer's right to engage the seller in complex factual litigation might have a value of $5000 to the consumer but impose a cost on the producer of $10,000.

If both parties were fully informed about the nonprice as well as the price terms, the problem of inefficient contract clauses that impose a greater cost on one party than the value they confer on the other would not arise. Professor Markovits has made this point in the context of discussing building code requirements, a form of legislated non-disclaimable duty:

> [I]n an otherwise Pareto optimal world, housing code enforcement would be misallocative. Inasmuch as landlords did not choose to supply their tenants with code-quality housing in the first place, the private dollar cost to the landlord of upgrading sub-code housing must have exceeded its private dollar value to the tenant.[190]

Moreover, it is important to realize that *if* tenants were fully informed, this conclusion would not be affected by saying that landlords have superior "bargaining power" or even monopoly power in a particular market. The presence of monopoly power only influences the ultimate value of the contract to the landlord and tenant; neither party has an incentive to employ an inefficient form for obtaining that value. Professor Schwartz has stressed this idea in the context of discussing product warranties: "If a monopolist's customers prefer to have warranties rather than disclaimers, and if these customers will pay the premium for additional warranty protection, the monopolist would be irrational not to offer a warranty. Offering only a disclaimer would cost him potential profits."[191] The problem, of course, is that tenants are not fully informed about the terms on which they are contracting with landlords.[192] From the point of view of the Austrian school, however, this is the beginning, not the end, of the analysis, because the government itself suffers from the problem of limited knowledge.[193]

This inherent limitation on the government's knowledge of relevant

190. Markovits, *The Distributive Impact, Allocative Efficiency, and Overall Desirability of Ideal Housing Codes: Some Theoretical Clarifications*, 89 Harv. L. Rev. 1815, 1831 (1976).

191. Schwartz, *A Reexamination of Nonsubstantive Unconscionability*, 63 Va. L. Rev. 1053, 1072 (1977).

192. *See* Markovits, *supra* note 190, at 1838.

193. See *supra* Part III.C.2.

facts has often been overlooked in the literature. An extraordinary amount of ink has been spilled, for example, on the question of whether *ideal* building codes are efficient and beneficial to the poor.[194] From the Austrian perspective, this emphasis is entirely misplaced. The Austrians freely concede that the market at any point in time is far from Pareto optimality, and thus an ideal nondisclaimable duty certainly could improve efficiency. The problem is precisely that the state lacks the information and the incentive needed to fix such ideal rules in the first instance or to change them once its initial assignment of rights proves erroneous.[195]

In fact, one important point that the Austrians stress is that the "ideal" rule governing, say, landlord-tenant relations, is extremely unlikely to be the same for all buildings or for all people. As noted earlier, the Austrians insist that the factors of production are not generic categories like "land," "labor" and "capital,"[196] and it is similarly risky to speak as if the housing market consisted of generic "apartments" and "tenants." Nondisclaimable duties imposed on all landlords for the benefit of all tenants are likely to have quite different consequences for various segments of the housing market, and it is therefore questionable whether any general rule could enhance efficiency for all such segments.

The problem is not simply that nondisclaimable duties might be inefficient, because in a world of imperfect information, contract clauses might be inefficient as well. The key difference is that while private mistakes encourage learning and adaptation, state regulation in the Austrian conception actually leads *away from* efficient outcomes over time. Each nondisclaimable duty tends to produce a market response such as an increase in price, a deterioration in other contract terms, or, if these fail, an attempt to abandon the industry.[197] Because these market responses conflict with the state's intention of benefiting the weaker party, the government tries to head off such "escape routes" by price controls, more nondisclaimable duties and prohibitions on exit.[198] Although such an

194. The following articles expressly limit their attention to the effects of "ideal" building codes: Ackerman, *More on Slum Housing and Redistribution Policy: A Reply to Professor Komesar*, 82 Yale L.J. 1194 (1973); Ackerman, *Regulating Slum Housing Markets on Behalf of the Poor: Of Housing Codes, Housing Subsidies and Income Redistribution Policy*, 80 Yale L.J. 1093 (1971) [hereinafter cited as Ackerman 1971]; Komesar, *Return to Slumville: A Critique of the Ackerman Analysis of Housing Code Enforcement and the Poor*, 82 Yale L.J. 1175 (1973); Markovits, *supra* note 190.

195. *See* Schwartz, *supra* note 191, at 1066 ("[A] seller has a large advantage over a court in accurately ascertaining [consumer] preferences. A seller has greater expertise in commercial matters, better facilities for ascertaining consumer preferences, and greater incentive to know them accurately.").

196. See *supra* note 61 and accompanying text.

197. *See* L. Mises, *supra* note 7, at 762-64; R. Posner, *supra* note 148, at 69.

198. This scenario has often been played out in the housing area, with government regulations raising the price of housing, inspiring rent increases followed by rent controls, attempted housing abandonment and prohibitions on housing abandonment. *See generally* J. Brenner & H. Franklin, Rent Control in North America and Four European Countries (1977).

approach might succeed in temporarily "trapping" some capital,[199] it tends in the long run to discourage production and to leave the industry without the free pricing needed for a functioning market process. In the Austrian conception, that is a particularly unfortunate outcome, because rational planning and calculation require market prices and other contract terms that at least approximately signal real scarcities.[200]

This is not to say that the Austrian approach is dogmatically opposed to the use of any nondisclaimable duties to replace nonprice contract terms. Some contractual terms may simply be too difficult to understand or may impose external costs on third parties. However, because nonprice terms signal entrepreneurs to new investments, we must preserve the idea that nonprice as well as price terms should be, as a general rule, disclaimable. As Hayek has stated:

> We must look at the price system as . . . a mechanism for communicating information if we want to understand its real function—a function which, of course, it fulfills less perfectly as prices grow more rigid. Even when quoted prices have become quite rigid, however, the forces which would operate through changes in price still operate to a considerable extent through changes in the other terms of the contract.[201]

CONCLUSION

In the Austrian conception, freedom of contract cannot be defended as a system ensuring a completely efficient resource allocation. The Austrians recognize that imperfect information and monopolistic elements will always leave the system of free contract far short of that efficient state. Nevertheless, because the Austrians believe that freedom of contract leads to an *increasingly* efficient economy, the Austrian conception does tend to extend the areas where freedom of contract is warranted beyond the range envisioned by neoclassical economists.

"Efficiency" is a cold word. It must not be forgotten, however, that the discovery of new efficiencies, which to the Austrians is the essential purpose of freedom of contract, is the discovery of new ways to provide things valued by flesh-and-blood human beings. Nondisclaimable duties may reduce a worker's hours of work at the expense of wages, increase wages at the expense of working conditions or improve working conditions at the expense of job security. Some of these compulsory trade-offs may indeed be desirable, just as the compulsory trade-offs imposed on consumers by forcing them to pay more to secure a warranty against personal injuries may be desirable. Nevertheless, significant expansion of

199. This argument is made by Professor Ackerman. *See* Ackerman 1971, *supra* note 194, at 1108. Over the long run, however, where decisions about structural repairs, new partially subsidized housing or housing destruction can all be varied, the results may be quite different from these short-run expectations.

200. See *supra* notes 57-72 and accompanying text.

201. Hayek I, *supra* note 5, at 526, *reprinted in* F. Hayek, *supra* note 5, at 86 (parentheses omitted).

the workers' or consumers' options in all their dimensions requires discovery of new efficiencies—new options created by higher productivity—brought to workers and consumers by the competitive process. The Austrian school of economics suggests it is this process to which contract law can make an important contribution.