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Law, economics and Calabresi on *the future of law and economics*

Alain Marciano[1] **· Giovanni Battista Ramello**[2]

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Abstract
There exists a distinction between 'law and economics' and the 'economic analysis of law'. The former, corresponding to Coase's approach, consists in taking legal rules into account insofar as they influence economic activities. The latter, associated to Posner's name, consists in using economics to analyze legal problems. Methodologically speaking, if one admits that the economic analysis of law consists in using economic tools to analyze legal problems, Calabresi's own work must be classified as such. However, Calabresi has always insisted that his own approach differs from Posner's economic analysis of law. In this paper, we take the opportunity of Calabresi's new book—*The Future of Law and Economics*—to revisit Calabresi's approach to law and economics. In his book, Calabresi explains that the economic analysis of law is unsatisfactory because economics is too narrow. He insists on the need to amplify economic analysis by: first, adopting a more realistic approach *à la* Coase; second, taking merit goods into account; and third, including individuals' propensity to be altruistic. We analyze these three aspects and show that it leads to a certain ambiguity in terms of the distinction between 'law and economics' and the 'economic analysis of law'.

Keywords Buchanan · Calabresi · Coase · Posner · Economic analysis of law · Law and economics · Merit goods · Altruism · Political economy

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✉ Giovanni Battista Ramello
giovanni.ramello@uniupo.it

Alain Marciano
alain.marciano@umontpellier.fr

[1] University of Montpellier, Montpellier, France

[2] Università del Piemonte Orientale, Alessandria, Italy

1 Introduction

To better understand Calabresi's work we must remember the distinction that exists between 'law and economics' and the 'economic analysis of law'. It was first noted by Epstein et al. (1997) when he explained that "two parts" co-exist in law and economics (1996, 103; or Coase in Epstein et al. 1997, 1138), that are "quite separate although there is a considerable overlap" (Coase 1996, 103). The first part, 'law and economics', places the focus on the economy, the economic system and economic activities. The institutional and legal framework in which economic activities take place is considered only to the extent that it affects the economy. In other words, legal rules and institutions are not taken as the main object of study. By contrast, the second part, the economic analysis of law, takes precisely the legal rules as its main object of study. As Coase goes on to say, the second "part" that exists in law and economics is "often called the economic analysis of law" (1996, 103) and is the part to which "Judge Posner is the person who has made the greatest contribution" (Coase in Epstein et al. 1997, 1138).

Law and economics rests on a definition of economics by scope, domain or subject matter. This was the perspective explicitly adopted by Coase—"economists do have a subject matter" (1998, 93) which consists in "certain kinds of activities" (1978, 206) or, more specifically, "the economic system, a system in which we earn and spend our incomes" (1998, 93). Hence, according to Coase, economists should study "the working of the social institutions which bind together the economic system: firms, markets for goods and services, labor markets, capital markets, the banking system, international trade, and so on" (1978, 206–207). In other words, economists "should use these analytical tools to study the economic system" (Coase 1998, 73).

An economic analysis of law, on the other hand, rests on a totally different premises. The focus is no longer put on economic activities—defined as those that take place in markets—and the objective is no longer to understand how legal rules influence the economy. The legal system is no longer seen as the environment in which economic activities take place, and hence external to the true object of study (the workings of the economic system). It becomes per se the object of study. In fact, and very straightforwardly, an economic analysis of law consists in using economics to analyze the legal system and how it works or, to quote Lewis Kornhauser, "Economic analysis of law applies the tools of microeconomic theory to the analysis of legal rules and institutions" (2011). This in particular means that legal rules become themselves the object of study. To quote Posner, an economic analysis of law consists in "the application of the theories and empirical methods of economics to the central institutions of the legal system" (1975, 39).[1]

Methodologically speaking, if we define economic analysis of law as the use of economic tools to analyze legal problems, Guido Calabresi ought to fall under this category, since his work indeed consists in an economic analysis of the law. He was

[1] On the distinction between "law and economics" and an "economic analysis of law" in terms of definition of economics see Harnay and Marciano (2009) and Marciano (2016).

even the first to introduce this kind of approach in the early 1960s with his article on liability rules (see Marciano 2012). Yet, Calabresi has always insisted that his own approach differs from an economic analysis of law, and instead corresponds to 'law and economics'—a claim he repeats in his newest book—*The Future of Law and Economics* (2016). This is the claim we would like to discuss here.

In a previous article, we proposed sketch out what we defined as a heterodox economic analysis of law, idiosyncratic to Calabresi's approach (Marciano and Ramello 2014; see also Marciano and Ramello 2018). Here we push this analysis further, by complementing it with what Calabresi writes in his new book. Our purpose is not to contradict Calabresi and go against how he sees and characterizes his work. Rather, by identifying to which tradition he belongs—and in particular how his work relates to Coase's—we aim to clarify the possible future direction of interactions between law and economics, and between economists and lawyers. Further, we want to see whether there is a way to resolve the aforementioned puzzle.

The remainder of this paper is organized as follows. In Sect. 2, we present Calabresi's views of what an *amplified* economic analysis of law should be. In Sect. 3, we discuss the role realism—which is very important to Calabresi—has to play in an amplified economic analysis of law, and connect it to Coase and Buchanan. In Sect. 4 and 5, we analyze what Calabresi wrote about merit goods and altruism. To Calabresi, these cases exemplify the failures of economic analyses of law. We explain why it may not be so straightforward, and how such problems might in fact be covered by an amplified form of economic analysis of law—but which can still be defined as an economic analysis of law.

2 Law and economics as *amplified* economic analysis of law

A central claim of Calabresi's latest book is that the future of law and economics does not lie in the economic analysis of law as it is practiced nowadays, but rather in law and economics. To Calabresi, law and economics differs from the previously given definition which, let us recall, corresponds to Coase's view that economists should not analyze legal rules but only take those rules into account insofar as they influence economic activities. Indeed, Calabresi admits the possibility to analyze legal rules—such as liability rules—with economic tools. Which means that he himself adopts a economic analysis of law perspective. But, according to Calabresi, this perspective is not satisfying. Economic analyses of law rest on too poor and narrow a foundation to correctly understand legal rules and the legal structure. Therefore, he argues, economic analysis needs to be "amplified". This would help improve the analyses made by economists or lawyer–economists, it would also improve the dialogue between economists and lawyers, and finally it would help to improve the legal structure. Thus, Calabresi seems to consider that an amplified economic analysis of law implies a departure from the economic analysis of law—as it has evolved since its origins in the early 1970s—to move towards a form of law and economics *à la* Coase.

Now, whether amplified or not, and even if the tools and assumptions are not the same as those used in what we might term 'standard' economic analysis of law,

this approach still consists in analyzing legal problems with economic tools. Thus, even with his claims of an 'amplified' economic analysis, Calabresi remains in an economic analysis of law perspective, since he still wants to use (amplified) economics to analyze the legal structure. To put it more provocatively, and possibly beyond the intention of Calabresi himself, the future of law and economics is the economic analysis of law. The lawyer–economist may be a lawyer in the first place, but she is still someone who adopts economic reasoning. This is not anecdotal, or simply a matter of labels. It is important because it clearly indicates the future relationship between economics and the law, between economists and lawyers: it will *not* consist in studying economic problems influenced by legal rules—such as problems in industrial organizations. Instead, being a form of economic analysis of law, it will consist in using economics to study the workings of the legal system, the origin of legal rules and the legal structure. Thus, the scope of Calabresi's amplified economic analysis of law is as wide the scope of Posner's economic analysis of law, and differs from Coase's.

Yet, Calabresi refers to Coase, among other economists, as one of those who should provide inspiration for the future direction of law and economics. He insists, in the first chapter of his book, that law and economics—and his amplified economic analysis of law—should start from "Coase the institutionalist," that is, the author of "The Nature of the Firm" (1937). The reason Calabresi gives is that Coase, in that very article, criticized the standard economic analyses of the firm and urged economists to adopt more realistic approaches. Realism is precisely what Coase—and others, of course—can bring to help amplify economics and, *at the same time*, to change economic analyses of the law. This is what Calabresi does. Thus, to put it another way, Calabresi's amplified economic analysis of law seems to be neither law and economics nor economic analysis of law—at least, it does not correspond the definitions given in the introduction.

However, generally speaking, the question of realism in economics is an old and tricky one. The lack of realism may not be an obstacle for economics and economists, but it is for lawyers. Lawyer–economists, writes Calabresi, need realistic tools because they have to apply economics to the law, to the legal structure. He assumes or claims that lawyer–economists are those who are looking at both sides (legal and the economic) of a problem.[2] Hence, they have to move back and forth between economics and the law with the goal of improving the "legal structure"—the legal rules that exist in a society.

What type of "realism" did Coase defend? And how can it be related to Calabresi's views?

[2] From this perspective, his definition of what a lawyer-economist is differs from the one given by Backhaus (2017).

3 Coase, Buchanan, realism and Calabresi

Coase did not defend realism in economics only in "The Nature of the Firm". He has always criticized what he eventually called "blackboard economics" (Coase 1998, 19, 28, 179; 1992, 714) for being abstract, that is, a form of economics that has "little concern", "disregard" or "disdain" "for what happens concretely in the real world" (Coase 1998, 72). The criticism was leveled at standard theories of the firm, which is reduced to a production technology for converting inputs into outputs, of markets—"in modern economic theory the market … has an even more shadowy role than the firm" (Coase 1998, 7)—and of individuals, who are reduced to a utility function which they supposedly maximize. In modern economics, firms, markets and individuals are abstract entities. And the theories produced by economists in this frame are "sterile" (1978, 208) because they do not tell us anything about how actual people behave and cannot teach us anything about how the system actually works. Or, even worse, these theories can lead to erroneous conclusions and policy recommendations (see, for instance, Marciano 2018).

One example discussed by Coase—lighthouses in economics (1974)—is of particular interest for this discussion about law, institutions and economics. Coase explained that lighthouses were used by economists as a perfect example of a public good. To be more precise, they assumed that lighthouses were a form of public good because of the interdependencies that clearly exist between consumers, and then concluded that they should "be provided by government rather than by private enterprise" (1974, 357). By definition, lighthouses could not be provided and financed by private enterprise.[3]

What Coase criticized was the fact that none of the economists who analyzed lighthouses in England studied how lighthouses were effectively financed: "[d]espite the extensive use of the lighthouse example in the literature, no economist, to my knowledge, has ever made a comprehensive study of lighthouse finance and administration" (1974, 375). This to him was a mistake—"[t]his seems to me to be the wrong approach" (1974, 375). Indeed, no one realized that private, market-like, mechanisms had in fact been devised to deal with the specific features of these goods. Thus, even if these goods had the properties of a public goods, there was no prima facie case for government intervention. Indeed, one can accept that markets fail to allocate resources efficiently without necessarily jumping to the conclusion that state intervention is needed. Not necessarily because the state may fail as well, but because individuals can—and most of the time do—devise private, market-like solutions to deal with interdependencies—(public goods and externalities).

Coase was not the only one to raise this critique. James Buchanan pointed at the same problem. More specifically, he claimed that identifying public goods and externalities, or interdependencies between individuals, is simply the identification of a problem, not of the solution. It tells us only that a market failure exists, and accordingly that gains from trade may potentially be realized though collective

[3] On Coase, the lighthouse and market failure, see Candela and Geloso (2018).

action—but that is all (see Buchanan 1959, for instance). The discovery of a market failure does not imply that economists must jump from that conclusion to a defense of intervention by the state. This approach—which is that of Paul Samuelson, Richard Musgrave but also Richard Posner and Gary Becker and Warren Samuels)—is not in general the correct approach to adopt in economics, as it would see a sort of a universal remedy to any market failure.[4]

The 'right' approach does not consist in assuming—normatively—what individuals should do according to the principles of economic theory, but rather "in discovering what is the structure of individual values" (Buchanan 1959, 137). Hence, the right approach in economics consists in starting from what individuals do—"[p]ropositions of positive economics find their empirical support or refutation in observable economic quantities or in observable market behavior of individuals" (Buchanan 1959, 127). It consists in observing how the economic system actually works. It consists in looking at what individuals actually do, at the kinds of institutions or legal rules they develop to organize their activities, before envisaging any policy recommendations:

> I think we should try to develop generalisations which would give us guidance as to how various activities should be best organised and financed. Buch such generalisations are not likely to be helpful unless they are derived from studies of how such activities are actually carried out within different institutional frameworks. (1974, 375)

Thus, both Coase and Buchanan criticized the same type of economic analysis—abstract and unrealistic—and defended the same type of political economy—one which starts from individual values and the institutions individuals devise to organize their interactions. Calabresi adopts precisely the same perspective. This is what he means by being a lawyer— looking that the legal structure, at the legal rules and at the institutions that exist.

This is particularly well illustrated in Calabresi's treatment of merit goods. Calabresi starts with a definition given by Musgrave and Tobin. He accepts the idea that individuals sometimes under-estimate the positive externalities associated with the consumption of certain goods and therefore under-consume them. These are what Musgrave named 'merit goods' (1957, 1959, for instance). As Musgrave noted, "[t]he apparent willingness of the public to provide for a second car and a third icebox prior to ensuring adequate education for their children is a case in point" (1957, 341). This legitimates a certain "interference with individual preferences", wrote Musgrave (1957, 341). The implication is that legal rules could be used to force individuals to consume these goods. It may also mean that these goods should be provided by the state. That was exactly the perspective on public goods adopted by Musgrave himself, by Samuelson, and many others. It was also precisely the perspective Coase and Buchanan criticized, and which Calabresi also rejects. In other words, unlike Musgrave, Calabresi does *not* conclude that the state should

[4] It is worth noting that this has also been the critique to the blind support for property rights that has occurred almost everywhere in last decades and especially in the case of intellectual property rights.

necessarily produce and finance those goods. Part of the explanation Calabresi gives is that most—if not all—of the goods that can be viewed as merit goods are produced and financed via hybrid mechanisms: he speaks of "the non-ordinary market treatment of only some selected goods" (2016, 117). Hence, the very fact that education or health are not provided privately should be viewed as a signal that these are merit goods. And moreover that individuals have certain values about these goods. This allows Calabresi to discover which are the values embodied in certain goods.

4 Law, economics and merit goods

Calabresi does not simply derive values from the observation that certain goods are produced and financed by hybrid mechanisms. He actually starts with a certain number of assumptions—or statements—about what individuals "like" and "do not like" and links them to the conclusion that—because of these preferences—certain goods should be considered merit goods.[5] But, of course, and as has been stressed by Leeson (2019) and Zamir (2017), there are other factors apart from individual values that could explain the institutions that exist in a society.[6]

What are these values? And why do they justify rejecting both the use of markets and the state to regulate the provision of merit goods?

Let us start with the first way of regulating the provision of merit goods, which he terms "command". This is the second difficulty we find in Calabresi's approach. Once such goods are identified, and if it is claimed that individuals do not consume them in sufficient quantities, the only consistent conclusion—drawn by Musgrave as also by the other defenders of merit goods—is that such goods should be provided by the state, or that the law should be used to force or orient individuals to consume them. Merit goods necessarily involve a form of state intervention or, at best, of paternalism. Yet, this is not Calabresi's conclusion. Despite adopting a rather objective and *ex ante* definition of merit goods, he rejects the logical consequence that the state should force individuals to consume merit goods or establish how much to value them: "we do not want the government to tell us, too obviously, that some lives in some circumstances are not worth saving" (Calabresi 2016, 47). The reason is, more broadly, that there are certain merit goods that "many do not want to have priced at all" (2016, 43). This is also the argument he uses to reject the use of markets to deal with merit goods.

Now, and this the third point we would like to emphasize, if we start from what individuals actually do, it transpires that they do, at least sometimes, use decentralized or market-like (that is, exchange-based) mechanisms to deal with merit goods. However, Calabresi resists the idea that merit goods can be provided on a

[5] For an overview on merit goods see Kirchgässner (2017).

[6] This is also a problem Buchanan encountered and discussed. To him, a legal structure is the consequence, the product, of the attempts made by the individuals to solve their problems. The law is, in Buchanan's views, the consequence or the outcome of the collective actions undertaken in the past by the individuals to deal with the interdependencies, externalities that could not be internalized on markets. They can be viewed as the product of a unanimous agreement.

market—that is, not only priced but also traded or more globally exchanged. Calabresi opposes to the idea of pricing certain merit goods—life, health, education—because it is too costly. It imposes moral costs on individuals and also on third parties.[7]

Yet, exchange does not necessarily involve pricing. Or, to put it better, there are forms of non-market alienation that impose obligations between parties—what might be termed a sort of exchange rate between actions—without a price. This is for instance the case of organ donations, adoption, or other gift exchanges occurring in different societies. However, Calabresi claims that there are certain merit goods for which no difference should be made between pricing and exchange (Radin 2001; Hyde 1983). That is to say, Calabresi targets pricing rather than exchange, but seems to reject pricing *and* exchange at the same time. Hence, he objects to exchange when it implies pricing. But he does not object to pricing when it does not involve a commodification that is too costly or too painful. For instance, it seems possible to raise membership fees that individuals would pay to be part of a club and benefit from such a merit good. However Calabresi does not say anything about the reverse case: exchanges *without* prices, referred to also as non-market alienations (Radin 2001). Should they also be prohibited? For instance, what about gifts? The answer seems obvious: donating an organ, say, does not seem to involve any heavy (social) moral cost. It might however not necessarily be the case. We can envisage situations where even a gift or other non-market alienation may still generate moral costs as well. For example is it acceptable for an employee to donate an organ to her boss, or vice versa? Should it be prohibited? Of course, even though market and pricing are not involved, there are other forces that might affect the choice.

The answer in this case, according to Calabresi, is that organs do not fall into the category of merit goods that are really costly and painful to trade. Organs are of a different type. To him, "the principal objection [to trading organs] has not been pricing itself, but what pricing has seemed to mean, given the prevailing distribution of wealth" (2016, 69). Indeed, organs fall into a second category of merit goods, "whose commodification does not really bother us, so long their allocation, the market for them is not determined by the wealth distribution that prevails generally" (Calabresi 2016, 43); these are "goods as to which the objection is not that it is loathsome to price them, but rather, what people abhor, is their allocation through a prevailing wealth distribution that is *highly unequal*." (2016, 62; emphasis added) Thus, from this perspective, selling a kidney is not wrong in itself but becomes wrong if the seller is poor. The same applies if there are other asymmetries determining the exchange, although outside the market.

This view is of course not obvious and raises many difficulties. First, would selling kidneys, sex or children, or paying for education no longer be a problem in a perfectly egalitarian society? Usually, these sorts of goods are considered taboo in most societies, egalitarian or not (Radin 2001). Second, and complementarily, trading merit goods is asymmetric between poor and rich people: it seems wrong that

[7] That idea was already present in Calabresi and Melamed (1978, 1111–1112) and in Calabresi and Bobbit (1978).

poor people have to pay for organs or education or that they have to sell a kidney to buy food or clothes, but this does not seem to be the case for rich individuals—at least, this is not clear in Calabresi's analysis. Third, this perspective ignores the role of individual preferences. Thus, Calabresi writes: "[a]n individual who is poor may indeed be better off by selling a kidney, and not regret it later, and yet the sale is, nonetheless, banned" (2016, 70). Again, to take another example, an individual who is poor may like tariffed sex, but this behavior should be banned. And the reason is that authorizing this type of behavior would highlight "how 'bad' our wealth distribution is, and that is something that we, literally, are pained to hear" (2016, 71). On the whole, if we go back to the question raised at the end of the previous paragraph—how can we treat a gift made by a rich man, such as the gift of an organ from a rich donor to a poor recipient—it seems that such a gift should be prohibited because it would take place under a situation of wealth and power inequality.

5 Altruism, merit goods and the law

The last thesis that we discuss in this paper is the one Calabresi makes about altruism and beneficence. Calabresi claims that economics should also be amplified to take into account individuals' preference for altruism and generosity—"we like them," he writes (2016, 140). Now, this is something that, according to Calabresi, economists tend to ignore. He claims that economists take altruism into account "only as a means" (2016, 139), as "an efficient way of getting something done." (2016, 139) Against this view he sets his own—, according to which altruism is "an end in itself; … something we have in our utility functions." (2016, 141)

Altruism is represented by economists in the form of interdependent utility functions. Thus, from this perspective, altruism is indeed something individuals have in their utility function. It is not a means but really an end. However, there is a major difference between this way of representing altruism and Calabresi's. Economists are interested in the altruism that an individual provides. Calabresi is interested in "beneficence by others" (2016, 145). Indeed, he writes, "People want other people to behave beneficently, and in altruistic way toward them. They are willing to pay … a fair amount to be in contact with each other in ways that are seemingly not self-interested" (2016, 151–152). Then, one of the consequences of this "desire" for being loved is that individuals do not only want to benefit from certain goods. They also want to have these goods produced cheaply but also in a way that "satisfies our desire for, and joy in, seeing people, governments and firms behave 'nicely'" (2016, 155). Thus, this is the exact reverse or complement of what Calabresi writes about merit goods. Individuals do not want to cause pain to others. They dislike these goods being priced because of the pain others suffer from it, and they want others to behave nicely to them.

The two questions are interrelated. Calabresi mentions this point in passing, in a footnote (fn 13, chapter 4), but argues that altruism "reduces externalities caused by wealth dependence". However, it seems that the conclusion should be more drastic than that. Let us detail the reasoning. Altruism has two dimensions. The first, which Calabresi takes into account, is that an altruist wants to be loved and is ready to

give gifts "to induce (not buy) love, but also to induce (through rewards that have value) beneficent private behavior." (Calabresi 2016, 162) But there is also a second dimension, which is that an altruist is concerned for the welfare of others and therefore ready to internalize the impact of his actions on others—and it is not clear that Calabresi takes this dimension into account.

As a consequence, no poor man can at the same time be an altruist and also willing to sell those merit goods that no one wants to be priced. The reason is straightforward: an altruist does not want to see others suffer (because he or she internalizes the impact of his or her actions on others) and therefore he or she cannot do something that he or she knows will generate pain. In addition, altruism solves the problem raised by Musgrave about the "apparent willingness of the public to provide for a second car and a third icebox prior to ensuring adequate education for their children". An altruist, who does not want to see his children suffer, and even other people who do not want to see the children suffer, will not buy a second car or a third icebox. There is no "case in point" in favor of the intervention of the state.

We can also note that Musgrave believed in the existence of merit goods because he was convinced—as was Samuelson—that individuals are rational self-interested utility maximizers. Merit goods are a problem *only* under this assumption and, one may add, this is also the case for public goods. By contrast, if one assumes that individuals are altruists, then the problems raised by interdependencies disappear. These problems are spontaneously and directly taken into account by the individuals themselves. In short, to assume that merit goods must be dealt with amounts to adopting the same attitude as Samuelson or Musgrave to public goods.

6 Conclusion

This paper presents some of the main elements that characterize *the future of law and economics*, as set out by Guido Calabresi in his latest book. The first element is that, in the future, law and economics must adopt an "amplified"—more realistic—analysis to improve our understanding of how the legal world works. This approach, Calabresi claims, should be a form of law and economics. Yet, methodologically speaking, Calabresi's approach remains a form of economic analysis of law—which certainly differs from Posner's and from most of what economists do in this regard—but which is still a form of economic analysis of law. This is important because it means that it will consist in analyzing the workings of the legal system.

However, there is indeed an element that makes Calabresi's approach in some respects *à la* Coase, at least in reference to the other seminal work by this English founding father of law and economics, that is to say "The Nature of the Firm". In the same vein as Coase's claims in that paper, Calabresi insists on the need to adopt a more realistic approach in law and economics. This makes Calabresi's idiosyncratic analysis of law not only closer to the early Coase, but also to Buchanan. This attitude is more realistic in the sense that it does not try to impose—normatively—a solution upon individuals, but instead looks at and starts with the institutions that individuals devise to organize their economic activities. From a law and economics perspective, this implies that there are different ways of regulating interactions.

The third thesis—concerning merit goods—appears delicate. Merit goods are those which individuals do not want to see bought or sold—because pricing them generates moral suffering—or allocated according to wealth. These two conditions create a complex set of situations. Merit goods would be relatively easy to deal with from a moral point of view—transactions about organs are banned because they are wrong. But Calabresi does not adopt a moral perspective. This leads to situations that are rather difficult to understand—for instance, banning gifts that people want to make and would not regret, because it pains others to see such gifts. Perhaps this perspective is ultimately what makes relevant the legal and political perspectives that use the efficiency paradigm as a tool but not as an end in itself. It is a burden that someone has to bear.

This is all the more complex in that Calabresi introduces altruism. Altruism tends to contradict the need to deal with merit goods or their existence. Merit goods exist because individuals are self-interested and unable to take into account the positive externalities that their actions would generate. This is not the case if they are altruists. Even if altruism relates to the desire to live in a nice environment—in that case, no one will be ready to create pain to others by trading or giving organs or by refusing to finance institutions.

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