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**Legal Foundations of the Market:
Implications for Africa**

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The economic systems of African nations are evolving. Some are selling state enterprises, legalizing and liberalizing trade between countries, abolishing price controls, and reducing government spending [Staatz 1989, van de Walle 1989, Steffen 1990]. This seems to be the agenda suggested by both the popular press and a lot of economists. There is only a little argument among economists over how fast this is to be done, though there is a lot of political argument. Attention is focused on such things as exchange controls and tariffs [Claassen 1992]. These trade barrier and macro systems choices hold center stage, but there is a micro institutional foundation of the market that needs attention. Depending on the detailed rules, there are many different kinds of markets available. Which kind do these countries want? Or can government just stand aside and let the best of all possible worlds emerge spontaneously?

To help answer this question for policy makers in Africa, it will be useful to review some institutional theory, history and a few observations. First, some theory. Economic interdependence creates conflicts and these conflicts have to be worked out. Order and predictability are not to be taken for granted but are the creative product of collective choice. Freedom is not something that pre-exists in nature but is the product of the human choice of institutions [Polanyi 1944, Ch. 21]. Given the need to resolve conflicts of interest, law is the instrument which defines what is economic growth and whose preferences count [Samuels 1989].

What ideas from institutional economics can be used to help understand the policy options that face African reformers? First, theory suggests the transaction as the unit of analysis. Second, there is a set of goods characteristics which create different kinds of interdependence which are then directed by institutions to create a predictable performance. These characteristics include incompatibility, exclusion costs, economies of scale, transaction costs, and others. These different situational variables will be implicit in the analysis to follow. For theoretical detail see Schmid [1987 and 1981].

There is less consensus on whether there are genuine issues of power in any economy or whether they can be subsumed under the drive for efficiency where everyone can or does gain. Institutionalists such as Allan Gruchy [1987] have made a strong case for collective planning even in market economies. The "new institutional economists" such as Oliver Williamson [1985] have made a case for private governance [also see, Nabli and Nugent 1989]. If public government will just get out of the way, people will bargain their way to an agreement on institutions which will achieve efficiency and maximize joint product. Williamson argues that much of our distrust of monopoly and non-standard contracts is misplaced because these arrangements often further efficiency. The parties in a market will choose just the right mix of hierarchy (integrated firms) and market to minimize transaction costs. William Dugger [1990]

has objected to Williamson's failure to observe power conflicts and predatory behavior, themes which institutional economists have emphasized [Gambas 1973].

The economic historian Douglas North [1990] also emphasizes that the path to development is paved with institutions which reduce transaction costs and allow the maximization of the gains to trade. This is a bit more than governmental standing clear for it requires contract enforcement which increases the predictability of one's opportunities when they conflict with others. This requires government keeping its hands off private property. The early success of England versus Spain is credited to arbitrary taxation and confiscation by the Spanish kings while the English barons kept their king at bay [North and Weingast 1989]. But we shall observe below that the early American government did a lot of clever confiscation to obtain a certain kind of growth. The right mix of continuity and change is difficult.

The coordination and combination of specialized activity mostly requires a passive role for government in the world of Williamson and North. Where contracts can be written to cover the relevant eventualities, government is only required to enforce private promises. Where contracts cannot be complete because of uncertainty, government should stand aside to accommodate benign private hierarchy. There is only joint profit maximization in this harmonious world. Sometimes it is recognized that there may be strategic bargaining over the division of these joint gains but many ignore the problem.

Now for some contemporary observation. Hernando De Soto [1989] is the darling of U.S. Agency for International Development for providing a dramatic illustration of the drag of governmental regulation. He pretended to establish a new business in Peru and documented the time and resources wasted to obtain all the necessary permits. In such an economy, all opportunities are an administrative gift which is only obtained by tribute to the administrators. To avoid these costs, many firms operate in the informal and hidden economy. Less noted is his argument that there is a major drawback to being outside of the law. When business people need government to enforce contracts, it is unavailable. The informal economy works fine between people who are related and known to each other. But as North also emphasizes, you can't take advantage of economies of scale and scope that way. This requires impersonal trade at a distance--a theme also developed by Commons [1924].

Another major theme identified in the literature on the role of law in development is to facilitate the aggregation of capital. This leads to the rules for the formation of corporations and to the institutions of credit, money and negotiable instruments [Galbraith 1975; Samuels and Miller 1987].

Is there more to the role of government than contract enforcement and to define which goods should be publicly provided? Institutionalists argue that cost is something chosen not found. When "growth" creates costs on others in an economy, does the actor have to compensate the loser or must the loser pay to avoid the effect if able? What is seen as a cost of action and to whom is a matter of rights. Rules of strict liability or negligence can be a substitute for taxes. Capital poor governments should take note. Finally, legal historians such as Willard Hurst and Morton Horwitz note that American law seemed to express a preference for doers over sitters, which often meant a preference for industrial over agrarian interests. The law favored people of action rather than rent collectors¹. But thieves and gamblers are people of action and some selection seems necessary. This gets one into the world of politics, ethics, and power play. Some choice among competing interests seems necessary.

To summarize thus far, several roles for the state in development have been identified in the literature:

1. Get out of the way of private governance.
2. Reduce transaction costs to realize gains from trade. Integrated firms (hierarchies) may be desirable for you. Predictability of one's relative opportunities is fundamental.
3. Facilitate the aggregation of capital.
4. Reduce what is a cost to developers.
5. Favor developers over rent collectors.

Institutions as power or efficiency is one way to look at the choices facing the formerly socialist nations today. Another perspective is Efficiency #1 vs Efficiency #2. We will explain the difference as we go. First, a bit more observation.

Consider Mali as an example of an African country evolving from socialist to capitalist ownership. Mali has disbanded its cereal trading monopoly [Staatz 1989, van de Walle 1989]. The former state trading agency is now reduced to maintaining an emergency food stock and a price information gathering system. In 1990, the author interviewed private traders and asked what opportunities they saw that they were not able to take advantage of. All said they needed more credit--a theme we will return to below. Several complained that the state tenders for supply of emergency stock storage depots were in lots larger than they could bid on because of limited capital. But why didn't they form a joint venture by contract with other traders and agree to each take a portion of the total. The essence of the responses suggested that they did not trust each other enough to form such joint ventures. An outsider may not be able to penetrate the real reason why such ventures are not happening. But this opportunity seems an obvious candidate for contract enforcement by government. If this had been a link between family members, the trust of family members and long time partners would have been no problem for the traders. But the promises of strangers are a different matter. If traders can't get together for something simple like sharing in a bid for a government contract, they are not going to be able to get together for something more complicated like a foundry to make motorcycle parts. But these traders were not used to thinking in terms of using courts. They distrusted them. There is a board of arbitration (private governance) maintained by the Chamber of Commerce, but the Chamber was dominated by large, long established merchants and these traders didn't trust them either. A trader with an idea for manufacturer of motorcycle parts shrugged off my suggestion of a joint venture by saying that the other traders would just steal his idea if he solicited their capital. Family and ethnic rivalry can't be ignored. Even if one person gains, the idea that a rival and sometime enemy may also gain is often unacceptable. Joint profit maximization is not a benign concept with its distribution an afterthought.

Mali has a new commercial code with its law of contract and rules for formation of corporate ventures. The government would like foreign aid to pay for some new judges to administer the code. The donors are uncertain. Would this be grease to reduce transaction costs or just another set of palms to grease? [Hunt and Hunt 1987].

Nominally, Mali has a modern commercial code just like France. But one can't help wonder if it is the commercial code that France had when it was in Mali's stage of development (if it ever was). Does Mali have any further choices to make now that it has chosen the market? Does it have to ask which market? Does it have to examine its micro-institutions and the social system in which they are embedded? Does it have to make plans or are all good things spontaneous and automatic? Are these things easily changed later or will the institutions be path dependent? Will it need politics and an ethic to choose among conflicting interests or is it all a matter of every one wins from a reduction of friction? For some clues let's look at a bit of history. The history of all the Western countries would be relevant, but to keep the story manageable, I will look only at U.S. legal history during its period of rapid industrialization 1790-1850. Conclusive evidence should not be expected. The world of scholarship seems divided between those who speak of legal transformations to accommodate a certain kind of growth and to choose between interests and those who speak of harmony and rational maximization from more or less timeless legal or economic principles--you want more rather than less don't you? Morton Horwitz [1977] observes a transformation in American law from 1790-1850 to fit the needs of merchants and industrialists at the expense of others, while Simpson [1979] and Teeven [1990] emphasize continuity of principle. The latter theme emphasizes finding the law with improved logic while the former emphasizes creating the law to fit the dominant interests (dare we say classes).

Role of the State During Industrialization

Before just any model of Western capitalism is accepted wholly by new market economies, let's be clear on how commercial law evolved in the U.S.. Four areas will be reviewed. 1. Direct government investments, 2. Laws determining what is a cost to whom, 3. Commercial law, and 4. Law of negotiable instruments.

Direct Government Investment

State and local governments made sizeable direct investments in post colonial America. They built roads, canals, and later railroads [Goodrich 1968]. The Pennsylvania Railroad was named after the state who was a major stockholder. The same was true of cities who made major investments in transportation and utilities. Cities were the first corporations who mobilized capital for works of improvement. Many of these were later sold. Maybe that's the secret--knowing when to get out. The dominant contemporary theme is now privatization, but it was not during early rapid growth in the U.S. Capital whether collected in taxes or attracted to shares was scarce. Governments searched for and found ways to make capital go further.

What Is A Cost To Whom?

There are inputs into a production function which are not costs to the decision maker. Cost is a function of rights. When a road or canal or ferry landing is built some previous services of the land are lost to those who enjoyed them. Government can tax everyone and compensate for these losses or it can simply assert that these opportunities were never the rightful property of previous users. Some states actually built roads without any compensation for the land. It was argued that the resulting increase in land value would more than compensate for any lost surface. This amounted to a kind of forced investment as a result of a collective decision rather than an individual purchase of shares. Less extreme were those marginal damages to previous activity which were not allowed. Governments or their associated private investors saved a lot of money by not having to pay for damages. Horwitz [1977, 63] sums this up by saying, "The process of economic development in the United States necessarily

involved a drastic transformation in common law doctrine which required a willingness on the part of the judiciary to sacrifice 'old' property for the benefit of the 'new.'" Economic development requires choosing sides.

The erection of water powered mills was a strategic ingredient in the development of the country. The states did not have much in the way of direct investment but they did plenty to help them. Sites for mill dams and their reservoirs are scarce. Land owners of rare sites are in a position to capture much of the rent of a mill. To lower mill costs and reduce uncertainty, the states passed Mill Dam Acts which allowed condemnation of private property by another private party. [Horwitz 1977, Schmid 1960] This meant that land owners received only the going price for average land and not the unique site value. Previously, juries set the amount of damages. This subjectivity created uncertainty and it can be imagined that local juries favored the interests of long time landed interests over those of industrial upstarts. So the courts began to replace juries with court appointed appraisers.

And as if that wasn't enough, the courts disapproved of damage claims by users of the natural stream and its banks. Horwitz [71] states his transformation thesis thusly, "At the beginning of the nineteenth century, ... courts were prepared to award damages for injury to property regardless of the social utility or absence of carelessness of the actor's conduct. By the time of the Civil War, by contrast, American courts had created a variety of legal doctrines whose primary effect was to force those injured by economic activities to bear the cost of these improvements."

Even the mills got in each others way eventually. In Palmer v. Mulligan² [1805] a downstream mill owner asked to recover damages from a new upstream mill owner. The court refused to apply common law rule against obstruction of natural flow, but rather emphasized a functional analysis saying the upstream mill furthered competition. Soon the economy needed larger dams to support integrated cotton mills with their economies of scale and scope. But a bigger dam might flood an existing smaller upstream site. In Cary v. Daniels³ [1844] the court forgot its competition dicta and went for the advantages of scale.

Was this painless? Were the gains in output large enough that the integrated mill could have bought out the smaller mill if the smaller mill had been granted rights to damage? At the average value of small mills or at the strategic price that could be demanded for limited sites? Location of liability has substantial wealth effects and changes relative prices [Field 1991]. It is doubtful that the resource would have had the same use regardless of the placement of ownership. The courts spoke of efficiency, but it had a more qualitative meaning of a sense of direction. Big mills were progress and the law accommodated them. It surely helped not to worry about the income distribution departures from voluntary exchange. This seems to violate some of the values we place on the sanctity of private property. But, where would we have been if the entrepreneur of the proposed integrated mill had to convince a banker to loan money to buy out the small mills? It seems like a profitable idea now, but these were mighty uncertain projects then. Does development require collective choice of direction as well as incentives for individual calculation of marginal gains in bilateral trade?

The general issue here is one of continuity vs change. If you want change, first in time can't be first in right. Some varieties of development mean that prior use can't determine new uses. In the Hohfeldian and Commons view of property correlates, dominion and freedom for one party mean exposure and non-freedom for someone else. Freedom of the original resource users to continue restricts the freedom of new entrepreneurs. Freedom as a criteria for choosing laws cuts both ways and never disposes of interdependence. The court was choosing

the definition of what constitutes development and not protecting freedom in the abstract. It needed and in fact made a moral judgment choosing between conflicting interests though it did not always admit it.

What has this to do with Africa? How are these little court cases relevant? Isn't the big issue capitalism and socialism? Firstly, the path of development is one of detailed resolution of all the ways that one person's actions affect another. After the market is chosen, the question is what are the market rules. Secondly, the cases suggest that the law must fit the time. America changed the English common law to suit its purposes [Nelson 1975, Bakken 1983]. It raises the question of whether French or other modern law fits Mali's purposes. (See Brietzke [1974] for a critique of French based law in Ethiopia.) Stability is functional, but so is the necessity of change. Thirdly, most quarrels between villagers who are doers and sitters never reach the courts. The proposed change is limited by public opinion. Is the only way out to destroy the power of the opinions of one's family and neighbors? A good family member does not cause assets losses to an uncle's business. Mali's goldsmiths are mostly Senegalese. Why? They get away from family obligations and can use savings for business investment rather than sharing them with extended family members. Is the alienation that Marx and the sociologists worry about the price of progress?

There are other human costs of progress. Industrialization and machinery create more opportunity for accident and injury. In the 1700's the American common law rule was one of strict liability. If your fire got away onto a neighbor's land it was a nuisance and you were liable. Same for your horse injuring a passerby. But as machinery proliferated the courts turned to the concept of negligence where the actor was liable only for gross negligence [Horwitz 1977, 85]. Loss of an arm in a machine was not the result of a direct act of the employer. Besides it was perhaps the result to a fellow worker. The employer was sitting in his office when it happened. These injuries were conceived of as inevitable and no one's specific fault, an act of god. This won't sell today.

Some poor countries have elaborate labor laws similar to rich countries. Workman's compensation statues and regulations protect workers against injury and dismissal. The result is higher labor cost relative to 19th century America. As De Soto observes, some firms escape these costs by hiding in the informal sector. But this means no economies of scale and no contract enforcement. Can the poor countries afford western style human rights? The West did not have these rules during its industrialization.

Regulation and court imposed rules of liability are substitute institutions. The rules of strict liability enforced by courts were the 18th century equivalent of today's Occupational Safety and Health Agency. So the choice is not just regulation vs. the free market, but what are the rules of the market. Who owns what? Under socialism there is some rule for who pays the medical care and lost salary of an injured worker and under the market there is either a regulation or a liability rule. The former socialist bureaucrats worried about their jobs should take hope. They can all become negligence lawyers. So the issue is not regulation vs the market, but what inputs to production have to be paid for (who bears the cost of development).

Today's policy makers interested in natural resources policy issues can learn from cases like Lexington and Ohio Railroad v. Applegate⁴ [1839]. Citizens objected to railroads being built through cities because of noise and dirt. The railroads feared injunctions which would have meant that they would have had to buy the right to quiet from many citizen owners. Transaction costs were not zero. The location of ownership would have affected resource allocation and railroad building. Yes, we had environmental policy in 1839 and it had something

to do with the path of economic development. Namibia recently refused payment to accept a nuclear waste dump. Did Union Carbide built its chemical plant in Bhopal, India because of its liability laws? In African and eastern European countries with socialist ownership of land, government enterprise could proceed without paying environmental damages. Now if these industries are privatized, will they have to pay damages? Who are the approved doers and who the sitters? Private buyers of former state firms in Africa must be concerned about their liability for the firm's past waste dumps. The placement of liability continues to play a role in the direction of economic development. In the U.S., the private nuclear industry could not have prospered in the face of uncertain and probably uninsurable risks of accidents without legislated limits to private liability for damages.

In many developing countries, you can't start a business without the government's permission. This was also the case in early America. Significant enterprises required a charter from the state. These charters served several purposes. As already noted above they served to cloak the business with the public interest and gave the enterprises rights normally reserved for public corporations such as eminent domain. Charters also served to regulate competition in a world of fundamental uncertainty of returns. For example, the State of New York offered a transportation monopoly on the Hudson River if Robert Livingston could invent a steam boat within a certain period of time. The state was not in a position to offer a cash prize or contract with a university, and expected competitive returns were not enough to bring forward the private investment.

In 1808, Livingston and Fulton succeeded in building the steam boat. And in 1811 they sued a rival steamboat operator for infringing their monopoly (*Livingston v. Van Ingen*)⁵. Livingston wanted an injunction, not just damages. The court had to decide if there was a property interest which deserved an injunction, which was worth far more than just damages. Horwitz [124] observes that "the expansive use of the injunctive remedy prevented the defendants from having their rights tried before a jury, where, one suspects, popular prejudice against monopoly would have tempered the enthusiasm with which chancellors who were free from immediate popular control subsequently extended the projections accorded the holders of franchises." Popular democracy is not always required for development.

So the court protected the rights of one private firm vs. another. What about North's' emphasis on the state not changing private rights? Technologies and demand change. Can the state issue another franchise to compete with the first? Turnpikes and ferries were to be replaced with canals and bridges and later railroads. The landmark case was *Charles River Bridge v. Warren Bridge*⁶ [1829]. Also see Kutler, [1971]. The bridge was built in 1785 under an exclusive charter when the population of Boston was 17,000 and Charleston 1,200. By 1827 the population was 60,000 and 8,000 respectively. The initial investment was \$51,00 plus 19,000 of later improvements and by 1827 the yearly tolls were \$30,000.

The court ruled that a competing franchise could be awarded. The Charles River bridge owners had become non-developmental rent collectors in the eyes of the court. The court by 1833 could observe that times had changed and uncertainty was reduced. Many large investments were being made without exclusive charters. So perhaps the lesson is that monopolies have their place but you have to know when to abolish them. Some African countries seem to think the time is now, but that doesn't mean that they were always a bad idea, or some won't be again. Many of the state firms have monopolies and when these are privatized the state will have to decide if the continued monopoly serves any public purpose.

A bridge is a specific asset and thus investors are exposed to losses from the opportunistic behavior of its customers and in this case the government which allows

construction of a competing bridge. Without safeguards, we would predict that only general purpose technology will be used [Williamson 1985]. Stick to wooden rafts. A contract could have been written to explicitly define the limits to competition. But the problem is that because of fundamental uncertainty, contract is necessarily incomplete. The alternative is hierarchy. The private investor does not have the option of buying the government, but the government could build bridges as a public enterprise. Then it would allow competition whenever the profits of all bridges exceeded the loss to any undepreciated immobile assets in the old bridge. But remember we are talking about an underdeveloped country and now the International Monetary Fund would discourage this drain on the public budget. And, the practical political problem today is that the prime minister's wife owns the first bridge and wants to keep on earning profits forever.

The incomplete contract can be seen as a framework for negotiation wherein the parties will live and let live to maintain themselves as going concerns. Thus they will privately govern themselves. But if the Charles River bridge owners don't want to compromise, the court is the arbiter. The court can explicitly choose the development path and decide when to allow competition and new technologies in what Schumpeter called creative destruction. Or it can duck behind legal principles. It can maintain that the charter is a sacred contract but then say that since the exclusivity wasn't spelled out, the government can grant another one. Or it could have said that the exclusivity was implied.

Economies of scale and specific assets create huge coordination problems for developing countries who want to start up a new industry. Suppose a firm thinks it might be able to compete in world markets for sugar. It needs a large plant with economies of scale. It needs to be assured that a sufficient number of farmers will grow sugar to satisfy its volume requirements. And because of specific assets, it can't have farmers changing their minds before the factory's capital assets have been recovered. It might try contracts and hope that it has thought of every eventuality. But contracting costs would be high. And because of risks, it may be hard to persuade enough farmers to accept a contract. And, of course, the sugar plant cannot accept the possibility of a competing plant. So the government of Indonesia required farmers to grow sugar. If they didn't plant sugar, the refinery could plant sugar on private land with their own hired labor. The farmer can't suddenly decide to grow vegetables because of price changes.

Similar arrangements occurred in contemporary Kenyan tea and sugar. The Tea Act gives the Tea Development Authority legal rights to take over the land under tea if the grower neglects it. [Buch-Hansen and Marcussen 1987, 541 and Bates 1989]. With respect to sugar, the state preferred a contract farming pattern but the management firm "did not trust the farmers' capacity to deliver a constant and sufficient quantity of care to the factory and hence demanded a nucleus estate run by the factory [Bates p. 542]. Management had a preference for estates and large scale farmers while the state preferred small scale contract farmers. "If the contract farmers do not carry out their obligations, they receive a warning. If the job is still not done, the company will have it done and charge the farmer for the service." [Bates, 544]. This requires concurrence by the state.

It is not reasonable to expect this all to happen incrementally via private governance. If the state wants small scale contractors it will have to supply the safeguards or the factory will utilize integrated estates with wage labor, if it is legal. As Robert Seidman [1968, 542] puts it, "The state, by enforcing private agreements, lends its reserved monopoly of violence to enforce the norms agreed upon by the parties to the interchange (and) since every decision-making function is necessarily value laden, the state is not and cannot be a value neutral arbiter." Private governance is not the way Japan, Singapore, Taiwan or Korea did it, but that's another

story [Amsden 1989; Rausser 1990; and Solo 1991, Ch. 4]. Privatization is a nice slogan, but anyone who believes it may fail or be an unwitting partner to a particular growth and distribution pattern.

Commercial Law

After a country has chosen to be a market economy there are many more choices to make. For example, when a contract is broken and an appeal is made to the courts, a choice must be made between expectation damages and reliance damages, rules must be defined about what constitutes an offer and its acceptance, what constitutes a material breach of contract, rules of interpretation, and for formal requirements like recording and writing of contracts. Governments must decide whether to regulate the substantive terms of some contracts through usuary laws, statues of fraud, implied warranties, enforcement of perpetuities, etc.

Contract law is what parties turn to when they think the other party has not lived up to the contract. This is where they learn what their words really meant. Contract law is what prevails if a particular matter at issue is not explicitly mentioned in the contract (from lack of certainty as to what to include or whatever reason). When trade was stable and prices customary, the American court could assume that all contracts implied the customary price and could enforce its payment according to its standards of justice regardless of the prices named in the contract. As markets became speculative, there was no natural price. This is going to be a new experience for many countries.

Modern markets are transactions in the present based on subjective future expectations [Lowry 1973]. When one party's expectations are thwarted by non-delivery of contracted for goods, the loss is not the price at the time of contract but the price at the time of delivery--which supposedly is what the buyer had in mind. Horwitz [1977, 169-70] observes that enforcement of executory contracts was rare until the 19th century. In Muir v. Kay⁷ [1787] a buyer of tobacco sued for non delivery and the seller counter sued for payment. The court would not enforce the contract because the buyer had not yet paid. Supposedly, the buyer could pay and then sue for damages for non-delivery. But what would be the basis for damages? In the fast moving world of modern commerce, the tobacco may already have been sold to a third party before the physical delivery date. It was not until 1790 that an American court said "Whenever a contract is entered into for the delivery of a specific article, the value of that article at the time fixed for delivery, is the sum a plaintiff ought to recover" (Davis v. Richardson)⁸.

English and early American courts sometimes voided contracts for lack of consideration. This meant that the court could substitute its own conception of fair value for the amounts stipulated in a contract. Horwitz argues that this substantive standard for price had to be abandoned in the modern world of speculation and executory contracts. So the courts invented the "will theory" of contracts. It would just execute the wills of the parties. But since wills are subjective, all that can be seen is the words of the contracts. The courts are the arbiter of what these words mean and of what was implied to cover an eventuality not anticipated. The active role of government can not be escaped.

The meaning of the words in a contract can only be known by reference to custom. Thus custom was reintroduced to determine intent of the parties. But if meaning is to be found in local custom, it makes long distance trading impossible. So a law broader than local custom was necessary. We will see below that starting in 1842 the Federal Courts began to enforce a national conception of commercial law and restricted state law. This will be especially difficult in Africa where the boundary of custom and nations are often not the same.

There are as many laws as there are ways for people to bother each other. The possibility of a minimal night watch man state is a myth. Pick up any commercial law book such as P. S. Atiyah's The Sale of Goods and one is impressed by the variety of ways that people do bother each other. Consider just one example. What governs the right to reject goods as not conforming to the contract? Assume A agrees to sell peas to B, but delivers beans instead. In the meantime B sells to C without inspection. Can B or C have recourse to A? Can the contract be repudiated, payment denied, or if already made, can they get their money back or just sue for damages, and how will damages be computed? Karl Llewellyn [193] describes the evolution of warranty of quality as the English speaking world evolved from the caveat emptor or horse trading to modern markets with more liability upon sellers in a marketing chain. What has this to do with Mali? It is going to be difficult to refer to capitalist custom where markets have been illegal. And if the custom of England, France, or Germany is used does it fit where developing countries want to go, if indeed they have thought about where they want to go other than they want to be rich like the West. If America had to reject parts of the English common law to fit its situation and objectives, does Mali have to reject some of the French commercial code? Do modern western laws work in the areas of illiteracy and few paper records of commercial transactions? The common law is usually fashioned to fit a country's situation although still choosing among interests to serve.

Consider the case where a party has a contractual obligation to pay for a previously delivered good at a certain future time. The party owing the money may know that the provider of the good is near insolvency and therefore might accept partial payment because they could not wait until the court could hear a suit for contract enforcement and damages. U.S. courts up to the 1950's supported these contract modifications and offered the rationale that the insolvent party had the option of turning to the credit market to tide the firm over until the court could enforce the original contract (Teeven 1990, 306.) Whatever merit this argument had in the U.S., it seems less relevant in a developing country where capital markets are less efficient.

Many contemporary surveys of African traders discover many complaints about delays in payments and complicated payments procedures [Kingsbury 1989, 174]. Further research is needed to discover what if any legal changes might reduce these transaction costs. Reducing legal barriers to trade is easy in concept although difficult in political practice. But finding laws which enable and support traders in lower cost transactions requires both conceptual and empirical research.

The availability of efficient insurance markets is another example of where contract law may influence development. Take the case of a builder whose work is destroyed before completion through no fault of his own. Eighteenth century U.S. courts often ruled that the builder had absolute liability and need not be paid for incomplete work (Gilmore 1974, 77-79). Toward the end of the century, the courts fashioned exceptions which had the effect of loss sharing. The issue became moot when insurance became common practice, but the reduction of risk via loss sharing may still be instrumental in countries where insurance markets are not available to small craftsmen. Process counts as much as nominal law.

It would be useful to compare Sagay's Nigerian Law of Contract with Atiya's English law. The discipline of law and economics claims to be able to label laws in terms of their efficiency and thus contribution to economic growth [Cooter and Rubinfeld 1989]. All that can be said here is that the discipline is mostly deductive and not much is available of an empirical nature for the West or the East [Mahoney 1977, Mead 1984, Nee and Young 1991, Snyder 1981].

Negotiable Instruments, Credit, and Money

Person A agrees to give B a quantity of goods or sum of money at some future date. B in turn endorses this IOU and uses it to pay C for some service, and so on. Is this legal, and if A defaults can C have an action against A or any of the other endorsees? In a cash short economy, the negotiability of debt substituted for money and greatly increased its velocity [Lowry 1973]. But American states were divided in their attitude toward negotiability. One of the concerns was that if person A had good reason to repudiate the contract with B, was that good reason now lost because of C's need to be able to rely on the second hand IOU. The needs of long distance impersonal trade had to run over a few individual problems in the way.

The Federal courts did not establish the notion of a general commercial law being able to override state laws until the 1842 case of Swift v. Tyson.⁹ And after many fits and starts it was as late as 1879 that the U.S. Supreme Court held that a Mississippi statute limiting the negotiability of bills of exchange was a violation of general commercial law [Oastes v. National Bank,¹⁰]. The court employed the concept of a "declaratory" theory of law that courts simply discovered and declared pre-existing rules. It is supposed to have reflected what Justice Holmes called the view of law as a "brooding omnipresence in the sky." But Justice Story's treatise of 1834 had already noted that incompatible legal rules among the states reflected differences in social objectives and were not merely errors of logic. [Horwitz, 246]

What is the relevance to Mali? Are cereal traders' IOU's used as money? Banks do loan money based on warehouse receipts, but could the receipts themselves be negotiable among individuals? Is the problem one of grades and reliable warehousemen, attitude toward paper, or the law of negotiable instruments? These are candidates for future research.

Much agricultural economics literature has been written about credit problems in developing countries [Weerasooria 1973]. Every merchant sees new opportunities if there just were more credit. What is credit? For one thing it is a substitute for cooperation. Suppose a cereal trader in Mali is aware of supplies in farmers' storage bins and opportunities for delivery in Bamako. To buy from the farmer requires credit. To buy trucking requires more credit and so on for all the participants. But if all these people were one integrated firm, they would all wait for sale of the goods in Bamako. A family work team does not demand payment at the time of individual performance.

If in the process of market and monetary reform a credit crunch occurs, firms risk insolvency and can't pay their bills because they have not been paid in turn by their customers. In this context, the rules for trade in negotiable instruments may be especially relevant.

The Submergence of Politics into Rational Law

When Hernando De Soto [1989] pretended to set up his clothing factory in Peru he faced a lot of government barriers. But he understands that a lot of liability law and regulation is someone's right to be free of losses due to the actions of others. Some of the regulations are there to provide safety to workers and consumers. These are good objectives for many people, though I have raised the question of whether poor countries can afford them. But in any case these good objectives frequently go wrong and become excuses for bureaucrats to extract bribes or slow things down. The modern welfare state is difficult for a poor country to manage. De Soto recommends that his country "replace the state's regulatory control of the economy by control expressed in judicial decisions. It means granting access to the market to all citizens and extending facilitating legal instruments to all. It means increasing the proportion of available resources so that the state can do what private individuals cannot do well. Last, it means delegating to informal organizations the responsibilities they can best meet." [p. 250] These are

worth consideration, but difficult in practice. Even where the formal law is adequate, making it accessible to small firms is another matter.

Horwitz notes the rise of the legal profession in early America. It strove to replace the haphazard unpredictable judgements of juries with rational reasoned principles. He argues that the law became increasingly formalistic after 1850. One expression of formalism was to allow common carriers to escape liability by notice. If the transport company put up a notice saying it accepted no liability this was interpreted as a contract between the company and the rider. The Supreme Court thus allowed escape from the common law in 1848.

Another expression of formalism was to allow employers to contract out of common law liability for workplace injury. No court cases of workplace injury occurred before 1840 because apprentices were considered family. But railroads created more impersonal employment. The case of Farwell v. Boston and Worcester R. R.¹¹ let employers escape their common law responsibility. Horwitz [1977] believes that contract ideology emasculated concepts of substantive justice and "the law had come simply to ratify those forms of inequality that the market system produced." [210] Or to put it differently, trade within one's opportunity set does not indicate the legitimacy of the set. The courts both facilitate trades within the set and inevitably confirm or change the set. So the court did not escape the question of just price, it confirmed a particular one. A worker or rider was in a weak bargaining position with a corporation. One answer was the union. And the law had to decide if it was a damnable conspiracy or approved collective action. Another functionally equivalent alternative would have been to retain common law liability. Government is equally present either way. What will Africa choose?

Does De Soto's suggestion that the courts replace direct governmental administration of health, safety and other objectives mean less government and an escape from politics to rationality? Horwitz suggests that there was an alliance during the 19th century between U.S. lawyers and commercial interests to replace popular politics with an apparently rationalistic court process. Maybe this process fooled the losers who could not have been beaten in the legislature. Maybe De Soto will fool the losers in Peru and get the IMF off the government's back. Maybe the judges will not just replace the old bureaucrats with their hands in the till. And maybe history will declare it all in the public interest. But, current policy makers should not be fooled. The size of the government budget is not an adequate measure of the role of the state in choosing among competing interests and promoting a particular kind of development. Many U.S. state's budgets were constant while the roads, canals and mill dams were built, but many of the costs were shifted around as the micro institutions of the common law of property and contract were changed.

Policy makers in Africa will miss a unique opportunity if they fail to see that there is more than one kind of possible market and that efficiency follows from the choice of property rights which shape what kind of development occurs. When there are prohibitions to trade it is easy to prescribe their removal. But when there are conflicts among traders whose selective resolution shapes the path of development, the intellectual task is more difficult. It is not a matter of getting rid of bad law, but the selective creation and empowerment of new opportunities and enablements--helping people do things that they cannot do by themselves. It cannot be done on some abstract legal or economic principles, but involves the political working out of what kind of society and economy a people want.

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Notes

1. Modern literature speaks of rent seeking and condemns it. The problem with this concept is that people have always sought surplus and the decision of which payment is non-productive and which is reward and incentive for approved behavior or legitimate income distribution is a matter for collective choice, not analyst discovery (Samuels and Mercurio 1984).
2. 3 Cai. R. 307 (1805).
3. 49 Mass (8 Met.) 466 (1844)
4. 8 Dana 289 (Ky. 1839).
5. 9 Johns. 507 (N.Y. 1812).
6. 7 Pick. 344, 456 (Mass. 1829).
7. 1 Papers of John Marshall, 215-18 (H. Johnson, ed. 1974).
8. 1 Bay 105 (S.C. 1790).
9. 16 Pet. 1 (1842).
10. 100 U.S. 239 (1879)
11. 45 Mass. (4 Met.) 49 (1842).