

**PRÁVO A EKONOMIE:
JE PRÁVO JEDNÍM Z HLAVNÍCH FAKTORU
OVLIVŇUJÍCÍCH CHOVÁNÍ EKONOMIKY?**

**LAW AND ECONOMICS:
IS LAW ONE OF THE MAIN FACTORS DETERMINING THE
PERFORMANCE OF AN ECONOMY?**

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ABSTRACT

The article analyses the relationship between law and economics through the insights and tools of economic analysis of law as a specifically developed field of study. The aim is to further discuss the topic and provide answers as well as further questions concerning the relationship between the two fields of study. In order to do that the methods of analysis, synthesis and deduction are used. The article is divided into introduction, then another part is devoted to the role of R.H.Coase in establishing the relationship and measuring the impact of one field upon another. Then some further developed theories of economic analysis of law are discussed. The conclusion then provides some further insights into the current state of research and its application as well as the possible flaws as well as proposals for future development. Nevertheless there is no doubt that it would be very beneficial for all concerned (economists, lawmakers, governments, society...) if it was possible to directly or indirectly measure the impact of law on the economy. The question is to what extent or if this is at all possible as well as the fact of usefulness of measurements that are not precise enough to copy the reality.

ABSTRAKT

Článek analyzuje vzájemný vztah mezi právem a ekonomikou pomocí vědeckých metod a nástrojů ekonomické analýzy práva jakožto speciálně vyvinutého vědního oboru. Cílem článku je hlubší diskuse daného tématu a poskytnutí odpovědí, stejně tak, jako dalších otázek týkajících se vzájemného vztahu těchto vědních disciplín. Je tak učiněno pomocí vědeckých metod analýzy, syntézy a dedukce. Článek je rozdělen do úvodu, další částí je pak samostatná kapitola věnující se roli R.H.Coase ve vývoji nahlížení na vzájemný vztah mezi právem a ekonomikou a měřením vlivu jednoho vědního oboru na druhý. Poté jsou analyzovány další teoretické aspekty ekonomické analýzy práva. V závěru jsou diskutovány výsledky současného vědeckého bádání stejně jako nedostatky současného stavu spolu s návrhy dalšího vývoje. V dnešní době je nepopíratelný přínos všech zúčastněných (ekonomů, právníků, vlády, společnosti...) z možného přímého nebo nepřímého měření vlivu práva na ekonomiku. Je však otázkou do zda vůbec a do jaké míry je toto vůbec možné stejně jako případný přínos teorie a měřitelných výstupů s ní souvisejících, která však nekopíruje danou realitu.

I. INTRODUCTION

There is no doubt about the fact that a lot has been said, written and discussed between the two sciences. The fact that in the centre of both is the individual, society consisting of indi-

viduals makes them both social sciences along with others and there is no doubt about a two way interaction between the two. Establishing the fact of superiority, inferiority or equality is another matter though. This very much depends who provides the answer and from what angle the relationship is looked at. The answer of an economist would be very different to the answer of a lawyer. On the theoretical level it might be possible to find a compromise though I believe deep down an economist would no doubt carry on viewing the law rather as an inferior tool that helps the economy on its way. Just as the lawyer would not change his mind about the superiority of the law without which the economy would not exist at all because it would be just too chaotic. The fact that they discuss and try to find a united approach and to work together seems to be the crucial outcome of that and perhaps one day these two fields might be able to walk along hand in hand to the large benefit of everyone, the whole society.

One thing that both these fields have to face together though is the fact that it is the individuals, people that they deal with. And this makes these two sciences in my opinion extremely vonurable because people change their minds, people change attitudes and generally human behaviour is not that easy to predictable at all as both these fields of study would need them to be. This is why sometimes it is necessary to use the findings of psychology to provide some answers though yet again that helps to cover possible alternatives but still leaves space for unpredictability. But what is the human factor with which it being delt.

The fact that there are many economic theories that are meant to help to predict future development of the economy and hence the socio-ecomomic part of the society is well known. The fact that though being applied to reality the actual usefulness for the reality and some sort of economic management of the near and far future is debatable though.

The relationship between law and economics is a matter which can be debated with much fervour. However there is an agreement with regard to two principles. First, economic analysis is at least politically significant to the lawmaker. And second, economic analysis is at least legally significant for those applying the law, to the extent that the law stipulates economics are the standard.¹

Should we look at the relationship from the economic point of view we would find out that in economic theory, there is such a thing as resources that generally cover three categories called labour, land and capital and that these are limited and any type of economic good that results from use of either of them or combinations of them is therefor scarce. On the other hand there is such a thing as needs, wishes and these are unlimited. Hence in economics it all comes to the core question of how limited resources can be distributed so as to be able to meet existing needs as efficiently as possible.

In the context where the resources found at the disposal of society are limited, some of them on the verge of extinction even, economy has been defined as the science of reasonable choice and studies the way in which a person or a group of people use the limited resources to the end of satisfying its own needs.²

The underlying idea is that an efficient allocation of resources adds to the prosperity of society as a whole. And vice-versa. Should there happen to be such a thing as an inefficient allocation of resources, society as a whole loses or lessens its prosperity. For an economist this is then where the law comes in. The law is there to help the most possible sufficiency in allocation of a scare resource. Well in theory anyway.

¹ HARTMAN, B., J. Perspectives on the Economic Analysis of Public Liability Law. *Journal of European Tort Law*. p.377-378.

² Same source of information..

On the other hand if we looked at the relationship from a legal point of view we would find that the idea of existence of complex factors that influence law has begun forming along with the first theories regarding the evolutionary, changing nature of law. There have been movements that considered the problem of material sources of law to exceed the area of legal science therefor denying the existence of any factors that would influence the will of the legislator. Admitting the existence of some configuration factors of law equate the recognition of the existence of certain social sources of law and represents a condition for understanding the birth process of legal regulation.³

Should we look at the law, its origins and factors influencing them we would find that economic life and social-political life are considered by many authors as necessary factors in understanding the essential traits of law and consequently as having a considerable weight among the configuration factors of law.⁴

Hence economics and an economy is then yet another factor that influences the development of the study. On the other hand it has to be said that there are no other legal evolutionary factors which have been discussed and analysed more attentively than economy.

The reason for this interest is that there are extremely tight connections between legal and economic life. The economic analysis of law has been initially pointed towards areas of private law (trading companies, competition, intellectual property) and later on this scope was extended to family law, criminal law, taxation, environmental pollution etc.⁵

The relationship between law and economy can be looked at from several points of view. Law might be looked at as a tool to carry out a certain economic policy in those cases where law intervenes in the relations between social behaviours, organizations and politics. There is also the question of law in the liberal economy as well as the above mentioned inter connection where the law is shaping the economic system through the policies it implements and sustains but vice versa the economy has in my opinion also influenced the legal order and analyses or tries to analyse law by measuring its efficiency as well as trying to react to current economic situations.

With the onset of legal positivism the independence of law from other spheres of social life mainly politics and economy has risen. In this context a question of how this legal independence could be used and taken advantage of in order to influence the process of globalization.⁶

The purpose of the economic analysis of law is to establish the efficiency of legal institutions and rules by applying instruments of microeconomics. Economic analysis of law begins from the assumption that law is an instrument and the efficiency of this instrument is sought out to be measured and established. Yet again it is clear that it was originally looked at the system from an economist point of view and that the economists were in search of answers to their questions hence necessity to measure efficiency etc. As a result though the law is no longer viewed as a tool to force a desired behaviour and forbid the undesired one. And the validity of such law is measured in the light of the results desired by the legislators.

But should law be primarily concerned with promoting economic efficiency as mentioned above in connection with limited scarce resources and unlimited wishes waiting to be fulfilled?

The modern field of the economic analysis of law dates back to the 1960s. Until then economics was thought relevant to only a few fields of law – all commercial law and tax law. By the end of 1960s economics was understood to be relevant to the entire domain of the law.

³ Same source of information.

⁴ KAJSCA, A., The role of economy as material source of law. *Current Juridic*. p.57.

⁵ Same source of information.

⁶ ČERVENÁ, K., ČIPKÁR, J. *Ekonomika, politika a právo v kontexte súčasnej globálnej krízy*. In: Právo, obchod, ekonomika II. Praha: Leges, 2012. p. 393-409 ISBN 978-8087576335

Relevant both to understanding the law, that is the positive analysis, as well as to reforming the law, that is the normative analysis. The evolution of law and economics has been shaped by a number of forces such as an increased matematization of economics, the increased availability of statistical data usable in empirical analysis, broadening of the scope of economics etc. There is also need for economic analysis of law, whether the researchers are economists, lawyers or lawyer-economist.⁷

The economic analysis of law as developed by the Chicago school in the early 1960s can trace its origins to various proceeding theories that shaped the western legal thought long before concepts such as market economy, efficiency, transaction costs and law as an instrument for promotion of economic efficiency. The impact of this field of study that pursues to measure the efficiency of legislation and court decisions with conceptual tools provided by economics has not been negligible in common-law systems, mainly in USA, its country of origin. The latest spin-offs of the economic analysis can be found in the comparative law field, namely in the legal origins theories, that link economic performance to certain characteristics of a legal system, implying that some systems are better suited to economic development than others.⁸

II. THE ROLE OF R.H.COASE IN ESTABLISHING THE RELATIONSHIP BETWEEN LAW AND ECONOMICS

1. R.H.Coase and some of his thoughts

*„What I wanted to do was to improve our analysis of the working of the economic system. Law came into the article because, in a regime of positive transaction costs, the character of the law becomes one of the main factors determining the performance of the economy“.*⁹

Here it can clearly be seen that the working of economic system was at the centre of Coase's attention but also it can be seen that that can not be done without considering the legal framework, and legal regulations. This is one of the reasons why I have chosen R.H.Coase and his views to demonstrate the relationship between law and economics as throughout his work the connection is analysed, determined and taken into consideration.

*„Economists commonly assume that what is traded on the market is a physical entity, an ounce of gold, a ton of coal. But as lawyers know, what are traded on the market are bundles of rights, rights to perform certain actions. Trade, the dominant activity in the economic system, its amount and character, consequently depend on what rights and duties individual and organizations are deemed to possess-and, these are established by the legal system. An economist, as I see it, cannot avoid taking the legal system into account.“*¹⁰

I believe that one can not but agree with what Coase put into words. The legal system has to be taken into consideration as it no doubt affects the performance of an economy. But in what way? How? When do for example property rights have a positive effect on the economy and when is the effect negative? When any legal regulation becomes a drive for the economy and when is it a drawback? How does it work and do the policy makers consider the impact of the newly established legal regulation, is it at all possible to predict the impact? How do we know if there are too much or too little regulation?

⁷ POSNER, R. A., BECKER, G. The future of law and economics. *Rev. LawEcon*. p.235-236.

⁸ POPA, M.F. The academic analysis of law- will the Romanian doctrine finally catch up with it? *Challenges of the knowledge society*. p. 597.

⁹ COASE, R.H. *Law and Economics at Chicag*, 36 J.L. & ECON. 239, 250-51. (1993).

¹⁰ COASE, R.H. *The 1987 McCorkle Lecture:Blackmail*, 74 VA.L.REV. 655-656. (1988).

„As I see it, progress in understanding the working of the economic system will come from an interplay between theory and empirical work. The theory suggests what empirical work might be fruitful, the subsequent empirical work suggests what modification in the theory or rethinking is needed, which in turn leads to new empirical work. If rightly done, scientific research is a never-ending process, but one that leads to greater understanding at each stage.”¹¹

It seems that understanding the economy, the interaction between economy and law and perhaps understanding generally seems to be a constant process, in which one always has to look back and forth, rethink, change, modify, take into consideration and so on but a process that hopefully leads to a greater knowledge of what is.

„We do not know, for the most part, what is true or what is false, what is significant and what is not, nor the character of the interrelations of various parts of the institutional structure of the economy. It is our aim to find out.”¹²

2. R.H.Coase and his work¹³

A paper cited by the Swedish Academy when awarding Coase the Nobel Prize was *The Problem of Social Cost* (1960). He wants to know why certain scarcity requires government regulation, whereas for other scarce means, the price mechanism is used. Coase argues that the absence of property rights blocks the use of the price mechanism to allocate the scarce resource to its highest bidder. At the same time, in a zero-transaction-cost world, all welfare effects, side effects included, will be traded efficiently. This idea is what economist George Stigler (1911-1991) termed the Coase theorem. Assignment of property rights may reduce transaction cost and induce trade, for example, in externalities.

Coase's position is that a transaction cost is positive, underlining that this cost profiles economic transactions and their accompanying social arrangements. Otherwise, economic theory may result in what he calls blackboard economics that is formulating economic theory without taking account of information problems. Coase had a coherent view of the economic system, which he owes to his London School of Economics master Arnold Plant (1898-1978), who he claims introduced him to Adam Smith's invisible hand.¹⁴ Coase shows the normal working of the economic system in the light of transaction cost.

Some of the terms that were actually introduced by either Coase himself or his followers are rather significant and help understand and get a better grasp of the relationship between law and economics.

The terms that need closer attention are the following:

¹¹ COASE, R.H. *The Conduct of Economics: The Example of Fisher Body and General Motors* (2006) – see <https://www.coase.org/aboutronaldcoase.htm>.

¹² Same source of information.

¹³ Compare with http://www.encyclopedia.com/topic/Ronald_H._Coase.aspx

¹⁴ Adam Smith introduced the term „invisible hand“ in his 1776 book "An Inquiry into the Nature and Causes of the Wealth of Nations" where he states:

"Every individual necessarily labours to render the annual revenue of the society as great as he can. He generally neither intends to promote the public interest, nor knows how much he is promoting it. He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for society that it was no part of his intention. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good."

Thus, the invisible hand is essentially a natural phenomenon that guides free markets and capitalism through competition for scarce resources. – compare with <http://www.investopedia.com/terms/i/invisiblehand.asp>

Transaction costs

Transaction costs refer to the costs involved in market exchange. These include the costs of discovering market prices and the costs of writing and enforcing contracts. Transaction cost economics, as developed primarily by Coase, suggests that economic organizations emerge from cost-minimizing behaviour which includes transaction costs in a world of limited information and opportunism.¹⁵

Coase argued that without transaction costs the initial assignment of property rights makes no difference to whether or not a farmer and a rancher can achieve the economically efficient outcome. If the cost of restraining cattle by, say, building a fence, is less than the cost of crop damage, the fence will be built. The initial assignment of property rights determines who builds the fence. If the farmer is responsible for the crop damage, the farmer will pay for the fence as long as the fence costs less than the crop damage. If the rancher is responsible for the crop damage, the rancher will build the fence. The allocation of property rights is primarily an equity issue, with consequences for the distribution of income and wealth, rather than an efficiency issue.¹⁶

Coase Theorem¹⁷

Coase Theorem represents a legal and economic theory that affirms that where there are complete competitive markets with no transactions costs, an efficient set of inputs and outputs to and from production-optimal distribution will be selected, regardless of how property rights are divided. Coase theorem asserts that when property rights are involved, parties naturally gravitate toward the most efficient and mutually beneficial outcome. It also states that where there is a conflict of property rights, the involved parties can bargain or negotiate terms that are more beneficial to both parties than the outcome of any assigned property rights.

The theorem also asserts that in order for this to occur, bargaining must be costless; if there are costs associated with bargaining such as meetings or enforcement, it will affect the outcome. Basically this brings us back again to the necessity of no transaction cost in this case in the form of costs associated with meetings or enforcements. It shows that where property rights are concerned, involved parties do not necessarily consider how the property rights are granted if they can trade to produce a mutually advantageous outcome.

Externalities¹⁸ and taxes

The concept of externalities refers to costs imposed or benefits conferred on others that are not taken into account by the person taking the action. Some economists such as Pigou would have argued that the existence of externalities is sufficient justification for government intervention. If someone is creating a negative externality, such as pollution, for instance, the producer is engaging in too much of the activity that generated the externality as a by product. Pigou advocated a tax on such activities to discourage them. On the other hand for someone creating a positive externality Pigou would have advocated subsidies for activities that created such positive externalities. These are now called Pigovian taxes and subsidies.

Pigou's analysis was accepted until 1960, when Ronald Coase showed that taxes and subsidies are not necessary if the people affected by the externality and the people creating it can easily get together and bargain. Adding to the skepticism about Pigou's conclusions is the new view, introduced by public choice economists, that governments fail just as markets do.

¹⁵ <https://stats.oecd.org/glossary/detail.asp?ID=3324>.

¹⁶ Compare with: http://en.wikipedia.org/wiki/Ronald_Coase as argued in the Problem of Social costs.

¹⁷ Compare with: <http://www.investopedia.com/terms/c/coase-theorem.asp>.

¹⁸ Compare with: <http://www.econlib.org/library/Enc/bios/Pigou.html>.

Nevertheless, most economists still advocate Pigovian taxes as a much more efficient way of dealing with pollution than government-imposed standards.

Property rights

An inefficient allocation of resources might emerge in case of externalities. These can arise if a decision-maker, in making his decision, disregards the costs and benefits which his decision will produce in relation to the third parties. Turning third-party costs and benefits into costs and benefits for the decision-maker thus helps to prevent misallocations and possible liability claims for damages.¹⁹

III. LAW AND ECONOMICS

Common law is one of the areas of law in which Coase saw the interaction between law and economics, one of the areas to which he devoted his research. He argued that the existence of a market solution means that the government should not get involved. On the other hand Cheren believes that „*Coase is wrong to argue that it is foolish for the government to handle problems that the market can handle. Whether it is by operating post offices and lighthouses or by resolving conflicts among neighbours or by acting merely because the government can.*”²⁰

That brings us to the question of the role of government as a policy maker and a provider of legal framework for the economic system. The role of the government as represented by individuals can be discussed from several points of view. The question to which extent the policy makers and creators of various legal acts are actually acting in the pursuit of prosperity of the whole system and to which extent they tend to pursue their own goals. So in a way it is not only a question of interaction between law and economics in order to reach prosperity as a whole, it is a question also involving politics. And yet again it is the individual human being that is in the centre of the system.

According to Cheren²¹ Coase's analysis of the common law arguing that common law courts and governments act to solve problems if and only there are both externalities and sufficient transaction costs, is unsound and incomplete. He believes that the existence of both externalities and prohibitive transaction costs is neither a sufficient nor a necessary condition for government action. Cheren goes further and quite bluntly asks: „*What then is the theory worth? What is a vending machine worth if it accepts counterfeit and rejects genuine notes?*”²²

Well, in a way this is very difficult to argue with. I would myself be inclined to feel the same as Cheren as I often ask myself what is a theory worth if it does not copy the reality and hence is useless for further predictions either due to the insufficient input due to the amount of variables or simply the condition so often used in economic theories called *ceteris paribus*. In my opinion in real life everything changes.

On the other hand Cheren admits that Coase's work is venerable and has formed a pillar of the law and economics movement. But a theory of government that is broken is neither sound nor complete it is a broken theory and must be rejected. Some would argue that it is worth modifying Coase's economic analysis in order to maintain its place in legal scholarship. But in Cheren's opinion that would still leave the problem of the analysis's failure to justify inef-

¹⁹ HARTMAN, B., J. Perspectives on the Economic Analysis of Public Liability Law. *Journal of European Tort Law*.p.377.

²⁰ Compare with CHEREN, R.D., *Tragic Parlour Pigs and Comedic Rascally Rabbit: Why Common Law Nuisance Exceptions Refute Coase's Economic Analysis of the Law*. *Case Western Law Review*.p.596-597.

²¹ Same source of information.

²² CHEREN, R.D., *Tragic Parlour Pigs and Comedic Rascally Rabbits. Tragic Parlour Pigs and Comedic Rascally Rabbit: Why Common Law Nuisance Exceptions Refute Coase's Economic Analysis of the Law*. *Case Western Law Review*.p.596.

ficient yet legitimate government action and Coase's staunch position that government should never act needlessly, regardless of the effect of action on its power to handle other problems. Cheren says that : „*However attractive it may be to save Coase by fixing his economic analysis for him. It is not worth the trouble.*”²³

IV. CONCLUSION

In this article I have tried to look closer at the relationship between law and economics through both using the tools and findings of a relatively new field of economics called The economic analysis of law and bring up some of the issues concerning the theory and research. On the other hand as stated above there can be found those who do not consider those findings relevant at all. For example

Schlag²⁴ believes that though Coase enjoined us to include law and legal regimes within the study of the economic system he had not provided an economic theory in which it would have been possible. He argues that: „*The neoclassical economics does not have any tools to do that.*”²⁵

He also states the following concerning the matter²⁶:

- 1) Law provides no uncontested or uncontroversial theory as to the effects or ideals of various legal regimes. Law certainly does not arrive on the scene with any adequate theory of its own explaining its (economic) architecture or effects.
- 2) As a formal matter, legal regimes are highly differentiated. The possibilities for decomposing and recomposing any given legal entitlement are numerous.
- 3) In practice, legal regimes are generally neither discrete nor additive in terms of their target domains. They are instead overlapping. Any given economic transaction might be susceptible to regulation by any number of bodies of law (e.g. property, tax, environmental, tort etc.).
- 4) A proper identification of the functions and optimalization of any given legal regime depends upon the identity and functions of neighboring, overlapping, re-enforcing, competitive and antagonistic legal regimes.

As to his first point one can not but agree. On the other hand if one looks at the interaction between the two from the point of view of economics, it is not the problem of the law. Law I believe is there to help the economy, it certainly can not be expected to come up with calculations and mathematical and statistical methods to derive its impact on the system. That I believe should be quite rightly done by the economic theories.

Schlag²⁷ adds that given these difficulties there is no guarantee of even partial success. It may be that once the economic effects of legal regimes are included in the neoclassical model, the latter is deformed and contextualized out of theoretical existence, leaving us with no model at all. And this absence of theory is precisely Posner's²⁸ complaint against the old institutional economics.

Schlag then continues with looking separately at the economists and lawyers in light of his findings. He believes that if Coase was right, then it would have made sense for the neoclassical economists to reconsider their model in light of the effects of law and legal regimes on the

²³ Same source of information.

²⁴ Compare with SCHLAG, P. *Coase Minus the Coase Theorem- Some Problems with Chicago Transaction Cost Analysis*. Review. p.198-204.

²⁵ SCHLAG, P. *Coase Minus the Coase Theorem- Some Problems with Chicago Transaction Cost Analysis*. Iowa Law Review p.198.

²⁶ Same source of information.

²⁷ Same source of information.

²⁸ POSNER, R. *The New Institutional Economics Meets Law and Economics*. Institutional and theoretical econ. p.149 .

identity and costs of production factors. But he believes that the model is in despair. It is in the odd position of excluding the roles of law and legal regimes and yet requiring their inclusion for sound analysis. He²⁹ says that: „Given the situation, one would have hoped that neo-classical economics would begin to take the character and effect of legal regimes into account. One would have hoped for some theorization of the relative virtues and vices of legal regimes in terms of optimizing production. It is safe to say that this did not happen. As for the lawyers it might have been hoped that they would try to develop an economic theory of law that would accord law its own constitutive role in the performance of markets. Well they have tried but not quite succeeded but at least they tried.”³⁰

The property rights approach can also be easily criticized. Champeyrache argues that „It’s emphasis on the absence of transaction costs generates a biased and limiting representation of the relationship between law and economics. The Coase Theorem and its various interpretations dismiss the real world of positive transaction costs and therefore take for granted the neutrality of the initial allocation of rights in the economic system. The function of law is not even discussed per se; it is assessed only in economic terms of efficiency. The zero transaction cost condition and the negation of the identity-of-owner problem actually lead to a process of law neutralisation, which is both artificial and unsatisfactory.”³¹

Is it the case that we have a field of science without relative theory? Or might it be the case that law with all its fields could need a slightly different approach in each case? Well, the fact that it is acknowledged that there is a need for such a theory and that the current one might have flaws as is not sufficient may be viewed both positively as well as negatively. The absence or partiality is no doubt negative on the other hand the promotion of such vacancy with the stress of its necessity gives a lot of hope and opportunities for the future.

KEY WORDS

economics, law, economic analysis of law, interaction, economic system

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²⁹ SCHLAG, P.*Coase Minus the Coase Theorem- Some Problems with Chicago Transaction Cost Analysis*.Iowa Law Review p.198.

³⁰ Same source of information.

³¹ CHAMPEYRACHE, C., *The Assumption of Law Neutrality: Property Rights Theory Versus Legal-Economic Nexus*. OECONOMIA.vol.3.2013.p.391-419. ISSN 1010-8831.

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