

**‘CAPACITAS’: CONTRACT LAW AND THE INSTITUTIONAL  
PRECONDITIONS OF A MARKET ECONOMY**

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**Abstract**

Capacity may be defined as a status conferred by law for the purpose of empowering persons to participate in the operations of a market economy. This paper argues that because of the confining influence of the classical private law of the nineteenth century, we currently lack a convincing theory of the role of law in enhancing and protecting the substantive contractual capacity of market agents, a notion which resembles the economic concept of ‘capability’ as developed by Amartya Sen. Re-examining the legal notion of capacity from the perspective of Sen’s ‘capability approach’ is part of a process of understanding the preconditions for a sustainable market order under modern conditions.

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## 1. Introduction

The concept of *capacitas*, whose roots lie in Roman law, signifies a status conferred upon citizens for the purpose of enabling them to participate in the economic life of the polity. In modern legal systems, ‘capacity’ is the principal juridical mechanism by which individuals and entities are empowered to enter into legally binding agreements and, more generally, to arrange their affairs using the instruments of private law. The legal concept of capacity is thereby the gateway to involvement in the operations of a market economy. In its traditional form, originating in the ‘classical’ contract law of the nineteenth century, capacity is defined negatively, that is to say, by its absence: the very young, very old or very ill are deemed, to varying degrees according to particular contexts, to lack the ability to make legally enforceable contracts. This is because they are understood not to possess the power to make rational assessments of their own self-interest of the kind required for market-based exchange. The concept of capacity is a doctrine of selective contract enforcement, which both protects the incapable from exploitation, but, equally importantly, protects the market against the incapable. In this way the classical core of contract law gives expression to a certain theory of the institutional preconditions of a market economy, albeit a rather minimalist one.

Incapacity is not the only occasion for invalidating contractual agreements made at arm’s length between consenting parties. Contract law recognizes that certain types of transaction can be denied contractual force on the grounds that they infringe particular values which, exceptionally, take priority over the value of freedom of contract. In the common law, these go under the heading of ‘public policy’, and their effect is to qualify the power to make binding agreements which is otherwise generally vested in economic agents. This body of law therefore offers fragments of a theory of functional limits to freedom of contract: these limits are necessary both to preserve the market against anti-competitive behaviour (as in the case, for example, of the doctrine of ‘restraint of trade’), and also to preserve society itself against the market (for example, the rules against the enforcement of certain illegal or oppressive contracts). These are no more than fragments, though; the common law notion of public policy is an extremely limited one which was frozen in time at the end of the nineteenth century. Social or regulatory legislation has become a far more significant source of contractual regulation. However, its relationship to the notion of contractual capacity is highly contested: does a law inserting mandatory or default norms into consumer or employment contracts constrain the autonomy of the contracting parties, with negative effects upon the operation of the market; or does it establish a new contractual equilibrium

which, by reducing transaction costs and reallocating risks, enhances efficiency?

Modern ‘law and economics’ analysis suggests that there is often no simple answer to that question. Nevertheless, the efficiency of social legislation as a mode of contractual regulation is increasingly being called into question. This is the consequence of the unraveling of institutional forms which were designed to for a world of protected national economies and stable economic relationships; the principal example of this is the conceptual ‘crisis’ affecting the institution of the employment relationship.<sup>1</sup> However, it unlikely that a simple return to private law, through ‘deregulation’, could offer a sustainable solution. This is because the classical or nineteenth century core of private law, to which deregulation promises to return us, offers an under-developed account of the basis for effective participation in economic life: this is one in which form – an idealised notion of juridical equality and contractual autonomy – prevails over substance – a reality of asymmetrical bargaining power and all-pervasive externalities. The problem is epitomized by the paucity of the modern legal concept of capacity and by the conceptual confusion surrounding this notion. In particular, we lack a convincing theory of the role of law in enhancing and protecting the substantive contractual capacity of market agents, a notion which resembles the economic concept of ‘capability’.<sup>2</sup> Re-examining the legal notion of capacity from the perspective of the economist’s ‘capability approach’ is part of a process of understanding the preconditions for a sustainable market order under today’s conditions.

To address that question, section 2 examines in more detail the implicit economic logic of the concept of capacity, explores its links to notions of individual rationality, and assesses the economic functionality of private law rules limiting freedom of contract. Section 3 then looks at the relationship between contractual capacity and regulatory legislation and section 4 considers the deregulatory critique against the insertion of mandatory norms into contractual relationships. Section 5 then addresses the following question: is it possible to identify the elements of a new concept of *capacitas*, one which goes beyond purely formal guarantees of market access, to encompass the conditions needed for effective participation in the complex economic orders which are now coming into being?

## 2. The economic logic of incapacity, public policy, and related grounds of invalidity in contract law

In civil law systems, contractual capacity is stated to be one of the basic conditions for the formation of a contract.<sup>3</sup> In the civil law, ‘capacity’ has two meanings, one referring to the ability to hold rights,<sup>4</sup> the other to the ability to exercise them.<sup>5</sup> Contractual incapacity is almost invariably an instance of second of these two categories. The capacity to hold rights, which is in effect a right to be treated as a legal subject and not as a mere object of legal relations, vests today in all physical persons from the point of birth,<sup>6</sup> as a result of the abolition of rules denying capacity to certain groups historically denied it,<sup>7</sup> such as married women. This is equally the position in the common law, where the formal distinction between the holding and exercising of rights is of no relevance. In all systems, the remaining grounds of incapacity are tightly defined; they mostly apply to agreements made by ‘minors’ (or ‘infants’), the very old, and those suffering from mental illness. The question of contractual capacity has been said to be of ‘reduced practical significance’ in the English law of contract; although not without some theoretical interest, particularly from the point of view of the interaction of contractual and restitutionary remedies, it is essentially treated as a footnote to the main body of the law of contract. The relative insignificance of the subject for English lawyers is compounded by the absence of certain complex rules of French-origin civil law systems, dealing with the circumstances under which lack of contractual capacity can be offset by assistance (*curatelle*) or representation (*tutelle*).<sup>8</sup> These have no equivalent in the English common law, and even some civil law systems, such as the German one, do not recognize the category of assistance.<sup>9</sup> In all systems, the effects of incapacity on a contract also differ according to context; complete nullity is only one option, others including voidability, while alternative remedies in tort or restitution may be available.<sup>10</sup>

The limited and diminishing practical significance of the concept of capacity in modern contract law should not however be confused with its structural significance within contract doctrine. Indeed, there is case for saying that it is still at the core what is meant by a contractual obligation. A simple exchange, even between otherwise consenting parties, is not enough to found a contract. It has to be shown, in addition, that each party is able to assess whether the transaction is in their best interests. The law presumes that this may not be so in the case of the young, on the grounds of their immaturity and inexperience, and to those such as the very old or mentally ill who for one reason or another may be unable to understand the consequences of their actions.

Put slightly differently, the concept of capacity is based on the view that one of the preconditions for the enforcement of contracts is that individuals possess the capability for rational economic action. One of the elements of the economic concept of rationality is that individuals possess stable preferences, that is, they can rank a given set of outcomes in order of preference. The absence of stable preferences can be understood as providing an economic justification the invalidation of contracts on the grounds of incapacity. In the terms used in law and economics analysis,

‘If the promisor’s preferences are unstable or not well-ordered, then he is unable to conclude a perfect contract. The law says that such people’s promises are unenforceable because they are legally incompetent. For example, children and the insane do not have stable, well-ordered preferences, and as a result, their promises are unenforceable...There are also special circumstances in which a person, who is ordinarily competent, may be temporarily incompetent, and during that incompetency she cannot conclude enforceable promises. For example, the ingestion of a prescription drug may make someone drowsy to the point of incompetency so that any promises given while in that state would be unenforceable. Consider a slightly more controversial example: if high pressure tactics are used to confuse a consumer and induce him to sign a contract, a court may be unwilling to enforce it. The consumer’s failing is described by some lawyers as a *transactional incapacity*, that is the incapacity to conduct this transaction rationally under these circumstances’.<sup>11</sup>

The effect is that contract law, in one of its core doctrines, views the market as more than just a space within which consensual exchange occurs. Market transactions are exchanges of a particular type, founded on individuals’ capacity for independent judgment.

We can go further. The capacity concept is predicated upon assumptions about the need for institutional underpinning of market exchange. One consequence of the doctrine of capacity is to provide protection to the incapable. But the doctrine also protects the market against the incapable,<sup>12</sup> by excluding them from normal participation in exchange relations. They may enter into transactions only with the aid of intermediaries. The doctrines of assistance and representation, formally stated in the civil law and implicit to some degree in the common law rules, are principally intended to enhance the contractual security of third parties and thereby secure confidence in the market as a whole. Thus an inference which may be drawn from the structure of contract law is that

legal enforcement of contracts matters, along with its corollary, namely selective non-enforcement. The maintenance of the market order depends upon the legal system being able to take a discriminating view about which contracts to enforce, and how.

To say that this is a foundational assumption of the system of contract law is not of course the same thing as saying that it is a proposition supported by empirical observation or by an economic or sociological perspective on law. It is simply another way of describing how the legal system views the external effects of its own enforcement mechanisms. However, it is noteworthy that the idea of the law-economy relation which is implicit in the structure of contract law differs markedly from the approach which has become predominant in the contemporary law and economics tradition. Gary Becker's highly influential claim that human behaviour in a wide (in fact the widest possible) range of contexts can be explained by the three axioms of stable preferences, maximizing behaviour, and market equilibrium, is at the heart of this tradition.<sup>13</sup> From the 'internal' viewpoint of contract law doctrine, Becker's basic position has to be qualified by the understanding that each of these conditions is not a natural state of affairs, but is instead the product of a certain institutional configuration, which is nowhere explained in Becker's account.

In considering that issue, it may be helpful to look more closely at the grounds on which, as a matter of core contract law, enforcement of arm's length transactions is regularly and routinely denied. In the common law systems, a significant set of exceptions to the principle of contractual enforcement takes the form of the doctrine of public policy. This doctrine applies not to contracts which are vitiated by misrepresentation, mistake or coercion, but to agreements which are in every essential respect consensual.<sup>14</sup> A variety of justifications is offered by non-enforcement: these include headings such as 'restraint of trade', 'agreements injurious to good government' and 'agreements contrary to family life'.<sup>15</sup> It is an eclectic and arbitrary-looking list. What, if anything, unites the different categories? If we go beneath the formal language use by the courts, two categories suggest themselves: cases in which the justification for non-enforcement is the protection of the market against itself (or, more precisely, against the deleterious effects of consensual exchange); and cases in which the principle is the protection of society against the market.

Falling into the first of these categories is the doctrine of restraint of trade. This has been called ‘a strange beast’; after all,

‘its role in contract law is traditionally understood to be that of denying validity to contracts that unduly restrain the freedom of one or both of the contracting parties. The doctrine appears to place non-procedural limitations on freedom of contract and, moreover, to place these limitations because of a concern for the contracting parties’ freedom. A concern for freedom is being used, it appears, to limit freedom’.<sup>16</sup>

But is it so strange? The doctrine of restraint of trade enables the court to strike down agreements, or parts of agreements, which unduly limit or restrict competition. Thus agreements by employees not to compete with a former employer can only be enforced if they involve the protection by the latter of a ‘proprietary interest’ in the form of protection against solicitation of customers or employees, or the maintenance of confidential information or trade secrets.<sup>17</sup> The doctrine has also been used in a variety of contexts to control market entry and exit rules, price fixing, wage regulation and other attempts of market actors to control the competitive process through agreement among themselves.<sup>18</sup> Here, then, is recognition that the principle of freedom of contract has the potential to undermine the competitive process on which the market order ultimately depends for its successful operation. Even if market relations in a broad sense could be maintained in a market partitioned by anti-competitive agreements, the precise and rather fragile conditions needed for a market equilibrium would seem to be particularly vulnerable to this kind of action. Thus the existence of the restraint of trade doctrine involves the recognition, again from the core of contract law (since this is an ancient doctrine), that selective legal enforcement of contracts is a necessity if the market is to function effectively.

Most of the other heads of public policy cannot be explained this way; rather, they appear to be based on the view that, important as freedom of contract is, there are certain values which take priority over it, and must be protected against it. It is on this basis that the courts will refuse to enforce contracts ‘contrary to public morals’, for example, or which are intended to undermine the government, or which oust their own jurisdiction. Thus the family, the apparatus of government, and the legal system itself are institutions which are not just separate from the market, and which operate on a distinctive and separate logic, but which also need protection from its potentially destabilizing effects.

However, as it stands, the list of grounds of non-enforcement is selective, and arguably outdated. This is the result of the courts' insistence, at the end of the nineteenth century, that the heads of public policy, as they then existed, were a closed set.<sup>19</sup> This position was no doubt influenced by the view, widely held at the time, that the foremost goal of public policy should be to defend the principle of freedom of contract itself.<sup>20</sup> But it also reflected a perception that regulatory legislation was a more effective and legitimate mechanism than the judge-made common law for regulating contractual relations. In this respect the English courts of 1890s, for example, were simply anticipating the expansion of regulatory legislation which began to gather speed around the turn of the twentieth century.

In both these manifestations – protecting the market against itself and protecting other social institutions against the market – the public policy doctrine operates in manner closely related to the concept of capacity. Across a wide range of consensual contracts, the law refuses to lend its support to contract enforcement. The existence of doctrines at the core of the judge-made law, in the common law systems, and embedded in the civil law codes, which formally limit freedom of contract in the interest of maintaining the market order and the wider social fabric of which it forms a part, is a sign that the market is not a self-constituting order, and that the conditions for its successful operation – including the foundational notions of individual rationality and market equilibrium – are not natural, but institutional, in origin.

### **3. The transformation of the concept of capacity in the modern law of contracts**

The diminishing importance of the capacity concept in contract law is part of a dual movement which took place in the course of the twentieth century. The first was the abolition of rules denying capacity to entire groups, in particular married women, a process which was still continuing in some jurisdictions in the middle decades of the century.<sup>21</sup> The reduction of the age of majority from 21 to 18 also removed most of the more significant cases of minors' contracts from the scope of the rule.<sup>22</sup> The second was the emergence of alternative techniques for countering the risk of exploitation in highly unbalanced or unequal contracts. Where the concept of capacity provided protection to the weak or vulnerable by denying legal enforcement to their contracts, thereby excluding them from independent participation in economic life, statutory regulation inserted mandatory and 'default' terms into contracts for the benefit of parties deemed to be at a disadvantage in terms of bargaining power.

Courts initially reacted with extreme hostility to what they saw as a new form of paternalism which undermined the contractual autonomy of the protected party and marked a reversion from contract to status. The English Court of Appeal, in giving a restrictive interpretation to workmen's compensation legislation in a judgment in 1905, noted that

'it presupposes a position of dependence; it treats the class of workmen as being in a sense "inopes consilii", and the Legislature does for them what they cannot do for themselves: it gives them a sort of State insurance, it being assumed that they are either not sufficiently intelligent or not sufficiently in funds to insure themselves'.<sup>23</sup>

In the same year, the language of capacity was used by the US Supreme Court in deciding, in the pivotal *Lochner* case, that statutory restrictions on working time were unconstitutional:

'when the state, by its legislature, in the assumed exercise of its police powers, has passed an act which seriously limits the right to labor or the right of contract in regard to their means of livelihood between persons who are *sui juris* (both employer and employee), it becomes of great importance to determine which shall prevail, - the right of the individual to labor for such time as he may choose, or the right of the state to prevent the individual from laboring, or from entering into any contract to labor, beyond a certain time prescribed by the state'.<sup>24</sup>

The majority concluded:

'There is no reasonable ground for interfering with the liberty of person or the right of free contract, by determining the hours of labor, in the occupation of a baker. There is no contention that bakers as a class are not equal in intelligence and capacity to men in other trades or manual occupations, or that they are not able to assert their rights and care for themselves without the protecting arm of the state, interfering with their independence of judgment and of action. They are in no sense wards of the state'.<sup>25</sup>

The 'substantive due process' doctrine which *Lochner* established was nevertheless held, from an early stage, to have no application to statutes concerning child and female labour.<sup>26</sup> These categories of employment were still overshadowed by the common law doctrine of contractual incapacity:

‘history discloses the fact that woman has always been dependent upon man... As minors, though not to the same extent, she has been looked upon in the courts as needing especial care that her rights may be preserved’.<sup>27</sup> In time, courts and legislatures arrived at a different justification: *all* workers were entitled to a basic level of health and safety protection, in order to protect their physical integrity. The germ of this idea was present in *Lochner* itself, in the dissenting judgment. Noting, in passing, that ‘there are very few, if any, questions in political economy about which entire certainty may be predicated’, the minority argued that

‘It is enough for the determination of this case, and it is enough for this court to know, that the question is one about which there is room for debate and for an honest difference of opinion. There are many reasons of a weighty, substantial character, based upon the experience of mankind, in support of the theory that, all things considered, more than ten hours’ steady work each day, from week to week, in a bakery or confectionery establishment, may endanger the health and shorten the lives of the workmen, thereby diminishing their physical and mental capacity to serve the state and to provide for those dependent upon them’.<sup>28</sup>

Thus the claim that social legislation possesses a *capacity-enhancing* effect was present at very beginning of the debate. In *Lochner*, the issue was phrased in terms of the physical integrity of the individual worker; the evolution of labour legislation from its early twentieth century beginnings can be understood as a gradual expansion of the range of interests which the law recognises to be at stake in the formation and performance of the contract of employment. These have been extended, in varying degrees in different systems, to include the economic security, psychological well being and personal dignity of the individual.<sup>29</sup> Thus laws which provide protection against the risks of interruption to earnings through illness, unemployment and old age (social insurance law), guarantee freedom of association for the purposes of collective action (collective labour law), stabilize the employment relationship against the consequences of economic uncertainty and the arbitrary exercise of employer power (unfair dismissal law), and insert basic labour standards with respect to the wage-work bargain and maximum hours of work, can all be understood as underpinning the contractual capacity of the worker. The presence of these norms makes it possible for the individual worker to enter into a contract which is necessarily incomplete and asymmetrical. Such regulatory norms do not ‘complete’ the contract or render it fully symmetrical, but they do compensate for the effects of incompleteness and asymmetry. Far from undermining the unilateral or prerogative power of the employer (‘subordination’), they

acknowledge its existence and legitimacy. To view labour law in this way is to recognize that it has information-sharing and risk-allocation functions in addition to the more explicitly ‘protective’ ones which are generally attributed to it.<sup>30</sup> This is not just ‘paternalism’, nor is it simply ‘redistribution’, despite the widespread use of such terms on both sides of the long debate concerning the legitimacy of the legislative regulation of contracts.<sup>31</sup> The process of inserting ‘social rights’ into the employment contract is one by which labour law re-establishes a contractual equilibrium between the parties.

A similar argument can be made for consumer protection legislation. Laws use a variety of techniques to protect individual purchasers of services or products in their dealings with business entities. Exclusion and limitation clauses may be struck out, and contract terms which are not individually negotiated may be subjected to a proportionality test. In consumer credit contracts, legislation may provide for ‘cooling-off periods’ or go so far as to require the provision of an independent third party opinion. The justification for this type of statutory control has gradually shifted over time from a focus on contractual inequality and the absence of ‘real’ consensus in standard-form agreements,<sup>32</sup> to the view that the role of the law is to provide incentives for information sharing and risk-shifting between the parties.<sup>33</sup> The effect has accordingly been described as enhancing the *financial capacity* of the individual.<sup>34</sup>

#### **4. Assessing the deregulatory critique of social legislation**

Notwithstanding the arguments which have just been made, a return to *Lochner*-type critiques of legislative controls over contract terms is a distinct recent trend, affecting all jurisdictions. How should they be assessed?

The common thread running through these critiques is the view that the market is a self-equilibrating order, in the context of which legislative norms constitute an ‘interference’ or ‘distortion’, preventing the operation of spontaneous forces. Deregulation, by stripping away layers of legislative control, can be expected to restore market mechanisms to their full operation. This view of the market owes much to the main methodological move within economic accounts of law, which is to imagine a world of frictionless exchange – a ‘zero transaction cost world’ – and then to loosen the assumptions underlying the model, in ways which invite a consideration of the sources of market imperfections. The foundational assumptions of neoclassical economics offer no obvious place for a normative order of any kind, other than the self-regulating order of the market which is itself ultimately reducible to the tendency of individuals to engage in maximizing behaviour. As we have seen, in Becker’s account, individuals are *assumed* to act rationally, in the sense of maximizing their own well being in

the face of constraints, on the basis of pre-given, ‘stable’ or ranked preferences; likewise, markets are *assumed* to clear, if they are not interfered with by external forces. The mathematical proofs of the ‘fundamental’ theorems of welfare economics are generally understood as demonstrating that in a world of purely competitive markets, the aggregate well being of all market actors – buyers and sellers – is *necessarily* maximized.

However, in the ‘new institutional’ variant of the law and economics literature, these various assumptions are relaxed, precisely so that a functional relationship between the market system and the legal-normative order can be identified. The environment may be less than perfect: contracts may be complex and hence incomplete, or exchange vitiated by externalities or asymmetrical information, leading to persistent market imperfections, to which contract law responds.<sup>35</sup> The basic behavioural assumptions of the model can be modified, through the concept of ‘bounded’ rationality,<sup>36</sup> or through the use of experimental or psychological evidence for the existence of cognitive biases or traits which, if present in particular contexts, prevent the realization of equilibrium states.<sup>37</sup> These techniques can be, and have been, used to justify departures from a regime of complete freedom of contract. Such interventions, whether they originate in the realm of ‘classical’ private law or in regulatory legislation, can be understood as aligning the allocation of economic resources more closely to that of a perfectly competitive market – a ‘market perfecting’ agenda. To that extent, the techniques used in the economics of law do not inevitably point in the direction of deregulation.

On the other hand, the presence of market imperfections does not necessarily justify regulation; many such imperfections are thought to be ‘irremediable’ because the costs of intervention can be expected to outweigh the benefits.<sup>38</sup> Public choice theory dictates that this is particularly likely in the case of legislative intervention, since the political process is thought to be especially vulnerable to the distorting effects of organized pressure group activity. The predominant theory of rule-making in the common law argues that judge-made law, by contrast, contains a self-correcting mechanism, in the form of private incentives for litigation, for the deselection of inefficient (or wealth-destroying) rules.<sup>39</sup> Some analyses have built on this argument to claim that legal systems which rely predominantly on legislation as a mode of rule-making are for that reason less adaptable, and hence less efficient, than those which give a greater priority to judge-made law; and this claim, in turn, has been used to argue that civil law systems are inherently less supportive of economic growth than those of the common law.<sup>40</sup> This ‘legal origin’ claim has nevertheless been contested on both methodological and empirical grounds. It is far from clear, for example, that the characterization of common law and civil law systems in the

most-cited studies in this area is accurate,<sup>41</sup> or that the mechanism by which legal origin (common law or civil law) translates into substantive rules of law has been adequately specified.<sup>42</sup> Nevertheless, it is having a tangible effect on the policy initiatives of the World Bank and IMF.<sup>43</sup>

One aspect of the recent legal origin literature is a revival of interest in F.A. Hayek's account of private law.<sup>44</sup> This differs from the modern law and economic synthesis in accepting, at a foundational level, the need for a legal-normative order to underpin market relations. Institutions are no longer viewed as isolated interventions, designed to counteract the effects of market failure. Rather, the 'abstract rules of just conduct' – in essence, the rules of contract, property and tort – are seen as functionally necessary for establishing freedom of disposition and security of transactions in the market place. By contrast, Hayek insists that social legislation, since it largely has a redistributive goal, interferes with market relations, in a way which undermines the spontaneous ordering of the market and of society more generally. More generally, Hayek argues that here, as elsewhere, 'attempts to "correct" the order of the market lead to its destruction',<sup>45</sup> suggesting that his schema is even less amenable to legal intervention than the market-perfecting agenda which characterizes most contemporary law and economics analysis.

The main empirical argument buttressing Hayek's account is historical: private law represents the core of a system of contract and property rights which predated the advent of twentieth century social legislation. In the nineteenth century, Richard Epstein suggests, US labour relations 'was governed by a set of laws that spanned the law of property, contract, tort and procedure'; in other words, a 'common law' of labour relations which could be reestablished if the New Deal labour laws of the 1930s onwards were repealed.<sup>46</sup> In the civil law, the concept of the 'private law society' (in the German tradition, the *Privatrechtsgemeinschaft*) expresses the same idea of a self-equilibrating legal order, which found its highest expression in the nineteenth century codes.<sup>47</sup> This view of history is, at best, highly selective, and at worst, actively misleading. In nineteenth century labour and product markets, the police power of the state buttressed the relations of private law: criminal sanctions were used to enforce labour contracts and break strikes.<sup>48</sup> It was this state-based disciplinary power, rather than a pure private law regime, which the social legislation of the twentieth century displaced.<sup>49</sup>

If the weakest point of the neoliberal critique of market regulation is the claim that a return to a private law society is possible (let alone desirable),<sup>50</sup> rejection of this claim is not, however, synonymous with uncritical acceptance of the model of social legislation inherited from the middle decades of the twentieth

century. Legislation regulating the contract of employment gave expression to a societal compact, in which inequality within the enterprise (the employee's 'subordination' to managerial prerogative) was traded off in return for certain social guarantees (such as protection against risks arising from injury, illness, unemployment, old age). That model was based on assumptions which are perhaps as questionable, although for different reasons, as the assumptions made in the Hayekian or neoliberal critique of regulatory legislation. In particular, the employment model of the mid-twentieth century assumed the vertical integration of the enterprise and the traditional division of labour within the nuclear family. The power of the nation state to regulate social and economic relations through legislation was also more or less taken for granted. In all these respects, the employment model was very much a product of a particular mid-twentieth century consensus which is now called into question.<sup>51</sup> The disintegration of the enterprise through mergers and acquisitions, outsourcing and subcontracting; changing family structures; and a perception of the limits to state-based legislative ordering of economic relations, together mean that the employment model is less and less able to fulfill its 'cornerstone' role of ensuring social protection while also providing a framework for the governance of work. The current 'crisis' of the regulatory state therefore arises less from its supposed incompatibility with a market economy, than from the contingency of the particular circumstances under which certain institutional forms, in particular the employment model, emerged in the course of the twentieth century.<sup>52</sup> Is it possible to renew the employment model and associated institutions of contractual regulation, in a way which aligns them with the today's changed conditions?

## **5. Contract law, market access and the capability approach**

The starting point for consideration of this question is to reexamine the concept of capacity which has been inherited from the private law codes and judge-made common law of the nineteenth century. As we have seen, capacity is the device by which the law accords individuals the power to enter into contracts (among other things). It involves the attribution of a set of legal powers to market actors. The abolition of traditional grounds of incapacity such as sex and marital status has left only age, to a limited extent, and mental incapability as grounds for denying parties the power to make legally enforceable agreements. Thus capacity has come to be defined in a sense which is both negative and narrow, as the absence of the ability to make reasoned, independent judgments. While this is a vital precondition for the effective functioning of a market order, it can be argued that is only one of a number of conditions which are necessary in order for the market to operate as an instrument for the creation of well being in society. That there is a wider set of

such requirements – involving institutions for sharing information, allocating risks and compensating for the effects of externalities – is implicitly recognized in the structure of laws inserting mandatory and default terms into contracts. These legal interventions can be seen as enhancing the contractual capacity of market agents, in the sense of endowing them with the resources needed to participate in market exchange in more than a purely formal or procedural sense. To view contractual regulation in this way is to counter the neoliberal critique which views protective legislation as simply carving out exceptions to the general principle of freedom of contract, with the result that contract law is parcellised and its effects fragmented. To enlarge on this counter-critique, it is necessary to locate a more complete conceptual analysis of capacity within a wider legal and economic discussion of the institutional preconditions of markets.

In the ‘standard’ (in the sense of orthodox or generally accepted) law and economics approach, the operation of markets results in the maximization of the aggregate wealth or well being of market actors, because it ensures to the greatest possible extent that the sum total of the preferences or wants of those actors is met. Individual choices cannot *fully* reflect individual preferences; choices are constrained both by the resources and entitlements with which particular individuals happen to be endowed and, in effect, by the preferences of all other actors. However, aggregate utility can be maximized if full scope is given for free exchange to occur, so that resources will end up in the hands of those who value them most highly. Market-based exchange is the most reliable mechanism for enhancing economic welfare under conditions of scarcity. It is through the act of contracting, unless it is vitiated by factors such as force or fraud, that individuals can express their preferences most consistently with the principle of constrained maximisation. This is the basis for the current orientation of normative law and economics analysis towards freedom of contract and it is also consistent with the negative and narrow version of the capacity concept which has been inherited from the contract law of the nineteenth century.

In this approach, resources, endowments and preferences are all taken as given; that is to say, they are exogenous to the operation of the market mechanism. The assumption of exogeneity is a necessary correlate of the assumption of constrained maximization. The standard economic model does not concern itself with the process by which preferences and endowments are formed.<sup>53</sup> This is the economic-theoretical equivalent of the idea that contract law is not concerned with the objective value of the consideration given for a promise.<sup>54</sup> Both ideas can be traced back to the period during which notions such as the ‘just price’ were banished to the margins of contract law.<sup>55</sup>

The more recent introduction into economic theory of the concept of ‘capability’ introduces a new dimension to this question. Rather than using the language of the maximization of preferences, the capability approach refers to the ‘conversion’ of an individual’s endowments into various desired end-states or activities, known as ‘functionings’. An individual’s capability set refers to the extent of their substantive freedom to realize a range of functionings:

the concept of ‘functionings’... reflects the various things a person may value doing or being. The valued functionings may vary from elementary ones, such as being adequately nourished and being free from avoidable disease, to very complex activities or personal states, such as being able to take part in the life of the community and having self-respect... A ‘capability’ [is] a kind of freedom: the substantive freedom to achieve alternative functioning combinations’.<sup>56</sup>

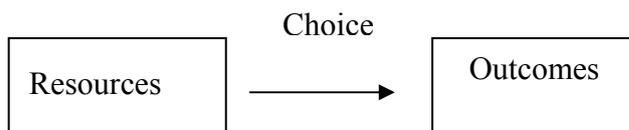
So far this appears to be no different to the standard economic approach. The difference, for present purposes, comes at the point where the nature of the ‘conversion’ of resources or commodities into outcomes is being considered. Amartya Sen puts it in the following way, using the example of eating as a nutritional and social activity:

The conversion of commodity-characteristics into personal achievements of functioning depends on a variety of factors – personal and social. In the case of nutritional achievement it depends on such factors as (1) metabolic rates, (2) body size, (3) age, (4) sex (and, if a woman, whether pregnant or lactating), (5) activity levels, (6) medical conditions (including the presence or absence of parasites), (7) access to medical services and the ability to use them, (8) nutritional knowledge and education, and (9) climatic conditions. In the case of achievements involving social behaviour and entertaining friends and relatives, the functioning will depend on such influences as (1) the nature of the social conventions in force in the society in which the person lives, (2) the position of the person in the family and in the society, (3) the presence or absence of festivities such as marriage, seasonal festivals and other occasions such as funerals, (4) the physical distance from the homes of friends and relatives and so on.<sup>57</sup>

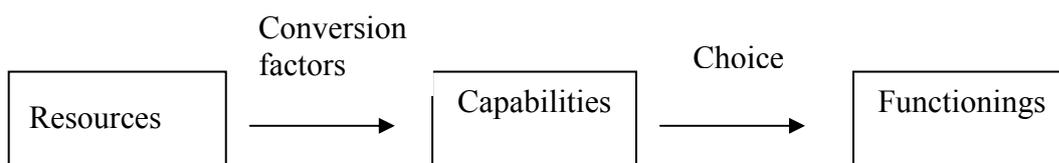
The conversion of endowments and preferences into substantive freedoms – capabilities – precedes choice (see Figure 1). Thus it is not simply a consequence of individuals engaging in ‘constrained maximisation’. Instead, the capability approach identifies a range of ‘conversion factors’ which are necessary for capabilities to come into existence. Conversion factors operate at multiple levels. Thus a person’s capability to achieve a particular range of functionings could be determined not just by the characteristics (both physical and social) of their person or even simply by the wider physical and technological environment, but also by the organizational context of their lives (inter-personal networks of the kind which may be based on family, kinship, personal connection, the workplace or membership of an occupational or professional group). Critically, social institutions such as the social norms, legal rules and legal-political forms which play a constitutive role in relation to social and economic activity, also operate as conversion factors.

**Figure 1**<sup>58</sup>

(1) Standard approach (Becker)



(2) Capability approach (Sen)



Thus in the capability approach, institutional rules do not simply constrain, they also empower. There are further points of difference with the standard approach. The quality of choice is not simply a function of the resources with which the individual is endowed or of their power for rational action; it also dependent on the institutional framework in which the relevant exchange is lodged. No doubt an effectively operating contract enforcement system has the potential to enhance individual capabilities in the context of exchange. But it is no more than one of the mechanisms which can achieve this end. It is neither necessary nor sufficient.

What would a contract law system look like if it encapsulated the capability approach rather than the standard approach to the conceptualisation of economic exchange? The answer to that question is that it would look very much like the kinds of contract law regime that are observed in European (and other) systems today – that is to say, regimes in which the classical principles of freedom of contract and *pacta sunt servanda* are complemented by mandatory and default norms of various kinds, mostly originating in legislation. Thus the main reason for taking the capability approach seriously in the present context is that it offers a more complete and coherent account of the structure and functioning of the modern law of contracts than that offered by the standard law and economics approach. This would be an account in which the capacity-enhancing role of contractual regulation is recognized as an ordering principle for the law of contracts.

The point has already been made that even in the classical, nineteenth century core of contract law, it is possible find exceptions to the principle of contract enforcement which imply limits to the idea of the self-ordering market, and, indeed, to the idea of a market order which is independent of other social institutions. Even the restricted doctrine of public policy in the common law attests to the functional importance of conjoining the market order with complementary social institutions such as the family and the legal system itself. There is a far greater volume and variety of laws qualifying freedom of contract and regulating contractual relations in contemporary societies. An example taken from one particular type of legislation affecting the employment contract may illustrate the potential relevance of the capability approach in helping us to understand the relationship of such regulation to the market order.

Discrimination law is the product of a series of legislative interventions which appear very substantially to constrain freedom of contract in the employment sphere.<sup>59</sup> Because the anti-discrimination principle affects all stages of the employment relationship, including hiring as well as the performance and termination of the contract, its regulatory scope is potentially more far-reaching than laws stipulating basic standards for wages and hours or regulating the process of dismissal. The grounds on which discrimination is prohibited have steadily been extended over time, to cover not just race and sex as in legislation of the 1960s and 1970s, but, as a consequence of recent legislative activity, sexual orientation, religion or belief, age and disability.<sup>60</sup> The anti-discrimination principle is, in many jurisdictions, embodied in constitutional texts, and thereby acquires the additional normative force of a fundamental social right.<sup>61</sup> It has both a collective and an individual dimension: on the one hand, it attacks institutional manifestations of group disadvantage, while on the other hand it profoundly individualises the position of the labour market actor,

by insisting that their membership of a particular sexual or racial group (and so on) may not be used as a criterion for determining their access to employment or work-related benefits. In all these respects, discrimination law provides the template for what labour law might become, or is in the process of becoming. As it extends to applicants for employment and certain categories of the self-employed, as well as to employees,<sup>62</sup> discrimination law has already largely overcome the rigid division between employees and independent workers which has severely limited the effectiveness of traditional protective legislation.<sup>63</sup>

The near universality of the anti-discrimination principle – it is a powerful and pervasive force even in legal systems, such as the United States, which are often (incorrectly) described as having little or no statutory regulation of employment – and its recent extension at a time when most other forms of employment legislation have been in retreat, suggests that it is not simply *compatible* with a ‘fluid’ or ‘flexible’ labour market order of the kind which is increasingly recognized to have come into existence with the decline of traditional forms of workplace organization and collective solidarity; it is *fundamental* to the contemporary model of labour market flexibility. Discrimination law has extended the scope of the labour market and actively promoted competition over and in relation to employment. Yet it does so by promoting an openly distributive agenda, in supporting the rights of historically excluded or marginalized groups (such as married women) to participate in employment on an equal basis (in principle) with those previously privileged (such as ‘male breadwinners’).

Discrimination law stands in the same relation to classical contract law as the capability approach stands in relation to standard law and economics analysis. Becker, again, has expressed the received approach most clearly: discrimination law is unnecessary because the cure for discrimination lies in the market itself. Employers with a ‘taste’ or preference for hiring men instead of women would pay a price for doing so – unless it was the simply the case all along that in hiring men, they were acting rationally. Where unequal pay and job segregation persist, they most likely represent efficient resource allocations.<sup>64</sup> It is perhaps an open question as to why Becker’s view, first expressed in the 1950s a few years before the advent of US civil rights legislation<sup>65</sup> and decades before the adoption of European directives on equal treatment in employment,<sup>66</sup> did not have a greater influence on legislators. Was it because of ‘rent seeking’ by insider groups? Or because classical contract law was widely perceived to be an inadequate mechanism for promoting economic integration of the kind which has accompanied the legal recognition of the equal treatment principle?

The capacity-enhancing function of discrimination law is particularly evident in the case of what is arguably the most advanced type of equal treatment legislation, that is, legislation prohibiting disability discrimination. This type of legislation is ‘advanced’ in the sense that concepts used elsewhere in discrimination law – ‘direct discrimination’, referring to unequal treatment on prohibited grounds, and ‘indirect discrimination’, referring to group disadvantage arising from institutional practices – have been modified in the context of disability, to produce a ‘duty of reasonable adjustment’ on the part of the employer.<sup>67</sup> This means that the employer has a responsibility to organise the workplace in such a way as to enable the individual worker to carry out the duties of the post in question, taking their disability into account. The duty is not absolute; the court applies in essence a proportionality test, taking into account the cost and practicability of adjustments and their impact on the ability of the worker to carry out the task. But even so, the effect is to alter the conceptual framework of discrimination law in ways which point to its potential for enhancing capabilities. The effect of the legislation was described in a recent House of Lords case, *Archibald v. Fife Council*,<sup>68</sup> as follows:

‘[the Disability Discrimination Act] is different from the Sex Discrimination Act 1975 and the Race Relations Act 1976. In the latter two, men and women or black and white, as the case may be, are opposite sides of the same coin. Each is to be treated in the same way. Treating men more favourably than women discriminates against women. Treating women more favourably than men discriminates against men. Pregnancy apart, the differences between the two genders are generally regarded as irrelevant. The 1995 Act, however, does not regard the differences between disabled people and others as irrelevant. It does not expect each to be treated in the same way. It expects reasonable adjustments to be made to cater for the special needs of disabled people. It necessarily entails an element of more favourable treatment’.

The following case, taken from guidance in the form of a code of practice, illustrates the effect in practice of the legislation:

‘An applicant for an administrative job appears not to be the best person for the job, but only because her typing speed is too slow as a result of arthritis in her hands. If a reasonable adjustment – perhaps an adapted keyboard – would overcome this, her typing speed would not in itself be a substantial reason for not employing her. Therefore the employer would be unlawfully discriminating if, on account of her typing speed, he did not employ her or

provide that adjustment.’<sup>69</sup>

The effect is striking – rather than requiring the individual to be ‘adaptable’ to changing market conditions, the law requires that employment practices be adapted to the circumstances of the individual. If disability discrimination laws go further than most forms of social legislation currently do in imposing affirmative duties on employer in the name of market access, they nevertheless exemplify the tendency of the law to grant substantive recognition to new forms of contractual capacity, or, in economic terms, ‘capability’. The extension of the labour market in contemporary societies is coterminous with the advance of the capability principle.

## 6. Conclusion

This paper has argued that *capacitas* or capacity should be thought of as the juridical concept through which the legal system defines the conditions of access to the market. The various ways in which capacity has been defined, in different periods and in different legal systems, is therefore revealing of ways in which the relationship between the legal system and the market can be conceptualised. In a narrow conception, capacity is defined as the ability to engage in rational economic action (in economic-theoretical terms, constrained maximisation on the basis of stable preferences). The consequence of the absence of capacity in this sense is the denial to the individual of the normal legal support for the enforcement of contracts. In a wider conception, capacity or *capacitas* is the sum total of the preconditions of effective participation in market relations, and the role of the law shifts from the selective enforcement of contracts, to the insertion into contracts of mandatory and default terms which serve a variety of functions. These include reallocations of risk and information, which are meant to offset the consequences of unbalanced or asymmetrical contracts. However, contractual regulation also has a wider remit, which is to protect and enhance the capability of the individual, understood as the substantive freedom to realise, through participation in the market, a range of desired end-states and activities.

It can be seen from this analysis that the debate over the scope and meaning of the capacity concept is essentially an argument over the nature of the institutional preconditions of a market order. The idea of the self-equilibrating or self-regulating market lies at the core of the predominant approach within the contemporary law and economics movement and of the related deregulatory critique of social legislation. It is also inscribed in a particular judicial attitude to contractual regulation which a century ago found expression in the *Lochner* judgment in the United States and in the restrictive interpretation given by the

English courts to the early legislation of the welfare state. According to this view, contractual relations rest upon a system of private law whose qualities of autonomy and self-regulation mirror those of the market itself. Social legislation appears, in this context, as an illegitimate interference.

The contrasting view is one in which contractual regulation complements, rather than obstructs, the institutions of private law in providing a framework for exchange relations. In this paper, examples have been given to illustrate this point from consumer law, employment law and discrimination law. A law of contracts constructed around the notion that the law has a role in protecting and enhancing capabilities is, it may be argued, in the process of emerging at these points of interaction between private law and social legislation. This would be a law of contracts in which the market was seen, not as an end in itself, but an institution for enhancing the substantive economic freedom of individuals; a law of contracts, in other words, in which the market was adapted to the condition of the individual, rather than the individual being adapted to the demands of the market.

## Notes

<sup>1</sup> See generally A. Supiot (ed.) *Au delà de l'emploi. Transformations du travail et devenir du droit du travail en Europe* (Paris: Flammarion, 1999).

<sup>2</sup> See A. Sen, *Commodities and Capabilities* (Deventer: North-Holland, 1985) and *Development as Freedom* (Oxford: OUP, 1999), and on the potential relevance of the capability approach to understanding capacity-building in the context of European labour markets, Supiot, *Au delà de l'emploi*, op. cit.

<sup>3</sup> For example, Article 1108 of the French Civil Code.

<sup>4</sup> *Capacité de jouissance, Rechtsfähigkeit, capacità jurídica*: see M. Hesselink, 'Capacity and capability in European contract law' (2005) 13 *European Review of Private Law* also published in S. Deakin and A. Supiot (eds.) *Capacitas: Re-examining the Legal Concept of Capacity* (forthcoming, 2006, Brussels and Oxford: Bruylant/Hart Publishing).

<sup>5</sup> *Capacité d'exercice, Handlungsfähigkeit, capacità di agire*: Hesselink, 'Capacity and capability', op. cit.

<sup>6</sup> As Hesselink (ibid.) points out, there is a human rights dimension to the capacity to hold rights which is to some degree recognized in European Union law, in the context, for example, of the rights of minors to benefit from the principle of free movement in Article 18 of the EC Treaty: Case C-200/02 *Man Lavette Chan and Kunqian Catherine Zu v. Secretary of State for the Home Department* (2004) OJ C 300, 4.12.2004, p. 7.

<sup>7</sup> E. McKendrick *Contract Law: Text, Cases and Materials* (Oxford: OUP, 2003) at p. 788.

<sup>8</sup> On which, see J. Hauser, 'Revisiter la notion juridique de capacité?' and S. Godelain, 'Le concept de capacité dans le droit des contrats français', both in Deakin and Supiot (eds.) *Capacitas: Re-examining the Legal Concept of Capacity*, op. cit.

<sup>9</sup> Hauser, 'Revisiter la notion juridique de capacité?', op. cit.

<sup>10</sup> For English law see the discussion of McKendrick, *Contract Law*, op. cit., ch. 21.

<sup>11</sup> R. Cooter and T. Ulen, *Law and Economics* (New York: Harper, Collins, 1988), at p. 237.

<sup>12</sup> Hesselink, 'Capacity and capability in European contract law', op. cit.

<sup>13</sup> See G. Becker, *The Economic Approach to Human Behaviour* (Chicago: Chicago University Press, 1976), ch. 1, discussed by A. Supiot, *Homo Juridicus: Essai sur la fonction anthropologique du Droit* (Paris: Seuil, 2005),

pp. 116-17. On the centrality of Becker's axioms to the law and economics movement, see E. Schanze, 'What is law and economics today? A European view', in P. Nobel (ed.) *New Frontiers of Law and Economics* (Zürich: Schulthess, 2006). Schanze adds 'institutional choice matters' to Becker's original list, a significant addition, but one which is not altogether easy to reconcile with the more minimalist approach taken by Becker which succeeds in avoiding any explicit reference to institutions.

<sup>14</sup> Cases of agreements which are vitiated by the grounds of mistake, misrepresentation and duress can be quite straightforwardly explained using basic microeconomic insights relating to risk and information: see for example H.G. Beale, W. Bishop and M. Furmston, *Contract: Cases and Materials* 4<sup>th</sup>. ed. (London: Butterworths, 2001), in particular ch. 4, setting out the basic position on the economics of contract law, and which is then applied throughout the book in chapters relating to particular doctrines.

<sup>15</sup> J. Beatson, *Anson's Law of Contract* 27<sup>th</sup>. ed. (Oxford: OUP, 1998), ch. 9.III, lists the following categories: agreements to commit a crime or civil wrong, or to perpetrate a fraud; agreements which injure the state in its relations with other states; agreements which tend to injure good government; agreements which tend to pervert the course of justice; agreements which tend to abuse the legal process; agreements which are contrary to good morals; agreements which affect the freedom of security of marriage or the due discharge of parental duty; agreements which oust the jurisdiction of the court; and anti-competitive agreements.

<sup>16</sup> S. Smith, 'Reconstructing restraint of trade' (1995) 15 *Oxford Journal of Legal Studies* 565-595, at p. 565.

<sup>17</sup> Beatson, *Law of Contract*, op. cit., at pp. 360-370.

<sup>18</sup> Ibid., pp. 358-60.

<sup>19</sup> *Janson v. Driefontein Consolidated Mines Ltd.* [1902] AC 484, 491 (Lord Halsbury).

<sup>20</sup> *Printing and Numerical Registering Co. v. Sampson* (1875) 19 LR Eq. 462, 465 (Sir George Jessel MR).

<sup>21</sup> As in the case of the (English) Law Reform (Married Women and Tortfeasors) Act 1935 and the Married Women (Restraint upon Anticipation) Act 1949.

<sup>22</sup> Family Law Reform Act 1969, s. 1.

<sup>23</sup> *Simpson v. Ebbw Vale Steel, Iron & Coal Co.* [1905] 1KB 453; see S. Deakin and F. Wilkinson, *The Law of the Labour Market: Industrialization,*

*Employment and Legal Evolution* (Oxford: OUP, 2005), at p. 88 for the background to this case.

<sup>24</sup> 198 US 45, 54 (1905).

<sup>25</sup> 198 US 45, 57 (1905).

<sup>26</sup> The doctrine was only abrogated in the 1930s. See generally H. Hovenkamp, *Enterprise and American Law 1836-1937* (Cambridge, MA: Harvard University Press, 1991).

<sup>27</sup> *Muller v. Oregon* 208 US 412, 421 (1908). The Court noted (at p. 418) that the state of Oregon had begun to repeal laws excluding the contractual and personal capacity of married women in the 1870s.

<sup>28</sup> 198 US 45, 71 (1905).

<sup>29</sup> See S. Simitis, 'The rediscovery of the individual in labour law', in R. Rogowski and T. Wilthagen (eds.) *Reflexive Labour Law* (Deventer: Kluwer, 1994); for an analysis linking the development of labour law to capability approach, see A. Vimercati, 'Una proposta di riflessione sulle capabilities nell'esperienza gius-lavoristica Italiana', in Deakin and Supiot (eds.), *Capacitas; Reexamining the Legal Concept of Capacity*, op. cit.

<sup>30</sup> See generally S. Deakin and F. Wilkinson, 'Labour law and economic theory: a reappraisal', in G. De Geest, J. Siegers, and R. Van den Bergh (eds.) *Law and Economics and the Labour Market* (Aldershot: Elgar, 1999).

<sup>31</sup> See A. Kronman, 'Contract law and distributive justice' (1980) 89 *Yale Law Journal* 472; D. Kennedy, 'Distributive and paternalist motives in contract and tort law' (1982) 41 *Maryland Law Review* 563; A. Ogus, 'Regulatory paternalism: when is it justified?', in K. Hopt, E. Wymeersch, H. Kanda and H. Baum (eds.) *Corporate Governance in Context: Corporations, States, and Markets in Europe, Japan and the US* (Oxford: OUP, 2005).

<sup>32</sup> F. Kessler, 'Contracts of adhesion – some thoughts about freedom of contract' (1943) 43 *Columbia Law Review* 629.

<sup>33</sup> Ogus, 'Regulatory paternalism', op. cit.

<sup>34</sup> Godelain, 'Le concept de capacité dans le droit des contrats français', op. cit.

<sup>35</sup> This is in essence the explanation offered by Cooter and Ulen (*Law and Economics*, op. cit., ch. 6) for the structure of the common law of contract.

<sup>36</sup> The implications of bounded rationality, along with market uncertainty and 'asset specificity' or relation-specific investments in transactions, are most systematically set out in O. Williamson, *The Economic Institutions of Capitalism and The Mechanisms of Governance* (Oxford: OUP, 1996).

<sup>37</sup> See generally the contributions in C. Sunstein (ed.) *Behavioural Law and Economics* (Cambridge: CUP, 2000).

<sup>38</sup> Williamson, *The Mechanisms of Governance*, op. cit., ch. 8.

<sup>39</sup> On this contrast between legislative and judicial rule-making, see P. Rubin, 'Common law and statute law' (1982) 11 *Journal of Legal Studies* 205-233.

<sup>40</sup> E. Glaeser and A. Shleifer 'Legal origins' (2002) 117 *Quarterly Journal of Economics* 1193-1229.

<sup>41</sup> M. Siems, 'Legal origins: reconciling law & finance and comparative law' Centre for Business Research Working Paper No. 321, University of Cambridge, March 2006.

<sup>42</sup> B. Ahlering and S. Deakin, 'Corporate governance, labour regulation and legal origin: a case of institutional complementarity?' Centre for Business Research Working Paper No. 312, University of Cambridge, September 2005.

<sup>43</sup> For a critique of the use of the legal origin approach in the World Bank's *Doing Business* series of publications, see C. Ménard and B. de Marais, 'Can we rank legal systems according to their economic efficiency?' in P. Nobel, ed., *New Frontiers in Law and Economics*, op. cit., who suggest that the *Doing Business* reports 'create an illusion. They pretend to measure the role of legal systems according to their economic efficiency. What they actually do is rank countries according to a set of indexes in which the real properties and specificities of legal systems are almost never captured'.

<sup>44</sup> See P. Mahoney, 'The common law and economic growth: Hayek might be right' (2001) 30 *Journal of Legal Studies* 503-525.

<sup>45</sup> F. Hayek, *The Mirage of Social Justice* (London: Routledge and Kegan Paul, 1976), at p. 142.

<sup>46</sup> R. Epstein, 'A common law for labor relations; a critique of the New Deal legislation' (1983) 92 *Yale Law Journal* 1357-1408, at p. 1357.

<sup>47</sup> On the 'private law society', see W. Steinmetz, 'Introduction' in W. Steinmetz (ed.) *Private Law and Social Inequality in the Industrial Age: Comparing Legal Cultures in Britain, France, Germany and the United States* (Oxford: OUP, 2000).

<sup>48</sup> All common law systems, including the United States, saw some role for forced labour and the criminalisation of breach of the service contract by workers in the period of industrialisation; see generally, D. Hay and P. Craven (eds.) *Masters, Servants and Magistrates in Britain and the Empire, 1562-1955* (Chapel Hill, NC: University of North Carolina Press, 2004). In the civilian systems of continental Europe, a police power to regulate labour contracts operated alongside the the private law codes until the middle of the nineteenth

century: see B. Veneziani, 'The evolution of the employment relationship', in B. Hepple (ed.) *The Making of Labour Law in Europe* (London: Mansell, 1986); A. Cottareau, 'Industrial tribunals and the establishment of a kind of common law of labour in nineteenth century France', in W. Steinmetz (ed.) *Private Law and Social Inequality in the Industrial Age*, op. cit.

<sup>49</sup> See Deakin and Wilkinson, *The Law of the Labour Market*, op. cit., chs. 2 and 3, on the British case.

<sup>50</sup> The *locus classicus* of the argument that attempts to create a pure market order have resulted in social catastrophe is K. Polanyi, *The Great Transformation: Origins of Our Time* (Boston, MA: Beacon Press, 1956) recently reissued (2001) with a new introduction, arguing for its contemporary relevance, by J. Stiglitz.

<sup>51</sup> See Supiot, 'Introduction', in Supiot (ed.), *Au delà de l'emploi*, op. cit.

<sup>52</sup> Deakin and Wilkinson, *The Law of the Labour Market*, op. cit., at pp. 14-18.

<sup>53</sup> G. Stigler and G. Becker, 'De gustibus non est disputandum' (1977) 67 *American Economic Review* 76-90.

<sup>54</sup> R. Posner, *Economic Analysis of Law* 2<sup>nd</sup> ed. (Boston, MA: Little, Brown and Co., 1977), at pp. 70-71: 'Courts inquire only as to the existence, not the adequacy, of the consideration for a contract. The distinction is important and economically sound'.

<sup>55</sup> P.S. Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford: Clarendon Press, 1979), at pp. 169-177.

<sup>56</sup> Sen, *Development as Freedom*, op. cit., at p. 75.

<sup>57</sup> Sen, *Capabilities and Commodities*, op. cit., at pp. 17-18.

<sup>58</sup> This is adapted from a presentation made by Jean-Michel Bonvin at the final meeting of the Eurocap project in Nantes, March 2006, and which I am grateful for permission to draw on here.

<sup>59</sup> See R. Epstein, *Forbidden Grounds: The Case Against Employment Discrimination Laws* (Cambridge, MA: Harvard UP, 1992).

<sup>60</sup> The most important reference point for this process in European law is the Framework Directive on Discrimination in Employment, Directive 2000/78/EC.

<sup>61</sup> In the context of European law, relevant sources for a constitutional instantiation of the anti-discrimination principle are Art. 13 of the EC Treaty and Chapter III of the Charter of Fundamental Rights of the European Union (2000).

<sup>62</sup> On this see S. Deakin and G. Morris, *Labour Law* 4<sup>th</sup> ed. (Oxford: Hart Publishing, 2005), at p. 631.

<sup>63</sup> See M. Freedland, *The Personal Employment Contract* (Oxford: OUP, 2003), 'Introduction' and ch. 1.

<sup>64</sup> G. Becker, *The Economics of Discrimination* (Chicago: University of Chicago Press, 1957).

<sup>65</sup> The first and most significant measure was the Civil Rights Act 1964.

<sup>66</sup> The earliest of these was Directive 75/117/EC on equal pay for equal work between men and women.

<sup>67</sup> See Deakin and Morris, *Labour Law*, op. cit., at pp. 715-720, explaining the structure of the anti-discrimination principle in the context of the Disability Discrimination Act 1995, ss. 3A and 4A; see also W. Brose, 'La recherche d'un concept de "capacitas" en droit du licenciement allemand', in Deakin and Supiot (eds.) *Capacitas: Re-examining the Legal Concept of Capacity*, op. cit., discussing a similar point in the context of German dismissal law.

<sup>68</sup> [2004] IRLR 651, at para 47.

<sup>69</sup> Disability Rights Commission, *Code of Practice: Employment and Occupation* (London: Disability Rights Commission, 2004), at para 6.5.

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