CONTRACTS AND CAPABILITIES: AN EVOLUTIONARY PERSPECTIVE ON THE AUTONOMY-PATERNALISM DEBATE

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Abstract

An evolutionary conception of contract law is suggested as a basis for assessing claims made in the autonomy-paternalism debate. Paternalism forms one part – although by no means the whole – of a discriminating approach to contract enforcement. Selective enforcement is a long-standing feature of contract law systems, which have developed alongside the emergence of market-based economies in liberal democratic societies. Contractual regulation of this kind can be justified in normative terms by reference to capability theory. Markets are significant capability-enhancing institutions, but their effect depends on complementary regulatory mechanisms, including some of those commonly (if not always accurately) termed ‘paternalistic’.

1 Introduction

Legal paternalism has been defined as an approach in which ‘the law seeks to override individual choice on the ground that the individual or individuals in question might not exercise that choice wisely, with consequential harm to themselves’. Paternalism, so defined, appears to involve the rejection of individual autonomy. It also seems to run counter to deep-rooted principles of private law, such as freedom of contract. Yet, paternalism is also widespread: ‘legal systems of western liberal democracies contain innumerable paternalistic rules and doctrines.’ This poses the twin questions of how to explain the prevalence of paternalism in modern, market-based economies and whether such intervention can be justified in normative terms.

This article will attempt to answer both questions by drawing on an evolutionary view of contract law. This is a perspective that sees contract law in functional terms as providing a framework for market-based exchange. Contract law performs this role, among other things, by taking a discriminating view of which contracts to enforce. Paternalistic justifications form a part, but only a part, of contract law’s selective approach to enforcement. Selective enforcement has been a feature of all modern contract law systems, even at the height of nineteenth century ‘laissez faire’. The rules of contract law governing when and on what conditions contracts are enforced are the public expression of emergent solutions to coordination problems that have arisen in market settings of various kinds. Some of them can be found within private law doctrines (ranging from the narrowly defined ‘incapacity’ and ‘public policy’ to the more widely ranging ‘good faith’), and some owe their existence to legislative intervention in specific contexts, such as worker or consumer protection. Whatever their origin, these rules of contract law express or encode norms of behaviour that, experience has shown, have the potential to contribute to market formation in various ways.

It neither necessary nor desirable to conflate the set of paternalistic interventions with the wider set of regulatory interventions in contract law. Paternalism can be justified where parties need to be protected against the negative welfare implications of their own choices. This describes a narrow range of cases in which parties do not display rationality in contracting, that is to say, an ability to exercise choice in a consistent

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way. The contract law doctrines of incapacity and undue influence provide illustrations of this type of justification for non-enforcement. However, other doctrines giving rise to selective enforcement, such as most of the heads of public policy, and instances of contractual regulation of the kind that are widespread in employment law and consumer protection law, cannot be explained in paternalistic terms. When parties enter into employment or consumer contracts on the basis of limited information or in situations of inequality of bargaining power, they may be making contracts that are based on mistaken beliefs or that are welfare-reducing in some way, but they are not acting ‘irrationally’ in the sense required for paternalistic intervention. The law intervenes here not to protect parties against themselves, but to overcome externalities and address information asymmetries in such a way as to extend the scope of the market and hence the division of labour, thereby promoting general societal well-being.

Selective enforcement is not a marginal addition to contract law, but is, rather, part of its core function in a market economy; it is also core to contract law in the internal legal sense of explaining some of its central doctrinal features. Two normative objections are commonly made against selective enforcement. The first is that the effects of regulation are indeterminate. Emergent regulatory solutions are necessarily imperfect: they may be transplanted out of context or lose their effectiveness over time in a changing environment. How far this is the case cannot be resolved a priori, but only through applied empirical work. The second objection is more basic. Even if regulatory interventions enhance aggregate well-being, they do so by making certain market participants (the wealthy, the well-informed or the simply fortunate) worse off than they would otherwise be. They can therefore be viewed (and have been by courts from time to time) as equivalent to an unconstitutional interference with contract and property rights.3

The resolution of this second question requires more than an empirical analysis of how contract law operates, although this can help in clarifying the nature and extent of the effects involved. In addition, it requires a consideration of the meaning of the notion of ‘private autonomy’ in a market setting. It will be argued here that the law of contract should (and generally does) protect private autonomy in the sense of the capacity (or ‘capability’) of individuals to participate in market-based exchange, but that this is not the same thing as the right to conduct an exchange free of legal regulation. This argument will be developed through the use of examples drawn from the regulation of contracts in labour market settings.

2 Evolutionary Perspectives on Contract Law

Gintis4 has recently proposed a unified evolutionary account of the behavioural sciences consisting of five conceptual building blocks: gene-culture coevolution,5 the socio-psychological theory of norms,6 game theory, the rational actor model7 and complexity (or systems) theory.8 A unified evolutionary theory of law would also draw on these

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3 Most significantly, and controversially, in the decision of the US Supreme Court in *Lochner v. New York*, 198 US 45 (1905).
5 Gene-culture coevolution, sometimes referred to as ‘dual inheritance theory’, is the idea that genetic evolution both influences and is influenced by aspects of the environment that are culturally transmitted across generations, that is to say, embodied in enduring practices and routines. See R. Boyd and P. Richerson, *Culture and the Evolutionary Process* (Chicago, IL: Chicago University Press 1985); P. Richerson and R. Boyd, *Not by Genes Alone* (Chicago, IL: Chicago University Press 2004).
6 Sociological and psychological theories see norms not simply as external constraints on action but as internalised standards of behaviour: see Gintis, above n. 4, at 212-214.
7 On the rational actor model as the foundation of game-theoretical models of strategic interaction, see Gintis, above n. 4, at ch. 3.
8 Complexity theory and systems theory are not synonymous, but for present purposes it is sufficient to emphasise the elements they have in common, in particular the idea of systems as emergent orders with adaptive, that is to say, evolutionary properties. The properties of systems are ‘emergent’ in the sense that they arise from the interaction of the component parts of the system and cannot be reduced to these
elements, although they are not all of equal importance in understanding contemporary legal phenomena. The nature of the link between human genetic evolution and modern-day legal institutions, in particular, remains poorly understood, and further work is required to demonstrate the relevance of models of gene-culture coevolution in this context. For the purposes of theorising contract law, the interplay between game-theoretical models of strategic action, which make use of the (boundedly) rational actor model, and the idea of society as consisting as a set of adaptive systems, should be the focus of analysis. Game theory can take us part of the way in understanding the evolutionary dimensions of contractual behaviour, but, as Gintis emphasises, it cannot go the whole way, since the macro-level properties of adaptive systems cannot be deduced from micro-level modelling using game-theoretical axioms. Gintis’s focus is on the behavioural sciences, and he does not extend his analysis to include a normative theory of social institutions. The study of law is not, or is only partially, a behavioural social science, and an evolutionary theory of law should in principle embrace interpretive and normative elements. Capability theory offers one way forward here.

From an evolutionary perspective, the ‘market’ consists of a set of linked practices or routines that govern decentralised exchange. When the market functions effectively, it operates to ensure that scarce resources are allocated to alternate uses in a way that reconciles individual autonomy with collective welfare. Market practices such as exchange, pricing and arbitrage can be understood as emerging through the repeated interactions of numerous individual agents. Having been stabilised through routinisation, these practices are essentially self-organising and self-reproducing.

The evolved or emergent nature of market behaviour is generally taken to be the antithesis of centralised direction, whether through law or otherwise. However, viewing the market as a self-organising system, in itself, tells us very little about the role that contract law plays in relation to market outcomes. This is because to view the legal system as directing market outcomes through a form of hierarchical ordering is misleading. The legal system is itself an adaptive system, which possesses many of the features of self-organisation that evolutionary theory ascribes to the market. The issue becomes one of understanding the nature of the inter-systemic evolution, or ‘coevolution’, involved in the law-market relationship.

The predominant approach within law and economics is to see legal rules as an expression of an underlying behavioural logic. In Becker’s foundational account, the economic axioms of ‘maximising behaviour, market equilibrium and stable preferences’ are capable, if ‘relentlessly and unflinchingly applied’, of explaining all societal phenomena, including the legal system. These assumptions can, even more parsimoniously, be reduced to two core ideas: a theory of individual behaviour based on optimisation and a theory of societal organisation based on the idea of the self-equilibrating market.

9 Gintis, above n. 4, at 248: ‘The traditional equilibrium concept in game theory, the Nash equilibrium, is implemented by rational actors only if they share beliefs as to how the game will be played . . . [but] the rational actor model includes no principles entailing the communality of beliefs across individuals. For this reason, the complex Nash equilibria that arise in modelling the coordination of behaviour in groups do not emerge spontaneously from the interaction of rational agents.’


The research programme associated with ‘behavioural law and economics’ has largely focused on the first of these two ideas, to the relative neglect of the second. Prospect theory has identified a number of pervasive behavioural traits that appear to refute aspects of the rational actor model. Yet, on one view, the core of rational actor theory remains intact. This is what Gintis calls the ‘beliefs, preferences and constraints’ (BPC) model. Actors form preferences that are based on their beliefs about the world. They act ‘rationally’ with regard to these preferences when they choose from among alternative courses of action in a way that is consistent with respect to anticipated outcomes. Choice-consistency, or stability of preferences, is all that is required here; the more demanding postulates of the expected utility theorem go beyond what is necessary for the basic model to work. The insights of behavioural economics into the circumstances under which individuals behave ‘irrationally’ – that is, in an apparently less than welfare-maximising way – can all be explained as cases in which individuals maximise with reference to a given preference function. The idea of bounded rationality can be accommodated in this way; actors’ preferences are determined by their current state of knowledge of the world, which is a function, in part, of their (limited) cognitive capacity. In addition, other-regarding behaviour – altruism – can be modelled in choice-consistent terms. This is a central finding of the models that have been developed in the past decade in evolutionary and epistemic game theory, and it is supported by a growing body of empirical literature, much of it based on laboratory experiments, but now supplemented by field work studies. Thus, rationality need not imply ‘selfishness’. More generally, it is not inconsistent with the BPC model to assume that individuals do not always choose correctly (they may act consistently while still being mistaken about the state of the world), that they change their beliefs over time in response to a changing environment (this is not the same thing as being unable to rank different outcomes at the point of contracting) or that their choices, once made, do not in fact maximise their welfare (this is to confuse the basis for action with its consequences).

With these important qualifications, the rational actor model can be understood as a value-neutral, generalisable account of behaviour under conditions of economic scarcity. However, difficulties begin when the theory is used to generate a theory of societal organisation and, even more so, when it is used to construct a normative theory for use in the design of legal institutions.

The rational actor model alone cannot account for the existence of the structures that make societal coordination possible. Rational actor theory provides the basis for game-theoretical models of decentralised coordination. These models frequently imply a radical disjuncture between individual rationality and optimal societal outcomes. Individual strategies may spontaneously converge on stable states that maximise aggregate welfare, but the conditions under which they do so are extremely restrictive. The game-theoretical concept of ‘correlated equilibrium’ predicts convergence of this kind only when individual agents possess common knowledge of what other agents will do and hence can predict future societal states. Knowledge of future states cannot be derived from experience of past interactions alone but depends on correlating devices, which include social norms and more formal ‘public indicators’ such as legal rules. Norms and rules, which are particular types of a more general set of institutional phenomena, serve as summary representations of the recursive patterns or routines around which individual actors expect future strategies to converge. There is a continuum between social norms and publicly-expressed legal rules, with the latter tending to crystallise the former.

15 Gintis, above n. 4, at 1.
16 Id., at ch. 3.
17 Id., at 44.
19 Gintis, above n. 4, at 240-242.
How norms evolve and how they operate is a key issue for the behavioural sciences and, by extension, for legal scholars interested in viewing legal phenomena from a social science perspective. To address the question effectively involves an acceptance that public indicators such as norms and legal rules operate at a different level from that of the interactions of individual agents. This does not mean that the indicators of this kind are exogenously supplied, whether by government or by a pre-existing moral order. Norms and rules can be understood as emerging endogenously, that is to say, on the basis of the accumulated experience of individual agents, but, since they also frame the behaviour of those agents, they cannot be described in exclusively behavioural terms. The relationship between norms and behaviour is one of mutual interaction, that is to say, of coevolution.

Normative orders, such as the legal system, make it possible to code, store and transmit the accumulated knowledge on which societal coordination depends. Orders of this kind are ‘systemic’ in the sense that they are adaptive to their environment. This does not mean that they are precisely aligned to their external context. The accumulation and transmission of knowledge across time and space implies that some kind of inheritance or retention process is in operation, akin to (but not necessarily identical to) the process of genetic transmission. Selection may ensure some kind of ‘fit’ between the content of norms and rules and the environment in which they are applied, but, unless the context is unchanged or otherwise very stable, the information contained within normative orders can only be completely functional for past environments. As some degree of misalignment between normative orders and their (present) environments is unavoidable, normative solutions to coordination problems are necessarily imperfect and incomplete.

Contract law is an emergent normative order that has evolved over time in a way that loosely matches, in the sense just described, the conditions of the societies in which it operates. It does not literally describe external social ‘reality’ but instead recreates its external environment in ways that can be understood in terms of its own dynamics. Thus, external economic phenomena have to be redescribed in the conceptual or dogmatic terms of legal analysis. The study of legal concepts (which can be distinguished from the analysis of rules as such) makes it possible to reconstruct, in historical terms, the process by which the legal system has shaped, and has been shaped by, the emergent market order.

From this perspective, the answer to the question of how societal coordination emerges from the micro-foundations of individual agents’ behaviour and beliefs is to be found, in part, within contract law itself, that is to say, within the body of doctrine that informs the production and reproduction of legal rules concerning contracts. Contract law has its own accounts of ‘individual rationality’ and ‘societal coordination’.

3 The Capacity Concept and the Conceptualisation of the Market in Contract Law

All contract law systems recognise the principle that a simple exchange, even between otherwise consenting parties, is not enough to found a legally binding contract. It has to be shown, in addition, that each party has the capacity to contract. One aspect of capacity is the ability of a contracting party to assess whether a transaction is in its 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 with regard to those such as the very old or mentally ill, who for one reason or another may be unable to understand the

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22 Luhmann, above n. 8; Teubner, above n. 12.
consequences of their actions.25 Thus, 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, understood as the ability to make decisions about exchange in a choice-consistent way.

The common law concept of undue influence performs a similar function, denying contract enforcement in cases where one party, with the knowledge or assumed knowledge of the other, enters into a transaction in a context where their ability to understand and express their own best interests is limited. This can occur, for example, where family ties, religious or social affiliations, or dependence on another for advice or expertise qualify the ability to exercise independent judgment.26 Viewed in this way, undue influence and the capacity concept express a similar underlying logic.

However, the capacity concept is not limited to providing an account of individual rationality. It is also predicated upon assumptions about the need for institutional underpinning of market exchange. In this sense, it discloses a theory of the societal organisation needed to make markets function.

Thus, one aim of the doctrine of capacity is, without doubt, the paternalist one of providing protection to the incapable. But the doctrine also protects the market against the incapable,27 by excluding them from unassisted participation in exchange relations. They may enter into transactions, but only with the aid of intermediaries, thanks to the doctrines of assistance and representation. These ideas, which are formally stated in the civil law and implicit to some degree in the common law rules, are intended to enhance the contractual security of third parties and thereby secure confidence in market transactions in general.28 Thus, an inference that 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 on which contracts to enforce and on how, or on what conditions, to enforce them.

To say that this is a basic assumption of contract law systems is not to imply that contract law necessarily works this way in practice. Empirical observation, informed by economic or sociological theory, might be able to confirm the functionality (in this sense) of contract law, but this type of evidence cannot be directly inferred from the study of contract law doctrine. Contract law doctrine provides an insight into how the legal system has come to view the external effects of its own enforcement mechanisms. In the ‘internal’ discourse of contract law doctrine, the market is seen not as a natural state of affairs but instead as the product of a certain institutional configuration. In this respect, contract law’s view of the market is a very different perspective from that of mainstream law and economics, which is itself, of course, no more a description of an external social or economic reality than contract law doctrine is. ‘Law and economics’ is just a certain economic doctrine’s view of the legal system.

A number of other doctrines provide for selectivity in the enforcement of consensual transactions. In the common law systems, the doctrine of ‘public policy’ sets out a series of such grounds.29 These consist of a range of apparently ad hoc and unconnected justifications: ‘restraint of trade’, ‘agreements injurious to good government’ and ‘agreements contrary to family life’, and so on. Viewed functionally, these justifications divide into two categories: cases in which non-enforcement is justified by the need to protect the market against itself (or, more precisely, against the market-limiting effects of consensual exchange) and cases in which the aim of selective enforcement is the protection of society against the market.

The doctrine of ‘restraint of trade’ is concerned with protecting the market against itself or, more precisely, against the freedom of market actors to make agreements that hinder the operation of the market. Market entry and exit rules, price fixing, wage

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26 Id., at ch. 16.
28 S. Godelain, ‘Le concept de capacité dans le droit des contrats français’ in Deakin and Supiot, above n. 24.
29 McKendrick, above n. 25, at ch. 14.
regulation and other forms of contractual self-regulation of the market potentially come within the scope of the restraint of trade doctrine. Contract law recognises that the competitive process on which the market order depends for its successful operation can be undermined by the very value of freedom of contract that the market is meant to uphold. Selective legal enforcement of contracts is a precondition for a functioning market order.

The other heads of public policy cannot be explained as protecting the market against itself. Instead, they involve the assertion of certain social values that take priority over the market. When courts refuse to enforce contracts that are ‘contrary to public morals’, that undermine governmental authority, or that oust their own jurisdiction, they are recognising that certain institutions, such as the family, the apparatus of government and the legal system itself, are not just separate from the market but operate according to a logic that is not that of market relations. For these reasons, they require legal protection from the potentially destabilising effects of the market.

The list of grounds of non-enforcement is, nevertheless, selective and, arguably, outdated. At the turn of the twentieth century, courts in most common law jurisdictions, taking their lead from the House of Lords, held that the heads of public policy, as they then existed, were a closed set. This was, in part, a reflection of the view that the foremost goal of public policy should be to defend freedom of contract itself. But it was also the product of judicial abstention in the face of the growing body of regulatory legislation that was emerging at that time. The English courts recognised that the formulation of social and economic policy was an area in which Parliament was increasingly taking the lead.

In the course of the twentieth century, social and economic legislation displaced both the capacity concept and public policy as a source of contractual regulation. The rise of regulatory legislation gave rise to a process that legal historians refer to as ‘derationalisation’, signifying the fragmentation of the unitary concept of capacity: new forms of legal protection have arisen, representing new interests. In consumer protection and employment protection law, the law substantially qualified the concept of freedom of contract, but without using the technique of incapacitation to do so. Instead, legislation imposed mandatory and default rules of various kinds as a condition of contractual enforcement.

The relationship between social or regulatory legislation and the notion of contractual capacity has never been less than highly contested. In the early decades of the twentieth century, the language of capacity was invoked to argue that mandatory regulation was an inappropriate and, in some jurisdictions, unconstitutional constraint on freedom of contract. During the 1980s, some of these arguments resurfaced, along with a new emphasis on the alleged inefficiency of social legislation as a mode of contractual regulation. Deregulatory policy initiatives found inspiration in the US-based law and economics movement, which acquired a certain intellectual resonance around this time, as the institutional forms that had been designed for a world of protected national economies and stable economic relationships were unravelling. A principal example of this is the conceptual ‘crisis’ affecting the legal institution of the employment relationship. However, a simple return to private law, through ‘deregulation’, has not proved to be feasible. Despite the efforts of political opponents of the welfare state, contractual regulation remains all-pervasive in liberal democracies with a commitment

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30 Janson v. Driefontein Consolidated Mines Ltd. [1902] AC 484.
31 Printing and Numerical Registering Co. Ltd. v. Sampson (1875) 19 LR Eq 462.
32 The English courts were not able to invoke a higher constitutional authority to review the propriety of regulatory legislation, as the US courts were able to in Lochner, above n. 3.
34 For the use of the term ‘capacity’ in US constitutional cases on social legislation around this time, see the judgments in Lochner, above n. 3, and in Muller v. Oregon, 208 US 412.
to market-based ordering in the areas of economic and, increasingly, social policy. To consider why this might be the case, we will take a closer look at how contractual regulation works in the context of labour markets.

4 Justifications for the Regulation of Labour Contracts

Labour markets in developed economies are intensively regulated. This is just as true of ‘liberal market’ systems, such as those of the United States and the United Kingdom, as it is of the ‘coordinated market’ economies of continental Europe and east Asia. The United States lacks employment protection legislation of the kind commonly found in Europe (including the United Kingdom) and its collective labour law system covers a diminishing segment of the workforce, but it has a considerable body of regulatory legislation in relation to such areas as minimum wages, hours of work, occupational safety and health, employment discrimination, social security, employer-based retirement pensions and employer-based health insurance. How much of this regulation can be justified, or at least explained, on paternalistic grounds?

Sunstein and Thaler’s influential definition views paternalism as any intervention designed to improve the welfare of individuals whose choices do not reflect their true interests. This is likely to be the case, they suggest, where individuals have less than complete information, limited cognitive capacities, and a lack of self-control. ‘Drawing’, as they put it, ‘on some well-established findings in behavioural economic and cognitive psychology’, they argue that these conditions prevail more often than not in the context (among others) of labour contracting. The employment relationship provides an example of a situation in which preferences are likely to be ill-defined and context-dependent: ‘contextual influences render the very meaning of the term “preferences” unclear’. Paternalism is not just legitimate, it is unavoidable in the sense that even a default rule of at-will employment (implying no external legal regulation of employment termination decisions) implies a framing effect of a particular kind that will influence behaviour.

‘Libertarian paternalism’ proposes a set of techniques aimed at enhancing the quality of choice and, hence, of outcomes in situations where individuals act with less than complete transactional capacity. Libertarian paternalism is incompatible with ‘any approach that blocks individual choices’ – in other words, mandatory legislation. It is, on the other hand, entirely compatible with the wide array of derogations, waivers and opt-outs (or opt-ins) that are increasingly found in employment statutes. These techniques allow the parties some freedom of choice but tend to frame that choice by requiring that derogations from legislative standards are confined in terms of their substantive scope (as in the case of statutory wage premia for over-time work) or by reference to procedural safeguards (such as requirements that individual waivers be in writing, in a certain form or validated by a legal adviser or other representative).

At the core of the libertarian paternalist proposal is the claim that, in many contexts, individual decision-making is irrational but can be made more rational through targeted regulatory interventions. These interventions are paternalistic in the sense of protecting individuals against the consequences of their own decisions but libertarian in the sense of improving the quality of the decisions they take. Private action is moulded, or steered, but not entirely displaced.

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39 Id., at 1162.
40 Id., at 1161.
41 Id.
42 Id., at 1186-1187.
The fundamental difficulty with libertarian paternalism is that it employs a notion of ‘rationality’ that is neither a good descriptive model of human behaviour nor a meaningful benchmark for the design of legal institutions. As we have seen, for behaviour to be rational it simply has to be preference-consistent. Decision-making influenced by the endowment effect, framing, inequality aversion or other heuristic biases identified by prospect theory is not, by virtue of such influence, ‘irrational’. None of these effects ‘illustrates preference inconsistency once the appropriate parameter (current time, current position, status quo point) is admitted into the preference function’.43

The point is not simply a definitional one. The model of rationality that is emerging from empirical studies of strategic interaction (both laboratory experiments and field work) in the last decade is one in which human behaviour is essentially ‘pro-social’. Individuals display tendencies towards ‘altruistic cooperation’ and its converse, the punishment of non-cooperation, in contexts where such behaviour is not in their individual self-interest, even over the long run. Human agents are other-regarding as well as self-regarding, they have ‘social preferences’ that ‘facilitate cooperation and exchange’ and ‘moral preferences’ for the character virtues of honesty and loyalty. Above all, they display a ‘meta-preference’ for conforming to norms that provide guidance on what constitutes socially appropriate behaviour in a given context. Thus, preferences do not lack ‘meaning’,44 but both they and their behavioural consequences are ‘situationally specific’.45

The origins of the pro-social bias in human behaviour are probably biological: ‘human beings did not evolve facing general decision-theoretic problems. Rather, they faced a few specific decision-theoretic problems associated with survival in small social groups’.46 This is an area in which the key research questions are still being formulated, let alone answered. We do not need to have more complete answers to this set of questions in order to consider the implications of the amended rational actor model for issues of legal policy and design.

A first point to make is that very few if any of the regulatory interventions that take place in modern labour (or other) markets can properly be termed ‘paternalistic’ in the sense of protecting contracting parties against the consequences of their own decisions. This set of cases should be confined to situations in which individual agents do not display preference consistency (true ‘irrational’ behaviour). As nineteenth century contract law recognised, contract enforcement should be denied, or at least conditioned by certain protective devices, in cases where it is not safe to assume that individuals possess the capacity for rational action in this specific sense of the term.47 This category of instances is of marginal and decreasing relevance for labour law. Early factory legislation may have regulated the working hours and employment conditions of women and children on the grounds, in part, that these groups, in contrast to adult males, did not know their own best interests,48 but this is not a ground for intervention that has been invoked since at least the early decades of the twentieth century.

A second point to flow from the amendment of the rational actor model is that alternative, non-paternalistic justifications should be sought for labour market interventions. New institutional economics provides part of the answer here, in suggesting a role for regulation in addressing contractual incompleteness, asymmetric information and externalities of the kind that are commonly found in labour markets.49 This body of literature suggests that labour law rules can be justified not solely by reference to the protection of the interests of the ‘weaker’ party to the employment contract but, more

43 Gintis, above n. 4, at 25.
44 Sunstein and Thaler, above n. 38, at 1161.
45 Gintis, above n. 4, at 75.
46 Id., at 29.
47 See the discussion in section 2, above.
48 See Deakin and Wilkinson, above n. 23, at 226-231.
generally, in terms of the beneficial effects they confer upon all market actors. In other
words, it is the aggregate wealth-enhancing effects of labour law rules that matter, not
their redistributinal effects for particular contracting agents.

Useful as it is in dispelling some of the more dogmatic and doctrinaire arguments
of law and economics scholars against labour market regulation, new institutional
economics perhaps claims too much in seeking to portray labour law rules as market-
perfecting devices. If they improve market outcomes, they tend to do so in an imprecise
way. A more realistic account of labour law rules would see them from an evolutionary
perspective, that is to say, as emergent solutions to coordination problems of the kind to
which labour markets typically give rise. These solutions (factory legislation, collective
bargaining, minimum wages, social insurance and so on) are historically contingent,
context-dependent and often imperfect in their effects. They may be endogenous in
the sense of being generated by conditions in labour markets to which they respond,
but they are not spontaneous. While they may enhance aggregate wealth or well-being,
they often do so at the expense of certain groups. As such, they almost invariably
involve distributional compromises that are the subject of deliberative decision-making
processes located, at least partially, in the political domain.

Sunstein and Thaler are right to point to the very widespread use of default rules of
various kinds in contemporary labour legislation, but it is not necessary to invoke the
theory of libertarian paternalism to explain the origin of these rules or how they work.
Their goal can be understood as ‘market steering’ in the sense of framing overall market
outcomes, but this is distinct from the aim of moulding individual transactions. For
the most part, labour law rules of this ‘reflexive’ type involve collectively negotiated
derogations rather than the individual waivers favoured by Sunstein and Thaler. As such,
they are premised on the assumption that the design and implementation of labour law
rules can benefit from collective learning, that is to say, from a process of dialogue and
deliberation involving the collective parties (representatives of employers and workers
and representatives of the state). Labour law involves an almost endless search for
workable solutions in which outcomes are mostly determined, for better or worse, by the
interplay of political forces and by the relative strength of the interest groups involved.

Under these circumstances, the libertarian paternalist agenda is highly problematic
for labour law. The libertarian aspect of the programme would involve the dismantling
of the many mandatory norms still operating in this field and their replacement with
default rules of various kinds. Making adherence to labour standards optional may be
beneficial if it helps to generate a learning process about which solutions work and which
do not, but it can also destabilise social norms that provide a basis for cooperation. The
paternalist aspect of libertarian paternalism implies that solutions can be crafted by
enlightened regulators deploying the techniques of cost-benefit analysis. This neglects
the role that collective deliberation plays in legitimising the distributional compromises
on which labour law rules ultimately rest. Better justifications for labour law regulation
are available.

5 Market Access as a Capability

Whatever their pre-modern roots may be, markets in modern industrialised societies are
not natural or spontaneous phenomena. They are complex systems that have evolved
alongside other mechanisms of coordination, including the legal system. The market and

50 A. Hyde, ‘What is Labour Law?’ in G. Davidov and B. Langille (eds.), Boundaries and Frontiers of
51 G. Davidov, ‘Comment on Alan Hyde: The Perils of Economic Justifications for International Labour
52 See above n. 38.
53 J. Howe, R. Johnstone and R. Mitchell, ‘Constituting and Regulating the Labour Market for Social
and Economic Purposes’ in C. Arup et al. (eds.), Labour Law and Labour Market Regulation (Sydney:
Federation Press 2006).
the legal system complement and, in a deep sense, stabilise each other. While markets may be self-organising, this does not mean that they are always stable. The regulation of exchange is one of the techniques by which the legal system imparts stability to the market and renders its operation compatible, more generally, with societal coordination.

It follows that one of the consequences of the legal regulation of contracts is to facilitate the kind of individual autonomy that exists within a functioning market order. This ‘autonomy’ is the result of the opportunity, which the market provides to those with access to it, to participate in a system of exchange based on an extensive, societal division of labour. The market, so conceived, makes it possible for the wants of any individual actor to be met to the greatest possible extent that is consistent with the wants of all others. In principle, the preferences of all market actors are factored into the prices against which individuals decide whether or not to trade and, if so, to what extent. Thus, the gains from trade that any one individual can expect to make are contingent not just upon their preferences and the resources available to them but also upon the value others place on them, which in turn is a function of those others’ preferences and resources.

This much is familiar from classical law and economics. But we can go further. The implication of evolutionary law and economics is that without the coordinating devices of (among other things) social norms and legal regulation, there would be no markets in the sense that we are familiar with from the experience of modern societies or only less extensive and less socially valuable ones.

Given the functional role played by norms and laws, in what sense can it be said that contractual regulation infringes the autonomy of the contracting parties? One implication of juxtaposing autonomy and paternalism is that individuals have a right to receive the returns that they would have made if the contract had been struck free of regulation. This is, however, an illusion. Just as there is no such thing as an entirely ‘free’ (or unregulated) market, so there is no exchange which, at some level, is not being influenced by the normative structures that make market coordination possible.

A more justifiable claim is that the legal system should acknowledge and protect the right of individuals to meaningful participation in the market. This does not mean a right to a particular outcome, such as a wage or income of a certain level, but nor does it mean simply a right to take part in a given, isolated exchange. One of the principles underpinning minimum wage legislation is that wages should reflect as far as possible the social cost of labour, which includes the costs of its reproduction. The claim for a ‘living wage’ is in essence a claim to a wage that at least meets the costs of subsistence. As nineteenth century political economy recognised, when wages are paid below subsistence, either the labour supply will shrink (so reducing the scope of the market) or other mechanisms of support, such as the family or the social security system (as the poor law has become), will have to be found. There are strong arguments on incentive-compatibility and resource-allocation grounds for ensuring that the social costs of labour are met as far as possible through the wage system, rather than the social security system. But the point can also be made in ethical terms: minimum wage laws are a more effective means of enhancing labour market opportunities than tax credits, the principal alternative, which have a low take-up in large part because of the punitively high marginal tax rates to which they give rise.

Access to the labour market is a ‘capability’ that many labour law rules, in particular those in the rapidly developing field of employment discrimination law, protect and promote. A ‘capability’, in this context, refers to the capacity of an individual agent to realise a range of desired goals through participation in the labour market. These goals (Sen’s ‘functionings’) are subjectively defined and are not restricted to the material or financial aspects of employment but also include the psycho-sociological benefits of participation in organised economic activity. The capability approach focuses not on the content of functionings (these are individual-specific) or on outcomes according to an objective criterion of individual welfare or well-being such as expected utility

56 Deakin and Wilkinson, above n. 48, at 231-234.
57 Id., at 188-192.
58 Id., at 342-353.
59 Sen, above n. 10, at 235-238.
but on the environmental preconditions (broadly understood) of effective choice. These preconditions may refer to the physical or institutional environment. Thus, the capability approach opens up a debate, among other things, about the appropriate institutional conditions for substantive choice. While markets are, in principle, capability-enhancing institutions, given the opportunities for social and economic participation that they provide, access to markets depends on a set of prior conditions that are institutional and, to some degree, legal in nature.

The way employment discrimination law works exemplifies this point. The relationship between discrimination law and classical contract law mirrors that between the capability approach and standard law and economics analysis. 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. Thus 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. 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, while taking account of his or her disability. The duty is not absolute; the court in essence applies 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.60 But even so, the effect is to alter the conceptual framework of discrimination law in ways that point to its potential for enhancing capabilities. 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.61 If disability discrimination laws go further than most forms of social legislation currently do in imposing affirmative duties on employers in the name of market access, they nevertheless illustrate a general tendency of the law to grant substantive recognition to new forms of contractual capacity or, in economic terms, ‘capability’.

The precise way in which legal rules perform this role is a matter for more detailed, applied analysis in particular contexts. An important starting point in this kind of analysis will be to consider how it can be informed by an evolutionary analysis of law. It would be consistent with the capability approach to advocate a methodology that is less concerned with measuring outcomes in welfare terms than with putting forward principles for action of a procedural kind, intended to enrich the process of knowledge accumulation on which societal coordination depends. Thus, ‘the capability approach points to an informational focus in judging and comparing overall individual advantages, and does not, on its own, propose any specific formula about how that information may be used’. It does not set out any particular ‘blueprint for how to deal with conflicts between, say, aggregative and distributive considerations’, and does not prescribe formal equality of capabilities, as opposed to the expansion of capabilities in general, as a meaningful goal.62 It may be doubted whether the capability approach, so defined, sits entirely happily with a conception of libertarian paternalism based on the assumed ability of an enlightened planner to ‘nudge’ individuals in the direction of exchanges that, by reference to an external standard, enhance their well-being.63

6 Conclusion

This article has attempted to set out an evolutionary conception of contract law as the basis for assessing claims made in the autonomy-paternalism debate. It has argued

62 Sen, above n. 10, at 232.
that a discriminating approach to contract enforcement is a long-standing feature of contract law systems, which has coevolved with the emergence of market-based economies in liberal democratic societies. The regulation of contracts with a view to establishing norms of societal coordination is at the core of contract law doctrine and is central to the market-supporting role that legal institutions in general perform. Using examples from labour law, the article has also shown how contractual regulation can be justified in normative terms by reference to capability theory. Markets are important capability-enhancing institutions, but this effect depends on regulatory mechanisms that complement the operation of the market.