The Economics of Contracts

Dr. Ranjul Rastogi

ABSTRACT

Economic analysis of law *is an approach to legal theory that applies methods of economics to law. It includes the use of economic concepts to explain the effects of laws, to assess which legal rules are economically efficient, and to predict which legal rules will be promulgated. Earlier the use of economic analysis for the study of law and legal institutions focused primarily to the fields of anti-trust legislation etc. Today, however, it is common to delve with property law, crime and punishment, torts, and contracts with economic tools.*

The economic basis for contract law is the creation of inducement for value maximizing behavior in the future; it encourages a process by which resources are efficiently stimulated through a series of exchange into successively more precious uses.

This paper demonstrates the usefulness of underlying economic principles for explaining the basic doctrines of contracts, enforcement of contracts, formation defenses and performance defenses. It further explores economically efficient breach also.

Key Words: *Contracts; Enforcements; Efficiency; Formation Defenses; Performance defenses; Value Maximization; Efficient Breach*

Introduction

Contract is the most exciting field of law in which economists are relaxed and feel at home. There are many excellent surveys which discuss economic analysis of contract law[1].

Scholars from economics discipline try to answer key issues related to contract law, such as; does our society really need contracts? If so, why and under what conditions? Should a contract always be performed, even if it causes an economic loss to one side or both of the contractors? What is the best solution when a party fails to perform his or her mandatory contractual obligations (Posner 2003)? [2]

In the traditional economist approach the law of the contract is viewed as a gadget for facilitating trade, passing on the risk between parties and economizing the cost of making transaction. By providing strategy for transaction it helps increase the wealth of nations.

Value maximization is the core of economic principles. The creation of incentives for value maximizing conduct in the future, encouraging a process

by which resources are smoothly moved through a series of exchange into successively more valuable uses forms a basis for contract law.

Basic Canons of Contract Law

A contract is a promissory agreement for a future exchange freely and voluntarily arrived at. The law of contract is designed to facilitate the process of exchange and to minimize the breakdowns and thus it contributes to transaction efficiencies.[3]

The basic doctrine of contract law is the presumption of voluntary action by both parties. Validity of contract depends on a clear sign of consent by both the parties and the presence of consideration. Duress or compulsion or other non-voluntary behavior is thus a defense to contract