
Law, Market and Marketization

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TABLE OF CONTENTS: 1. Introduction; 2. Law & Markets; 3. Law & Marketization; 3.1. Assetization; 3.2 Transferring Assets; 3.3 Authentication and Valuation of Assets; 4. Conclusion.

ABSTRACT: Marketization is a process occurring in many transitional economies as countries seek to adjust their legal systems to facilitate broader market participation while expanding global trade. This essay sets out one way of understanding this process by focusing on the relationship among, law, markets, and marketization. It identifies and explains basic legal requirements for marketization and links these to a need to transform legal thinking by integrating a greater understanding of economics into both law and public policy.

KEYWORDS: *Law and Economics; Markets; Marketization; Rule of Law; Property.*

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1. INTRODUCTION

In the second decade of the new millennium, as we deal with the post-financial market meltdown and the failure of self-correcting market theory to prevent a global financial crisis, the legal pragmatists among us realize a need to think carefully about the relationship between law, markets and marketization.¹ Putting the recent financial collapse into perspective, we should note that we have already spent some forty years with law and economics as an important influence in jurisprudence,² bringing market thinking firmly into law, and that we have already been through the processes of *globalization*, *harmonization*, and the *transition to market economies* in such countries as China, and in some of the countries of Eastern Europe and the former Soviet Union. Therefore, it is a fitting time to reflect on the role of law in facilitating the ongoing process currently referred to as *marketization*.

The process of marketization can be understood in at least two different ways. First, it might simply refer to the process of expanding competition and choice. This interpretation is consistent with the jurisprudence of people such as Adam Smith. A second way of understanding marketization is in terms of legal commodification. This article uses the second interpretation. The process of marketization as a form of commodification is one in which various social, legal, political, and cultural

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¹ See THE FUTURE OF FINANCIAL REGULATION (Ian G. MacNeil & Justin O'Brien eds., 2010); LAW AND ECONOMICS OF GLOBAL FINANCIAL INSTITUTIONS (Peter Nobel, Katrin Krehan, & Anne-Catherine Tanner, eds., 3d ed. 2010); MICHAEL MALLOY, ANATOMY MELTDOWN: A DUAL FINANCIAL BIOGRAPHY OF THE SUBPRIME MORTGAGE CRISIS (2010); Robin Paul Malloy, *Mortgage Market Reform and Fallacy of Self-Correcting Markets*, 30 PACE L. REV. 79 (2009); David Reiss, *Subprime Standardization: How Rating Agencies Allow Predatory Lending to Flourish in the Secondary Mortgage Market*, 33 FLA. ST. U. L. REV. 985 (2006); THOMAS E. WOODS, MELTDOWN: A FREE-MARKET LOOK AT WHY THE STOCK MARKET COLLAPSED, THE ECONOMY TANKED, AND GOVERNMENT BAILOUTS WILL MAKE THINGS WORSE (2009).

² Ronald H. Coase, *The Problem of Social Cost*, 56 J.L. & ECON 837 (1960); GUIDO CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS (1970); RICHARD A. POSNER, THE ECONOMICS OF JUSTICE (1981); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (9th ed. 2014); ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS (2000); ROBIN P. MALLOY, LAW AND MARKET ECONOMY: REINTERPRETING THE VALUES OF LAW AND ECONOMICS (2000); NICHOLAS MERCURO & STEVEN G. MEDEMA, ECONOMICS AND THE LAW: FROM POSNER TO POST-MODERNISM AND BEYOND (2d ed. 2006).

institutions reform themselves with reference to market mechanisms and market values. Thus, lawyers move from discussions of “natural law” and of the moral foundations of law, to conversations of “cost and benefit” analysis and the economics of justice.³ Similarly, legal institutions increase their focus on matters of “efficiency”, and increasingly speak of “justice” in terms of economic opportunities and outcomes. The process of marketization involves a reinterpretation of legal and social relationships in terms of the needs of commerce, and it increasingly makes reference to economic terms such as efficiency and wealth maximization when evaluating such relationships. While this process does not equate law to economics, it does mean that the legal interpretive frame of reference changes and that more and more decision making is based on price calculations and other economic considerations. In the process of marketization law serves the purpose of commercialization by protecting property, promoting production, and facilitating consumption and trade. Freedom, equality, fairness, and progress become understood in terms of law’s relationship to market interests; including the perceived interests of owners, creditors, investors, entrepreneurs, consumers, and workers.

In this brief essay, I approach the process of marketization as one of understanding the market from a legal perspective rather than one of doing an economic analysis of law; and, I outline the way in which law functions as a form of infrastructure to facilitate trade and exchange. Because the law and legal institutions function primarily as infrastructure for trade and exchange, they are frequently underappreciated. To many people, trade seems to happen by operation of an invisible hand; with law appearing primarily when a transaction goes bad and the parties need to resolve a dispute.⁴ Dispute resolution is, of course, an important function of law, but much of law deals with making transactions stable, efficient, and predictable, even as between parties who are unknown to each other.

³ See POSNER [THE ECONOMICS OF JUSTICE], *supra* note 2; POSNER [ECONOMIC ANALYSIS OF LAW], *supra* note 2; COOTER AND ULEN *supra* note 2; MALLOY, *supra* note 2; ROBIN PAUL MALLOY, LAW IN A MARKET CONTEXT: AN INTRODUCTION TO MARKET CONCEPTS IN LEGAL REASONING (2004).

⁴ See MALLOY, *supra* note 2; MALLOY, *supra* note 3; Malloy, *supra* note 1.

The starting point for identifying the connections among law, markets, and marketization probably goes back to Adam Smith.⁵ In *THE WEALTH OF NATIONS*,⁶ published in 1776, Adam Smith observed that legal and economic systems developed together and reflected a community's' economic stage of development. Smith identified four stages of development and suggested that the age of commerce; based on the specialization of labor, the protection of property, the freedom of contract, and the development of good legislation, produced more prosperity and greater freedom than observable in any one of the earlier three stages of hunting, herding, and farming.⁷ Each stage also involved a stronger emphasis on property, and on the need for more advanced legal arrangements to deal with property. For Smith, the age of commerce and the process of marketization facilitated social progress. This was because Smith understood that advancing through these stages involved expanding opportunities for competition and choice, and this in turn facilitated a rising standard of living for everyone.

Today, political and economic elites in emerging and developing countries see the prospects for a more prosperous future arising from marketization and the transition to a market economy. In such a market economy, relationships are structured in terms of costs and benefits and are translated in to value neutral exchanges. Talk of morals and politics are implicitly sidestepped as interaction is driven by the desire for making money and for turning a profit. This may potentially reduce interpersonal conflict as people are motivated by self-interest to work at making money and improving their personal fortunes rather than engaging in conflict over abstract ethical, moral, and theological matters. In Smithian terms, this may also be beneficial because individuals pursuing their own self-interest

⁵ ADAM SMITH, *THE THEORY OF MORAL SENTIMENTS* (1759); ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* (1776); ADAM SMITH, *LECTURES ON JURISPRUDENCE* (Glasgow ed., Lexicos Publishing 1982) (1896).

⁶ See SMITH, *supra* note 5.

⁷ See generally C.A. Cooke, *Adam Smith and Jurisprudence*, Neil McCormick, *Adam Smith on Law*, Peter Stein, *Adam Smith's Jurisprudence—Between Morality and Economics*, David Lieberman, *Adam Smith on Justice, Rights, and Law*, Fabrizio Simon, *Adam Smith and the Law*, in ADAM SMITH AND LAW (Robin Paul Malloy ed., forthcoming Feb. 2017).

naturally advance the public interest at the same time; even though the public interest may be no part of their original intention.⁸

To be effective, the process of marketization requires embracing a need to reform other institutions to reflect the language, values, and outcomes that a market economy will hopefully bring. This is because market economies not only need the infrastructure of open and unrestricted trade; they need the validation of desirability from a variety of other social institutions. Marketization, thus, becomes the process of cross validation of institutional support for a more open, competitive, and decentralized coordination of scarce goods, resources, and services; and, ultimately for stronger legal rights. In the process, law not only provides the infrastructure for more efficient market activity, it normalizes the power dynamics of market relationships and makes them appear “natural.”⁹

In exploring these ideas, this essay describes some of the key ways that law and legal institutions facilitate market exchange. The essay is not intended to be all encompassing nor overly detailed. It is meant to offer a general and overarching understanding of the various ways in which law usefully functions to incentivize and protect market expectations. In proceeding, therefore, I should note that many of the ideas expressed herein extend on work explored in two of my early books: *Law and Market Economy: Reinterpreting the Values of Law and Economics*;¹⁰ and *Law in a Market Context: An Introduction to Market Concepts in Legal Reasoning*.¹¹ In each of these books I develop the idea of law and market economy. This approach is one based on understanding the market as a dynamic process of exchange in which the act of exchange itself creates and transforms meanings and values in the relationships of participants and the things they trade.¹² For instance, when the United States engages in trade with China, both countries have a change in values over time. While the United States may believe that trade facilitates China becoming more invested in freer markets and in democratic reforms, the United States simultaneously experiences pressure to adjust its labor and

⁸ See MALLOY, *supra* note 2; MALLOY, *supra* note 3; Malloy, *supra* note 1.

⁹ See generally ADAM SMITH AND LAW (Robin Paul Malloy ed., forthcoming Feb. 2017).

¹⁰ MALLOY, *supra* note 2.

¹¹ MALLOY, *supra* note 3

¹² *Id.*, MALLOY, *supra* note 2.

production practices in order to be more competitive with China. Consequently, as with any exchange relationship, both sides to the exchange influence each other because exchange requires the continuous mediation of conflicting cultural–interpretive tensions.

In this approach, the problems of the law are economic because law governs the ways that people deal with the competition for limited resources; and, the problems of economics are legal because law provides the “tools” and infrastructure for trade and exchange. Consequently, this approach focuses on the strategic role of law in relation to the stages of social development; and, marketization involves the movement of a community from the early stages of economic development (the age of hunters, herders, and farmers), to the more advanced stages of commerce. In this transition to a commercial society, it is also important to understand that the value of any given market transaction depends on its position and its relation to all other elements of a given system of exchange (a given market context). Thus, exchange and the values generated by it are contextually informed by a variety of factors such as history, ideology, and culture. In such an environment, price functions as a relative interpretation of value; and is not value itself. An important implication of this is that cost and benefit analysis implicitly incorporates within its calculus a set of historical, ideological, and cultural values. For this reason, cost and benefit analysis cannot provide a neutral and objective approach to legal decision making. Cost and benefit analysis must reflect community values with respect to relative pricing, and it favors values that are easily priced over values that are abstract and difficult to price, while privileging the preferences of those with many resources over the preferences of those with few resources. In this context, law not only facilitates these transactions, it normalizes them and makes them appear to be natural and desirable.

In exploring the ways that law functions as an infrastructure for markets and marketization, I proceed in two steps. First, I consider the relationship between law and markets; where trades are organized, stabilized, and pursued in ways that respond to the legal environment in which trade takes place. Second, I address the relationship between law and the process of

marketization; where marketization is understood as the process of institutionalizing and incentivizing interpersonal relationships in terms that facilitate the capture and creation of value through trade.

2. LAW & MARKETS

Markets are about the human process of exchange; a giving of a “this” for a “that”. In this process, the rules, standards, and norms of law mediate the tension between private and public interest so as to peacefully promote the common interest.¹³ Importantly, law organizes exchange by creating the infrastructure to expand beyond local and informal trade networks.¹⁴ It does this in several ways. For the purposes of this paper, discussion is focused on five key functions of law. These functions include establishing and enhancing: 1) acceptable networks and patterns of exchange; 2) transparency; 3) predictability; 4) stability; and 5) trust.

Law is critical to formalizing exchange networks that operate effectively across time, and beyond reliance on local and personal relationships.¹⁵ Law defines and frames the terms, consequences, and acceptable objects of exchange. It also categorizes different types of exchanges; such as by consent (contract), gift, and operation of law. Each of these categories of exchange has different rules. Likewise, law informs us about who may engage in certain types of exchanges. For example, minor children (under the age of eighteen years) often have no power or only limited power to engage in certain types of trades, and corporations have to meet certain tests to qualify as legal persons able to enforce contracts or conduct legal trades. In a similar way, law often regulates pricing and the content of exchange agreements, while also limiting legally permissible objects of exchange. For example, law permits trade in oil, diamonds, and automobiles but does not generally permit transactions for the sale of babies, body parts, or governmental elections.

¹³ MALLOY, *supra* note 2; MALLOY, *supra* note 3.

¹⁴ See, e.g., DE SOTO HERNANDO, *THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE* (2000); MALLOY, *supra* note 2, at 109.

¹⁵ See, e.g., DE SOTO, *supra* note 14; MALLOY, *supra* note 14.

Law must also define consequences of trades. Some trades, if permitted and properly executed, are upheld by law, other types of trades such as those in violation of the appropriate exchange rules (exchanges on the black market, for instance), may be disallowed and the parties may be charged with crimes. Some exchanges may be legally classified as fraudulent or be unenforceable because of the way in which one party obtained the consensual compliance of the other party. The nature of what is exchanged, who participates in exchange, and the terms and consequences of exchange are all structured in reference to law and legal institutions. Even informal and illegal trades make reference to formal law by the simple fact that they hold the status of informal and illegal exchanges because they are outside of the formal framework.

In addition to identifying the permitted objects of exchange, law functions to describe, quantify, and represent the objects of trade. For example, the law may provide for private property ownership and for the sale and purchase of property within certain approved exchange networks. For this to work effectively, law must also describe and define the interest being exchanged. Thus, law has to provide a representation of the property that can be easily dealt with; this can be accomplished with a deed or other document of title. The deed is not the property but a representation of the property that is easier to deal with.¹⁶ Extending this example, the deed can be used to represent a person's interest in a particular property and can be used to support credit, as in using it to secure a mortgage.¹⁷ The mortgage is thus a representation of a right against the property by the creditor in the event of nonpayment, and simultaneously a representation of the right to receive a stream of cash flow under the terms of the mortgage repayment schedule. As a representation of the cash flow under the mortgage, this representation can be used to support the issuing of a security based on the expected value of the cash stream (e.g. mortgage backed securities).¹⁸ All of this facilitates trade and enhances the opportunities for capturing and creating value from exchange.

¹⁶ MALLOY, *supra* note 14; MALLOY, *supra* note 3.

¹⁷ MALLOY, *supra* note 3.

¹⁸ Malloy, *supra* note 1; ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES AND MATERIALS 400 (4th ed. 2013).

Law plays an important role in establishing transparency in the exchange network. Transparency is very important for purposes of reducing transactions costs, particularly in large and impersonal trading networks.¹⁹ Transparency performs at least two very critical functions. It reduces information and search costs across the network, and it facilitates the process of authentication. The idea of information and search costs is well known. Authentication is probably less well understood.²⁰ Authentication is a key factor in exchange. It involves the ability to “prove out” the substance of a trade. This includes confirming the identity of the other parties, the validity of the documents, the accuracy and availability of credit, and the substance of the underlying object of the trade. For example, in a ponzi scheme (such as that undertaken by Bernie Madoff)²¹, and as in the recent collapse of mortgage markets in the United States, there was little or no reality in the underlying economic substance of the trade to support the represented value of the exchange. In each case the underlying value was misrepresented such that the exchange at the level of a representational interaction (e.g. buying securities based on an underlying real estate transaction) was not an authentic reflection of the actual economic substance of the underlying situation.²² People were engaging in trades that had no sound basis in economics because they either did not or could not properly authenticate the underlying arrangements upon which their trades were based. Law can provide mechanisms for making it possible to better authenticate the trades people are making. Transparency thus reduces risk and lowers the cost of exchange.

Law facilitates predictability in exchange. This also reduces risk and cost. By establishing uniform documents, and promoting the standardization and harmonization of the terms and conditions of trade, law enhances predictability while reducing bargaining costs. Law identifies the background legal framework and default rules that apply to certain exchanges and it establishes remedies for particular types of failures in performance among

¹⁹ MALLOY, *supra* note 2; MALLOY, *supra* note 3.

²⁰ Malloy, *supra* note 1.

²¹ See STEPHANIE YANG, *5 Years Ago Bernie Madoff Was Sentenced to 150 Years In Prison – Here's How His Scheme Worked*, BUSINESS INSIDER, (Jul. 1, 2014), <http://www.businessinsider.com/how-bernie-madoffs-ponzi-scheme-worked-2014-7>.

²² Malloy, *supra* note 1.

the parties. With shared knowledge of these criteria, strategic planning and structuring of a trade is greatly enhanced because the parties have a more predictable basis for assessing and managing risk.

Law, through legal institutions, must also establish stability. Even though markets are dynamic and fluid, the legal system must impose a sense of stability on the networks of exchange. Just as it is difficult and costly to work in an environment when one never knows if there will be electric power available, or if the computer system will be working, or if the banks will be open and operating from one day to the next, so too if the stability and longevity of the legally supported network is in doubt. Markets can be destabilized when governments simply confiscate private property, or unexpectedly deflate the currency. Likewise, if the very governance structure and functionality of a state and its legal system are in question, exchange will be much more difficult and costly.

Finally, we know from the success of some informal exchange networks that trust is an important element of a strong, extensive, and efficient trading network.²³ Trust can arise within kinship groups, in local communities where everyone knows each other, and in other specified circumstances. Trust, however, is really about reputation value. Close friends can trade with each other because they probably have good information about each other and they have a sense of the reputational value of the likely performance of the other party to the exchange (trust). Law can facilitate trust by backing up and enhancing that which already exists in the network of trades taking place. It can also make many more trades possible by providing a substitute reputational reference point. A party can effectively trade with another unfamiliar party over a very long distance and across a long time horizon if both parties place a high value on the rule of law and legal framework applicable to their exchange. In other words, a transparent, predictable, stable, and well defined legal system can provide the reputational trust value necessary to facilitate trade on a global scale.

Some aspects of a legal system may even become individually “branded”. While there are a number of strong legal systems from which to

²³ See FRANCIS FUKUYAMA, TRUST: THE SOCIAL VIRTUES AND THE CREATION OF PROSPERITY (1996).

choose when doing trades (choice of law rules), some aspects of a particular system may take on the status of a highly sought after brand product. For example, many exchanges involving admiralty and maritime law select England and English law to govern the trades.²⁴ Similarly, in the United States, many people select the law of the state of Delaware in choosing to incorporate their business.²⁵ Maritime law and England, and corporate law and Delaware; these are examples of particular legal institutions that have gained “brand status” for facilitating trust among distant and impersonal exchange partners trading in these particular legal categories.

While particular details of law and legal institutions are subject to many variables, it seems critical for law to perform the above five functions. In facilitating markets by providing a formal infrastructure of exchange, law reduces the cost of trading and it makes it possible to extend the networks of exchange beyond that of purely local and personal arrangements. This is important because value and opportunity are greatly enhanced as the scale of trading increases and the flow of information expands. Global market activity and economic growth on a large scale are only really manageable under a rule of law. Among other things this rule of law must address are: exchange, transparency, predictability, stability, and trust.

3. LAW & MARKETIZATION

By the term marketization I refer to the process of institutionalizing the meanings and values of exchange in networks designed to transform, capture, and create value from economically beneficial trades. This process is facilitated by law in several ways. Law provides infrastructure for: 1) fixing of assets (defining property / the process of assetization); 2) transferring of assets (most significantly for markets the voluntary transfer by contract); 3) authenticating and valuing assets; and 4) sustaining a dynamic process of value formation.

²⁴ See generally Joseph C. Smith, *Comparative Aspects of Commonwealth and U.S. Law Since the Collision Convention*, 57 TUL. L. REV. 1092 (1983).

²⁵ See FRANKLIN A. GEVURTZ, *CORPORATION LAW* 38-40 (2d ed. 2000).

3.1 ASSETIZATION

Assetization is the process of fixing assets so that they are capable of easy exchange.²⁶ This includes fixing a writing for purposes of copyright, and fixing an invention for purposes of patent law, just as much as it includes fixing a legal description and an estate interest for the identification of real property.²⁷ Thus, while real property and intellectual property may have significantly different qualities, each is able to be properly understood as a property asset because each involves the fixing of an interest within the basic framework of a property law regime. The idea that certain interests might also be describable in non-property terms does little to diminish the reality that such an interest can also be a legally fixed property asset.²⁸ Not all property assets need to share exactly the same qualities or characteristics.

Fixing an asset involves identification, definition, and assignment of certain qualities, characteristics, and categories to it.²⁹ The underlying qualities include definitional matters such as fixing a legal description and the particular estate interest for real property. In terms of assigning characteristics to the asset, the typical characteristics of ownership include the right of use and possession, the right to exclude, the right to transfer, and the right to the profits attributed to the asset (including equity appreciation).³⁰ Finally, property related assets are categorized in such terms as real, personal, intangible, cultural, and intellectual property. This permits a more nuanced treatment of the asset. Fixing the asset also involves ascribing certain default rules, such as remedies, for example, to transactions in that asset.³¹ Thus, by simply categorizing something as “real property” one can ascribe certain qualities, characteristics, and potential causes of action to the asset. This makes dealing with the asset more efficient by reducing

²⁶ See, e.g., Robin Paul Malloy, *Real Estate Transactions and Entrepreneurship: Transforming Value Through Exchange*, 43 IND. L. REV. 1150 (2010); DE SOTO, *supra* note 14.

²⁷ Malloy, *supra* note 26.

²⁸ Malloy, *supra* note 26.

²⁹ Malloy, *supra* note 26.

³⁰ See JOSEPH WILLIAM SINGER, *PROPERTY LAW: RULES, POLICIES AND PRACTICES* (4th ed. 2006).

³¹ See RICHARD H. THALER AND CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH AND HAPPINESS* (2008).

various transaction costs associated with learning about its potential value. Property law and property lawyers focus primarily on the fixing of assets.³²

Assetization is a more flexible term than property because the idea of property has different meanings in different communities, and the legal mechanisms for dealing with property vary significantly among and between common law and civil law jurisdictions. There are some interests such as trademark which function in many ways like property but are not categorized as property.³³ We can talk about “property-like” assets in a broader context of discussing assets that express property-like characteristics in certain circumstances and under certain conditions.

Once fixed, assets become commodified and they are capable of being more readily traded and exchanged in the marketplace. Part of assetization, therefore, involves the creation of standard and formal representations of the assets; such as developing paper representations of assets that are difficult to move or are abstract in nature; including deeds for real property that “represent” the interest held in an underlying piece of land, and mortgage documents that represent the right to cash flow from payments being made to purchase land on a credit basis (as well as contingent rights to the land itself if the borrower defaults), and a patent or copyright representing rights in a given invention or expression.

3.2 TRANSFERRING ASSETS

There are generally three methods of transferring property: by gift, operation of law, and by exchange for value. A gift is generally not a market event in the sense that it need not involve a quid pro quo exchange. A transfer by operation of law involves such things as a transfer of ownership under the rules applicable at death; the law by its operation transfers the asset from one party to another. Exchanges for value can be consensual or forced. Consensual exchanges make up the biggest part of market transactions between willing buyers and sellers. Forced exchanges might include transfers by trespass with a remedy, or a takings with just compensation under the United States Constitution, or a taking under the property provisions of

³² Malloy, *supra* note 26.

³³ Malloy, *supra* note 26.

constitutional documents as they exist in many countries.³⁴ Law must provide rules, standards, and institutional infrastructure for each type of transfer, with consensual transfers being of most interest to the idea of market exchange. Thus, there are rules on contract formation, performance, and enforcement, as well as rules dealing with gifts and other types of transfers.

Two important concepts that facilitate incentivizing transfers are liquidity and leverage. In turn, both of these are enhanced by the fact that assets can be fixed and represented in documentary form. Liquidity involves the velocity of value capture, formation, and transformation through market exchange.³⁵ Assetization involves the fixing of assets, and liquidity relates to the efficiency of the exchange networks. Liquidity is enhanced by a system of uniform and predictable contract rules, standardization of forms and documentation, certainty of pricing, ease of spreading risk, and availability of good information. Liquidity is also enhanced by expanding the scale of the market to include more and more potential traders.

Related to liquidity is the idea of leverage. Leverage advances the quantity and volume of trade value by allowing current access to future value by way of debt and equity financing.³⁶ Leverage can facilitate liquidity by making more exchanges possible by expanding the amount of money/credit in circulation. Liquidity focuses on the velocity of exchange and leverage expands the pool of credit available for exchange.

Connectivity is also important to transactions and trade. An expanding market creates more and more opportunities for interactive exchange combinations.³⁷ As the exchange combinations expand, the system can become more diverse and organize more and more information, thereby enhancing the potential for value-adding creativity. Connectivity is akin to

³⁴ TOM ALLEN, *THE RIGHT TO PROPERTY IN COMMONWEALTH CONSTITUTIONS* (2000).

³⁵ See JEFFREY J. HAAS, *CORPORATE FINANCE* 25 (2014).

³⁶ *Id.* at 157.

³⁷ See generally OZ SHY, *THE ECONOMICS OF NETWORK INDUSTRIES* (2001); Brett M. Frischmann, *An Economic Theory of Infrastructure and Commons Management*, 89 MINN. L. REV. 917 (2005); BRETT M. FRISCHMANN, *INFRASTRUCTURE: THE SOCIAL VALUE OF SHARED RESOURCES* (2012); YOCHAI BENKLER, *THE WEALTH OF NETWORKS: HOW SOCIAL PRODUCTION TRANSFORMS MARKETS AND FREEDOM* (2006); 1 MANUEL CASTELLS, *THE RISE OF THE NETWORK SOCIETY: THE INFORMATION AGE – ECONOMY, SOCIETY, AND CULTURE* (2nd ed. 2010); KECHENG LIU, *SEMIOTICS IN INFORMATION SYSTEMS ENGINEERING* (2000).

expanding the network architecture of exchange. As with a computer or cell phone network, expanding the legal infrastructure of exchange to enhance liquidity, leverage, capacity, accessibility, and strategic interaction can increase participation value for all users. The more interconnected (in the sense of degrees of connectivity) the system and the larger the scaling of exchange, the more strategic the network is to the value of market activity.

Law facilitates connectivity by developing uniform documents, standardizing and harmonizing rules and norms, and by establishing a set of default rules that lower the cost of bargaining. Law also functions to expand the market by creating a partial substitute and an enhancement to “trust”. Law can provide a formal, transparent, predictable, and stable substitute for local and personal contacts. In this way, the trust functions of personal knowledge and experience can be substantially shifted from the individuals to the reputational value of the legal system governing exchange, and if the system is highly regarded it can function to reduce the risk associated with impersonal exchanges across place, space, and time. This reputational value may be associated with strong protection of rights to assets, well developed contract rights and remedies, objective (apolitical) decision making, and a variety of other factors.

3.3 AUTHENTICATION AND VALUATION OF ASSETS

In order for the marketization process to work effectively law must provide mechanisms to facilitate authentication and valuation.³⁸ Authenticating a transaction is similar to the idea of authenticating a password access to certain web pages on the internet, or authenticating a right to be in a given place by use of encrypted codes driven by finger prints and other devices. In the typical transactional setting it means authenticating the existence of the asset, its basic quality and quantity, and such things as the authority of the person transferring the goods. It also involves authenticating the “originality” and completeness of all documentation. Some ways of dealing with these issues require reference to information recorded on the public records; review of corporate documents with respect to corporate existence and authority of particular individuals to transfer assets; surveying with

³⁸ Malloy, *supra* note 1.

respect to land, and other similar action such as credit checks. The basic idea is that markets with good tools for authentication have more liquidity, better capacity for leverage, and greatly reduced risk.

As to valuation, law must provide a means for translating value into easily measurable units, usually in terms of money for purposes of trade. In the marketization process, price, to a large extent, serves as an interpretation of value. Through pricing mechanisms, complex systems become easily comprehensible in terms of the relative exchange values between different positions in the system. Pricing performs the function of translating numerous competing preferences and values into a common language. This enhances the speed and ease of comparing relative tradeoffs across a large scale network. Law and legal institutions need to define the acceptable and enforceable methods of translating price into value and the degree to which particular translations will be backed up with legal sanctions and remedies.³⁹

More particularly, value is a complex theoretical subject but we can begin to understand some basic elements of value by thinking in terms of three transactional categories of value: use value, exchange value, and network value. Simply and briefly stated: use value is the value derived from being able to use an asset (a house provides shelter); exchange value is the value, and potential value, that an asset represents as an access point to the market (the ability to borrow against one's home, or its value in resale); and, network value is the value of an asset in relationship to an integrated plan of asset exchanges (such as the value of housing in terms of being a source of employment for construction workers and lumber companies, and as an engine for furniture and appliance sales, and in terms of an input item, via mortgage activity, to securitized asset markets).

Value must, of course, also account for different underlying measures of fair market, hedonic, and contingent valuation across the above three mentioned categories. It also requires knowledge of present discounted value

³⁹ See EVE PREMINGER ET AL., TRUSTS AND ESTATES PRACTICE IN N.Y. § 9:249 (Volume D-E New York Practice Series)(explaining that the three most common methods used to determine the fair market value of real property are cost method, income capitalization and the comparable sales method); see also MALLOY, *supra* note 3 (discussing contingent and hedonic value); see also HAAS, *supra* note 35, at 53-5 (explaining how to calculate discounted present value).

and the extent to which various legal rules account for different definitions of value.

The process of marketization can be positive when it expands the opportunities for trade. For instance, being in a small village with an informal market system provides much less value enhancing potential than being connected to a larger scale national or global market network. In the local market, people may know each other and have relatively good information about the people and parties to an exchange. Larger and more effective exchange networks bring in more and more people so that discrete bits and pieces of knowledge (embedded within individual and personal experiences) come into the market. It is the bringing together and mixing of fragmented information that allows for opportunities to discover new, better, and lower cost avenues of trade.

Marketization can have negative implications to the extent that it involves subordinating a variety of cultural and ethical values to a system in which price stands not just for an interpretation of value but is interpreted as value itself. Thus, rewriting the grounds upon which human relationships take place. It can be a move away from the idea of the sacred, of nature, of the spiritual, and the mystical, to the rational reduction of feelings and emotion into a cost and benefit calculus; a calculus in which all human values are expressed in terms of wealth calculations, whereby everything is given a price, and wealth maximization becomes the highest value. Law must function to “soften” the marketization process to ensure that it is understood as a means to achieving desirable human ends, and that it avoids the temptation to become a simplifying end in itself.

To be positive, marketization has to be based on the advancement of human values and the respect for community standards and norms. Marketization does not involve merely privileging the individual pursuit of self-interest. Market actors are social beings embedded within a culture. In order for the pursuit of self-interest to be positive it must be tempered with a regard for others, and this tempering and constraint is judged with reference

to a third party; a party that Adam Smith identified as the *impartial spectator*.⁴⁰ The idea of an impartial spectator might well define the modern day understanding of the phrase, “the rule of law”. The impartial spectator is symbolically akin to lady justice both representing impartiality and a sense of blindness to the qualities of the individuals involved in the exchange. Law functions as an impartial spectator to facilitate trades in ways that are transparent, predictable, stable, and within the reasonable expectations of the original intentions of the parties. At the transactions level, law frequently imposes rules on exchange that focus on the protection of third parties. This happens, for example, in terms of title registration and recording which protects not on the immediate parties to an exchange but third parties who might deal in the property at a future date.⁴¹ Likewise, with rules related to protecting bona fide purchasers and holders in due course.⁴² A third party, impartial spectator view is also apparent in such legal standards as those that evaluate action with reference to that of a reasonably prudent person, custom in trade, and course of dealing. Law functions to promote impartiality so as to encourage a perception of fairness in exchange. At the same time, law seeks to protect third parties so that future exchanges can be lower risk and thus, more highly valued. The value of the property I acquire today includes the potential for me to exchange it at a later date with a willing third party buyer. Therefore, sustainability of exchange depends on including legal protections for potential, yet possibly unidentifiable, future traders.

4. CONCLUSION

Law plays an important role in the process of marketization. Through the process of marketization law facilitates trades and exchanges in ways that validate unequal distributions of resources and that protect the owners of many assets from the desires of those who have fewer assets. At the same time, law creates a network infrastructure capable of peacefully organizing human activity across place, space, and time. This network infrastructure

⁴⁰ See ROBIN PAUL MALLOY, *supra* note 2; see also MALLOY, *supra* note 3; see generally ADAM SMITH AND LAW (Robin Paul Malloy eds., forthcoming Feb. 2017).

⁴¹ MALLOY & SMITH, *supra* note 18, at 235 –94.

⁴² See, e.g., JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 151-52 (4th ed. 1995).

facilitates opportunities for all people to improve their well-being. In so doing, law provides a foundation upon which a market society may rest, and where the language of the market becomes ubiquitous in talking about and describing activities and relationships that had not previously been thought of in market terms.