



Procedural Control over Transaction Cost

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This paper is the fruit of a project funded by Zhejiang Planning Office of Philosophy and Social Science (No. 06CGZF25YBX).

Abstract

Coase and his followers have not pointed out the effects of transaction procedure on transaction cost saving. Using transaction procedure to control transaction cost is a kind of procedural method differing from traditional ways (defining property rights, and constructing enterprise system). Coase and other scholars' neglects over the procedural method are not casual but for the absence of transaction procedure theory in the traditional private laws. The procedural method is significant for researches on economics and private laws.

Keywords: Transaction cost, Transaction procedure, Procedural method

Commercial act is a kind of business behavior. The business nature of commercial act indicates it is a sort of repetitive and regular act. Therefore, it is a procedural and professional act. From a view of business law, this procedural character means transaction procedure. Based on the contract procedure, the implementation procedure, the security exchange procedure, the business conference (shareholders' conference, board conference, and creditors' conference) procedure, the business election (the election of the president, the directors, and the supervisors) procedure, and the negotiable instrument procedure, the author makes systematic researches on the procedural theory of commercial act (Chun Chen, 2006). Then, in order to study the function of transaction procedure, the author tries to find out the causes from Coase and his followers' theories. However, the author finds that Coase and his followers have not clearly pointed out the effects of transaction procedure on transaction cost saving.

It is acceptable that Coase's theory serves as a bridge for economics and laws. If the study of Coase and his followers does not concern the relationship between the private law's transaction procedure and transaction cost, the bridge is incomplete. In fact, it is well known that "a clear property rights can save transaction cost". However, nobody has even mentioned that "to design transaction procedure can help to save transaction cost". In the field of private law, the Coase Theorem has never been applied to the transaction procedure field. This paper tries to discuss the effects of private law's transaction procedure on transaction cost saving and its meanings in economics and law.

1. Limitation of traditional method

According to Coase's theories, minimizing the transaction cost is an important way to improve transaction efficiency. The legal scholars in England and America emphasize on the economic analysis of laws. They even agree that minimizing the transaction cost is a pillar of modern legal scholarship in modern legal studies (Peter H. Schuck, 1992, p18). For private law, what are the ways of saving transaction cost?

From the angle of private law, Coase advanced two ways of saving transaction cost. One is to define the property rights, namely saving transaction cost by optimizing the definition of property rights. In *The Problem of Social Cost*, Coase put forward the concept of transaction cost (or transaction expense) and the "Coase Theorem". Coase declared that with the precondition of transaction cost, the initial definition of legal right would generate effects on the efficiency of economic system's operation (Coase, 1990, p92). Therefore, the reasonable definition of property rights can help to save transaction cost. The other is to save transaction cost by enterprise system. In *The Nature of Firm*, Coase pointed that the price mechanism would consume costs, including the cost of finding relative prices and the cost of negotiation and signing contract, what are the transaction costs. The theme of his thesis is: to replace the market transaction with firms is a way of saving transaction cost; the nature of firm is a substitution of market mechanism; the aim is to save transaction cost (Coase, 1994, p355).

According to analysis above, we can conclude two ways for transaction cost saving, namely the definition of property rights and the construction of enterprise system. It seems that people emphasize particularly on the great effect of property rights definition. That is the origin of economics of property rights. Today, economic scholars have already reached an agreement on that to save transaction cost can improve economic efficiency. Meanwhile, how to design

property rights system to save transaction cost has also become an important subject studied by economic scholars. Coase's theories agree with China's public property rights reform. "To save transaction cost by define property rights clearly" has become a popular saying at present.

Although Coase's theories have presented two ways for saving transaction cost, his theories have had a fundamental limitation from an angle of private law. These theories neglected the relationship between private law's transaction procedure and transaction cost. The private law includes not only property rights rules and enterprise rules, but also amounts of transaction procedure rules, such as contract procedure, implementation procedure, business conference procedure, security exchange procedure, and negotiable instrument procedure. The methods mentioned by Coase aim at saving transaction cost by the rights and enterprise system in private law, without considering the effects of transaction procedure on transaction cost. In Coase's essays, most concern the definition of property rights and enterprise system, but never concern how to design transaction procedure.

Coase had never directly pointed out the relationship between transaction procedure and transaction cost in private law. Whether did his followers gain progresses? In James McGill Buchanan's opinion, because Coase had applied the result principles to the analysis of action process' effect and he had never noticed the efficiency of process his researches were not reliable (James McGill Buchanan, 1988, p95). McGill Buchanan's researches focus on the field of public choice theory. The behavior mentioned in his researches refers to public choice. Therefore, he has studied the efficiency of constituting rules (namely the process of legalization) and concluded that the efficiency of legalization is as important as the efficiency of law (James McGill Buchanan, 1988, p105). Although he has noticed the efficiency of process, he has not studied the relationship between private law's transaction procedure and transaction cost (or transaction efficiency). In addition, he has not revealed the meanings of legal procedure to transaction efficiency from a common angle. Therefore, although his theories have gained progresses more or less, his theories can not provide with theoretical causes for the function of transaction procedure.

Later, economic scholars have developed Coase's theories further. But none of them has made progresses in the field of transaction cost saving. For example, Williamson has divided transaction cost into afore-hand transaction cost and post transaction cost. The former includes cost of drafting, negotiating, and guaranteeing certain contract, and the later cost of implementation and quarrel (Dongming Hu, 2002, p52). A. Allan Schmid has classified transaction cost into three types, namely contract cost, information cost, and control cost (A. Allan Schmid, 1999, p136). According to their explanation, these costs consist in the transaction process. However, they have always studied this issue from the aspect of enterprise system and property rights definition and never concerned how to design private law's transaction procedure. Law economic scholars have followed Coase and made more economic analysis on laws. But nobody has discussed the effects of private law's transaction procedure on transaction cost saving. Many articles and works concern the economics of law. Law and Economics, and Economic Analysis of Law are two representatives. Law and Economics states Coase Theorem from an aspect of law, in which nothing concerns private law's transaction procedure (Robert Cooter. & Thomas Ulen, 2000, p82-87). Economic Analysis of Law does not concern the issue of private law's transaction procedure either (This book has made cost-benefit analysis on law of property, law of contract, and law of torts but no part concerns private law's transaction procedure issue. R.A. Posner, 1997, contents). In addition, scholars conclude the legal effect of Coase Theorem. A relatively authoritative theory thinks that Coase Theorem has three legal meanings: Coase Theorem guarantees the necessity of re-allocating the property rights for the state; in choosing the aims of legal value, Coase Theorem gives benefits priority and then fairness; Coase Theorem regulates that the way of law protecting property rights should be based on the principle of benefit (Chunde Gu, 2004, p521). Not mention whether the three conclusions can be concluded from Coase Theorem or not for the moment, it is a fact that these conclusions do not concern private law's transaction procedure and even ignore the important status of modern enterprise system. In 2005, some scholar reconsider the aim of minimizing transaction cost and conclude the present ways for transaction cost saving in law, in which none is to save transaction cost by private law's transaction procedure (David M. Driesen. & Shubha Ghosh, 2005, p71-73).

To sum up, Coase and his followers have neglected the effect of private law's transaction procedure on transaction cost control.

2. Procedural method for transaction cost control

Although Coase has advanced two ways, namely defining property rights and constructing enterprise system, we can find the third way for transaction cost saving from his essays, namely procedural method. In other words, it is to control transaction cost by transaction procedure. Transaction is a process. The cost of finding out relative prices, and the cost of negotiating and signing a contract mentioned in his works are costs of transaction process in essence. A reasonable information disclosure system can save cost of finding out relative prices. A reasonable signing-contract procedure can save cost of negotiating and signing a contract. Then we can conclude that reasonable transaction procedures can save transaction costs. Therefore, it is right for Coase Theorem taking in a new item: only if there is transaction cost, transaction procedure will affect transaction efficiency; reasonable transaction procedures can save transaction costs and

improve transaction efficiency. For the sake of convenience, we name this method as “procedural method”, taking rank with other traditional ways, such as property rights definition mentioned above.

Considering the multiple meanings of transaction and transaction cost, except for special notice, the transaction and transaction cost in this paper merely refer to private transaction and its procedural cost. Just as what was said in the first paragraph in this paper, the transaction procedure refers to the transaction process in law, namely the transaction procedure regulated by private law. Although economics of law always adopts the wide concepts of transaction and transaction cost, this paper defines them from a narrow aspect in order to emphasize on the way of saving transaction cost by private law’s transaction procedure and its meanings. It is necessary and wise to define the transaction procedure as a legal procedure. In a society ruled by law, the law is the most popular and powerful institutional arrangement. If a man who believes in laws and orders fails to consider the transaction issue from the aspect of law, it will be hard for his theory being translated into law system, losing practical meanings.

It is well known that the property rights are an extremely complex concept. Whether the property rights include the transaction procedure mentioned above? Whether the ways of defining property rights include the procedural method? Here, it is necessary to make analysis on this issue in an attempt to recognize the principle of procedural method and its independence further. Considering the evident differences between enterprise system and procedural method, this paper will not make comparison between them.

All concepts of property rights do not concern transaction procedure. Everyone who studies economics of property rights will be bothered by the complication of property rights. However, it is not hard to exclude the subjection relationship between property rights and transaction procedure based on present conclusions. Property rights are a set of rights concerning occupation, use, transfer, and profits. Property rights are the ownership of property. Property rights are the rights of choosing matters which are implemented by force in society. The definitions are various. From these definitions, we can not find any element related with procedure (Xuangong Wu, 2000, p5). According to researches on economics of property rights, we can draw two specific conclusions: firstly, the definition of property rights does not include the design of transaction procedure; secondly, no matter what property rights are, they are rights anyway. In Coase’s theories, property rights are described as “legal rights”. For the sake of conveniently constructing the corresponding relationship between law and economics, and perfecting the legal system, it is necessary to insist to this definition. Only when property rights are equal to “legal rights” or “lawful rights”, can theories of property rights become acceptable in fields of law and economics and serve as a bridge between them. Considering this point, next the paper merely compares the differences among rights, transaction procedure, and relevant methods in law.

In law, rights are different from procedure. The main differences include: rights are certain content of legal relations, and procedure is the content of legal behavior. They belong to different systems. Rights are static and procedures are dynamic; the core of rights theories is “what to do” and “whether to do or not”, and the core of procedure theories is “how to do”; rights emphasize on ownership. In contrast, procedures emphasize on operation. Rights need a designing and applying process in order to realize an operation; rights and procedures are not in a one-to-one relationship. One right includes many acts. And each act has a specific procedure. Take employees’ democratic right for example, it has many acts means relevant act procedures are various; rights have value biases. They express parts of profits, purposes, and other aspects that benefit the subjects. However, procedures can protect many legal values, including not only the self-governance that represents the benefits of act subjects, but also fairness, safety, and other contents that do not directly represent the benefits of act subjects or even restrain the act of subjects. Correspondingly, the primary function of rights theories and system is to protect rights. However, because of the diverse functions of procedure theories and its system, self-governance, fairness, safety, and other value protections are all its aims (Chun Chen, 2006, p66). Therefore, we can conclude that the definition of property rights and the design of transaction procedure are different.

Present rights theories can prove their differences. In law, although rights have many concepts, most concern what rights are, what their expressions are, what they have, or what they can do, such as the interest rights, the purpose rights, and Wesley Hohfeld’s theory of analytical law. No researches are about how to do, what procedures we can follow, though the rights theories keep in further development. Today, the most famous rights theory is Hohfeld’s rights concept. He summarizes eight fundamental concepts and classifies them into four groups: right and duty; no-right and privilege; power and liability; disability and immunity (Yong Wang, 2004, p82). The four groups of concepts reflect what rights do, can do, or can not do. For the issue of how to do, namely the procedures of relevant acts, these concepts do not and can not explain.

Procedural method is to design transaction procedure. Property rights definition is to define property rights. To define property rights and to design transaction procedure are two relatively independent processes. Transaction procedure chiefly includes transaction time, places, procedures, approaches, and sequence. Procedural method is to save transaction cost by designing these items. Property rights focus on occupation, use, profits, and management. Property rights definition is to motivate the subjects of rights and exclude externality by allocating these elements in order to save transaction cost. Property rights are different from transaction procedure. No matter which kind the right is, it is

valid or invalid. As far as transaction time, places, procedures, approaches, and sequence are concerned, they are not and should not belong to the contents of property rights theory.

With the precondition of defining property rights, transaction procedure is optional. At this moment, the choice of different transaction procedure will lead to different efficiency. That is the relative independence of procedural method. For example, property rights are far different from contract procedures in the aspect of civil law. In the civil law, the allocation of property rights and the design of contract procedures are two entirely different systems. With the definition of property rights, contract procedures may be different. Suppose a, b, c, and d are different contract procedures that will cause different costs. Here, the efficiency of property rights system P_0 has no relation with the efficiencies of different contract procedures P_a , P_b , P_c , and P_d . Legislators can choose the relatively better design as the legal contract procedure for the sake of contract cost saving.

In the process cost control, procedural method is more direct than property right definition. Transaction procedure is a direct control over the time, place, process, and approach in the transaction process. People can reduce transaction cost directly by choosing transaction procedure. In contrast, property rights definition is not a direct design for act process. It has to follow a legal transaction procedure. It can generate indirect effects on transaction process by making best use of the free discretion in procedural system. For example, take property rights as motives to accomplish transaction process in a better way in shorter time. Therefore, procedural method is more direct than property rights definition in controlling process cost.

To sum up, design procedures and definition of property rights are two different ways for transaction cost control.

3. Why the procedural method has been neglected

The concept of transaction cost and the ways for transaction cost saving are key issues for economics of property rights. Coase and his followers have noticed that transaction cost is generated from transaction process. Why have they put forward the procedural method directly? So, maybe some scholar regards it as an unintentional neglect. Just as what has been mentioned above, Coase and other scholars have already talked about transaction procedures. What this paper does is to draw more inferences from Coase's theories or make further development of Buchanan's theory from public law to private law.

Things are not easy. Every scholar will face an insurmountable gulf if he or she tries to advance an idea of "transaction cost's procedural control", because traditional private law does not include procedural theory. If Coase wanted to put forward the procedural method, he would firstly be stopped by the issue of private law's procedures. No matter what it is the demonstration of procedural method or the concept of transaction procedure, this issue is unavoidable. If traditional private law has matured transaction procedure theory, former scholars may advance the procedural method. However, the problem is that procedure theory is always the "patent" of public law. Private law is regarded as an edition of rights. It has nothing related with the concept of procedure, not mention the theory of transaction procedure. Because Coase and his followers made researches based on traditional private law theories, they could easily put forward the property right definition method and other ways but not the procedural method.

Traditional private law has never included the procedure concept and theory. On one hand, the Anglo-American private law has not systematic private law act theory. In the Anglo-American law system, the private law seldom concerns researches on abstract behavior. It has little interests in civil legal act theory. Differing from public law, it does not emphasize on act procedure. In stead, it takes practicality as the base, and focuses on solving specific problems, showing no interests in constructing systematic private law's act theory. By this way, it effectively avoids the bugs existed in the conceptual law in the civil law system. But it also causes the imperfection of act theory, which leads to the absence of systematic act theory. Under this background, it is impossible for private law to form the transaction procedure concept and theory. On the other hand, although the civil law system has systematic act theory, it does not include the concept and theory of procedure. In the civil law system, the private law's act theory takes civil legal act as the primary content, including the concept of civil legal act, the theory of intent expression, the theory of intent self-governance, the theory of flawed intent, and the theory of valid document. None of these theories concerns the concept of procedure, or the concept of practical procedure. Among all these theories, the theory of flawed intent comes down to the act process. But it still fails to care about the process. What it cares is the consistency and authenticity of expressions and intents. Therefore, it discusses whether there are cheats or threats during the process of intent expression by way of parenthesis. Limited by this aim, it is impossible to establish the procedural rule for expression. What's more important is that transaction procedure is to regulate the transaction process by law. This fundamental attribute indicates that the more the law demands for transaction process, the more important the transaction procedure is. Reversely, if the law does not regulate the transaction process, the transaction procedure deserves nothing at all. A Germany scholar has made it clear that intent expression serves as the tool for legal act and legal act serves as the tool for private law's self-governance (Dieter Medicus, 2000, p142). Civil legal act theory is for private law's self-governance, which radically excludes the position of transaction procedure in civil legal act theory. Under the guidance of intent self-governance, if the law has certain requirements for transaction process, these requirements are not for the

establishment of transaction procedure. Instead, the law should guarantee the self-governance of transaction procedure but not restrict the steps and approaches of transaction. In the traditional law, commercial act is regarded as a special legal act. Naturally, the theory of commercial act does not concern the concept and theory of transaction procedure.

In correspondence with the phenomenon above, traditional private law takes rights as the core. The Anglo-American private law has developed the theory of rights. And the most famous theory of rights is Hohfeld's concept of rights. Hohfeld and other scholars' researches have enriched the theory of rights in the Anglo-American private law. Because of lacking systematic act theory, rights become its core naturally. In the civil law system, the private law, taking German Civil Code as the representative, has formed the rights-oriented theory and practice, namely the rights-center theory. This theme is deeply reflected by German Civil Codes and relevant other civil law theories. German scholars think that "property rights are the core concept of private law and also the final abstract of various legal lives" (Dieter Medicus, 2000, p62). Similar words appear in many works of civil law. German Civil Codes include general provisions, credit law, real right law, family law, and law of inheritance. Rights are the primary clues in design its structure.

In Coase's essays, law and economics have accomplished a right combination. However, Coase has merely focused on the implementation of former theories in traditional private law system. He has not created a brand-new private law's procedure theory. In *The Nature of Firm*, Coase has advanced a question: since owners of production factors can achieve cooperation by market transaction, why do firms exist? What factors determine the scale of firm? These kinds of questions can help to find out the nature of firms but not the transaction procedure theory. In *The Problem of Social Cost*, Coase has analyzed the relationship between transaction cost and property rights' initial definition but not the relationship between transaction procedure and transaction cost. Anyway, Coase has not surpassed the traditional concepts of rights and legal person in private law. His thinking has been restrained by the rights-oriented theory of private law.

Surely, we should not ask Coase and other scholars to create private law's procedure theory. To break through traditional thinking of private law, complex and tough demonstration would be a must, what is hard to be accomplished by economic analysis method and theory that is the specialty of Coase. The difficulty is: just as what has been mentioned above, traditional private law has perfect rights theories but not transaction procedure theory. In Anglo-American law system, there is even no systematic act theory. Procedure is not the subject of private law for all the time. Coase Theorem and other theories of economics of property rights have been under the influences of traditional private law. What's more important is the procedure study is the advanced level of act study. In general, the three questions, what to do, what can not to do, how to do (how is the procedure), are in a sequence. The first two have priority over the third. In law, theories of rights, and act abilities chiefly solve the first two questions. Because the third question has to be solved at an advanced level, deepening researches may help to solve it. Traditional private law's act theory does not reach this level apparently.

If we want to put forward the procedural method for transaction cost saving, it is a must to form the private law's transaction procedure theory. That is the key for the problem. Commercial act procedure theory rightly solves this issue. In essence, commercial act means transaction act in private law. Commercial act procedure theory is transaction procedure theory. The appearance of private law's transaction procedure theory breaks the tradition that procedure is the patent of public law, and removes the barrier to procedural method theoretically. That is the theoretical base for the method advanced in this paper.

Evidently, why Coase and his followers have not brought forward the procedural method is because they have been restrained by the private law's theories and ideas at that time. Once the private law's transaction procedure theory has been established, to advance the procedural method would become easy.

4. Procedural method deserves emphases

Procedural method is nothing but an extension of classic theory after removing barriers. This study seems too easy indeed. However, procedural method still deserves emphases.

Firstly, it has developed the transaction cost theory and the view and method of relevant economics of property rights, and new institutional economics. Conceptions and theories of transaction cost have contributed a lot to economics and law. But for a long time, people have taken the reasonable allocation of rights, and the construction of enterprise system as the ways for transaction cost saving. People seldom or even nobody has ever thought over the transaction procedure that could be used to save transaction cost. The economics of property rights have just taken property rights as the core, ignoring the procedure issue. Although the new institutional economics has considered the efficiency of institution from a wider aspect, it has not advanced the proposition of using transaction procedure to save transaction cost. The appearance of procedural method can help to enlarge the view of relevant theories and serves as new way for transaction cost saving. Economics of property rights emphasizes on the allocation of property rights and neglects the transaction process, emphasizing static method and ignoring dynamic control. Procedural method emphasizes a dynamic process cost control, which can rightly make up the shortage of economics of property rights. It seems that

new institutional economics overcomes the bug that economics of property rights merely emphasizes the design of property rights. As a matter of fact, ways for transaction cost saving advanced by new institutional economics are only the design of property rights and the design of enterprise system. Although new institutional economics tries to bring about comprehensive theories in general, it does not work at all. There is interaction between law and economics, what is not new discovery of Coase and his followers. The contribution of new institutional economics is to knit a dense net of theories for the relationship between law and economics for the sake of catching more specific and practical details. Procedural method may provide with a specific way that is equal to the design of property rights and other traditional ways for transaction cost saving. By this way, the new institutional economics may possess more novelties and realize its aim of comprehensive institutional design in a sense.

Secondly, procedural method can provide with efficiency theory for private law's transaction procedure or even whole procedure law. Fairness and efficiency is always a pair of conceptions in law. Reviewing the public law's procedure theories, people will find that the theory of justice procedure and John Rawls' theory of pure procedural justice supply sufficient theoretical bases for procedural justice (John Rawls, 1988, p85). Few theories concern procedural efficiency. "To design legal procedure is supposed to save transaction cost", what should supply the theory of efficiency for procedure. However, because of the absence of private law's procedure theory, people can not draw this conclusion in a common sense. As a result, Coase Theorem fails to serve as the common cause for legal procedure's efficiency. Private law's transaction procedure theory gives "legal procedure" a general meaning in public law and private law. Procedural method may be developed into a popular conclusion that "reasonable legal procedure design will help to save transaction cost". Therefore, it can supply theoretical bases for all legal procedures in public law and private law, serving as directions for procedure's design, explanation, and implementation.

Thirdly, procedural method makes it clear that to design transaction procedure is one of primary tasks of private law, which can benefit the researches on private law's transaction procedure design. The task of private law is not only to allocate rights properly but also to design transaction procedure scientifically. In the field of public law, procedure design has already aroused attentions. But in the field of private law, procedure design has not listed in the schedule. A society without transaction cost is similar to a nature without friction. It is impractical. Similarly, a private transaction without transaction procedure is not practical. Traditional private law neglects procedure design. Today, what it faces is not whether to consider transaction procedure design or not but how to design transaction procedure to save transaction cost. The neglect of transaction procedure will lead to such a result that transaction may follow worse procedure. For specific procedure design methods, private law is poor. In this aspect, it needs summarization, references, and improvement.

Fourthly, it reveals the bugs in traditional private law and warns that economists should pay more attentions on private law theories. Public law emphasizes on procedures and private law rights. As far as transaction cost saving is concerned, the allocation of rights and the design of procedures are both important. They deserve equal attentions. To equalize rights and procedures is an overall private law idea. Coase has ever repeated that he was not a lawyer and what he knew about law was very superficial (Many law articles take references from Coase's arguments, which makes Coase surprise and uncomfortable more or less. R. H. Coase, 1996, p3). Surely he was modest more or less. But we should take his words as constructive advices for economists. In order to study the issue of property rights or institutions, we should make deep researches on private law's theories. Coase has not advanced the procedural method because he had been restrained by private law's rights-oriented theory indeed. Although his innovations are wonderful, his limits and advices deserve more reflections.

This paper emphasizes the procedural method, which does not mean the better, the more procedures. Similarly, to emphasize property rights definition or enterprises' existence does not mean to advocate certain institutional arrangement without any precondition. Law and economics should emphasize the procedural method in order to design and choose the best transaction procedure.

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