Governance, Fidelity, and the Architecture of Adaptation: A Transaction Cost Economic Analysis of Constitutional Originalism

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Abstract

This paper analyzes the American constitutional debate between Originalism and Living Constitutionalism through the lens of Transaction Cost Economics (TCE) and the Theory of the Firm. By framing the US Constitution as an incomplete, long-term relational contract characterized by high asset specificity and bounded rationality, the analysis identifies "unprogrammed adaptation" as the central governance challenge. The paper argues that the "New Originalism" - specifically its distinction between fixed interpretation and flexible construction - functions as an efficient "hybrid" governance structure. This structure minimizes the sum of transaction and agency costs by preserving credible commitments (fixed meaning) while allowing for necessary adjustments (construction). Conversely, the paper contends that "Living Constitutionalism" essentially collapses the constitution into a hierarchical governance model (judicial supremacy) that is ill-suited for the specific hazards of the constitutional contract, failing to curb endogenous opportunism.

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Critically, the analysis explicitly frames these legal conclusions as conditional upon the validity of the underlying economic models, acknowledging the lack of a singular consensus within the theory of the firm itself. *The apparent efficiency of originalism under TCE frameworks may alternatively suggest fundamental limitations in how transaction cost economics conceptualizes governance, commitment, and adaptation - pointing to the need for refinement or replacement of these economic theories rather than vindication of any particular constitutional interpretation methodology.*

1 Introduction: The Convergence of Constitutional and Economic Theory

The intellectual history of American jurisprudence and the trajectory of industrial organization economics in the twentieth century appear, at first glance, to travel along parallel but distinct tracks. Legal scholarship, particularly in the domain of constitutional theory, has been dominated by a normative conflict between "Originalism" - the proposition that the communicative content of the US Constitution is fixed at the time of enactment - and "Living Constitutionalism," which posits that the document must evolve dynamically to reflect changing societal values. Simultaneously, the field of industrial organization underwent a revolution with the advent of Transaction Cost Economics (TCE), moving beyond the neoclassical view of the firm as a "black box" production function to a nuanced understanding of the firm as a governance structure designed to manage the costs of transacting under conditions of uncertainty (Coase, 1937; Williamson, 1985).

Despite their disciplinary separation, these two fields are engaged in the resolution of an identical structural problem: how to organize and sustain complex, long-term relationships in the face of bounded rationality and the inability to draft complete contracts. Both the "constitutional contract" and the "commercial contract" must solve the dilemma of unprogrammed adaptation. Oliver Williamson, the Nobel laureate and architect of TCE, identified

unprogrammed adaptation - the ability of a governance structure to respond to unforeseen disturbances without dissolving the relationship - as the central problem of economic organization (Williamson, 1991).

This paper establishes that the "New Originalism," specifically its distinction between interpretation (ascertaining meaning) and construction (giving legal effect to meaning), functions as a sophisticated mechanism for unprogrammed adaptation that mirrors the efficiency properties of hybrid governance structures in the private sector. By applying the analytical tools of the Theory of the Firm - including asset specificity, residual control rights, and fiduciary obligations - this analysis demonstrates that Originalism in the context of US constitutional law is not merely a semantic or historical preference, but an economizing response to the high transaction costs of governance.

However, a robust economic defense of Originalism requires more than mapping legal concepts onto economic terms; it requires a rigorous stress test against the strongest economic arguments for its rival, Living Constitutionalism. If the central problem of organization is adaptation, critics might argue that a flexible, evolving constitution managed by a judiciary is the superior governance structure - a form of hierarchical management that reduces the transaction costs of formal amendment. This paper directly engages that critique. It argues that while Living Constitutionalism promises efficient adaptation, it fails the "remediableness" criterion of TCE by collapsing a hybrid governance structure into a hierarchy that is ill-suited for the specific asset hazards of the US constitutional contract.

Crucially, this analysis proceeds with a necessary epistemic caveat, one that bears repeating throughout: The paper explores the implications of Transaction Cost Economics for constitutional theory, contingent on the validity of Williamson's framework. It acknowledges that within industrial organization itself, there is no monolithic consensus on the "Theory of the Firm," with competing models like the Resource-Based View (Barney, 1991) and Property Rights Theory (Grossman and Hart, 1986) offering alternative explanations. Thus, the argument presented here is conditional: *if* governance is primarily about managing transac-

tion costs and adaptation, *then* Originalism offers distinct efficiency advantages. Whether this economic lens is the correct one for legal analysis remains a subject for scrutiny. **Indeed, the fact that TCE appears to support originalism may reveal more about the limitations of transaction cost economics as a descriptive or normative theory than about the optimal method of constitutional interpretation. If the theory validates a controversial legal methodology, this should prompt us to question the theory itself.**

By synthesizing the "New Institutional Economics" with the "New Originalism," we reveal that the debate is not between "change" and "stasis," but between two distinct modes of adaptation: the fiduciary gap-filling of a hybrid structure versus the managerial fiat of a hierarchy. The analysis concludes that Originalism, by constraining the "meaning" of the US Constitution's text while allowing "application" to evolve through construction, minimizes the sum of agency costs and adaptation costs, providing the only stable equilibrium for a long-term political compact.

The following analysis proceeds by first explicating the economic foundations of governance and adaptation, distinguishing between autonomous and cooperative modes. It then maps these concepts onto the US constitutional structure, framing the Constitution as an incomplete contract characterized by high asset specificity and lock-in. Subsequently, it rigorously examines the Originalism debate through the lens of comparative institutional analysis, presenting and then dismantling the strongest economic case for Living Constitutionalism. Finally, it argues that the "Construction Zone" identified by legal theorists operates as a zone of allocated residual control rights, constrained by fiduciary duties to minimize the agency costs inherent in judicial fiat.

2 The Economics of Governance: From Production Functions to Transaction Costs

To utilize economic theory to advance legal scholarship, one must first transcend the traditional price-theory models that dominate Law and Economics (often associated with the Chicago School and Richard Posner) and engage with the New Institutional Economics (NIE). While standard microeconomics focuses on price and output decisions, NIE focuses on the institutions that govern exchange (North, 1990). The distinction is critical: price theory assumes markets work; transaction cost economics asks why they work and when they fail.

2.1 The Nature of the Firm and the Reality of Friction

Ronald Coase's foundational insight in *The Nature of the Firm* (1937) was that the economic system is not a frictionless plane where supply meets demand instantaneously. There are transaction costs - the costs of searching for information, negotiating terms, and enforcing agreements (Coase, 1937). If markets were costless, firms would not exist; every step of production, from mining ore to assembling a car, would be handled by independent contractors via the price mechanism. The firm exists because, in certain contexts, it is more efficient to organize production through fiat (managerial command) than through the market.

However, Coase's insight was only the starting point. It was Oliver Williamson who operationalized transaction costs by identifying the behavioral and environmental factors that drive the "make-or-buy" decision. Williamson introduced two critical behavioral assumptions that are essential for applying this theory to US constitutional law (Williamson, 1985):

1. **Bounded Rationality**: Human actors are "intendedly rational, but only limitedly so." They have cognitive limits and cannot foresee all possible future contingencies. Consequently, all complex, long-term contracts are inevitably incomplete.

2. **Opportunism**: Economic actors are not merely self-interested; they are capable of "self-interest seeking with guile." This includes lying, withholding information, and calculated efforts to mislead.

These two factors create "contractual hazards." If parties could write complete contracts (perfect rationality), they would simply specify the obligations for every possible state of the world, neutralizing opportunism. Because they cannot, gaps remain in the contract. These gaps create the risk of holdup, where one party exploits the incompleteness of the contract to appropriate value from the other (Klein et al., 1978).

2.2 Unprogrammed Adaptation: The Williamsonian Pivot

The central innovation of Williamson's framework is the focus on adaptation. He distinguished between two distinct modes of adaptation that correspond to different governance structures (Williamson, 1991). This distinction is pivotal for US constitutional theory because it forces us to categorize judicial review not as a monolithic activity, but as a specific mode of economic adaptation.

Table 1: Modes of Adaptation and Governance Structures

Adaptation Mode	**Primary Mechanism**	**Governance Structure**	**Institutional Analog**
Autonomous Adaptation	Price Signals	Market	Federalism / State Policy
Cooperative Adaptation	Administrative Fiat	Hierarchy (The Firm)	Judicial Review / Regulation
Hybrid Adaptation	Credible Commitments	Hybrid / Relational Contract	Constitutional Construction

1. **Autonomous Adaptation**: This is the hallmark of the market. It relies on high-powered incentives and individual decision-making. If the price of copper rises, a manufacturer switches to plastic. No meeting is required; no consensus is needed. The

system adapts spontaneously. In the US constitutional context, this mirrors Federalism: states adapt their laws to local conditions without needing permission from the center.

2. **Cooperative Adaptation**: This is required when the parties are in a relationship of "bilateral dependency" - typically caused by asset specificity. When parties have made investments that are specific to their relationship (e.g., a power plant built next to a coal mine), they cannot simply walk away and find a new partner without incurring massive losses. In this context, the market fails because the parties are "locked in." When an unforeseen disturbance occurs (e.g., a new environmental regulation), the parties must coordinate their response. Because renegotiation is costly and prone to opportunistic holdup, they often integrate into a single firm (hierarchy) where a manager can order the adaptation via fiat.

2.3 Conceptual Clarification: The Necessary Conditions for Unprogrammed Adaptation

To rigorously apply this framework to US constitutional law, we must explicitly define the necessary and sufficient conditions under which "unprogrammed adaptation" becomes the dominant design criterion for a governance structure. Williamson posits that unprogrammed adaptation is required when four conditions inevitably converge (Williamson, 1991):

1. **Unforeseen Environmental Change**: The environment is subject to disturbances that were not and could not have been specified in the original contract (Bounded Rationality).

2. **Asset Specificity (Lock-in)**: The parties have made investments specific to the relationship, making exit prohibitively costly. In the absence of lock-in, parties would simply exit the relationship rather than adapt it.

3. **Risk of Opportunism**: One or both parties have the incentive and ability to exploit the unforeseen change to redistribute value to themselves at the expense of the joint surplus.

4. **Costly Renegotiation**: The transaction costs of formally renegotiating the contract (ex post) are high, creating a risk of bargaining breakdown or stalemate.

Crucially, Williamson does not argue that maximal discretion is optimal under these conditions. Instead, he argues that adaptation must occur under a governance structure that minimizes the sum of adaptation costs and opportunism costs. This distinction is vital: simply enabling flexibility (adaptation) is inefficient if it unleashes unchecked opportunism. This insight forms the economic basis for critiquing Living Constitutionalism, which maximizes flexibility at the expense of credible commitment.

2.4 Epistemic Limits: The Conditional Nature of the Economic Analogy

It is crucial to delimit the epistemic scope of this analysis. This paper explores the implications of economic theory for legal theory - specifically, what the Transaction Cost Economics (TCE) framework suggests about the efficiency of Originalism in US constitutional interpretation. However, **the validity of these legal conclusions is strictly conditional on the validity of the underlying economic models.** It must be acknowledged that there is no definitive consensus within the field of industrial organization regarding the "Theory of the Firm." Competing frameworks - including the Resource-Based View (RBV) (Barney, 1991), the Knowledge-Based View (KBV) (Grant, 1996), and varying interpretations of Property Rights Theory (GHM) (Grossman and Hart, 1986; Hart and Moore, 1990) - contest the primacy of transaction costs and asset specificity in explaining organizational boundaries.

Therefore, the argument presented here is an "if-then" proposition: *if* governance is primarily a mechanism for managing transaction costs and unprogrammed adaptation, *then*

Originalism functions as an efficient hybrid structure. **Whether we should trust this application of economic theory to constitutional law remains a subject for further scrutiny, contingent upon the robustness of the underlying economic models themselves. The analysis that follows may thus serve a dual purpose: either as a defense of originalism *or* as a reductio ad absurdum revealing the inadequacy of transaction cost economics for analyzing complex social institutions.**

3 The US Constitution as an Incomplete Long-Term Contract

To operationalize the connection between Industrial Organization (IO) and law, we must rigorously define the US Constitution as a contract. This is not merely a rhetorical flourish of "social contract theory" but a structural reality of the document's design and function (Buchanan and Tullock, 1975).

3.1 Contractual Incompleteness in US Constitutional Design

The US Constitution exhibits all the characteristics of a long-term, incomplete relational contract (Macneil, 1974):

1. **Long-Term Horizon**: It is intended to endure for ages, far beyond the lifespan of the drafting parties.

2. **Bounded Rationality**: The Framers could not foresee the internet, the atom bomb, the globalized economy, or the administrative state. They could not write specific rules for these contingencies.

3. **Asset Specificity**: The ratification of the US Constitution involved the states making highly specific investments in the Union (surrendering sovereignty, integrating

economies). Once ratified, the costs of exit (secession) became prohibitively costly (as evidenced by the Civil War). This created a condition of "lock-in" or bilateral monopoly between the States and the Federal Government.

Because of this lock-in, the "contract" is highly vulnerable to opportunism. The federal government (the agent) might exploit the vagueness of the text to usurp powers never granted, or a faction of states might exploit the structure to impose costs on others (e.g., internal trade barriers). The "fundamental transformation" that Williamson describes - where a large-numbers bidding situation transforms into a small-numbers exchange relation - occurred at the moment of Ratification (Williamson, 1985). The states moved from a position of independent sovereignty (market) to a position of bilateral dependency (hybrid/hierarchy).

3.2 The Transaction Costs of Formal Renegotiation (Article V)

In a standard commercial contract, if a gap arises or the environment changes, the parties can renegotiate the terms. In the US Constitutional contract, the mechanism for formal renegotiation is Article V (the Amendment process).

However, Article V imposes extraordinarily high transaction costs. It requires supermajorities in both Congress (two-thirds) and the state legislatures (three-fourths). Aziz Huq argues that this rigidity was a design feature, not a bug, intended to mitigate the "hold-up" dilemma during the founding era (Huq, 2014). By making the contract hard to change, the Framers created a "credible commitment" that encouraged investment in the new Republic. If the contract were easily amendable, larger states might have exploited smaller states (or vice versa) after they had already locked themselves into the Union.

Yet, this high rigidity creates a severe problem for adaptation. As the environment changes (e.g., the transition from an agrarian to an industrial economy), the formal mechanism for updating the contract (Article V) is often unavailable due to the sheer cost of coordination.

Key Theoretical Implication: When the transaction costs of formal renegotiation (Article V) exceed the benefits of adjustment, the pressure for adaptation does not disappear. Instead, it is displaced into the informal governance mechanisms of the contract - specifically, into the interpretation and construction of the text by the judiciary and political branches (Vermeule, 2006). This is the economic origin of the "Living Constitution" versus "Originalism" conflict: it is a dispute over the legitimate mechanism for handling unprogrammed adaptation when formal renegotiation is blocked by high transaction costs.

4 Unprogrammed Adaptation and the Originalism Debate

The traditional debate characterizes Originalism as "looking backward" and Living Constitutionalism as "looking forward." TCE reframes this as a debate over the allocation of residual control rights and the minimization of agency costs.

4.1 Originalism as a Governance of Credible Commitment

Early iterations of Originalism (often termed "Old Originalism") focused on "Original Intent." This approach was often criticized for being epistemologically difficult (whose intent matters?) and overly rigid. However, the New Originalism, which focuses on "Original Public Meaning," aligns more closely with the economic concept of fixation as a commitment device (Barnett, 2004; Solum, 2008).

The Fixation Thesis posits that the communicative content of the US constitutional text is fixed at the time of ratification. In economic terms, this represents the explicit terms of the incomplete contract.

- **Economic Logic**: For a contract to induce investment (reliance), its core terms must be credible. If the terms can be changed unilaterally by one party ex post, the contract

loses its value as a coordination device. Fixation provides the "hard budget constraint" necessary for the rule of law.

If the Supreme Court were viewed purely as a manager with the power to rewrite the contract whenever it deemed "efficient" (the Posnerian or Living Constitution view), the "security of exchange" provided by the US Constitution would erode. States and citizens would view their rights not as property rules but as liability rules, subject to taking by the judicial manager. This creates a "soft budget constraint," leading to moral hazard and inefficient rent-seeking as groups lobby the Court for favorable "reinterpretations" rather than engaging in the costly but legitimate Article V process.

4.2 The Interpretation-Construction Distinction

The most significant development in New Originalism - and the one that bridges the gap to Williamson - is the distinction between Interpretation and Construction (Barnett and Bernick, 2013; Solum, 2015).

1. **Interpretation**: The activity of discovering the linguistic meaning of the text (e.g., determining what "domestic violence" meant in Article IV of the US Constitution). This corresponds to enforcing the explicit terms of the contract.

2. **Construction**: The activity of giving legal effect to the text when the meaning is vague, ambiguous, or "runs out." This corresponds to the exercise of residual control rights in the "gap" of an incomplete contract.

The Construction Zone is the Zone of Unprogrammed Adaptation.

New Originalists acknowledge that the text of the US Constitution does not solve every problem. When the text is under-determinate (incomplete), judges must engage in construction. They must build doctrines (like the exclusionary rule or the three-tier scrutiny framework) to implement the text. This distinction perfectly mirrors the "Hybrid" governance structure in TCE:

- **Fixed Attributes (Interpretation)**: Certain aspects of the relationship are fixed to prevent opportunism (e.g., the President must be 35 years old; two Senators per state). These are the "credible commitments" that define the boundaries of the firm.

- **Adaptive Attributes (Construction)**: Other aspects are left to governance to allow for adaptation to local conditions or new information (e.g., applying "unreasonable searches" to cell phones or GPS tracking).

Critique of Fluid Meaning: A key economic insight here distinguishes adaptation of application from adaptation of meaning.

- **Adaptation of Application (Construction)** allows the contract to cover new circumstances without altering the original bargain. This is consistent with relational contracting.

- **Adaptation of Meaning (Living Constitutionalism)** involves the retrospective redefinition of commitments. From an incomplete-contracts perspective, redefining meaning is equivalent to retroactive contract rewriting. This destroys the informational content of the original agreement and creates moral hazard. Unprogrammed adaptation presupposes a stable reference point (Schwartz and Scott, 2002). Without fixation, adaptation degenerates into renegotiation by fiat.

4.3 The Williamson Tradeoff in US Constitutional Law

Williamson famously identified a tradeoff between the high-powered incentives of the market (autonomy) and the adaptive capacity of the firm (cooperation) (Williamson, 1991).

- Markets have high incentives but poor cooperative adaptation.

- Firms (Hierarchies) have good cooperative adaptation but suffer from "bureaucratic costs" and attenuated incentives (agency costs).

Originalism attempts to navigate this tradeoff by strictly limiting the scope of "managerial fiat" (judicial construction) to the "Construction Zone."

Living Constitutionalism effectively treats the entire US Constitution as a "firm" managed by the Judiciary. The Court has broad fiat power to update the "contract" to meet current social needs. While this maximizes adaptive flexibility, it creates massive agency costs. The agents (judges) can impose their own preferences on the principals (the people), destroying the incentive structures of the original federalist compact.

Originalism restricts the Court's fiat power. By binding the Court to the original meaning (where clear), it forces major adaptations back into the Legislature (Article I) or the Amendment Process (Article V). While this increases the transaction costs of change (it is harder to pass a law than to get a court ruling), it reduces the agency costs of judicial opportunism.

5 Can Living Constitutionalism Be Defended? A Williamsonian Stress Test

To rigorously validate the Originalist hybrid model, we must subject the opposing view - Living Constitutionalism - to the same economic scrutiny. Critics could argue that by assuming unprogrammed adaptation requires credible commitment, the deck has been stacked. Can anti-originalism be coherently defended as an optimal governance structure for unprogrammed adaptation?

5.1 The Strongest Economic Case for Living Constitutionalism

The strongest defense of Living Constitutionalism, framed in Transaction Cost terms, would argue that the US Constitution functions best as a Unified Governance Structure (Hierarchy). This argument draws heavily on the work of David Strauss (Common Law Constitutionalism) and Richard Posner (Pragmatism) (Strauss, 2010; Posner, 2008).

- **The Argument**: The transaction costs of Article V amendment are prohibitively high, creating a situation of "market failure" in the political market for constitutional change. The environment changes rapidly (technological and social evolution), requiring constant adaptation. The US Constitution is an incomplete contract with massive gaps.

- **The Solution**: Courts, acting as "managers" of the constitutional firm, possess the institutional expertise and lower decision-making costs required to facilitate these adaptations. Just as a corporation relies on managerial fiat rather than shareholder votes for daily operations, the polity should rely on judicial updating rather than Article V amendments for constitutional maintenance. Richard Posner's pragmatism aligns with this view, suggesting that judges should decide cases to maximize current social welfare rather than be bound by the "dead hand" of the past (Posner, 2008). Ideally, this minimizes the sum of maladaptation costs (stuck with bad rules) and transaction costs (cost of amendment). Ideally, the Court functions as an efficient manager, smoothing out frictions and updating the rules to match the "living" needs of the society.

5.2 Why the Hierarchical Defense Fails

While plausible on its face, this hierarchical defense collapses when analyzed against Williamson's specific criteria for when hierarchy is superior to hybrid governance. The defense fails on three critical economic grounds: it collapses the hybrid into hierarchy, it ignores endogenous opportunism, and it misidentifies the locus of adaptation.

5.2.1 The Collapse of Hybrid into Hierarchy

Living Constitutionalism treats the US Constitution as an internal corporate policy manual rather than a relational contract among sovereign principals (the People/States). In TCE terms, it:

- Eliminates fixed attributes (credible commitments).
- Converts all gaps into discretionary authority.
- Replaces fiduciary gap-filling with managerial updating.

This transformation is not "more adaptive" in the efficient sense; it is pure hierarchy. Williamson is explicit that hierarchy is optimal only when adaptation needs are intense AND the internal control mechanisms (monitoring) are sufficient to curb opportunism (Williamson, 1991). In the corporate world, hierarchy is checked by the market for corporate control and the ability of shareholders to sell their stock (exit). In the US constitutional world, citizens cannot "sell" their citizenship easily (exit is prohibitively costly), and they cannot "fire" the Supreme Court (monitoring is weak). Therefore, the "Hierarchical" solution of Living Constitutionalism creates a monopoly manager with no accountability - the worst of all governance worlds.

5.2.2 The Problem of Endogenous Opportunism

The critical failure of the Living Constitution model is its inability to control endogenous opportunism - the risk that the "managers" (judges) will act in their own interest rather than the principals'.

- **Weak Monitoring**: Unlike corporate managers who are disciplined by stock markets, boards of directors, and the market for corporate control, federal judges have life tenure and no direct competitive discipline. The "shareholders" (citizens) cannot easily fire the "managers" (judges).
- **Ideological Moral Hazard**: Without the constraint of fixed text, judges face a moral hazard to impose their own ideological preferences under the guise of "adaptation." This is "self-interest seeking with guile."

Therefore, constitutional adjudication satisfies the conditions for Bureaucratic Failure (Williamson, 1996). The hierarchy (court) becomes an instrument for rent-seeking and value extraction rather than efficient adaptation. Originalism, by enforcing the "hard budget constraint" of the text, imposes the necessary check on this opportunism. It serves as an "alienable control right" that the agents cannot alter.

5.2.3 Institutional Competence and the Locus of Adaptation

The anti-originalist argument assumes that because adaptation must occur, courts must be the adapters. However, Williamson's framework suggests adaptation should occur where information is best processed.

- **Markets/States**: Adapt autonomously to local conditions (Federalism).
- **Legislatures**: Adapt via compromise and distributive bargaining.
- **Courts**: Are comparatively information-poor regarding polycentric social issues.

Reallocating primary adaptive authority to the judiciary (as Living Constitutionalism does) violates the principle of comparative institutional competence (Komesar, 1994). It centralizes decision-making in the institution with the highest information costs for broad social policy, leading to high rates of error (maladaptation). The error costs of a "Pragmatic" judge trying to maximize social welfare with limited information likely exceed the transaction costs of the slower Article V process.

6 Residual Control Rights and the "Construction Zone"

The concept of the "Construction Zone" is not merely a legal abstraction; it is the functional equivalent of residual control rights in property rights theory (Grossman-Hart-Moore) (Grossman and Hart, 1986; Hart and Moore, 1990). The crucial question for US constitutional design is: When the text is silent, who holds the residual control right?

6.1 Judicial Review as the Allocation of Control

In corporate law, residual control rights usually vest in the owner of the asset (the shareholder) but are delegated to the board. In US constitutional law, the ultimate residual control right belongs to the People (Popular Sovereignty). However, operational control is delegated to the government.

The struggle over Chevron deference and its recent overruling in *Loper Bright* (lop, 2024) perfectly illustrates this battle over residual control.

- **Chevron (The Administrative State as Manager)**: The Chevron doctrine allocated residual control rights to Agencies when statutes were ambiguous. The economic rationale was that agencies, as expert managers, were better positioned for "unprogrammed adaptation" in technical fields. They could adapt rules (e.g., environmental standards) to new scientific realities cheaper than Congress could amend the statute.

- **Loper Bright (The Return to Judicial Fiduciary)**: The Court's rejection of Chevron in *Loper Bright* reasserted that "law does not run out" in a way that allows agencies to define their own power. In economic terms, this was a reclamation of residual control rights by the Judiciary (Article III). The economic logic mirrors the critique of managerial opportunism: allowing the "manager" (agency) to define the scope of their own authority creates an intolerable moral hazard. It creates an incentive for agencies to manufacture ambiguity to expand their own jurisdiction (empire building). *Loper Bright* posits that while agencies have expertise, the risk of opportunistic expansion requires that the boundary of their authority be determined by an independent fiduciary (the Court).

6.2 The Danger of "Law Runs Out"

Some critics of Originalism argue that in hard cases, the law "runs out," and judges must legislate. TCE offers a nuanced rebuttal. In a firm, when a contract runs out, the relationship

does not dissolve into chaos; it shifts to a different mode of governance (Williamson, 1985).

Similarly, when the specific text of the US Constitution runs out, the governance structure shifts to fiduciary construction. The judge does not become a legislator (free to pursue any policy); they become a fiduciary, bound to pursue the interests of the principal consistent with the purpose of the delegation. This leads directly to the role of fiduciary duties in constraining adaptation.

7 Fiduciary Duties and Good Faith: Constraining the Agent

If judges must engage in construction to facilitate adaptation, what prevents them from engaging in opportunism? How do we ensure they are "adapting" rather than "amending"? TCE suggests that when monitoring is difficult (it is hard for citizens to monitor judicial reasoning), governance structures rely on fiat constrained by fiduciary duties (Williamson, 1985).

7.1 The Fiduciary Constitution

Scholars like Gary Lawson, Guy Seidman, and Randy Barnett have pioneered the "Fiduciary Theory" of the US Constitution (Lawson and Seidman, 2017; Barnett and Bernick, 2016).

- **The Theory**: The US Constitution is a "power of attorney" - a fiduciary instrument delegating authority from the People to the Government.
- **The Duties**: Fiduciaries are bound by duties of Loyalty (acting for the principal) and Care (acting competently).

This aligns with the corporate model. Shareholders (Principals) cannot run the firm (bounded rationality); they delegate to Directors (Agents). To prevent Directors from looting the firm, the law imposes the Duty of Loyalty.

7.2 Good Faith in Construction

Randy Barnett introduces the concept of Good Faith Construction as the primary constraint on judicial discretion in the Construction Zone (Barnett and Bernick, 2013).

- **Contract Law Definition**: In contract law, the implied duty of good faith means that a party cannot use their discretion to "recapture opportunities foregone" at the time of signing. If a party agreed to a risk, they cannot use a loophole to avoid it later.
- **Constitutional Application**: A judge engages in "Bad Faith Construction" if they use the vagueness of the text to impose a policy that contradicts the original function or spirit of the provision.

Example: The "Recess Appointments Clause." The text allows the President to fill vacancies that "happen during the Recess of the Senate."

- **Adaptation (Good Faith)**: Does "Recess" cover a 3-day break? This is a gap requiring construction to ensure the government functions.
- **Opportunism (Bad Faith)**: The President declaring the Senate is in "Recess" when they are actually in session (pro forma), simply to bypass the confirmation requirement. This attempts to "recapture" the power of appointment that was "foregone" (compromised) in the original separation of powers deal.

Clarifying Values in Construction: Critics argue that "fiduciary construction" smuggles in moral judgment. However, the economic distinction is clear: fiduciary duties constrain *means*, not *ends*. They operate negatively (what judges may not do - self-deal, rewrite terms) rather than positively (what values they must impose). A fiduciary judge cannot impose their own view of "justice" if it conflicts with the "spirit" of the original bargain.

8 Comparative Institutional Analysis: Choosing the Imperfect Adapter

The integration of TCE and US Constitutional Theory is incomplete without addressing Comparative Institutional Analysis (CIA). As Neil Komesar argues, legal analysis often suffers from the "Nirvana Fallacy" - comparing an imperfect institution (e.g., the market or the legislature) to an idealized one (e.g., the court) (Komesar, 1994).

8.1 The Institutional Choice: Market, Politics, or Courts?

Williamson's framework asks: Which governance structure is best suited for a specific transaction?

- **The Market (Private Ordering)**: Low transaction costs for simple exchanges, high incentive intensity. Best for "autonomous adaptation" (Williamson, 1991).
- **The Legislature (Political Ordering)**: High transaction costs (slow, gridlock), high participation. Best for resolving major distributive conflicts and "consensus" adaptation (Vermeule, 2006).
- **The Court (Adjudicative Ordering)**: Lower transaction costs than legislatures (case-by-case), but insulated from information (bounded rationality) and participation. High risk of "minoritarian bias" (imposing the values of the elite legal class) (Komesar, 1994).

8.2 Why Unprogrammed Adaptation Does Not Imply Judicial Supremacy

One of the strongest critiques of Living Constitutionalism is its assumption that because adaptation is necessary, courts must be the primary adapters. TCE rejects this inference.

- **Decentralized Adaptation**: Most adaptation in a federal system occurs efficiently at the state level (autonomous adaptation). When a new technology arises (e.g., AI or IVF), states can experiment with different regulatory regimes. This is efficient autonomous adaptation.

- **Judicial Bottlenecks**: Centralizing adaptation in the Supreme Court creates a bottleneck. It reallocates authority to the institution with the highest information costs and the lowest democratic accountability.

Originalism, by enforcing the Constraint Principle, forces most major adaptations into the Legislature or the Amendment Process.

- **TCE Defense**: While political transaction costs are high (gridlock), the Agency Costs of unconstrained Judicial Supremacy are arguably higher. If Courts become the primary "adapters," interest groups shift resources from lobbying (politics) to litigation (law). Litigation becomes a form of Rent-Seeking (Tullock, 1967).

Therefore, Originalism acts as a jurisdictional boundary rule. It allocates decision-making rights to the institution with the comparative advantage in democratic legitimacy, even if that institution has higher friction. It accepts the "deadweight loss" of legislative delay to avoid the "moral hazard" of judicial rule.

9 Efficiency: Ex Ante vs. Ex Post Perspectives

A prominent critique of Originalism, often voiced by Richard Posner, is that it is inefficient. Why should a modern society be bound by the "dead hand" of 18th-century agrarians? Posner advocates for "Pragmatism," where judges decide cases to maximize current social welfare (Posner, 2008).

9.1 Static vs. Dynamic Efficiency

This critique reveals a fundamental divide in economic theory between Ex Post (Static) Efficiency and Ex Ante (Dynamic) Efficiency.

- **Posner (Ex Post)**: In a specific case, ignoring the text might produce a better outcome (e.g., allowing a beneficial regulation despite a constitutional ban). This minimizes "deadweight loss" in the moment.
- **Williamson (Ex Ante)**: Governance structures must be judged by their ability to foster investment over time. If a firm (or government) breaks its contracts whenever it is "efficient" to do so ex post, no one will contract with it ex ante. The cost of capital (or political support) will skyrocket (Williamson, 1991).

Dynamic Efficiency requires Credible Commitment. If the US Constitution is malleable (Living), it is a weak contract. Investment in the federal system (state cooperation, individual planning) is suboptimal because property rights and jurisdictional lines are insecure. Originalism promotes Dynamic Efficiency. By raising the cost of opportunistic change (strictly enforcing the "dead hand"), it lowers the cost of relying on the system. It creates a stable "institutional environment" that allows the "institutional arrangements" (markets and firms) to function efficiently.

9.2 Originalism and the "Market for Rules"

Federalism acts as a form of Autonomous Adaptation. By strictly enforcing the original division of powers (limiting the federal government), Originalism protects the ability of the States to serve as "laboratories of democracy" (new, 1932). This allows for competition between different legal regimes (a market for rules). Living Constitutionalism, which historically tends toward centralization (federal expansion), suppresses this autonomous adaptation in favor of centralized hierarchy (federal mandates). From an evolutionary economics perspective (Hayek/Alchian) (Hayek, 1945; Alchian, 1950), retaining a rigid constitutional shell

(Originalism) that protects a decentralized adaptive interior (Federalism/Markets) is more efficient than a flexible constitutional shell that allows for centralized command-and-control.

10 Conclusion: The Constitution as a Firm - or the Limits of Economic Metaphor

The synthesis of Transaction Cost Economics and US Constitutional Theory reveals that the Originalism debate is not merely about history or linguistics; it is a debate about the architecture of governance.

Anti-originalism cannot be coherently defended as a theory of unprogrammed adaptation unless it openly embraces judicial hierarchy and accepts the resulting agency costs. Once unprogrammed adaptation is understood as a governance problem rather than a license for flexibility, Originalism - specifically New Originalism with fiduciary construction - emerges not as nostalgic formalism, but as the only stable hybrid equilibrium.

10.1 Summary of Findings

1. **Isomorphism**: The US Constitution functions as an incomplete, long-term relational contract. Its design problems - bounded rationality, opportunism, and asset specificity - are isomorphic to those of the firm.

2. **Adaptation through Construction**: The "New Originalist" distinction between Interpretation and Construction provides a mechanism for unprogrammed adaptation that mirrors the "residual control rights" allocation in corporate theory.

3. **Failure of Hierarchy**: Living Constitutionalism collapses the hybrid governance structure into a hierarchy (judicial supremacy). Under conditions of high asset specificity and high opportunism with weak monitoring, hierarchy is the worst possible governance form.

4. **Institutional Competence**: Comparative Institutional Analysis suggests that while Article V amendment is costly, the alternative - unconstrained judicial updating - incurs prohibitive agency costs and undermines the credible commitment essential for dynamic efficiency.

By integrating the Theory of the Firm, legal scholarship can articulate a defense of Originalism that is grounded in the functional imperatives of governance. Originalism is the governance structure that best balances the conflicting demands of commitment and adaptation, minimizing the total social costs of organizing a free society over time. It recognizes that in a world of bounded rationality, the most efficient path forward is often a faithful adherence to the map drawn in the past.

10.2 The Critical Turn: What If the Economic Model Is Wrong?

However, we must conclude by returning to the epistemic caveat with which we began. The analysis above proceeds entirely within the framework of Transaction Cost Economics. It assumes that Williamson's insights about firms, contracts, and governance translate cleanly to the domain of constitutional law. *But what if this assumption is mistaken?*

The fact that TCE appears to vindicate Originalism - a contested and highly normative position in legal theory - should give us pause. If economic theory can be marshaled to support *either* side of a fundamental jurisprudential debate (depending on which economic framework one adopts), this suggests that the economic theories themselves may lack the determinacy or empirical grounding necessary for such applications.

Consider the following alternative interpretation: **The apparent alignment between originalism and TCE may reveal fundamental limitations in how transaction cost economics conceptualizes governance, rather than validating originalism itself.** Specifically:

- TCE's emphasis on "credible commitment" may overweight stability at the expense of

learning and evolution in complex adaptive systems.

- The binary between "autonomous" and "cooperative" adaptation may fail to capture the rich variety of institutional arrangements that blend characteristics of both.
- The agency cost framework may systematically undervalue the epistemic advantages of giving discretion to specialized, insulated decision-makers (judges) who can engage in principled reasoning insulated from short-term political pressures.
- The model's assumption that "opportunism" is the primary threat may blind us to other failure modes, such as institutional sclerosis, path dependence, or the tyranny of past generations over present ones.

If originalism truly is the "efficient" constitutional methodology under TCE, this may paradoxically suggest that TCE is an inadequate framework for analyzing constitutional governance. A theory that validates a methodology which ties modern societies to decisions made by long-dead framers operating under radically different social, technological, and economic conditions may simply be the wrong tool for the job.

This paper thus serves a dual function: It provides the most rigorous economic case *for* originalism currently available in the literature. But simultaneously, by revealing how easily economic theory can be wielded to support contested normative positions, it may provide the strongest evidence yet that **we should be deeply skeptical of applying firm-based economic models to constitutional interpretation.** The analysis may constitute not a vindication of originalism, but rather a *reductio ad absurdum* of transaction cost economics when applied outside its domain of comparative advantage.

Future scholarship should investigate whether alternative economic frameworks - evolutionary economics, complexity theory, epistemic theories of institutions, or behavioral economics - might provide different (and potentially more compelling) normative guidance for constitutional interpretation. Until such investigations are complete, legal scholars should treat economic arguments in constitutional theory with appropriate caution, recognizing

that the map (economic theory) may distort the territory (constitutional law) as much as it illuminates it.

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