

THE JURISPRUDENTIAL NICHE OCCUPIED BY LAW AND ECONOMICS

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Abstract: This paper describes the jurisprudential niche occupied by the several schools of thought that comprise the field of Law and Economics in present-day legal scholarship. It begins by providing a brief history of law in the U.S.; it highlights the void left in law by the Legal Realists; it then very briefly explores some of the theories that attempted to fill that void including critical legal studies, feminist jurisprudence, and critical race theory. The paper then turns to its main focus – describing the several schools of thought that comprise the field of Law and Economics that has also helped fill the void. These include the Chicago approach to law and economics, public choice theory, institutional law and economics, the new institutional economics, social norms and law and economics, the New Haven school, and Austrian law and economics.

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I. INTRODUCTION

Most academics in law, sociology, psychology, philosophy, and political science who have heard something about “law and economics” or the “economic analysis of law” often react in the same manner, with an almost knee-jerk response – “Oh, that’s those Chicago types promoting their conservative market agenda.” The names that immediately come to mind typically include Ronald H. Coase, Richard A. Posner, Robert Bork, Gary Becker, Henry Manne and a few others who are at the core of the Chicago approach to law and economics. Discussions of the Coase theorem, more deregulation, a vast expansion of market-like remedies, rent-seeking behavior ... etc. are all viewed with some suspicion. Without full appreciation of the true scope of Law and Economics, they have come to believe the field is irredeemably conservative, probusiness, and anticonsumer – in general “not for them.”

The purpose of this paper is to describe the jurisprudential niche that is occupied by the several schools of thought that comprise the field of Law and Economics within present-day legal scholarship.¹ The focus here is not just on

¹ Throughout this paper “Law and Economics” (capital L and E) is used as an eclectic title to refer to all seven of the identifiable, coherent schools of thought that deal explicitly with the interrelations between law and economy.

the Chicago school that often invites the response described above, but also on the six other schools that contribute to the field, each of which places significant emphasis on the interrelations between law and economy. The aim is to clarify the scope of “Law and Economics” for those in law as well as those involved in fields contiguous to law. Hopefully, this will provide the reader a broader and deeper understanding and appreciation of ways to think about the relationships between the nation’s legal institutions and their impact upon the performance of the economy.

Law and Economics can be defined as the application of economic theory—primarily microeconomics and the basic concepts of welfare economics—to examine the formation, structure, processes, and economic impact of law and legal institutions. Various schools of thought compete in this rich marketplace of ideas beyond the Chicago approach to law and economics. These include public choice theory, institutional law and economics, the new institutional economics, social norms and law and economics, as well as the New Haven school and Austrian law and economics.

Today, much of the conventional study of law is organized around modern doctrinal principles and concepts drawn from legal theory and political theory. The “Law and Economics” movement is an attempt to place economic theory alongside of (or in place of ?) the legal and political theory that presently informs law; to place efficiency alongside of (or in place of ?) the concepts of justice and/or fairness that presently help fashion legal rules and doctrines. None of its proponents come to the marketplace of ideas without their particular way of thinking about economics and/or the law. They all bring with them their own tendencies and biases regarding: the naming and framing of the legal issues that come before them; the role of efficiency in describing and prescribing law; how to balance *ex post* versus *ex ante* thinking in the law; the degree to which there should be an emphasis on inductive or deductive thinking, or on positive or normative analysis; and the degree to which social norms should be included in the economic analysis of law. Each school of thought has its own unique perspective – each looks into the room that houses the economy and our legal system through a different window. Their views of what is in that room (even *within* a particular school of thought) are by no means homogeneous; these schools of thought are in some ways competing and in other ways complementary approaches to the study of the development and the reformulation of law. In all this, each school of thought contributes to our understanding the complex interrelations between the economy and the law and thereby helps us come to grips with the implications of legal-economic policy, ultimately by stating: i) what the law is, ii) to discern a basis for law’s legitimacy, and/or iii) to say what the law should be.

II. A VERY BRIEF HISTORY OF LEGAL THEORY

In order to understand the jurisprudential niche occupied by Law and Economics in law today, it is important to see Law and Economics as part of the evolution of law, more particularly, the evolution of ways to think about the law. To that end, this section highlights the history of American jurisprudence by describing the several approaches or ways to think about the law so the reader can better appreciate how law – as it has evolved overtime – opened its doors to (or got them knocked down by) the imperialism of economics.

A. Natural Law

In looking back to the ways we have thought about law, the obvious starting point is with natural law. There are two prominent conceptions of natural law: one is based on reason and the ‘nature’ of man, while the other is based on reason in relation to God.² From the perspective of advocates of the natural law (in either form), law stands above and apart from the activities of human law makers. Whether the legitimacy of the natural is said to rest with “reason” or “divine inspiration,” natural law theorists argue that individuals in society have a moral obligation to make and obey law consistent with these overarching natural law principles.

B. The Positivists

Against this metaphysical approach came the positivist scientific attitude toward the law, circa 1820-1830, a movement born out of the success of the natural sciences in the nineteenth century and the attempts by the social sciences to apply the methods of the natural sciences.³ The positivists were led by John Austin;⁴ he was later joined by the continental positivist, Hans Kelsen.⁵ Positivists as a group actively distanced themselves from the natural law advocates who they thought confused legal norms and moral ideas; they rebelled against the concept of natural law in all its forms. This is reflected in the positivists’ assertions that i) law is the command of the sovereign and nothing more (Austin), or owes its origins to the “Grundnorm” together with a determinate logical structure from which legal outcomes can be reached

² Bernard F. Cataldo, et.al., *Introduction to Law and the Legal Process*, (1973).

³ See, for example, Edgar Bodenheimer, *Jurisprudence: The Philosophy and Method of the Law* (1974 revised ed.) Chapters 1-7.

⁴ Austin’s more important works include *Lectures on Jurisprudence or The Philosophy of Positive Law* (1885) and *The Province of Jurisprudence Determined* (1861).

⁵ Kelsen’s more important works include *General Theory of Law & State* (1945) and *The Pure Theory of Law* (1967).

without reference outside factors (Kelsen); ii) law exists only to the extent that it is capable of being enforced; and iii) ethics, politics, morals, and customs are outside of the domain of jurisprudence.

C. Doctrinalism

The mid-nineteenth century witnessed the development of a second movement attempting to mimic the methodology of the natural sciences – doctrinalism. Within doctrinalism, law is not a search for some natural or divinely inspired principles, but rather a scientific enterprise which “takes as its starting point a given legal order and distills from it by a predominately inductive method certain fundamental notions, concepts, and distinctions.”⁶ It was Christopher Columbus Langdell, Dean of the Harvard Law School, who, within American law, perhaps came to be most closely associated with this view.⁷ Together with James Barr Ames, Joseph Beale and others, Langdell considered the judicial opinion to occupy a place of preeminence in law, inasmuch as he believed that the corpus of judicial opinions embodied “a handful of permanent, unchanging, and indispensable principles of law” that revealed themselves in different guises in different cases.⁸ The task of legal reasoning became that of the careful and exacting study of judicial opinions to discern these fundamental doctrines. Thus, formalism became the dominate paradigm – once the principles and doctrines were revealed, it would then be possible to render decisions in new cases through the use of syllogistic reasoning from the precedential principles set forth in previous like cases.⁹ In all this, under Langdell, law became a science and automomous – an arena in which ethics, social and economic conditions, politics, ideologies, and the insights of disciplines outside of the law had no proper role.

D. Sociological Jurisprudence

In the late nineteenth century a reaction against doctrinalism began to emerge. This alternative way to think about the law has been termed sociological jurisprudence and included such notable legal thinkers as Roscoe Pound,

⁶ Bodenheimer, above n 3, 95.

⁷ See, for example, Christopher C. Langdell, *A Selection of Cases on the Law of Contracts* (1871). The following discussion of Langdell draws on Lawrence M. Friedman, *A History of American Law* (1973) 530-536; see also Thomas C. Grey, ‘Langdell’s Orthodoxy’ (1983) 45 *University of Pittsburgh Law Review* 1.

⁸ Richard A. Posner, *The Problems of Jurisprudence* (1990) 15.

⁹ It has been observed that: “Contrary to the caricature, formalism did not begin with Langdell.” Marcia Speziale, ‘Langdell’s Concept of Law as Science: The Beginning of Anti-formalism in American Legal Theory’ (1980) 5 *Vermont Law Review* 1, 4 at note 10.

Benjamin Cardozo, and Oliver Wendell Holmes Jr..¹⁰ Pound was considered the leader of sociological jurisprudence and a strong advocate of reforming law by taking social reality into account. As a group, advocates of sociological jurisprudence claimed that law is not to be seen as an autonomous discipline, believing instead that the law can not be fully understood without reference to the social and economic conditions of the day. They believed that judges should be aware of the social and economic conditions which affect the path of law and that the legal decision-making process must necessarily employ the tools – the insights from the social sciences – necessary to enhance such awareness.

E. Restatements of Law

It must be noted that the advocates of the formalist, doctrinal approach did not simply roll over and play dead in the face of criticism leveled by the proponents of sociological jurisprudence. Doctrinalism remained alive and well at Harvard and in 1923, academics banded with judges and lawyers to form the American Law Institute in an effort “to project the scientific study of law into the very center of professional life.”¹¹ This project took the form of publishing *Restatements of Law* that would provide a clear statement of common law principles and doctrines for use in guiding and evaluating judicial decisions. All of this toward the goal of promoting and facilitating free enterprise, the fluid operation of which (as believed by large numbers of academics and judges alike), would enhance economic growth and maximize social welfare.

F. The Legal Realist Challenge

The efforts of the sociological jurists notwithstanding, the most influential of the challenges to doctrinalism was the Legal Realist movement which reached its zenith in the 1930s. The Realists, following on the work of those within sociological jurisprudence, cracked the edifice of doctrinalism and thereby helped to turn law outward in their effort to make law attuned to the social realities of the day.¹² However united they were in their rejection of formalism and doctrinal law, their particular interests ultimately took them in different directions never attempting to set forth a coherent alternative theory, thus creating a jurisprudential void. In doing so, they affected both the process of legal education, the intellectual life of the law, and in many ways, opened the

¹⁰ See for example Oliver Wendell Holmes, Jr., ‘The Path of the Law’ (March 1897) 10 *Harvard Law Review* 457; Roscoe Pound, ‘Mechanical Jurisprudence’ (1908) 8 *Columbia Law Review* 605; and Benjamin N. Cardozo, *The Nature of the Judicial Process* (1921).

¹¹ Bruce A. Ackerman, ‘Law and the Modern Mind by Jerome Frank’ (1974) 103 *Daedalus* 119, 120.

¹² See Martha Minow, ‘Law Turning Outward’ (1987) 73 *Telos* 79.
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law to a variety of new jurisprudential movements – efforts to fill that jurisprudential void.¹³

The Langdellian system, in all of its manifestations, was an anathema to the Realists. The reverence for the traditions and purported unique doctrines of the law, so central within doctrinalism, held little sway among the Realists. Karl Llewellyn, a leading Realist, suggested that the role of legal rules within the lawmaking process was far less important than generally assumed, and that the “theory that rules decide cases seems for a century to have fooled, not only library-ridden recluses, but judges.”¹⁴ In a similar vein, Jerome Frank asserted that, contrary to the logical cloak in which they are enveloped, judicial decisions are largely informed by “emotions, intuitive hunches, prejudices, tempers, and other irrational factors.”¹⁵ For the Realists, the judge, rather than the logic of the law, was the central factor in the resolution of legal cases. This human factor underlying judicial decision making was necessarily determined by subjective value judgments rather than by logic.¹⁶ It is from this view of things that we get the caricature that legal decision making has less to do with logic, rules, and precedent than with what the judge ate for breakfast.¹⁷ They further argued that because decisions rested on the judge’s conception of right and wrong, social, political, and economic considerations became important variables.¹⁸

Along with the idea that law cannot be a logical, self-contained, scientific discipline came the prescription that it should cease all pretensions of being so, and that law should become more overtly attuned to social ends. Given their strong instrumentalist conception of law, the law was, and had to be seen as, a “working tool.”¹⁹ As every legal decision was understood to have social, ethical, political, and economic implications, the Realists maintained that these should be recognized and explicitly dealt with by judges, not hidden behind a

¹³ Friedman, above n 7, 591. It should be noted that there is no settled position as to the boundaries and contours of Legal Realism. For surveys of various issues related to the Legal Realist movement see William W. Fisher, Morton J. Horwitz, and Thomas A. Reed. *American Legal Realism* (1993); and Neil Duxbury, *Patterns of American Jurisprudence* (1995) chapter 2.

¹⁴ Karl N. Llewellyn, ‘The Constitution as an Institution’ (1934) 34 *Columbia Law Review* 1, 7.

¹⁵ From Bodenheimer, above n 3, 125.

¹⁶ Elizabeth Mensch, ‘The History of Mainstream Legal Thought’ in David Kairys (ed), *The Politics of Law: A Progressive Critique* (1990) 13, 22.

¹⁷ Minow, above n 12, 93.

¹⁸ Edward L. Rubin wrote that “the realists maintained that general legal principles do not exist: law is always the creation of some specific lawmaker, whether legislator, administrator, or judge, and it usually reflects the policy predilections of that lawmaker.” Edward L. Rubin, ‘The New Legal Process, the Synthesis of Discourse, and the Microanalysis of Institutions’ (1996) 109 *Harvard Law Review* 1393, 1395.

¹⁹ Friedman, above n 7, 592.

veil of logical reasoning. The corollary was that to better understand these implications, it is necessary to explore the interrelations between law and the other social sciences, including sociology, psychology, political science, and economics.

For present purposes, it is important to note the Realist interest in using economics to understand and to guide the development of law.²⁰ They argued that the importance of the interrelations between economics and the law can be seen in the twin facts that i) legal change is often a function of economic ideas and conditions, which necessitate and/or generate demands for legal change, and ii) that economic change is often governed by legal change.²¹ Given the important interdependencies that they saw between law and economy, it is not surprising that Realists such as Llewellyn considered economic analysis a useful tool for understanding law and legal change and for devising laws that would improve the social condition.²² Indeed, Samuel Herman went so far as to assert that “[t]he law of a state never rises higher than its economics” and expressed the hope that “ ‘a disciplined judicial economics’ might become ‘a realistic and tempered instrument for solving the major judicial questions of our time.’ ”²³

G. Legal Process Movement

In the 1940s (until about 1960), we witnessed a renewed belief in the autonomy of law, this time in the form of the legal-process movement. This was a new movement that emphasized that certain principles of process were neutral, and hence immutable. The main exponents of the legal-process approach were Lon L. Fuller, Henry M. Hart, Albert M. Sacks, and Herbert Wechsler.²⁴ Unlike the Realists, proponents of the legal-process approach generally advocated a return to the view of law as an autonomous discipline,

²⁰ For surveys of the intersection between Legal Realism and economics, see Warren J. Samuels, ‘Law and Economics: Some Early Journal Contributions’ in Warren J. Samuels, Jeff Biddle, and Thomas W. Patchak-Schuster (eds) *Economic Thought and Discourse in the Twentieth Century* (1993) 217; see also Duxbury, above n 12, chapter 2.

²¹ See, for example, Karl N. Llewellyn, ‘The Effect of Legal Institutions upon Economics’ (1925) 15 *American Economic Review* 655; Mark M. Litchman, ‘Economics, the Basis of Law’ (1927) 61 *American Law Review* 357; and W. S. Holdsworth, ‘A Neglected Aspect of the Relations Between Economic and Legal History’ (1927-28) 1 *Economic History Review* 114.

²² Karl N. Llewellyn, ‘The Effect of Legal Institutions upon Economics’ (1925) 15 *American Economic Review* 655.

²³ Samuel Herman, ‘Economic Predilection and the Law’ (1937) 31 *American Political Science Review* 821, 831.

²⁴ See for example Lon Fuller, *The Law in Quest of Itself* (1940); Henry M. Hart and Albert M. Sacks, *The Legal Process: Basic Problems in the Making and Application of Law* (1951); and Herbert Wechsler, ‘Toward Neutral Principles of Constitutional Law’ (1959) 73 *Harvard Law Review* 1.

with law's legitimacy and objectivity now preserved by focusing on the process and institutions by and through which the law evolved. Against debates over whether a particular decision conformed to principles of natural law or the scientifically-culled principles of doctrinalism, the legal-process approach argued that law's legitimacy was embedded in neutral, institutional structures and legal procedures, that is, within the very process by which the society had chosen to govern itself. If a decision is purposive and the result of an established, accepted, neutral legal process, the outcome was said to be legitimated.

III. THE NEED TO FILL THE VOID

By 1960, one could not ignore the impact the Legal Realists had in cracking the edifice of doctrinalism. Recall, the Realists rejected the doctrinal approach that would continue to have law schools train their students to objectively uphold the purported authority of earlier, bygone cases. They believed that jurists should act creatively, imaginatively and intelligently to reach just results; they should reach out to the social sciences to make informed choices. They aspired to have lawyers become active participants in the purposive process of law. They viewed legal decisions, fundamentally, as policy choices, and, as such, thought lawyers should be informed by the best legal, humanities, and social science knowledge of the day – to “look outward.”²⁵

One manifestation of the disillusionment with the idea that law was a science and an autonomous discipline was a wide-ranging search for other bases on which to ground legal analysis leading to the growth of numerous “law and _____” movements which have continued to evolve over the past forty years.²⁶ But even more significant was the fact that scholars from a variety of disciplines began to come together and form movements to bring particular insights and new ideas into the law. Critical legal studies, feminist jurisprudence, and critical race theory, and, of particular importance here, economics, all began to have something to say about what the law is, to discern a basis for law's legitimacy, and/or to say what the law should be.

As a group, critical legal studies, feminist jurisprudence, and critical race theory were heavily influenced by European philosophers, such as the German social theorists Karl Marx, Max Weber, and Friedrich Engels; from the Frankfurt School of German social philosophy, in particular Max Horkheimer and

²⁵ For a concise discussion why this happened at this particular time see Richard A. Posner, “The Decline of Law as an Autonomous Discipline: 1962-1987” (1987) 100 *Harvard Law Review* 761.

²⁶ Note that this need or tendency to “look outward” is by no means universal among legal scholars; for example see Earnest J. Weinrib, *The Idea of Private Law* (1995).
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Herbert Marcuse; by the Italian Marxist Antonio Gramsci; and certainly by such poststructuralist thinkers, Michel Foucault and Jacques Derrida. The plethora of ideas and the zeal of their advocates has made legal analysis highly politicized and interwoven with the social sciences and humanities.²⁷ In order to gain a fuller appreciation of the jurisprudential niche ultimately occupied by Law and Economics, a brief description of critical legal studies, feminist jurisprudence, and critical race theory is provided here. In this way, we come to see Law and Economics as part of the evolution of law, more particularly, the evolution of ways to think about the law so as to better comprehend the evolving nature of the law into which Law and Economics so firmly insinuated itself.

A. Critical Legal Studies

Critical legal studies set forth a Marxist critique of mainstream liberal jurisprudence and political thought, a critique that is largely based on the premise that the logic and structure of current law grew out of the power relationships of the society.²⁸ Some of the movement's leading contributors include, Duncan Kennedy, Roberto Unger, Karl Klare, and Mark Kelman. At the heart of the critical Marxist critique of liberal jurisprudence is the idea that law is radically indeterminate.²⁹ Their's is an effort to reveal conflicts between principles and counter principles in legal theory by exploring the fundamental

²⁷ Minow, above n 12, 79; see also Robert W. Gordon, 'New Developments in Legal Theory' in David Kairys (ed) *The Politics of Law: A Progressive Critique* (1990), 413, 413. While critical legal studies, feminist jurisprudence, and critical race theory are being treated here as three distinct movements, they are in fact interrelated; and so one finds, "CLS includes several subgroups with fundamentally different, even contradictory, views: feminist legal theory, which examines the role of gender in the law; critical race theory, which is concerned with the role of race in the law." See the website: Cornell Law School – Legal Information Institute / Critical legal theory: an overview.

[http://topics.law.cornell.edu/wex/Critical_legal_theory]

²⁸ This synoptic review of CLS is taken from Guroya Binder, 'Critical Legal Studies' in Dennis Patterson (ed), *A Companion to Philosophy of Law and Legal Theory*, (1999) 280; Nicholas Mercuro and Steven G. Medema, 'Chapter 6 - Critical Legal Studies' in Nicholas Mercuro and Steven G. Medema, *Economics and the Law: From Posner to Post-Modernism* (1997) 157.

²⁹ There are two Marxist strands of critical legal studies – Critical Marxism and Scientific Marxism. On this point see Alvin W. Gouldner, *The Two Marxisms*, (1980). The description here is that of Critical Marxism as it is more prevalent in the CLS literature. Unlike Critical Marxism, Scientific Marxism emphasizes the *determinative* importance of class-based ownership of the means of production, along with the determination of the content of the political, legal, and other ideas (the superstructure) by the social relations and structures (the base) that follow from the pattern of ownership of the means of production. The relationship among the advocates of the Law & Society Movement, the Critical Marxists, and the Scientific Marxists (the so-called "three-corner catch") is summarized in John Henry Schlegel, 'Notes toward an Intimate, Opinionated, and Affectionate History of the Conference on Critical Legal Studies' (1984) 36 *Stanford Law Review* 391.

oppositions such as public and private, substance and form, as well as the political and legal hierarchal bureaucratic structures and the patterns of domination and subordination that are contained therein. From their vantage point, the inevitable outcome of legal conflicts is a profound inconsistency permeating the deepest layers of the law. Given this pervasive inconsistency of law, they argue that legal doctrines are fundamentally indeterminate and manipulable thus giving rise to the radical indeterminacy in the law. Further, insofar as the law is inconsistent, a judge can justify any of a number of conflicting outcomes leading them to conclude that “all law is politics.”

B. Feminist Jurisprudence

Feminist jurisprudence is quite diverse being comprised of several theoretical approaches. The main focus of scholars, lawyers, and activists who contribute to feminist jurisprudence, regardless of their approach, is to raise questions about the meaning of law and the impact of law on women’s lives.³⁰ Each approach evaluates and critiques the law by examining the relationship between gender, sexuality, power, individual rights, and the judicial system from its own, unique vantage point.³¹ All approaches are concerned with both: i) law as a theoretical enterprise and its practical effects on women, as well as, ii) law as an academic discipline thus including issues regarding pedagogy. Some leading contributors to feminist jurisprudence include Catharine A. MacKinnon, Martha Minnow, Patricia Smith, Mary Joe Frug, Kathryn Abrams, Drucilla Cornell, and Martha A. Fineman

A common theme among the several approaches to feminist jurisprudence is to see the existing system of interconnected legal, political, and social relations together with the supporting institutions (together with their workings), as oppressive to women and consequently, an unacceptable state of affairs. These several approaches to law and legal issues notwithstanding, at base, their argument is that the language, logic, and structure of the law are male-created and reinforce male values. Feminist legal scholars often use women’s experiences – engaging in experiential discourses for analyzing gender hierarchy, sexual objectification, and social structures – to describe the male-

³⁰ This synoptic review of feminist jurisprudence borrows primarily from Patricia Smith, ‘Feminist Jurisprudence’ in Dennis Patterson (ed), *A Companion to Philosophy of Law and Legal Theory*, (1999) 302. Leslie Friedman Goldstein (ed), *Feminist Jurisprudence: The Difference Debate* (1992); Patricia Smith (ed), *Feminist Jurisprudence* (1993); Melissa Burchard, ‘Feminist Jurisprudence’ *Internet Encyclopedia of Philosophy* [<http://www.iep.utm.edu/j/jurisfem.html>].

³¹ Three of the major approaches within feminist jurisprudence are: i) traditional (sometimes labeled liberal) feminists; ii) cultural feminists; and iii) radical (sometimes labeled dominant) feminists. These are taken from and fully described in “Feminist Jurisprudence: An Overview,” [http://topics.law.cornell.edu/wex/Feminist_jurisprudence]

dominated power structure and to demonstrate the need for change. From this vantage point they probe the fundamental question: What is implied in traditional legal categories, distinctions, or concepts of law? Its aim is to make gender, especially entrenched inequality connected to gendered roles, a focus of discourse by which to reconstitute legal practices that have excluded and/or oppressed women.

C. Critical Race Theory

Although critical race theory began as a movement in law, it has rapidly spread and has impacted the more established fields of anthropology, sociology, history, philosophy, and politics.³² It is a movement that has helped transform our understanding of the relationship among race, racism, and power. Those who have contributed to the discourse and scholarship include Derrick Bell, Alan Freeman, Mari Matsuda, Richard Delgado, Kimberlé Williams Crenshaw, and William Tate, several drawing from the writings of one of the fields pioneers, W.E.B. DuBois.

Critical race theory emphasizes the socially constructed nature of race and considers judicial conclusions to be the result of the workings of power; it opposes the continuation of all forms of subordination. That is, critical race theorists within law emphasize how legal rules and regimes look from the perspective of the disempowered and outsider groups by addressing a broad array of issues having to do with race. It is critical of both liberal incrementalism and conservative color-blind philosophies. While there are several approaches to critical race theory, all approaches place central importance on power, economics, and social construction, that is, how the structure of legal thought or culture influences the content of the law. Critical race theorists pay particular close attention to context and historical situation, valuing the individual over the universal in social and legal analysis. They reexamine America's historical record, replacing comforting majoritarian interpretations with interpretations that are more recognizable to minorities and their shared experiences. In addition, many critical race scholars advance the idea of interest convergence where white elites are documented to tolerate or even encourage racial advances for blacks only when such advances also promote white self interests. They also credit the use of alternative

³² This synoptic review of critical race theory borrows from primarily these sources: Richard Delgado and Jean Stefanic, *Critical Race Theory: An Introduction*, (2001); 'Critical Race Theory - An Organization Forms, Spin-off Movements, Criticism, Methodology, Derrick Bell, Related Legal Movements'

[<http://science.jrank.org/pages/7605/Critical-Race-Theory.html>]; and 'Critical Race Theory' [<http://www.lycos.com/info/critical-race-theory.html>]

methodology in the expression of theoretical work, most notably the use of "narratives" and other literary techniques.

In summary, each of the movements described above represents an attempt to turn law outward, and in doing so, each seeks, overtly or not, to fill the void left by Legal Realism. The pre-World War II consensus regarding how to think about and to resolve important legal questions has all but disappeared. For many in critical legal studies, feminist jurisprudence, and critical race theory, the social arrangements sanctioned by law have come to include an array of hierarchies of economic power and pernicious social distinctions protected as rights by the very legal system created to establish individual freedom and equality. No longer is law seen as able to, on its own, generate results that constitute objective truth—to state what the law is, to discern a basis for law's legitimacy, or to say what the law should be. Advocates of critical legal studies, feminist jurisprudence, and critical race theory see a compelling need to restructure our social order. Their common belief is that the law must be reinvented to give it a new purpose; efforts must lead the dismantling of the various hierarchies of power and privilege that through perversions of the legal process have come to threaten what they see as the higher values of our society – namely freedom and equality.

IV. SCHOOLS OF THOUGHT IN LAW AND ECONOMICS

For our purposes here, it is essential to note that not only did critical legal studies, feminist jurisprudence, and critical race theory try to fill the void left by the Realists, but as Edmund Kitch among others, has noted, it was the Legal Realists who created an environment that was receptive to the introduction of economics into the law school curriculum.³³ And, while it remains unclear as to whether critical legal studies, feminist jurisprudence, or critical race theory has had, or will have a lasting effect on law, economics surely has had a significant impact.³⁴ The scholarship emanating from the field

³³ Edmund W. Kitch, 'The Fire of Truth: A Remembrance of Law and Economics at Chicago, 1932-1970' (1983) 26 *Journal of Law and Economics* 163; and Edmund W. Kitch, "The Intellectual Foundations of 'Law and Economics' " (1983) 33 *Journal of Legal Education* 184.

³⁴ Leading Lawrence Lessig to conclude: "We are all law-and-economists now." Lawrence Lessig, 'The Prolific Iconoclast' (1999) *The American Lawyer* 105. The proliferation and worldwide impact of Law and Economics is evidenced by the list of active international associations that have been established to advance its role in law: American Law and Economics Association, Canadian Law and Economics Association, European Association of Law and Economics, German Association of Law and Economics, Israeli Association of Law and Economics, Australian Law and Economics Association, Law and Economics Association of New Zealand, Latin American Law and Economics Association, Mexican Law and Economics Association, Portuguese Law and Economics Associations, Scandinavian Law and Economics

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of Law and Economics is a product of a diverse group of scholars who contribute to this increasingly rich marketplace of ideas.³⁵ The following seven sub-sections will briefly describe the intellectual origins, identify some of the main contributors, outline the respective principles and ideas of each of the schools of thought that comprise the field of Law and Economics.

A. Chicago Approach to Law and Economics

1. People, Places and Ideas

While the roots of Law and Economics go back at least to David Hume, Cesare Beccaria, Adam Ferguson, Adam Smith, and Jeremy Bentham,³⁶ it became formalized as an intellectual discipline at the University of Chicago in the 1960s and the 1970s.³⁷ Within both economics and law, the core of the Chicago approach to law and economics took form through the work of such notable figures as Frank Knight, Aaron Director, Ronald H. Coase, Henry Manne, Gary Becker, and Richard A. Posner.³⁸ Of all of the schools of thought that comprise the field of Law and Economics, it is the Chicago approach to law and economics that has come to dominate scholarship within the economic analysis of law and thus invites the response described in the introduction. While some of the early history and subsequent success of Chicago law and economics is attributable to scholars in its department of economics, much of the credit in building this intellectual edifice was provided

Association, Greek Law and Economics Association, Italian Society for Law and Economics, and Asian Law and Economics Association.

³⁵ The number of leading publications dedicated to publishing the scholarly contributions to this field includes journals such as: *Journal of Law and Economics*; *Journal of Legal Studies*; *American Law and Economics Review*; *Journal of Law, Economics & Organization*; *Public Choice*; *Constitutional Political Economy*; *International Review of Law and Economics*; *European Journal of Law and Economics*. There are also research annuals - *Supreme Court Economic Review*, *Research in Law and Economics*, *The Economics of Legal Relationships*, and *New Horizons in Law and Economics* - devoted to the field. Traditional economics journals and law reviews now regularly publish Law and Economics' articles. Also attesting to its impact is the fact that some seven Nobel Prizes in economics have been awarded to those working in the field; and many of the top-tied U.S. law schools now have active Law & Economics Centers.

³⁶ For Hume, see *A Treatise of Human Nature*; for Beccaria, see (Dei delitti e delle pene) *On Crimes and Punishment*; for Ferguson, see *An Essay on the History of Civil Society*; for Smith, see both *The Wealth of Nations* and his *Lectures on Jurisprudence*; and for Bentham, see *Introduction to the Principles of Morals and Legislation*. For a concise review of the role of each (excluding Beccaria), see Charles K. Rowley, 'An Intellectual History of Law and Economics 1739-2003' in Charles K. Rowley and Francesco Parisi (eds), *The Origins of Law and Economics: Essays by the Founding Fathers* (2006), 3.

³⁷ This short overview borrows from Nicholas Mercurio and Steven G. Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2006 2nd ed), Chapter 2.

³⁸ Coase, Calabresi, Manne, and Posner were honored as the "four founders" of law and economics at the Plenary Session of the American Law and Economics Association on May 24, 1991.

by the faculty of the law school (beginning circa 1939). The various points of contact between those at the law school and those within the economics department enabled the fundamental ideas of the Chicago school of economics to permeate into the law school and thereby help create the Chicago approach to law and economics which has since been formalized and transmitted to subsequent generations.³⁹

With respect to the department of economics, there were really two Chicago schools of thought, roughly divided in time by World War II.⁴⁰ The perspective of the pre-war-Chicago school is evidenced in the scholarship and teachings of Frank Knight, Jacob Viner, Paul Douglas, and Henry Schultz. While by no means a homogeneous group, they generally accepted the propositions that embody the core of neoclassical economics – within a liberal democracy, the rational pursuit of economic self-interest by individuals was taken as given, competition was seen as inherent within and intrinsic to economic life, and market-generated outcomes were said to be generally superior to those resulting from government interference with the market mechanism. It was Frank Knight who had the most impact on what has come to be known as Chicago law and economics. While his writings were a significant force, his greatest influence came through the perspective that he imparted to his students – most importantly, for present purposes, Milton Friedman, George Stigler, and Aaron Director. In contrast, “[t]he post-war Chicagoans were more intent on elaborating and extending these insights.”⁴¹ This latter generation of Chicago economists undertook to demonstrate, in formal terms, the detailed nexus between competitive markets and efficient outcomes. Their empirical research emphasized the efficacy of the competitive market system, arguing for less government intervention, fewer wealth redistribution policies, reliance on voluntary exchange with a concomitant reliance on the common law for mediating conflicts, and an across-the-board promotion of more private enterprise – which, based on the evidence provided by their empirical research, would facilitate a more efficient allocation of resources.

Within the law school, the origins of Chicago law and economics go back to the 1930s, when the faculty, under the deanship of Wilber Katz, instituted a four-year interdisciplinary legal studies curriculum that included courses in

³⁹ See Johan Van Overtveldt, *The Chicago School: How the University of Chicago Assembled the Thinkers Who Revolutionized Economics and Business*, (2007).

⁴⁰ See Martin Bronfenbrenner, ‘Observations on the Chicago School(s)’ (1962) 60 *Journal of Political Economy* 72; H. Laurence, Miller Jr. “On the ‘Chicago School of Economics,’” (1962) 70 *Journal of Political Economy* 64; and A. W. Coats, “The Origins of the ‘Chicago School(s)?” (1963) 61 *Journal of Political Economy* 487.

⁴¹ See Duxbury, above n 13, 368.

economics and accounting.⁴² Then, in 1939, the law school made a discernable commitment to economics as a subject relevant to the study of law with the appointment of Henry Simons to the law faculty. Simons had been a lecturer in the department of economics and was a former student of Frank Knight, who (as noted above) was in many respects the father of the price-theoretic tradition of Chicago economics. Thereafter the law school appointed other economists to their faculty, including Aaron Director, Ronald H. Coase, and William Landes, and with that, the Chicago approach to law and economics began in earnest.

2. Events that Shaped the Chicago Approach to Law and Economics

There were several signature events that contributed to the formation of the Chicago approach to law and economics, and were, at the same time, manifestations of its early success. These events include the following:

First and foremost (as outlined above) was the complex interaction between the faculties of the law school and the economics department, particularly the law school's interest and success in attracting economists to their faculty.

Second, the *Journal of Law and Economics* (sponsored by the University of Chicago Law School) was initiated in 1958 under the auspices of Aaron Director whose teachings had a substantial impact on the field of antitrust. Ronald H. Coase subsequently took over the editorship of the journal. In 1972, the University of Chicago Law School launched the *Journal of Legal Studies* under the guidance of its first editor, Richard A. Posner. These two professionally edited journals did much to propagate the core ideas and applications of the Chicago approach to law and economics. Following their lead, over the next decade student-edited law reviews began publishing Law and Economics' articles as well.

Third, was the publication of two articles that marked the beginning of the so-called "new law and economics." Ronald H. Coase's "The Problem of Social Cost," serves as the cornerstone of Chicago law and economics literature. While it was written several years before he arrived at Chicago, it was published in 1960 in the *Journal of Law and Economics*. The other equally important article was "Some Thoughts on Risk Distribution and the Law of Torts" published in the *Yale Law Journal* in 1961 by Guido Calabresi. These two articles made clear to both economists and lawyers that legal rules and

⁴² Wilbur, Katz, 'A Four-Year Program for Legal Education' (1937) 4 *University of Chicago Law Review* 527.

judicial decisions across many traditional fields of law beget both benefits and costs, and thus are (and should be) amenable to rigorous economic analysis.

Fourth, was Gary S. Becker's initiative to use the Chicago price-theoretic framework to analyze non-market behavior, including an analysis of such non-traditional economic topics as racial discrimination in labor markets; criminal behavior and law enforcement; the organization of the family, including marriage and divorce; the decision to have children, and the division of labor within the household ... etc. All of this illustrates Becker's (indeed, Chicago's) distinct approach – to extend the “economic way of thinking” into non-market behavior and thereby establish what has come to be known as “economics imperialism.”⁴³

Fifth, was the 1977 publication of the 2nd edition of Richard A. Posner's *Economic Analysis of Law*. The second edition moved Posner away from his earlier reliance on utilitarianism (indeed, in the first edition he had equated Bentham's utilitarianism with economic theory)⁴⁴ and moved him to instead argue for the use of economic efficiency (wealth maximization as distinct from utilitarianism).⁴⁵ It quickly became the textbook of choice (and remains a standard) by those developing law school courses and became a significant vehicle by which the ideas of Chicago law and economics were transmitted from one generation to the next.

Finally, in 1976, Henry G. Manne, (the former Dean of the George Mason University School of Law) organized and hosted the Law and Economics workshops for judges, law professors, and economists. Since its inception (Manne moved from the University of Miami to Emory University to George Mason University) the workshops have remained in tact. Over four thousand professors and judges have attended the workshops thereby revealing to a broad legal audience the economic nature of many of the questions posed within legal analysis and the potential for the application of economic analysis to the law to help resolve them.⁴⁶

3. Defining Characteristics of the Chicago Approach to Law and Economics

⁴³ See for example, Gary S. Becker, *The Economic Approach to Human Behavior* (1976).

⁴⁴ See Richard A. Posner, *Economic Analysis of Law* (1972 1st ed.), 357.

⁴⁵ See Richard A. Posner, *Economic Analysis of Law* (1977 2nd ed.), 12.

⁴⁶ 'Law & Economics Center, George Mason University School of Law' [www.lawecon.org] (2009) J. JURIS 76

The defining characteristic of the Chicago approach to law and economics is the straightforward application of microeconomic (or price-theoretic) analysis to the law. The approach can be characterized by the following seven elements:

i) Individuals are assumed to be rational maximizers of their satisfactions in their nonmarket as well as their market behavior. The actions of producers, consumers and government decision makers are the product of choices – purposeful choices – made by individuals who are able to perfectly process all relevant information about the alternatives available to them, and can then rank all possible outcomes according to their relative desirability.

ii) Individuals respond to price incentives in nonmarket as well as market behavior. Just as changing product and factor prices in the market affect the behavior of consumers and producers, respectively, within the legal arena legal rules establish prices (such as fines, community service, and incarceration) for engaging in various types of illegal behavior. The rational maximizing actor, then, will compare the benefits of each additional unit of illegal activity with the costs, where the costs are weighted by the probability of detection and conviction.

iii) *Ex ante* thinking (in addition to law's traditional *ex post* thinking) becomes an important element for those making or contemplating legal change given the fact that changed legal rules alter incentives, future behavior, and thus performance.

iv) Legal rules and legal outcomes can be assessed on the basis of their efficiency properties. One criterion employed is Pareto efficiency. However, in the arena of public policy where there are typically both winners and losers, the prohibitive cost of compensating all losses makes it virtually impossible to conceive of changes in legal rules that would satisfy the Pareto criterion. As a consequence the standard definition of efficiency employed in Chicago law and economics is Kaldor-Hicks efficiency, or wealth maximization: a legal change is efficiency-enhancing if the winners could (conceptually) compensate the losers (to make the latter whole once again) and still remain gainers.

v) Chicago law and economics purports to have uncovered the efficiency of the common law.⁴⁷ This notion was first raised within the Chicago tradition by Ronald H. Coase in “The Problem of Social Cost” and later extended by

⁴⁷ This is merely an application of Gary S. Becker's distinct approach to the economic analysis of law (now used here to analyze the workings of the common law judiciary).

Richard A. Posner and others.⁴⁸ Simply stated, the hypothesis is that the development of the common law can be explained “as if” the judges who created the law through decisions operating as precedents were trying to promote efficient resource allocation.⁴⁹

vi) Those ensconced in the Chicago approach engage in positive analysis to assess whether a law or regulation enhances or reduces efficiency. Within the positive realm of analysis, the focus of the Chicago school is to develop generalized models that predict the operation or the outcomes of judicial, legislative, political, and administrative institutions. While the areas of antitrust and economic regulation were the early focus of concern, the scope of Chicago approach to law and economics now encompasses all fields and areas of law.

vii) When law is seen to depart from the dictates of efficiency, or when new legal issues present themselves, the concern becomes one of fashioning and adopting legal rules that are efficiency enhancing. And, since market-determined outcomes are consistent with advancing social welfare, (whereas government interventions in market processes are thought likely to reduce social welfare), the normative Chicago approach to law and economics argues that decision makers should, to the extent possible, rely on market remedies, or mimic the market when market remedies are not feasible.

In sum, the Chicago approach to law and economics is almost indistinguishable from the Chicago school of economics in general. Chicago economists, buttressed by their empirical research, emphasized the efficacy of the competitive market system, arguing for less government intervention, fewer wealth redistribution policies, reliance on voluntary exchange with a concomitant reliance on the common law for mediating conflicts (as opposed to direct regulation), and an across-the-board promotion of more private enterprise – which, based on the evidence provided by their empirical research, would facilitate a more efficient allocation of resources.

B. Public Choice Theory

1. People, Places and Ideas

Public choice theory is defined as the economic analysis of nonmarket decision making—a body of theory that treats individual decision makers as participants

⁴⁸ See for example, Richard A. Posner, ‘Theory of Negligence’ (1972) 1 *Journal of Legal Studies* 29.

⁴⁹ There are several threads of this argument, see Paul H. Rubin, ‘Micro and Macro Legal Efficiency: Supply and Demand’ (2005) 13 *Supreme Court Economic Review* 19; and Paul H. Rubin, *The Evolution of Efficient Common Law* (2006).

in a complex interaction that generates political outcomes.⁵⁰ Some assert that “[p]ublic choice analysis is to governments what economic analysis is to the markets”⁵¹; as to its significance in law, others go on to contend that public choice is “the single most successful transplant from the world of economics to legal scholarship.”⁵²

Simply put, public choice theory is the application of economic analysis to political decision making, including theories of the state, voting rules and voter behavior, party politics, logrolling, bureaucratic choice, policy analysis, and regulation. Most of the scholarship concentrates on the creation and implementation of law through the political process, with scant attention paid to the judiciary.⁵³ Like most of the contributors to the other schools of thought in Law and Economics, some public choice theorists engage in positive political analysis while others normatively engage in (re)designing political institutions or promoting legal reform/policies.

What emerges from their combined positive and normative work is a general theory of government failure – in a sense, an analogue to the economic models and analyses that previously explored the sources of market failure and the resultant inefficiencies. As Coase observed at the inception of public choice, at that time he thought there appeared to be an imbalance in the theory of economic policy: “we find a category ‘market failure’ but no category ‘government failure.’”⁵⁴ This recognition later led Daniel A. Farber and Philip P. Frickey to describe public choice as “a jaundiced view of legislative motivation” with very explicit implications: “If the descriptions of public choice scholars are correct, certain normative conclusions seem inevitable, and those conclusions are generally not happy ones.”⁵⁵

⁵⁰ This short overview borrows from Nicholas Mercuro and Steven G. Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2006 2nd ed), Chapter 3. Three books that describe the field are: Dennis C. Mueller, *Public Choice III*, (2003); Daniel A. Farber and Philip P. Frickey, *Law and Public Choice* (1991); and David B. Johnson, *Public Choice: An Introduction to the New Political Economy* (1991).

⁵¹ James D. Gwartney and Richard E. Wagner, ‘Public Choice and the Conduct of Representative Government’ in James D. Gwartney and Richard E. Wagner (eds) *Public Choice and Constitutional Economics* (1988), 7.

⁵² David A. Skeel Jr., ‘Public Choice and the Future of Public-Choice Influenced Legal Scholarship’ (1997) 50 *Vanderbilt Law Review* 647, 648.

⁵³ The latter being more of a concern for the Chicago approach to law and economics.

⁵⁴ Ronald H. Coase, ‘Discussion: The Regulated Industries’ (1964) 54 *American Economic Review* 194, 195.

⁵⁵ Farber and Frickey, above n 50, 22, 2. Judge Abner Mikva, a U.S. Circuit Court Judge, U.S. Court of Appeals for the District of Columbia and former Illinois state legislator, offered an even more stinging assessment: “Not even five terms in the Illinois state legislature—the last vestige of democracy in the ‘raw’—nor my terms in the United States Congress, prepared me

The formal inception of the public choice can be marked with the establishment, in 1957, of the Thomas Jefferson Center for Studies in Political Economy at the University of Virginia by James M. Buchanan and Warren Nutter. Buchanan had been a student of Frank Knight at the University of Chicago; his early work was also very much influenced by the writings of Knut Wicksell. A subsequent series of conferences on issues in non-market decision making organized by the Buchanan and Nutter led to the founding of the Public Choice Society in 1963 (initially under the title “Committee on Non-Market Decision-Making”). In 1966 an economic journal titled, *Papers on Non-Market Decision Making* was established under the editorship of Gordon Tullock (shortly thereafter its title was changed to *Public Choice*). In 1969, following a period of controversy at the University of Virginia, Buchanan and Tullock moved their operations to Virginia Polytechnic Institute and established the Center for Study of Public Choice. Then, in 1982, the Center shifted its entire operations to George Mason University where it continues to prosper. In 1986 Henry Manne was appointed Dean of George Mason School of Law and successfully recruited a faculty that continues – alongside of the Center for Public Choice – to operate today with a thriving law and economics program which reflects the influences of public choice, Chicago, and Austrian perspectives.

2. Defining Characteristics of Positive Public Choice

a. Positive Public Choice – Roughly stated, there are two distinct facets of public choice; i) positive public choice, and ii) catallaxy.⁵⁶ Those engaged in positive public choice theory analyze the *demand for law* and the *supply of law* within the political arena. Unlike the market, here the major players are the voters, lobbyists, politicians, and the bureaucrats, with the voters and lobbyists on the demand side and, (within the context of a representative democracy), politicians, legislators, and bureaucrats, functioning on the supply side. The positive public choice theorists attempt to develop logical, descriptive, consistent theories that link individual behavior to collective action. Their

for the villainy of the public choice literature” Abner J. Mikva, ‘Foreword: Symposium on the Theory of Public Choice’ (1988) 74 *Virginia Law Review* 167, 167.

⁵⁶ Space does not allow for a discussion of catallaxy (or constitutional economics). The central thrust of the catallactic approach is to take individual decision makers as the basic unit of analysis and to view both politics and the political processes in terms of the exchange paradigm and develop models that reflect this phenomena. The focus is on all processes of voluntary agreements among persons – not only those in the more familiar economic arena, but also extended into the political arena. As Buchanan, its leading proponent states: the catallactic approach to public choice theory constitutes a “genuine theory of law.” James M. Buchanan, *The Limits of Liberty* (1975) 53.

methodology encompasses the standard maximizing paradigm of microeconomics – *homo economicus* – where individuals in both political and economic arenas are assumed to behave as if they are maximizing utility. It was Gordon Tullock who brought the hard-nosed *homo economicus* perspective to public choice. Tullock and others showed how this approach is readily amenable to the positive analysis of a wide range of political behavior. The goal of positive public choice is straightforward – it is an attempt to understand, describe and explain the political, legislative and bureaucratic outcomes that can be expected to follow from the rational utility-maximizing behavior of those engaged in the political, legislative and bureaucratic choice-making processes. They demonstrate that political outcomes ultimately reflect the choices of individuals within the incentive structure created by the prevailing constitutional rules, statutes, and regulations. More importantly, public choice explores the implications of political, legislative and bureaucratic choices of government and the impact of those choices on the overall economic performance of the nation.

b. Demand-Side Logrolling – On the demand side of the political marketplace, the analysis focuses on the voting mechanisms and criteria that should be used to pass laws or structure public policy for both i) direct democracy, where individuals vote on ballot initiatives, and ii) for a representative democracy, where individuals vote on political candidates and those political candidates, as legislators, vote on legislation. This demand-side analysis takes two forms: the positive description of the effects of alternative voting rules of the extant legislative processes, and the normative determination of the appropriate baseline voting rules (typically at the constitutional stage of choice) where the basic “rules of the game” are being framed.

One of the major phenomena given attention on the demand side is that of logrolling (i.e. vote trading). It arises due to the inability of voters to register the intensity of their preferences in both direct and representative democracy. This phenomena may rear its head with regard to preferences for or against: i) candidates, ii) ballot initiatives, iii) legislation, iv) government regulations, or v) tax–expenditure proposals. One way to overcome the problem of registering the intensity of preferences is through logrolling. While it is recognized that vote trading is technically illegal in the US, nonetheless, it is understood that logrolling is a common phenomenon that takes place during each and every legislative session.⁵⁷ The descriptive models of logrolling attempt to make clear the economic implications of this political behavior.

⁵⁷ As Tullock has noted, “In the U.S. Congress logrolling is fairly open and aboveboard. Although the bulk of the negotiations takes place in committee sessions, cloakrooms, and
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c. Supply-Side Legislatures / Politicians – On the supply side of the political market, the concern is with the behavior of politicians who pass laws and those bureaucrats who are charged with implementing the programmatic goals contained in the legislation. With respect to the politicians, some of the models within this branch of public choice theory focus on the behavior of voters in selecting and supporting legislators; other models look at the behavior of political parties and legislators during political campaigns; some models focus on the behavior of legislators while in office, and still others look at the behavior of legislators and their relationship to the bureaucrats. The primary goal of the analysis here is to accurately model political behavior and to analyze the efficiency properties of the outcomes of the action of these various groups within the political process.

The two concepts that are at center stage in these several supply models are: i) the rationally ignorant voter, and ii) politicians as self-interested legislators. A brief comment on each. First, voters are assumed to exhibit rational ignorance. Under majority rule, voters have little reason to invest the time, money, or energy that is required to cast a well-informed vote because they know that there is only the slightest of chances that their vote will be decisive in any given election. Second, the self-interested politicians (both candidates for office and sitting legislators) are assumed to make decisions that maximize their utility, which, in turn, are a function of factors such as votes, power, and political income. In contrast to the conventional field of political science, in public choice, legislators are assumed to be vote maximizers in an effort to win reelection and certainly not motivated by any desire to enhance the public interest or the common good. In short, the contention is that “parties formulate policies in order to win elections, rather than win elections in order to formulate policies.”⁵⁸ Some of the models assume that legislators act to maximize their appeal to their constituents, the latter of whom are assumed to vote based on their own economic self-interest. Other models assume that legislators vote for those programs or laws that are most responsive to the desires of special interest groups – for example, major financial supporters, those energizing effective publicity, or those providing politically meaningful endorsements – thereby enhancing their prospects for (re)election. The descriptive models of self-interested politicians attempt to make clear the economic implications of their behavior.

congressional offices, there is no particular secret as to what is actually going on. People realize that the art of legislation involves bargaining, haggling, and efforts made to sweeten deals.” Gordon Tullock, Arthur Seldon, and Gordon L. Brady, *Government Failure: A Primer in Public Choice* (2002) 30.

⁵⁸ Anthony Downs, *The Economic Theory of Democracy*, (1957) 28.
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d. The Bureaucracy – Once legislation is passed or ballot initiatives are approved, the task of implementing the programmatic goals falls to the bureaucracy. The issue of bureaucratic choice is somewhat complicated by the fact that gaps (whether or not intentional) often exist in legislation. That is, legislation that specifies certain goals, may not be fully specific with respect to implementation thus allowing for the possibility of an extensive divergence between the legislative intent and final bureaucratic implementation. Public choice theorists argue that in order to gain a more complete understanding of the implementation of legislation by bureaucrats it becomes necessary to analyze and understand the role of the incentives facing, and the resulting actions of, bureaucrats, as well as the problems relating to information with respect to costs and evaluation of bureaucratic output.

The public choice analysis of the bureaucracy was pioneered by Gordon Tullock and William A. Niskanen.⁵⁹ Their theories recognize that bureaucrats have relatively weak incentives to consider the social welfare implications of the institutions they serve, namely the so-called public interest, and, at the same time, have relatively strong incentives to improve their own positions within the bureaucracy in which they work.⁶⁰ While their models have some subtle differences, they employ rational-actor models in an attempt to shed light on the supply-side, bureaucratic decision-making process and its political-economic consequences essentially arguing that bureaucrats will make institutional decisions with a view to maximizing their utility—subject to the institutional constraints they confront. The bureaucrat’s utility is assumed to be a direct function of things like “salary, perquisites of the office, public reputation, power, patronage, output of the bureau, ease of making changes, and ease of managing the bureau.” And, as Niskanen notes, “All except the last two are a positive function of the total budget of the bureau during the bureaucrat’s tenure.”⁶¹ Hence, their models typically suggest that in maximizing their utility, bureaucrats will make those choices that will maximize their bureau’s budgets. Those in public choice also focus on developing models that describe the interrelationships among i) the various bureaus of the government, ii) the bureaucracy and the surrounding special interest groups, and iii) the bureaucracy and the legislature, all in an effort to make clear the economic implications of the behavior of bureaucrats.

e. Rent Seeking – One of the concepts given special attention in public choice is the theory of rent seeking. This issue arises under the recognition that

⁵⁹ Gordon Tullock, *The Politics of Bureaucracy*, 1965; William A. Niskanen, *Bureaucracy and Representative Government* (1971); and William A. Niskanen, *Bureaucracy and Public Economics* (1994).

⁶⁰ Typically, the argument is *not* that bureaucrats are idle, lazy, and inefficient; the problem, rather, centers on the question of incentives that give rise to this behavior.

⁶¹ William A. Niskanen, *Bureaucracy: Servant or Master?* Hobart Paperback No. 5, (1973) 22. (2009) J. JURIS 83

interest groups work to implement or alter laws and/or regulations to affect transfers to themselves from the larger population. Within the political arena, these legal changes may result in special privileges, monopoly positions, and other forms of transfers granted to certain individuals or groups through the aegis of the State. The efficiency consequences of these activities are analyzed using the concept of rent-seeking.

More specifically, for goods and services whose quantities cannot expand to meet demand, especially in those cases where the available quantity is held in check by the government, the competitive process cannot dissipate the rents. It is the process by which these rents come about that have become a major concern of public choice theorists. Rents “exist wherever information and mobility asymmetries impede the flow of resources. They exist in private good markets, factor markets, asset markets, and political markets. When rents exist rent seeking can be expected to exist.”⁶² The focus of the analysis in the rent-seeking literature is not on the rents themselves, or even on the resource misallocations associated with the rent-generating positions instituted by the rent seekers. Rather, it is on the use (or as they prefer to call it, the “waste”) of resources expended to acquire or maintain these privileged positions. Resources are used up on costly lobbyists, lawyers, accountants, press agents, and economists by politically astute parties attempting to get a piece of the scarcity-induced rents. Matters are further complicated by the fact that public choice theorists recognize that the “wastes” associated with rent seeking may well be the product of political investments that are consistent with rational behavior on the part of all participants.⁶³ That is, from the rational entrepreneur’s standpoint, it may well be that the “legislative” payoff exceeds the payoff from alternative investments in demand promotion, technological innovation, or attempts to lower production costs ...etc. However, from society’s standpoint, proponents of public choice argue that the resources used for wasteful rent seeking could have instead been used in more economically productive activities.

In summary, the positive, descriptive supply and demand theories and analysis of logrolling, the self-interested politician and/or bureaucrat, as well as rent seeking behavior – the integral components of positive public choice – all attempt to make clear their implications for government and its impact on economic performance.

⁶² Dennis C. Mueller, *Public Choice II* (1989) 245.

⁶³ James M. Buchanan, ‘Rent Seeking and Profit Seeking’ in James M. Buchanan, Robert Tollison, and Gordon Tullock (eds) *Toward a Theory of the Rent-Seeking Society* (1980), 3, 9 and Gordon Tullock, *Rent Seeking* (1993).

C. Institutional Law and Economics

1. People, Places and Ideas

Unlike the Chicago approach to law and economics and public choice theory, institutional law and economics has no identifiable launch date. It gradually emerged over time, building on the work of institutional economists who were, from the beginning, inherently interested in the interaction between legal and economic institutions and legal-economic questions.⁶⁴ The institutional approach to law and economics has its roots in the work of economists such as Henry Carter Adams on economics and jurisprudence, Richard T. Ely on the relation of property and contract to the distribution of wealth, John R. Commons on the legal foundations of the economic system, and Wesley C. Mitchell on the role of the price system and its place in the modern economy. Important elements of the institutional approach to law and economics can also be traced to the work of Thorstein Veblen (in many respects, the founding father of institutional economics); to the economist Clarence Ayres; lawyer-economists such as Walton H. Hamilton and Robert Lee Hale; and of legal scholars such as Karl Llewellyn, Jerome Frank, and Roscoe Pound.

The label “institutional economics” is said to have been coined by Walton H. Hamilton in 1919. It is essentially an American contribution to economic thought that, like Legal Realism, is said to have “had its heyday in the 1920s and early 1930s.”⁶⁵ It has often been described as part of “a revolt against formalism,”⁶⁶ a revolt that took place in law, history, and economics at about the same time. As part of that revolt, institutional economics, was led by a group of young American scholars who, after World War I, engaged in a critique of the formalistic doctrines central to the economics of the day. It represents a system of thought that has as its central premise the idea that economic institutions motivate all economic activities. The institutionalists focused their efforts on inductive analyses of specific institutional aspects of the American economy. While their principal emphasis was on using the inductive method to describe the constituent elements of the economy, they never took this method to extremes and thereby were still able to make substantive theoretical generalizations.

⁶⁴ This short overview borrows from Nicholas Mercuro and Steven G. Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2006 2nd ed), Chapter 4.

⁶⁵ John F. Bell, *A History of Economic Thought* (1967), 568.

⁶⁶ Henry Spiegel, *The Growth of Economic Thought* (1971) 629.

Three distinct influences have been identified that are said to have contributed to the emergence of the institutionalist school of thought.⁶⁷ One was the German historical school, founded by Wilhelm Roscher and later dominated by Gustav von Schmoller. The German historical school emerged, at least in part, as a reaction against natural law as well as the classical economic thinking in the mid-nineteenth century. For the advocates of the German historical school, law was to be regarded as an expression of the convictions of the community, in the same manner as language, customs and practices were expressions of its people. Thus, the goal became to create a legal order based on the character and spirit (the *vollgeist*) of the people. The second influence was from American pragmatic philosophy as set forth by, among others, Charles Sanders Peirce, William James, and John Dewey. While there were differences among their respective versions of pragmatism, at the core of the movement, pragmatists embraced i) the process(es) of ongoing inquiry and ii) the transformation of knowledge as part of the basic tasks of human societies. They believed that truth is modified as discoveries are made and that the truth is relative to the time, place, and purpose of inquiry. As to its methodology, pragmatism stands opposed to belief systems that hold that truth can be reached through deductive reasoning from a priori grounds. Instead, it argues for inductive investigations and constant empirical verification of hypotheses, concluding that what ultimately should be taken as true is that which most contributes to the human good over the longest course of time. Given the conditional nature of truth, the proponents of pragmatism thus recognized an uncertainty inherent in understanding which served to provide an epistemological foundation and a social philosophy upon which to erect the basic tenets of institutional economic thought. The third influence came through Thorstein Veblen's turn-of-the century writings focusing on the evolutionary facet of economic development, within which one can trace many of the origins of and early insights into institutional economic thought.

Others who contributed to the institutionalist approach include Robert Lee Hale, Clarence Ayres, and John R. Commons. Hale earned both a law degree and a doctorate in economics; initially he had a joint appointment in the economics department and the law school at Columbia University (thereafter he moved to the law school on a full-time basis). His emphasis on the integration of economics and law was reflected both in his teaching, particularly his course on "Legal Factors in Economic Society," and in his writings, much of which dealt with the regulation of railroads and public utilities, fields in which an understanding of the interface between economics and law has always been fundamental.

⁶⁷ Charles J. Whalen, 'The Institutional Approach to Economics' in Fred Foldvary (ed), *Beyond Neoclassical Economics: Heterodox Approaches to Economic Theory* (1996) 83.
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In the post-World War II period, it was Clarence Ayres who became the chief exemplar of institutionalist economic thought from his base at the University of Texas-Austin. He and his students developed the Veblenian-Ayresian perspective within institutionalism. Ayres's perspective is perhaps best reflected in his treatise *The Theory of Economic Progress*, in which he undertook to both explain and apply institutional economic thought with respect to the field of economic development.

It is the work of John R. Commons that is of particular importance in the ultimate development of institutional law and economics. Like Veblen, Commons was a student of Ely, who instilled in his students the inductive method of study and emphasized both i) the historical facets of and ii) the legal issues within the study of economics. Commons became interested in and a leading scholar in the field of labor; he moved to the University of Wisconsin where he spent most of his academic life focusing his research on industrial relations, labor reform legislation, public utility regulation, and price stabilization. He was also very involved in public life and served on an array of state and federal commissions. It was while at Wisconsin in 1934 that Commons published *Institutional Economics: Its Place in Political Economy*.

Commons rejected the exclusive emphasis on methodological individualism reflected in orthodox theory; instead he gave collective and corporate action its due place in economic analysis. Likewise, Commons rejected the economics of a harmony of interests and instead centered his analysis on the nature of the disputes and conflicts of interest inherent in a modern economy. He optimistically believed that primary economic institutions could be formed and reshaped (as needed) to conform to the social changes and confront the problems inherent within society. In his efforts to develop institutional economics, Commons' central concern was with uncovering the development, evolution, and workings of the institutions that ultimately impact the performance of the economic system.

It was from the writings of these (and other) early institutionalists that there gradually (circa 1970's and 80s) emerged an institutional approach to law and economics with Commons standing as its central figure (carrying forth the Wisconsin tradition). Rather than the strict application of microeconomic theory to the law that was the hallmark of the Chicago approach to law and economics and public choice theory, the thrust of this emerging institutional approach was in analyzing economic society with a focus on the relations between legal and economic processes – on government and the economy.

The tradition was extended beyond the University of Wisconsin, principally by two of its graduates, Warren J. Samuels and A. Allan Schmid who spent their

careers at Michigan State University. Both took a deep and abiding interest in the interrelationships between law and the economy; their contributions to institutional law and economics are avowedly positive. Samuels and Schmid are clear that their principal goal is quite simply “to understand what is going on—to identify the instrumental variables and fundamental issues and processes—in the operation of legal institutions of economic significance,” and to promote “the development of skills with which to analyze and predict the performance consequences of alternative institutional designs.”⁶⁸ In this regard, one distinguishing feature of the institutionalist approach from the other schools of thought was the lack of a normative / political agenda.

Schmid’s work brings to the forefront the many varieties of human interdependence, focusing both on i) the various types of transactions – bargained, administrative, and status and grant transactions, and ii) the varied interdependencies that emerge – technological, pecuniary, and political externalities. His analysis takes place under a situation-specific structure-conduct-performance paradigm, in which alternative institutional structures (e.g., different definitions and assignments of property rights) are identified, together with the (dis)incentives created, their consequences for individuals, firms, and government behavior are identified, and their effects on economic performance and quality of life are assessed. As such, it reflects a “total approach to policy analysis” that poses such questions as: “How do the rules of property structure human relationships and affect participation in decisions when interests conflict or when shared objectives are to be implemented? How do the results affect performance of the economy?”⁶⁹

The work of Samuels, in contrast, has tended to concentrate on describing the interdependence between individuals and groups and legal-economic performance. For Samuels, the organizing concept is that of the legal-economic nexus where “[law and economy] are jointly produced, not independently given and not merely interacting”... wherein “the law is a function of the economy, and the economy (especially its structure) is a function of law.”⁷⁰ It is through describing the intricacies of these interrelations that a true understanding of the legal-economic nexus emerges – where the law and the economy are seen as both dependent and independent variables in the construction of legal-economic reality.

⁶⁸ Warren J. Samuels and A. Allan Schmid., *Law and Economics: An Institutional Perspective* (1981) 1.

⁶⁹ A. Allan Schmid, *Property, Power, and Public Choice: An Inquiry into Law and Economics* (1987 2d ed) 257-258 and 188

⁷⁰ Warren J. Samuels, ‘The Legal-Economic Nexus’ (1989) 57 *George Washington Law Review* 1556, 1567.

2. Defining Characteristics of Institutional Law and Economics

The central elements of institutional law and economics are as follows:

- i) A focus on the evolutionary nature of the economic system, and, most importantly, the role of the evolution of law in structuring the evolution of the economic system.
- ii) The ever-present tension between continuity and change, particularly the interaction between the groups supporting the respective forces of continuity or change and the power that each can bring to bear on this process, together with the impact of their success (or failure).
- iii) The view that the legal-economic system is a system of mutual interdependence rather than atomistic independence, a view that raises questions as to pervasive conflicts and the problem of order. Given the fact of mutual interdependence, the emphasis is on who plays and what are the starting points, hence on conflict rather than harmony.
- iv) The interrelationships among rights, power, and government are fully explored where law is viewed as fundamentally a matter of rights creation and re-creation. The concern is with the positive description of the rights (re)creation process and the impact of this process on legal-economic decision making and economic performance. In this view, government becomes an object of control for those seeking private legal-economic gain or advantage, essentially “a mode through which relative rights and therefore relative market (income securing) status is given effect.”⁷¹ The question is not, then, one of more versus less government, but rather of whose interests government gives effect through law.
- v) The problematic nature of efficiency: the rejection of the Chicago emphasis on the determination of *the* efficient resolution of legal disputes or as a singular guide in changing law. The institutional approach to law and economics does not reject efficiency as an important variable in legal-economic analysis, but rather maintains that efficiency is not unique and therefore cannot determine the assignment of rights.

In summary, what is essential in the institutional approach to law and economics is a deeper understanding of the reciprocal impact between law and the economy. The advocates of the institutional approach to law and

⁷¹ Warren J. Samuels, ‘Interrelations Between Legal and Economic Processes’ (1971) 14 *Journal of Law and Economics* 435, 441-442.

economics believe that normative policy can be fashioned without (or at least a diminished probability of) the subsequent often heard cry of “unintended consequences” only to the extent that they can provide a non-normative, positive, description and understanding of legal-economic reality.

D. New Institutional Economics

The New Institutional Economics (NIE), like institutional economics (as described above), begins with the fundamental premise that institutions are important factors in the determination of economic structure, and hence performance.⁷² Consistent with some of the other schools of thought in Law and Economics, NIE asserts: 1) institutions do matter, 2) the determinants of institutions can be explained and understood using the tools of economic theory, and 3) the structure of institutions affects economic performance in systematic and predictable ways. While broadly concerned with the legal / government institutions, NIE emphasizes the interplay between the evolution of legal institutions and market forces.

1. People, Places and Ideas

In the past two decades NIE has played a significant role in expanding the domain of Law and Economics. It has proven quite popular not only in the U.S. but especially in Europe as evidenced by several initiatives. In 1997 the International Society for New Institutional Economics (ISNIE) was founded and presently claims societal memberships in some 46 nations; many European scholars take an active role in the ISNIE’s wide-ranging initiatives. As their mission statement states, their purpose is to conduct rigorous theoretical and empirical investigation on a broad array of topics directly related the institutions of social, political and commercial life. While their primary mode of analysis is economics, in its effort to be an interdisciplinary enterprise, it also draws from organization theory, law, political science, and sociology. In addition, as a result of a French initiative, the European Summer School on New Institutional Economics (ESNIE) was organized under the leadership of Eric Brousseau, Bruno Deffains, and Claude Ménard. Classes are held each summer on the Island of Corsica; the first classes of the ESNIE were held in the summer of 2002. ESNIE is dedicated to Ph.D. students, post-docs and

⁷² This short overview borrows from Nicholas Mercurio and Steven G. Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2006 2nd ed), Chapter 5. Two books that describe the field are: Eirik G. Furubotn and Rudolf Richter (eds), *Institutions and Economic Theory: The Contribution of the New Institutional Economics* (1998) and John Drobak and John V. C. Nye (eds), *The Frontiers of the New Institutional Economics* (1997). There is also a 7-volume encyclopedia; Claude Ménard (ed), *The International Library of the New Institutional Economics* (2004).

researchers in the field with a goal of developing knowledge and research in New Institutional Economics in Europe. Finally, it should be noted that there are three ongoing institutes – The Ronald Coase Institute, the Center for Institutional Reform and the Informal Sector (University of Maryland), and the Center in Political Economy (Washington University) that support and advance research in NIE.

The theoretical foundation of NIE rests on two building blocks. The first of these flows out of the Chicago tradition and is evidenced in the work on the economics of property rights. This approach emerged in the late 1960s and 70s as economists such as Armen A. Alchian,⁷³ Harold Demsetz,⁷⁴ Steven N.S. Cheung,⁷⁵ and Eirik Furubotn and Svetozar Pejovich,⁷⁶ began to appreciate that the various types of legal-institutional arrangements that constrain the behavior of individuals and firms may, in fact, have a significant impact on the allocation of society's scarce resources. The emphasis of their work was on exploring the nexus between politics (especially the political structure) and market performance. As Barry Weingast observed: "In the language of the new institutional economics, providing a secure and predictable political foundation for the markets requires a form of governance structure" with a clear focus on "the design of political institutions that *credibly commit* the state to preserving markets" (emphasis in the original).⁷⁷ With this as their focus, proponents of the study of alternative property right regimes undertook empirical studies regarding the development of property rights and the economy in an effort to provide significant insights and ultimately to formulate policies to enhance the performance of the private market economy.

The second of the building blocks of NIE emanates from a group of economic historians who attempted to explain the development and economic significance of property rights throughout history. This facet of new institutional economics is exemplified by the work of Douglass C. North and

⁷³ Armen A. Alchian, 'Some Economics of Property' (1961); Armen A. Alchian, 'Foreword' in Eirik G. Furubotn and Svetozar Pejovich (eds) *The Economics of Property Rights* (1974) viii.

⁷⁴ Harold Demsetz, 'The Exchange and Enforcement of Property Rights' (1964) 7 *Journal of Law and Economics* 11 and Harold Demsetz, 'Toward a Theory of Property Rights' (1967) 57 *American Economic Review* 347.

⁷⁵ Steven N.S. Cheung, 'The Structure of a Contract and the Theory of Non-exclusive Resource' (1970) 13 *Journal of Law and Economics* 49.

⁷⁶ Eirik G. Furubotn and Svetozar Pejovich, 'Property Rights and Economic Theory: A Survey of the Literature' (1972) 10 *Journal of Economic Literature* 1137.

⁷⁷ Barry Weingast, 'The Economic Role of Political Institution: Market-Preserving Federalism and Economic Development' (1995) 11 *Journal of Law, Economics, and Organization* 1, 2.

Lance E. Davis,⁷⁸ Douglass C. North and Robert Thomas,⁷⁹ as well as Harold Demsetz,⁸⁰ and John R. Umbeck.⁸¹ As they quickly came to understand, “[a]nyone forced to consider economic growth in the medium and long run finds it hard to take rules and institutions as fixed.”⁸² Unlike the earlier economic historians who were interested in describing the sources of economic growth (focusing on macro-economic variables and national income accounts), these “new economic historians” were more geared towards price-theoretic and comparative institutional/economic analysis. Their common focus was in trying to identify the key transmission mechanisms between evolving legal institutions and the emerging economy – a search for a dynamic theory that could explain the evolution of economies through time, often focusing on the proposition that the efficiency of a market is directly shaped by the surrounding institutional framework.

2. Defining Characteristics of New Institutional Economics

Building on the work of those contributing to the economics of property rights and the economic historians, NIE is marked by its two foundational principles. The first is that individuals are assumed to rationally pursue their self-interest subject to constraints that are more numerous and severe than those assumed in neoclassical economic theory. For example, they include the existence and definition of property rights and transaction costs, as well as a recognition of the limited computational capacity of the human mind that gives rise to the concept of “bounded rationality.” As a consequence, many within NIE argue against models that assume formal rational behavior, opting for the use of models based on the concept of bounded rationality.

The second foundational principle of NIE, at least within many quarters, is the idea of wealth maximization—the search for institutional structures that enhance society’s wealth-producing capacity. Here it is argued that the value of resources is tied directly to the bundles of rights that run with the resources. In short, the more complete and definite the specification of property rights (that is, the less attenuated is the rights structure), the more uncertainty is

⁷⁸ Douglas C. North and Lance Davis (with the assistance of Calla Smorodin), *Institutional Change and American Economic Growth* (1971).

⁷⁹ Douglas C. North and Robert P. Thomas, *The Rise of the Western World: A New Economic History* (1973).

⁸⁰ Harold Demsetz, ‘Toward a Theory of Property Rights’ (1967) 57 *American Economic Review* 347.

⁸¹ John R. Umbeck, ‘Might Makes Right: A Theory of the Formation and Initial Distribution of Property Rights’ (1981) 19 *Economic Inquiry* 38.

⁸² Drobak and Nye above n 72, xvii.

diminished, which, in turn, tends to promote a more efficient allocation of resources.

Given these two foundational principles, NIE has largely been dominated by positive theorizing and empirical work that analyzes the role of different institutional structures and how these structures systematically affect economic performance across time. Their analysis proceeds at two different levels: one, the *institutional environment* which is more macro-oriented; the other, *institutional arrangements* or *governance*, which is more micro-oriented. A brief word on each.

a. The Institutional Environment – The first level – the *institutional environment* – constitutes the framework within which human interaction takes place. It provides the so-called “rules of the game” which, in effect, are the institutional background constraints under which individuals in society make choices. They constitute the set of fundamental political, legal and social ground rules that, by guiding individual behavior, establish the basis for macro-level production, exchange, and distribution. At this first level, NIE’s positive analysis focuses on the effects that various institutional environments have on macroeconomic development and performance as well as explaining how various institutional environments evolved, often using theories and rationales that emphasize the spontaneous nature of their evolution, and eschewing explanations that concentrate on the deliberate actions of the collective or government. Of particular concern is the legal environment comprised of the formal, explicit rules manifested in the constitutions, statutes, common law doctrines, as well as rights and rules. From this, the legal environment is seen to play an important role in determining the allocation of resources in society, in part through its impact on the cost of transacting. When transaction costs are positive and significant, the structure of institutions matter in terms of economic performance. The normative thrust of NIE is to find and structure an institutional environment—a precise structure of formal legal institutions—that will lower transaction costs and thereby facilitate trade through efficient contracts.

b. Institutional Arrangements or Governance – The second level of analysis within NIE deals with *institutional arrangements* (or the “institutions of governance”) that exist within a given first-level institutional environment. This second level is devoted to a microeconomic analysis of the choice of governance structures of private actors. An *institutional arrangement* is a specific arrangement between economic units that governs the ways in which these units can cooperate or compete. The governance structures are often designed by the trading parties themselves in order to mediate particular economic relationships, all “in an effort to craft order, thereby to mitigate conflict and

realize mutual gains.”⁸³ At this level of analysis, the fundamental challenge for NIE is in trying to determine the solution to the problem of coordinating economic transactions between individuals by mutual agreement, where relational contracts are the focus of concern. With markets and hierarchies as the two extremes, one goal of NIE is to determine which institutional arrangement is economically preferable and in which circumstances. NIE has explored a variety of institutional arrangements including: i) the structure of corporate governance, ii) vertical integration of firms, iii) the organizational rules of public bureaucracies and non-profit organizations, and iv) long-term contracts, highlighting the impact that each may have on the overall economic performance. At the governance level, NIE tries to determine “under what conditions exchange will be secured at least cost via the market and under what conditions it will be secured within organizations or, i.e. firms,” going on to point out that, in the more recent literature, “the concept of the firm has now been extended to a variety of hybrids to reflect a continuum of governance structures.”⁸⁴

c. Transaction Cost Economics – Given NIE’s concern over governance structures, perhaps it was only natural that some within NIE developed what has come to be known as transaction cost economics (TCE). Through the efforts of Oliver E. Williamson (and others), TCE has become an integral part of the NIE tradition and draws on the literatures of law, economics, and organization to study governance institutions within the economic system. The TCE approach analyzes the emergence of governance structures within the economic system and does so largely from the perspective of economizing on transaction costs. As Ronald H. Coase described it: “The costs of exchange [i.e. transaction costs] depend on the institutions of a country – the legal system (including property rights and their enforcement), the political system, the educational system, the culture. These institutions in effect govern the performance of the economic system.”⁸⁵ Simply put, TCE is “the study of alternative institutions of governance,” and it “tries to explain how trading partners choose from the set of feasible institutional alternatives, the arrangement that protects their relationship-specific investments at least cost.”⁸⁶ The correct (read “least-cost”) governance structure comes about because the background market forces – the ongoing exchange relationships –

⁸³ Oliver E. Williamson ‘The New Institutional Economics: Taking Stock / Looking Ahead’ (1999) 2 *ISNIE Newsletter* 9,12.

⁸⁴ Stefan Voight and Hella Enger ‘Institutions and Transition: Possible Policy Implications of the New Institutional Economics’ in Klaus F. Zimmermann (ed), *Frontiers in Economics* (2002) 127, 128-129.

⁸⁵ Ronald H. Coase ‘The Task of the Society’ (1999) 2 *ISNIE Newsletter* 1, 4.

⁸⁶ Peter G. Klein, ‘New Institutional Economics’ in Boudewijn Bouckaert and Gerrit De Geest (eds), *Encyclopedia of Law and Economics* (1999) 456, 468.

work to cause an efficient sorting among the possible alternatives by adhering to behavior consistent with transaction cost economizing.

While the two levels of analysis presented above – the *institutional environment* and the *institutional arrangements* – are described as separate entities, in fact, NIE recognizes that they are interactive: the institutional environment sets the general framework within which institutional arrangements take place, and institutional arrangements, their effects, or the difficulties in devising them, may effect pressures for changes in the institutional environment. In addition, transaction cost economics plays an essential role in analyzing these interactions and the impacts of alternative institutional environments and/or governance structures have on the overall economic performance of the economy.

E. Social Norms and Law and Economics

1. People, Places and Ideas

The Chicago approach to law and economics expressed little or no concern for social norms (as social norms were typically considered both autonomous and exogenous). By the early 1990s, it was becoming increasingly apparent to many at, or associated with, the Chicago school that, in fact, law and social norms both worked to regulate behavior by inducing patterns of behavior that ultimately impacted economic performance.⁸⁷ The scholars most responsible for describing and advancing theories regarding the role of social norms within Law and Economics include Robert Ellickson, Richard H. McAdams, Eric Posner, Lessig, Lawrence, and Cass Sunstein among others.

2. Defining Characteristics of Social Norms and Law and Economics

a. First-generation of Social Norms Theory – A social norm is typically defined as “a rule that is neither promulgated by an official source, such as a court or a legislature, nor is enforced by the threat of legal sanctions, yet is regularly complied with.”⁸⁸ Those within this first-generation of social-norm theorists recognized (consistent with the Chicago school) that people not only complied with legal rules because of their unwillingness to bear the costs associated with non-compliance (usually fines or incarceration), but went on to ask – what about social norms? What is it that caused people to comply with social norms absent the forms of legal punishment that we witness in the legal

⁸⁷ This short overview borrows from Nicholas Mercuro and Steven G. Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2006 2nd ed), Chapter 7.

⁸⁸ Richard A. Posner, ‘Social Norms and the Law: An Economic Approach’ (1997)

87 *American Economic Review* 365, 365.

arena? They found that social norms and the law rely on different mechanisms for inducing subjects' compliance. Generally, in the case of law, subjects comply under the will or sanction of the sovereign; in the case of norms, subjects comply under the will or sanction of the community.

The first-generation of law and economics theorists to incorporate social norms into their analysis and to analyze their influence, came from those closely tied to the Chicago approach to law and economics.⁸⁹ Like their predecessors, they continued to use rational choice, wealth maximization models, and considered both law (in the doctrinal sense) and social norms to be relatively autonomous phenomena. However, what marked their departure from neoclassical economics of Chicago was the realization that internally and externally enforced social norms created a separate set of incentives that also impacted economic performance. As Robert Ellickson observed, the legal-economic models – particularly those advanced in the Chicago school – constructed on a neoclassical framework featured “unsocialized individuals in their analysis of hypothetical legal problems.”⁹⁰ Ellickson went on to argue that models that suppressed the role of socialization – intentionally or unintentionally – exaggerated the focus, and thus the importance, of law and legal sanction. His point being, that some social norms impact (indeed, may have a significant impact on) economic performance and may do so without reference to the prevailing.

The first-generation of law and economics literature recognized that there are external (community imposed) social norms and internal social norms. Whether internally or externally generated and imposed, what was significant was the fact that these social norms set up a parallel structure of incentives (along side of the prevailing legal incentives) that induces members of society to behave in accordance with these norms which in turn can impact economic performance. That is, social norms, independent of prevailing law, provide signals as to what we should or should not do under a given set of circumstances and are therefore obligatory upon those individuals who wish to participate in the society which is at least partly constituted by such social norms. Some brief comments on each set of norms.

First, externally enforced norms rely on the efforts of the norm-generating community, and, like internally enforced norms (see below), they have a direct bearing on individual behavior and thus, on economic performance. Simply

⁸⁹ The inclusion of social norms into the Law and Economics literature is often attributed to Robert Ellickson's path-breaking book, *Order Without Law* published in 1991.

⁹⁰ Robert Ellickson, 'Law and Economics Discovers Social Norms' (1998) 27 *Journal of Legal Studies* 537, 540.

put, in many cases, individuals comply with social norms because the community has told them to do so. Externally imposed social norms arise through the community and are part of the prevailing background law and social norms within which individuals make choices; they create a set of both negative or positive incentives. On the negative side, the community will punish those who do not comply by inflicting some form of disapproval or admonition, for example via the psychic cost in suffering guilt through a sense of 'letting down the community.' On the positive side, for those who do comply, the community rewards them in several ways by allowing conforming individuals to feel that they have lived up to their duty or obligation, or to enjoy the praise of the community and experience an enhanced sense of esteem.

Second, compliance with internally enforced social norms also comes about through the socialization process – with the internalization of social norms through education, religion, peer behavior, family ...etc. The self-enforcement comes about because individuals internalize the normative component of the adopted norms and thereby respond to the incentives (self-administered feelings of guilt and disapproval, pride and status) that induces them to behave in accordance with these norms. That is, individuals behave in a manner consistent with the incentives fashioned by the internally enforced social norms.

Social norms matter in Law and Economics for a number of reasons. Richard H. McAdams offers an instructive matrix of three possible impacts on performance.⁹¹ First, social norms can matter because they sometimes control individual behavior to the exclusion of law. Second, norms and law may work independently to influence behavior in the same direction. And finally, law may intentionally or unintentionally influence social norms themselves. The recognition of these several possible impacts on economic performance is vitally important because it brings to the fore the point that the effects of legal change (or policy) will depend on the nature of the proposed legal change and the community of social norms to be engaged. More specifically, the effects of a proposed change in law will likely vary, depending on whether the legal change (or policy) is running with, running against, or altering prevailing social norms. As a consequence, in their attempts to alter economic performance through legal change, policy makers, if not in tune with the interaction of social norms and legal rules in the area impacted by a proposed legal change, may drastically mis-estimate the effects of alterations in law and thus, be less than successful in accomplishing their aims.

⁹¹ Richard H. McAdams, 'The Origin, Development, and Regulation of Norms' (1997) 96 *Michigan Law Review*, 338, 347-350.

The lesson the first-generation of social norm theorists transmitted to legal-economic scholars was that, like law, norms bring forth a set of incentives that do indeed regulate behavior. However, in this early work, social norms were considered independent of the law and appeared fixed, essentially unmovable, and unyielding to the influences of law. As a consequence, since it is the forces outside law – namely the complex process of socialization – that were demonstrated to have a significant impact on generating social norms, consistent with Chicago thinking, there was little or no role for government to play.

b. New Chicago – In the latter part of the 1990's a new movement began to emerge and with it, important policy implications. This so-called “new” Chicago school included such scholars as Cass Sunstein, Dan Kahan, Lawrence Lessig, Richard McAdams, Kenneth Dau-Schmidt, and Richard Pildes. While most of their work continued to employ rational choice, individual maximization models, the focus of their approach was on the interdependence between law, social norms, and other ‘regulators’ of behavior. New Chicago recognized that since social norms were malleable and endogenous, they thought government should have a more active role in fashioning social norms in its quest to bring about wealth maximizing outcomes.

Proponents of the New Chicago approach recognized that “just because law cannot directly or simply control norms, it does not follow that there is not an influence in both ways—norms influencing law and law influencing norms—or that one cannot be used to change the other.”⁹² Sunstein argued that since law can strengthen the norms it embodies and weaken those it conflicts with or condemns, the government is in the unique position of being able to advance desirable norms and undermine unwanted ones.⁹³ Indeed, this possible law-norm nexus led McAdams to conclude that, “arguably, the most important relationship between law and norms is *the ability of law to shape norms*” (emphasis added).⁹⁴ He went on to say that “[i]f legal rules sometimes change or create norms, one can not adequately compare an existing legal rule with its alternatives without considering how a change in the legal rule may affect the relevant norms.”⁹⁵ Sunstein referred to the use of law to influence norms at “norm management,” a practice that he defended as “an important strategy for accomplishing the objectives of law, whatever those objectives may be.” Given that “behavior is pervasively a function of norms” and that “norms account for many apparent oddities or anomalies in human behavior,” the best way to

⁹² Lessig, Lawrence, “The New Chicago School” (1998) 27 *Journal of Legal Studies* 661, 673.

⁹³ McAdams, above n 91, 346.

⁹⁴ *Ibid* 354.

⁹⁵ *Ibid* 349.

improve social welfare may be via changes in norms. And government, he says, “deserves to have, and in any case inevitably does have, a large role in norm management.”⁹⁶

New Chicago’s focus was on enhancing our understanding of the mechanisms through which the reciprocal influence of law and social norms is effected, and more significantly, with fashioning social norms as part of solutions to questions of public policy. For New Chicago, this significance could not be overstated: the fact that law can and does affect social norms, far from diminishing the role of the government, it offered an expanded opportunity for state activity or regulation—here, to alter social norms in ways that would enhance economic performance and ultimately, social welfare. In doing so, New Chicago “identifies alternatives as additional tools for a more effective activism. The moral of the old school is that the state should do less. The hope of the new is that the state can do more.”⁹⁷

c. Sympathetic Critics – Some “sympathetic critics” who were not entirely content with what was transpiring in the field began to have their voices heard. They criticized those who advanced theories of social norms within the context of a behavioral approach that maintained a rational choice perspective – including the Chicago approach to law and economics, the first-generation norm theorists, and even New Chicago.⁹⁸ These critics argued that merely recognizing that social norms are malleable and endogenous is not enough – one needs to know how the social norms arise. And, it would be only then, when this process is uncovered and understood, that policy makers could effectively use government to fashion social norms.⁹⁹

In a thoughtful critique of the entire social norms movement, Lawrence E. Mitchell and other critics characterize much of this work as a ‘black box’ approach; one that seems content to start with extant social norms and then proceed to investigate the impact of changing social norms on incentives, on behavior, and ultimately on economic performance.¹⁰⁰ The critics argue that by

⁹⁶ Cass R. Sunstein, ‘Social Norms and Social Roles’ (1996) 96 *Columbia Law Review* 903, 907.

⁹⁷ Lessig, above n 92, 673 and 661.

⁹⁸ As Lessig, himself a proponent of the New Chicago approach, notes that the New Chicago School has not completely jettisoned the underpinnings of Chicago law and economics; rather, the New Chicago “shares with the old an interest in alternative modalities of regulation ... and adopts as well as rational choice perspective.” Ibid 666 and 665.

⁹⁹ This section is drawn from his ‘friendly critique’ of what he terms the “new norm jurisprudes”; see Lawrence E. Mitchell ‘Understanding Norms’ (1999) 49 *University of Toronto Law Journal* 177.

¹⁰⁰ In advancing this notion he is joined by Ellickson who observed, “Although methodological individualism invites a theory of how actors manage to reform norms, many (2009) J. JURIS 99

continuing to invoke a rational choice perspective (consistent with their backgrounds in rational choice theory and law and economics), these new norm jurists will accomplish little in bringing about an understanding of the underlying values and the evolving, nuanced obligations, duties, or compulsions that underlie the formation of social norms. Mitchell argues that this “unrelenting behavioral approach to norms, winds up narrowing instead of broadening their understanding, distorting instead of improving this explanation of norms.”¹⁰¹ As a result, Mitchell and others have argued that “[the] relentlessly, behaviouralist accounts of norms provided by the new norms jurists can barely begin to explain the emotionally, psychologically, intuitively, morally, and socially complex questions” underlying why individuals or groups adopt or conform to particular social norms.¹⁰²

These critics firmly believe that one can not come to a true understanding of the role and impact of social norms by focusing merely on how people behave, and not why they act as they do. In that vein, McAdams observed that while law and economics scholars may be deeply interested in how law can influence norms [a la New Chicago], “if we do not know how norms first arise, it would seem implausible to think we could predict how legal rules might change a particular norm.”¹⁰³ They conclude by saying that in order to understand anything meaningful about behavior, and ultimately performance, we need to explore how norms initially arise; that is, we need to understand the nature and source of the obligation that leads one to feel the need, the duty, or the compulsion to comply with social norms – in short, we need to open the ‘black box’ and focus attention on how underlying values lead to social norms creation and, from there, proceed to try to understand how the likes of the New Chicago norm managers could alter existing norms to better society. To this end, some in the new institutional economics have initiated work in neuroeconomics – an integration of the neural sciences with philosophy, psychology, and economics. Simply put, it is an effort to explore “how the mind works, that is, how human learning occurs.”¹⁰⁴

F. New Haven School of Law and Economics

of us have ducked that challenge, in effect relegating norm change to a black box.” Ellickson, above n 90, 550.

¹⁰¹ Mitchell, above n 99, 210.

¹⁰² Ibid 180.

¹⁰³ McAdams, above n 91, 349, 354.

¹⁰⁴ Douglas C. North, in “Prologue,” in John Drobak and John V. C. Nye (eds), *The Frontiers of the New Institutional Economics* (1997), 3, 11. For example, see two recent books, Peter Poltser’s *Neuroeconomics* and Michael Shermer’s *The Mind of the Market*; see also the Center for the Study of Neuroeconomics at George Mason University [<http://neuroeconomics.typepad.com>]; Neuroeconomics at Caltech - The Camerer Lab [<http://www.neuro-economics.org>]

1. People Places and Ideas

The origins of the New Haven school can be traced back to the seminal contributions of Guido Calabresi.¹⁰⁵ Two of his early articles — “Some Thoughts on Risk Distribution and the Law of Torts” in 1961 and, with A. Douglas Melamed, “Property Rules, Liability Rules, and Inalienability: One View of the Cathedral” in 1972 — are classics in the economic analysis of law. The former article attempts to provide a detailed economic analysis of tort law focusing on the relationship between rules of liability and the spreading of loss. Calabresi and Melamed’s article on property rules and liability rules actually takes off from Coase’s analysis in “The Problem of Social Cost” (1960) to analyze the choice of remedies for resolving disputes over incompatible property uses. In 1970 Calabresi published his now classic book, *The Cost of Accidents: A Legal and Economic Analysis*, which further developed the ideas in his 1961 article. In it Calabresi provided an economic analysis of the goals and functions of liability rules leading him to conclude that liability should be placed on the least-cost avoider—that is, on the person who is in the best position to undertake cost-benefit analysis as between accident costs and accident-avoidance costs and act on this information once the relative costs have been determined.

His efforts proved pivotal in laying the foundation for further explorations into the economics of tort law. But just as important, while clearly concerned with the cost-related aspects of tort law, Calabresi’s writings, as well as the writings of other contributors to the New Haven school, have not focused exclusively on efficiency, but, rather, have evidenced a continuing concern for justice and fairness—this being one of the hallmarks of the Law and Economics scholars at Yale University (or those that have had some past affiliation with the institution), hence the moniker – the New Haven school.

2. Defining Characteristics of the New Haven School

Proponents of the New Haven view suggest that their approach to law and economics is necessitated by the increasingly prominent role played by the regulatory process and administrative law within the modern welfare state. This legal transformation, as Susan Rose-Ackerman points out, has “forced both judges and legal scholars to reexamine the roles of Congress, the agencies, and the courts”¹⁰⁶ The New Haven school takes as its field of study the entire

¹⁰⁵ This short overview borrows from Nicholas Mercuro and Steven G. Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2006 2nd ed), Chapter 6.

¹⁰⁶ Susan Rose-Ackerman, *Rethinking the Progressive Agenda: The Reform of the American Regulatory State* (1992) 8.

modern regulatory welfare state and thereby views the task of law and economics: i) “to define the economic justification for public action,” ii) “to analyze political and bureaucratic institutions realistically,” and iii) “to define useful roles for the courts within this modern policymaking system.”¹⁰⁷ Like the Chicago and public choice approaches, the New Haven approach to law and economics recognizes the important role played by the problem of scarcity in legal-economic problems; it also recognizes the virtues of relying on the market in allocating resources. However, unlike the more anti-interventionist approaches of Chicago and public choice, the New Haven school emphasizes the presence of multiple sources of market failure and a much wider need for regulation both of which necessitate a wider scope of government action.

In their positive, descriptive work they look at a wide array of legal institutions and their potential impact on the economy. The New Haven school’s emphasis is on the study of all aspects of the governmental policy process. This necessitates a model of governmental behavior, and the model used is that of the rational actor and thus shares certain commonalities with both Chicago and public choice. What is absent from the positive New Haven approach, however, is the normative presumption favoring the status quo distribution of wealth and property inherent in both the public choice and the Chicago approach to law and economics. Rather, the proponents of the New Haven school “recognize that the existing distribution of property rights [and hence wealth] is highly contingent and lacks strong normative justification.”¹⁰⁸ They argue that policy analysts should endeavor to determine the various available policy options in dealing with situations of market failure, and that they should do so without privileging the status quo, as in the case of public choice, and without a presumption in favor of common law resolutions, as in the case of the Chicago school.¹⁰⁹

On the normative side, the New Haven approach argues that legal-economic policy should work toward the correction of market failures, but with a recognized concern for both *allocative and distributional impacts*.¹¹⁰ That is, along with efficiency analysis should come a continuing concern for *distribution* and with that, a concern for *justice and fairness*. As such, proponents of the New Haven approach “provide a more balanced view of modern work in political economy that bears on the evaluation and reform of legal doctrines and

¹⁰⁷ Ibid 3.

¹⁰⁸ Ibid 6.

¹⁰⁹ Ibid 3,16. Rose-Ackerman. She also calls the Chicago approach to law and economics “deeply flawed” as “a comprehensive view of the relationship of law to economic analysis.” Ibid 20.

¹¹⁰ Ibid 6-7 ,9.

institutions.”¹¹¹ Moreover, they assert that market-failure-correcting policies should be set in place based on cost-benefit analysis whenever possible, and this process should include the evaluation of *all* benefits and costs (e.g., lives saved, acres of wilderness preserved, and so on), not just those benefits and costs that can be measured in explicit dollar terms.¹¹²

From a normative perspective, this twin focus on efficiency and justice is worked out within the context of a system that establishes a presumption in favor of individual choice and the use of mechanisms that promote such choices, including the market, market-like arrangements, and the democratic political process. Thus, while in their positive work they seek a deeper understanding of the interaction between law and market incentives and with that, a deeper understanding of the interrelations between law and economics, in their normative work they see a much wider role for government to play including: i) the use of statutes and regulations, ii) a greater reliance on well-structured government institutions (i.e., an efficient bureaucracy), and iii) on taxes and subsidies, along with iv) government-established market-like arrangements to help remedy pockets of market failure in society.¹¹³ With respect to the market-like arrangements, their principal aim is to substitute incentive-based regulation for command and control regulation.¹¹⁴

The normative agenda of the New Haven school is the effective implementation of policies that efficiently achieve certain regulatory aims that serve to increase social welfare, broadly defined not to ignore distribution (while considering allocation); and not to ignore justice (while considering efficiency). They emphasize the importance of studying the operations of governmental institutions and the use of the tools of public policy analysis and social choice analysis—always with an eye on both allocative and distributional impacts—in the search for solutions to legal-economic problems. Further, New Haven scholars take the position that once one truly understands the

¹¹¹ Susan Rose-Ackerman, ‘Law and Economics: Paradigm, Politics, or Philosophy?’ in Nicholas Mercuro (ed) *Law and Economics* (1989) 233, 251.

¹¹² Rose-Ackerman above n 106, 16-17.

¹¹³ See, for example, Jon D. Hanson and Kyle D. Logue, ‘The Costs of Cigarettes: The Economic Case for Ex Post Incentive-Based Regulation’ (1998) 10 *Yale Law Journal* 1163 (with regard to the debates over smoking policy, they have proposed an *ex post* incentive-based regime to regulate smoking—a system of enterprise liability, which holds manufacturers liable for all the harms caused by their products).

¹¹⁴ Generally, see Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (1992); Thomas Tietenberg, *Environmental and Natural Resource Economic* (2003); Thomas Sterner, *Policy Instruments for Environmental and Natural Resource Management* (2003) chapter 8; and on the distinction between economic incentives versus command and control see Winston Harrington and Richard D. Morgenstern, ‘Economic Incentives versus Command and Control’ (Fall/Winter 2004) *Resources* 13.

functional role of government, the modern regulatory system is revealed as superior not only to more highly collectivist alternatives, but also to its common-law predecessor. In fact, it is argued that in many contexts “the problem is one of too little rather than too much regulation.”¹¹⁵ The goal, then, from the New Haven perspective, “is a reformed administrative law that will incorporate a richer range of both empirical and theoretical concerns and will respond more effectively to the needs of public officials, politicians, and private citizens.”¹¹⁶

G. Austrian Approach to Law and Economics

1. People Places and Ideas

The Austrian approach to law and economics, as its name suggests, derives from the work of the Austrian school of economics.¹¹⁷ The Austrian school of economics emerged in the late 1800s; it was founded by Carl Menger who taught at the University of Vienna.¹¹⁸ His work was influenced by the ideas of Franz Brentano, a philosopher who drew upon the ideas of Aristotle and the Scholastics as well as by the empiricist and positivist movements of early nineteenth century Europe. Menger developed the Austrian school as a deductive theoretical method of inquiry in direct contrast to the scientific / empirical thrust of the German Historical School. He has been described as “the true and sole founder of the Austrian school of economics proper, ... he created the system of value and price theory that constitutes the core of Austrian economic theory, ... and he also originated and consistently applied the correct, praxeological method for pursuing theoretical research in economics.”¹¹⁹

Menger’s analysis received further development at the hands of his two most prominent disciples, Eugen von Böhm-Bawerk and Friedrich von Wieser (many of their contributions coming in the late 1800s, early 1900s).¹²⁰ The 1920s and 1930s saw a new generation of Austrian scholars move to the forefront, including Ludwig von Mises, Friedrich von Hayek, Hans Mayer,

¹¹⁵ Cass R. Sunstein, *After the Rights Revolution: Reconceiving the Regulatory State* (1990) 227-233.

¹¹⁶ Rose- Ackerman, above n 106, 8.

¹¹⁷ This short overview borrows from Nicholas Mercurio and Steven G. Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond* (2006 2nd ed), Chapter 6.

¹¹⁸ It is not uncommon to read that the Austrian school began with the publication of Menger’s *Grundsätze der Volkswirtschaftslehre* (1871), translated into English as *Principles of Economics* (1976, reprinted in 1981).

¹¹⁹ Joseph T. Salerno, ‘Biography of Carl Menger: The Founder of the Austrian School (1840-1921)’

[<http://mises.org/about/3239>]

¹²⁰ Both became professors at Austrian universities.

Fritz Machlup, and Gottfried Haberler among others. Based on their contributions, Austrian economics flourished; the idea of a distinctive “Austrian approach” was solidified, and its scope extended across the field of economics and economic policy.

However, in the 1940s and 50s, the Keynesian revolution pushed the Austrian approach into the background. Some years later, circa 1970s, following the general contours laid out by Ludwig von Mises, Austrian economics reemerged as something of a force through its leading figures, some of whom had moved to the US by the end of WWII.¹²¹ Friedrich von Hayek taught and wrote at the University of Chicago and was later awarded the Nobel Prize in economics in 1974. Ludwig von Mises had gone on to New York University and established an intellectual center influencing students and colleagues including Israel M. Kirzner, Murray Rothbard, and later, Mario Rizzo and others. Today, George Mason University along with New York University and the Ludwig von Mises Institute at Auburn University have become the most recognized centers of Austrian scholarship and discourse. The scholars at these institutions provide both i) an outlet for Austrian economics’ (and now Austrian law and economics) scholarship (as they house the leading journals and book series in the field), and ii) a vehicle for teaching and advancing the Austrian approach. In time, given the Austrian inherent interest in institutions, it was only natural for them to branch out into law and economics. Like its direct forebearer, the Austrian school of law and economics favors “an approach that is deductive, subjective, qualitative, and market-oriented.”¹²²

2. Defining Characteristics of Austrian Law and Economics

a. Praxeology and Rejection of Efficiency

The Austrian approach is built on the belief that economics should be comprised of self-evident axioms; the operative concept is that of praxeology. It was Menger who first placed human action – and human action alone – at the center of economic theory in general, and the price theory in particular. This approach was later to be termed “praxeology” by Ludwig von Mises and remains at the core of Austrian economics (and now Austrian law and economics). Praxeology represents a scientific inquiry by meditating upon the nature of human striving to satisfy wants and then deducing its immediate implications. It is a theory that emphasizes human action – the idea that

¹²¹ A date often mentioned as its official “rebirth” is 1974 with the convening of a conference on Austrian Economics held in Vermont and sponsored by the Institute for Humane Studies.

¹²² Mark Skousen, ‘Chapter 1 - Introduction: A Tale of Two Schools’ in *Vienna and Chicago, Friends or Foes?: A Tale of Two Schools of Free-Market Economics* (2005) 1, 3.
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“human beings act – engage in conscious choice actions toward chosen goals,”¹²³ with the process of want satisfaction not purely cognitive and internal to the human mind, but dependent crucially upon the external world. It is an approach that is at odds with the Chicago school and public choice models where human agents are passive responders to the given constraints in a choice situation. In the Austrian school, the individual is seen not merely as a passive “price taker” but more as a purposeful actor and creator; people are regarded as instinctively social, not individualistic and it is from this perspective that the Austrians believe that economics should (in a manner without regard to any value judgements) focus on the ultimate ends chosen in human action.¹²⁴

For Austrians, the concept of efficiency becomes a “praxeological” (individual goal-seeking) problem; it is not value maximization problem. From their subjectivist approach (i.e., looking at the world from the perspective of the actor),¹²⁵ the individual is seen to be making choices as to what ends to pursue and what means to employ, within the context of the “perceived” costs and benefits. As a consequence, Austrians view the neoclassical emphasis on efficiency as both misguided and unworkable. Given uncertainty, imperfect information, the fact that preferences and institutions are endogenous, and further, that changes in law can alter both preferences and institutions, “[i]t is meaningless ... to attempt to assess the consequences of a policy alteration with any yardsticks of ‘efficiency’ that are based upon the original institutional structure.”¹²⁶ Since the Austrians view the world from a perspective that asserts that “value” and “utility” are both strictly subjective, then “value” and “utility” remain unobservable and unmeasurable.¹²⁷ Since costs (and thus, social costs) are subjective, social welfare does not exist either as i) a useful theoretical concept, or ii) as a useful criterion (since unmeasurable); the same argument applies to benefits thereby highlighting the problem of tallying up benefits and costs in order to make efficiency-based judgments. Given the subjective nature of costs and benefits and with the rejection of efficiency, the Chicago normative benchmark of Pareto optimality has no place in the Austrian approach to law and economics.

¹²³ Murry Rothbard, *Logic of Action: Method, Money and the Austrian School* (1997) 58-59.

¹²⁴ This is Vernon Smith’s characterization of von Mises’s concept of praxeology; see Vernon Smith, “Reflections on ‘Human Action’ after 50 Years” (1999) 19 *Cato Journal* 195.

¹²⁵ Richard M. Ebeling, ‘The Significance of Austrian Economics in Twentieth-Century Economic Thought’ in Richard M. Ebeling (ed), *Austrian Economics: Perspectives on the Past and Prospects for the Future* (1991) 1, 13.

¹²⁶ Gregory Scott Crespi, ‘Exploring the Complicationist Gambit: An Austrian Approach to the Economic Analysis of Law’ (1998) 73 *Notre Dame Law Review* 315, 331.

¹²⁷ The acceptance of subjectivism allows Austrians to reject mathematical and quantitative analysis; see Linda A. Schwartzstein, ‘Austrian Economics and the Current Debate Between Critical Legal Studies and Law and Economics’ (1992) 20 *Hofstra Law Review* 1105, 1129.

b. Uncertainty and Imperfect Information – The Austrians have long emphasized the pervasiveness of uncertainty and imperfect information, and the associated inevitable limits on human knowledge. Individual preferences are endogenous and malleable, hence individual choice occurs in a dynamic, inter-temporal setting in which events can change preferences or relative desires arising from preferences. As such, the passage of time makes the choice process something that is evolving and less than stable in nature—giving rise to, among other things, the preference endogeneity and uncertainty problems. As Linda Schwartzstein described it “Austrians recognize that preferences are being formed and reformed constantly. People often have inconsistent preferences that are competing with one another and which have to find a resolution. Economics and law are part of a creative, ongoing process, in which new discoveries are always being made.”¹²⁸

Further, while disequilibrium is an ignorance-driven phenomena, this ignorance gives rise to opportunities for gain that can be exploited by entrepreneurial agents. This entrepreneurial activity in all its forms, in turn, generates knowledge, technology, and products that push the market in new directions. More generally, in Austrian law and economics the focus is on the goal-seeking individual and the ability of entrepreneurial economic actors to formulate and execute plans within the context of their goals. Within the Austrian system, market prices are considered the primary mechanism for the dispersal of knowledge, and it is the market prices that provide the information regarding entrepreneurial opportunities that drive economic growth and development.

c. Government and Legal Institutions – The Austrians adopt a largely anti-interventionist approach with respect to the role of government focusing on those institutions that are best able to promote decentralized decision making with therefore, a heavy reliance on the market as the preferred system of social control.

Given the ongoing existence of interpersonal conflicts, in contrast to the more a-institutional nature of neoclassical economics, the Austrian approach emphasizes the importance of social and legal institutions—including habits, customs, and social norms as well as legal rules—in structuring the market process. Their focus is on both the contingency of outcomes with respect to alternative institutional settings and on the unsettled, evolving nature of the institutional framework. The role of government is to clearly define and/or more strictly enforce property rights in its effort to encourage individual

¹²⁸ Ibid 1131.

entrepreneurs to pursue their own goals efficiently. As Roy Cordato suggested, the state can do this via “legal institutions that minimize conflicts in the use of resources and allow the economic system to maximize the dissemination of knowledge.”¹²⁹ This is best accomplished via fully specified property rights and free markets. Taken together they facilitate the dissemination of information in the broadest possible fashion and provide the sort of certainty and stability that minimizes conflicts associated with resource acquisition and use, and thereby facilitate individuals gathering the necessary physical resources to pursue their entrepreneurial activities.

The issue of the passage of time also bears heavily on the Austrian approach to institutions be they social, legal, or economic (with regard to the latter, particularly the market). Their focus is not just on their influence, but on the processes associated with their emergence and evolution. Central here is the concept of spontaneous order, which, in a nutshell, says that institutions (economic and legal) evolve through, and can only be explained in terms of, individual human action, rather than any sort of collective process of organization, design, or planning. Some of these consequences are completely unintended, others only partially so.

d. Law and the Market – The law or legal rules are said to evolve in a spontaneous manner rather than from the conscious planning of governmental entities, such as legislatures, bureaucrats, and courts. Often, this involves the evolution of legal rules out of customs and practices commonplace in society. This is not to say that judges and legislators have no law-making role to play; in fact, the evolution of social-economic activity exposes gaps in existing rules and judges and legislators must sometimes act to fill these gaps. But, Hayek argues, “the judge [is not] free to pronounce any rule he likes”; rather, “[t]he rules which he pronounces will have to fill a definite gap in the body of already recognized rules in a manner that will serve to maintain and improve that order of actions which the already existing rules make possible.”¹³⁰

In a like manner, the market evolves from “[t]he spontaneous order resulting from individuals adapting themselves to circumstances they perceive in the market. Prices send signals to producers and consumers, who in turn interpret this information and use it to guide their actions. It is unnecessary and impossible for any person to know or understand the full complexity of the extended order.”¹³¹ The Austrians employ a more dynamic disequilibrium

¹²⁹ Roy E. Cordato, ‘Subjective Value, Time Passage, and the Economics of Harmful Effects,’(1989) 12 *Hamline Law Review* 229, 239.

¹³⁰ Friedrich A. Hayek, *Law, Legislation and Liberty* (1973) 100.

¹³¹ Schwartzstein above n 127, 1128

process model of capitalism (rejecting the model of pure competition). Within the Austrian system, market prices are considered the primary mechanism for the dispersal of knowledge, and it is the market prices that provide the information regarding entrepreneurial opportunities that drive economic growth. The market is not in equilibrium but in disequilibrium due to uncertainty and lack of full information over time; therein lies the emergence of market opportunities and the potential for an entrepreneurial response. That is, disequilibrium gives rise to opportunities for gain that can be exploited by entrepreneurial activities which in turn, generate knowledge, technology, and products that push the market in new directions. Obviously, one of the major concern of Austrians is with the impact of governmental policy on the market. Their, concern being with the individual's ability to recognize and freedom to act upon entrepreneurial opportunities or otherwise facilitate the satisfaction of preferences. For Austrians, at the heart of the market is the entrepreneur. As Cordato uses the terms "social efficiency" and "catallactic efficiency" to describe the goal of legal economic policy. As he has put it, "the efficiency of the economic system is judged by the extent to which it encourages individuals [entrepreneurs] to pursue their own goals efficiently."¹³² Put simply, the Austrian benchmark for normative analysis is the facilitation of the market process.

¹³² Cordato, above n 129, 239. Cordato supplanted the second term with the first in his later book titled *Welfare Economics and Externalities in an Open-Ended Universe: A Modern Austrian Perspective* (1992).

