The Future of Law and Economics

Douglas G. Baird

Law and economics has already worked a revolution in legal scholarship and education, but its promise continues to be great because it provides judges, lawyers, and legal scholars with two valuable tools. First, economic analysis of law offers a way to understand the structure of the law itself. Complicated legal doctrines, such as remedies for breach of contract, are often neither random nor arbitrary. A few basic principles may unite them and these principles are frequently economic ones. Economics, in other words, sometimes gives us a way to organize the law and understand the connections between rules that on their surface appear to have nothing in common. Second, and equally important, economics also helps us to understand what effects legal rules have. When we subject laws or judicial opinions to scrutiny or ask what shape incremental law reform should take, the effects of a legal rule are important. We want to know if a law can fulfill its ambitions. We want to know whether it can make the world a better place and at what cost. Law and economics addresses precisely these concerns.

The earliest successes in law and economics were in antitrust because antitrust law embraces a policy that is based explicitly on economic principles. Law and economics has done much to aid our understanding of joint ventures, predatory pricing, tie-in sales, and vertical price restraints, but it has since shed light on many other areas of the law. Copyright and patent law, by constitutional design, offers writers and inventors rights to their work for a limited time in order to give them an economic incentive to create in the first place. Determining how much of an incentive writers and inventors require and how to balance this incentive against the need to make new ideas accessible to others requires us to ask questions that economics may equip us to answer. The law of torts is designed in large measure to ensure that parties take account of the costs their activities impose on others. Environmental law may be similarly designed to ensure that firms take account of both the social and private costs of their actions.

In short, much of the process of lawmaking and judicial decisionmaking requires a weighing of costs and benefits and here law and economics is in its element. Law and economics can take us further than intuition alone. It enables us to make sense of legal rules and to understand their effects. For both reasons, law and economics is now part of mainstream legal education and economic concepts such as cost-benefit analysis, moral hazard, marginal cost, comparative advantage, public goods, and least cost avoider are a standard part of every law student's vocabulary.

Henry Simons, Edward Levi, Aaron Director, Ronald Coase, and others mapped the basic terrain. Today, the general principles of law and economics are well understood. Much work, however, remains to be done. The world, after all, is a complicated place and the behavior of discrete individuals cannot easily be reduced to a single algorithm. Account must be taken of imperfect information and the possibility of strategic behavior to understand how any group will respond to a legal rule. Even in fields such as antitrust that have been a focal point for
scholarship for many years, there are still new insights to be made. New advances in economics itself, especially in game theory, make subjects such as predatory pricing as interesting and as controversial as ever.

At Chicago, we seem well positioned to continue to advance the field. Our scholars remain productive and eager to explore new fields and re-examine old ones. Ronald Coase, Richard Posner, William Landes, and Richard Epstein, who gave shape to the field, remain active scholars at the Law School. My own contemporaries,

Many contributions to law and economics that have been made at Chicago are now so much a part of the established wisdom that it is easy to forget the controversy they originally provoked. These well understood contributions are not regarded as economic analysis of law, but simply as common sense.

including Daniel Fischel, Frank Easterbrook, and Geoffrey Miller, set much of the terms of the debate in law and economics in the 1980s and continue to find new paths to explore.

Young scholars, such as Alan Sykes, Dan Shaviro, Stephen Gilles, and Randall Picker, are poised to challenge the conventional wisdom, even if what is now the conventional wisdom was once cutting edge law and economics.

The ultimate ambition of legal scholarship is to say useful things about how the world works. Hence, the question is not whether the assumptions of law and economics capture all the nuance and ambiguity that exists in the world, but whether these assumptions capture enough of the essence of our world to shed light on how it works. In the end, every contribution to law and economics should lead to an empirical test. In many cases, such as the law and economics of corporate and securities law, there is a wealth of data and the tests are easy. In other areas, data is less accessible and the challenges are greater.

A brief survey of the current projects at the Law School gives a sense of the many facets of law and economics, its broad focus, and its commitment to rigorous examination of areas of the law that matter the most.

Richard Epstein is writing on health law and the many ways in which government regulation of the medical profession affect the quality of health care in this country. Randal Picker continues his work on the basic principles of the law of bankruptcy and corporate reorganization. Daniel Shaviro is undertaking a major reexamination of our law of corporate income taxation. Alan Sykes continues using economics as a way of understanding the structure and the policies inherent in the laws governing international trade regulation. We remain confident that in these and other areas, careful and thoughtful economic analysis will make it possible to understand and improve the law.

Many contributions to law and economics that have been made at Chicago are now so much a part of the established wisdom that it is easy to forget the controversy they originally provoked. These well understood contributions are not regarded as economic analysis of law, but simply as common sense. Of course, if the idea had been a commonplace at its inception, it could not have been much of a contribution. Too often, however, we forget that the idea was first greeted with derision, hostility and disbelief. The ultimate test of good scholarship is whether it can make the passage from being an idea that is obviously wrong to being one that is obviously right. As one might expect, one of the swiftest passages was made by Coase's "The Problem of Social Cost." When he first presented the paper at Chicago, a vote was taken at the outset on whether Coase was in error and the vote was twenty to one against Coase. As George Stigler explained later, "If Ronald had not been allowed to vote, it would have been even more one-sided." At the end of the evening another vote was taken, and there were twenty-one votes in Coase's favor and none against.

Douglas G. Baird is Harry A. Bigelow Professor of Law and Director of the Law and Economics Program.