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# Law and Economics: Its Glorious Past and Cloudy Future

*Richard A. Epstein*†

The title I have given to this short comment is one that does not speak to any great optimism about the future of Law and Economics, and it is incumbent upon me, even in a short essay, to indicate the sources of my uneasiness. When I entered legal academia in 1968, Law and Economics was just getting started as a separate field. The magnitude of the intellectual revolution is hard to recount today because virtually everyone who works in common law subjects is familiar with the now routine exercise of showing why it is, or has to be, the case that this or that common law rule is, or is not, efficient. But the present familiarity should not be read back into the past. In my student days at Oxford between 1964 and 1966, I engaged in an exhaustive study of the common law of contract, property, and torts. I studied legal history and jurisprudence, and learned Roman and international law to boot, all with reference to contract, property, and torts. Yet I cannot recall a single instance in which common law rules were praised for their efficient properties or criticized for their lack thereof. For our normative work, we relied on some intuitive notion of fairness or justice, which seemed to produce on average better economic results than the self-conscious instrumentalism that guides so many judges today. For our descriptive work, we relied on *stare decisis* and close case readings.

To be sure, English academics and judges were less innovative than their American counterparts. The United States had law and economics before “Law and Economics.” In the 1950s, Aaron Director and Edward Levi introduced an integrated study into the area of monopoly regulation. But, in a sense, that connection was too obvious to deny: how could anyone understand the regulation of monopoly without having some idea of how monopolies were formed and how monopolists behaved. The early use of economics, moreover, was not thought in any obvious sense to be generalizable to other areas of legal endeavor, and certainly not to such areas as constitutional, family, or criminal law. Only

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with the new work of the 1960s were the broader connections clearly seen. Ronald Coase<sup>1</sup> and Gary Becker<sup>2</sup> were obvious leaders in this movement, although in different ways. There were others as well: Guido Calabresi, Henry Manne, and of course, Richard Posner. Posner's *Economic Analysis of Law*, which first appeared in 1973,<sup>3</sup> sounded most explicitly the modern theme of economic imperialism: You name the legal field, and I will show you how a few fundamental principles of price theory dictate its implicit economic structure.

In 1968, I was quite skeptical about what I thought to be the pretensions of the movement. One source of difficulty was the counterintuitive nature of many of its central claims. When I first encountered Coase's work on reciprocal causation (at the University of Southern California, but under the tutelage of my then-colleague Michael Levine, who had been a Law and Economics Fellow at the University of Chicago) it struck me as utterly at variance both with the ordinary use of causal language and with the common law approaches to proximate causation. Depending on the sunspot cycle, the common law emphasized intervening actions or events, direct causal connections, or the foreseeability of the consequences to a reasonable actor standing in the position of the "injurer." But we can apply the term "injurer" only with caution in a Coasean world of reciprocal causation, which accords equal causal status to both parties in any unfortunate interaction.

Only much later did it become clear to me (but perhaps not to others) that the disjunction between Coasean views and ordinary views of causation diminishes vastly once the structure of property rights is made explicit.<sup>4</sup> The observation that "his face got in the way of my fist" does not make any sense where persons have the right to be where they are, which is ordinarily the case. But it makes good sense if the fist (or automobile) has the right of way and the face (or pedestrian) reaches its location second—even though it has a right to be there first. That in turn leads to the somewhat larger question of how these property rights are arrayed in the first instance. To answer this question, it is necessary to develop some rough efficiency hypothesis as to whether separate property, as with private lands, or common property, as

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<sup>1</sup> See R.H. Coase, *The Problem of Social Cost*, 3 J L & Econ 1 (1960).

<sup>2</sup> See Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J Pol Econ 169 (1968).

<sup>3</sup> Richard A. Posner, *Economic Analysis of Law* (Little, Brown 1973).

<sup>4</sup> See Richard A. Epstein, *Takings: Private Property and the Power of Eminent Domain* (Harvard 1985).

with highways and waterways, promises the greater benefit from a given set of resources.<sup>5</sup> That determination depends on a resource-specific judgment of the relative costs of exclusion (in a regime of private property) and coordination (in a regime of common property) of separate users, which happily turns out to be an intensely economic inquiry after all.

My second concern with early Law and Economics was that it claimed too much in certain areas. I can still recall the arguments, championed by Richard Posner, that a negligence system was efficient because it stated liability in terms of the Hand formula.<sup>6</sup> The most obvious difficulty with this position is that a strict liability system, given the same optimistic behavioral assumptions on how people act under uncertainty, yields the same cheery outcome: individuals will still take only cost-effective precautions even if they are held liable for certain harms not worth avoiding. At this point, the relative superiority of either rule is in doubt from a strictly economic viewpoint, in part because so much turns on other aspects of the tort system, such as: the role of contributory negligence and assumption of risk, the treatment of proximate causation, and the scope of *res ipsa loquitur*. Thus a world with a strong assumption of risk defense cuts out much employer liability for injured workers that a pure negligence/contributory negligence system would allow. A rule that confines causation to the last wrongdoer bars complex causes of action that hold a landlord liable for crimes committed by third persons on his premises<sup>7</sup> or hold a manufacturer liable for making a vehicle that fails crashworthiness standards.<sup>8</sup> A *res ipsa loquitur* rule that reaches defendants who are no longer in possession of goods has far greater reach than the one that takes the "exclusive possession" requirement more literally.<sup>9</sup>

Finding out what efficiency looks like in the welter of these secondary complications is a difficult task, and the problem was made more acute by those—especially the early Posner—who insisted on the efficiency of the common law, even as the legal sys-

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<sup>5</sup> For my views, see Richard A. Epstein, *On the Optimal Mix of Private and Common Property*, 11 Soc Phil & Pol 1 (1994).

<sup>6</sup> See Richard A. Posner, *A Theory of Negligence*, 1 J Legal Stud 29, 32 (1972). See also *United States v Carroll Towing Corp.*, 159 F2d 169, 173 (2d Cir 1947) ("[L]iability depends upon . . . whether B [is] less than PL.").

<sup>7</sup> See *Kline v 1500 Massachusetts Avenue Apartment Corp.*, 439 F2d 477 (DC Cir 1970) (finding such liability).

<sup>8</sup> See *Larsen v General Motors Corp.*, 391 F2d 495 (8th Cir 1968) (allowing crashworthiness cases on a negligence theory).

<sup>9</sup> See, for example, *Halloran v Virginia Chemicals, Inc.*, 41 NY2d 286, 361 NE2d 991 (1977).

tem was moving inexorably in the opposite direction. After all, the central normative proposition of standard Law and Economics theory is that tort should give way to contract or, equivalently, that the role of harm should be trumped by consent. Yet the case law that developed from the early 1960s found all sorts of dubious reasons to knock out contractual arrangements in what appeared to be competitive markets, be they for the provision of medical services,<sup>10</sup> ordinary products,<sup>11</sup> or rental real estate.<sup>12</sup> The positive theory of an efficient common law utterly fails to explain why, with transaction costs in decline and information more readily available, judicial regulation should be expected to increase. Nor does it explain why statutory developments moved in the same direction as the common law rules, often for the same global reasons—be they fear of unequal bargaining power or concerns with ostensible inequalities based on race or sex. Any contrast between efficient common law rules and silly statutory ones grossly oversimplifies both domains.

The simultaneous expansion of judicial and legislative regulation counts as a powerful counterargument against some of the more extravagant positive claims of Law and Economics. But one should not (as I was too eager to do) turn these sound particular criticisms into wholesale objections about the overall intellectual power of Law and Economics scholarship. There is nothing intrinsic to the field that commits it to the superiority of this liability rule over that one, much less to the inexorable efficiency of the common law. Law and Economics at its best is a mode of inquiry that yields understanding, not preordained results. The approach does not require in and of itself some programmatic solution. It could well be that the relative efficiency of the negligence and strict liability systems is close to even, or perhaps even indeterminate. It is quite possible for the common law to have developed efficient rules for the creation of leases and inefficient ones for the creation of legal remainders. Programmatic generalizations are dramatic. They are also likely to be wrong.

Once that basic point was grasped, it became possible to make enormous and rapid advances in the field, which had much virgin territory to conquer. At one level, simple and basic principles of economics—including the ideas that self-interest is an

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<sup>10</sup> See *Tunkl v Regents of University of California*, 60 Cal 2d 92, 383 P2d 441 (1963) (medical services).

<sup>11</sup> See *Henningsen v Bloomfield Motors, Inc.*, 32 NJ 358, 161 A2d 69 (1960) (knocking out warranty disclaimers in product liability cases).

<sup>12</sup> See *Henriouille v Marin Ventures, Inc.*, 20 Cal 3d 512, 573 P2d 465 (1978) (The common law rule in this case anticipated the statute.).

important behavioral force, that scarcity counts, and that demand curves slope downward—were applied in an easy and straightforward way to legal and policy questions of major importance. The economics of common pool resources became well understood.<sup>13</sup> The economics of information developed from seminal work of George Stigler in the early 1960s.<sup>14</sup> Gary Becker pioneered the field of human capital, which in turn helped with the study of taxation and family law (How does one deal with the deductibility of educational expenses or the division of property upon a marriage's dissolution?).<sup>15</sup> The public choice work of James Buchanan and Gordon Tullock helped us apply the account of individual self-interest to political markets, just as it had been applied to standard economic markets.<sup>16</sup> To those in the know, rent-seeking became an epithet. Mancur Olson's account of the collective action problem sparked major examinations of public goods problems across a wide range of legal fields, from patents to taxation to labor law.<sup>17</sup> The work of Amos Tversky and Daniel Kahneman raised questions as to whether various "cognitive biases" threatened the smooth operation of markets and (because no one gets a free ride) the efficiency of government interventions.<sup>18</sup>

The diffusion of economic knowledge into law did not take place suddenly and universally during the 1960s and 1970s. It did, nevertheless, take place. Speaking very crudely, the 1970s were a period in which the most extensive investigation took place into simple two party transactions. In the law of tort, the dominant conception became that of externality. The effort was to show how legal rules could counter the risk of externalities by forcing individuals to consider the adverse consequences that their decisions inflicted on others, just as they considered the costs (and benefits) to themselves. The point of legal rules was to create incentives to minimize (we quickly learned that we could never eliminate them) these divergences between private and social costs. In the law of contract, scholars examined the various

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<sup>13</sup> See, for example, H. Scott Gordon, *The Economic Theory of a Common-Property Resource: The Fishery*, 62 J Pol Econ 124 (1954).

<sup>14</sup> See generally George J. Stigler, *The Economics of Information*, 69 J Pol Econ 213 (1961).

<sup>15</sup> See Gary S. Becker, *Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education* (Columbia 1964).

<sup>16</sup> See James M. Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (Michigan 1962).

<sup>17</sup> See Mancur Olson, Jr., *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard 1965).

<sup>18</sup> See Amos Tversky and Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 Science 1124 (1974).

doctrines that ensure the integrity of voluntary transactions, along with those rules that establish the appropriate excuses (as in cases of mistake and impossibility) or that indicate the optimal level of damages for each kind of breach.<sup>19</sup>

Virtually any legal doctrine could be explained, attacked, or defended by the use of these simple economic arguments. Because the field was so open during the 1970s, the rate of intellectual return on relatively straightforward problems was exceedingly high: virtually everyone (including me) learned to restock his tool kit with the new devices from Law and Economics. As a crude approximation, I think that by the close of the 1970s most standard two party transactions and events, including sales, leases, employment contracts, medical malpractice, and landowner disputes, had been well analyzed within the newly emerging economic framework.

Speaking very broadly, the 1980s marked a shift in emphasis. As the material on simple two party interactions became more refined, the attention tended to move toward areas of law that involved multiple actors. These common pool and collective action problems arise in a large number of legal contexts. They obviously apply to such questions as collective bargaining under labor law<sup>20</sup> and to the relationships between shareholders on the one hand and officers and directors of a corporation on the other. The same type of arguments were easily and powerfully extended to property law, where the exhaustion of the common pool through overfishing, overhunting, or overgrazing became a standard example of how the lack of cooperation led to solutions that nobody wanted but that nobody could avoid.

Once alerted to the issue, scholars saw the collective action problem everywhere. A landlord who owned and managed common areas had to prevent their deterioration due to tenant actions, because each tenant could keep all the benefits from using the common area, while bearing only a fraction of the relevant costs. A similar analysis was applied to the law of bankruptcy, where the unilateral action of an individual general creditor could destroy a common pool asset, such as the "going concern" value of the firm, to the detriment of the class of general creditors.<sup>21</sup> This issue surely had a constitutional component, which

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<sup>19</sup> See, for example, Alan Schwartz, *The Case for Specific Performance*, 89 Yale L J 271 (1979); Anthony T. Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J Legal Stud 1 (1978).

<sup>20</sup> See Mayer G. Freed, Daniel D. Polsby, and Matthew L. Spitzer, *A Reply to Hyde, Can Judges Identify Fair Bargaining Procedures?*, 57 S Cal L Rev 425 (1984).

<sup>21</sup> See Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Credi-*

was the centerpiece of the law of public choice. The question is whether, for example, the elimination of the interest of some surface owner to the oil and gas below the surface could be a taking of private property.<sup>22</sup> In a world of indefinite property rights, individual political actors could cause social losses in excess of private gains. At the same time, majority politics could force some individuals to bear the brunt of regulations whose benefits were enjoyed by others. The question of how legal regimes should be used to counteract collective action problems gave new life to the Law and Economics scholarship of the 1980s. Thus, for a period of thirty years, starting roughly with Ronald Coase's oft-cited classic, *The Problem of Social Cost*,<sup>23</sup> and running through the end of the 1980s, the progress was uniform.

What has Law and Economics done for an encore since then? Now the picture turns cloudy. The easy conquests of theory and practice have already been made. The analysis of most private law subjects is so heavily influenced by economic thought that it is difficult to think of how a scholar of torts, contracts, corporations, or restitution could proceed in ignorance of the basic principles of the area. But precisely because knowledge is so great, the law of diminishing returns explains why new advances are so hard to come by. The question is not how much intellectual ore was taken from the mine. It is how much remains after the mine has been picked over.

There is also a second trend at work. When I first arrived at the University of Chicago in 1972, there was a long-standing conversation between the Economics Department and the Law School over the full range of issues. It was a rare economics presentation that did not hold some strong interest to the lawyers. We could understand the technical economics, even if we could not reproduce it. And the institutional implications of the economists' presentations—deregulate wages and prices—were easy to understand. Much of that has changed. To an outsider, the technical obstacles have become almost insuperable. Yet at the same time, it appears that the creative burst inside economics has subsided. That field today is in a period of consolidation and elaboration, not fundamental revision. More is known, but less is added. I do not see any rising collateral economic field that has the breadth or power of the economics of information, transaction

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tors' Bargain, 91 Yale L J 857 (1982).

<sup>22</sup> See, for example, *Ohio Oil Co v Indiana (No 1)*, 177 US 190 (1900); *Bernstein v Bush*, 29 Cal 2d 773, 177 P2d 913 (1947).

<sup>23</sup> 3 J L & Econ 1 (cited in note 1).



costs economics, cognitive bias, or public choice. Recent growth has been within established disciplinary lines, not across them.

This pattern holds ominous implications for Law and Economics. Our discipline is no longer nourished by huge advances outside its own field. Familiar doctrinal issues are exhausted: we do not need yet another theoretical article that proves the (in)efficiency of comparative negligence. So where do we go? One possibility is to examine the foundations of the field to show, for example, that the language of “preferences” is inadequate for economics, as some economists themselves have tried to do.<sup>24</sup> But I see little return from this approach. Whatever it may capture about the foibles of individual decisionmaking, it seems to be a philosophical difficulty in search of a real world problem. It is the kind of terminological doubt that to me adds little to the institutional knowledge about the major decisions facing any political order. Rather, I think that the greatest hope for advancement, barring any major unforeseen conceptual breakthrough, is from more attentive study to the evolution—be it by growth or decline, or both—of particular institutions and social arrangements. In effect, the study of legal doctrine and theory has to be enriched with a greater appreciation of institutional arrangements. There are vast areas of historical and social activity that would repay close study, such as the evolution of telecommunications, public utilities, banking, insurance, and nonprofit organizations. To be sure, much work of this sort has already been done, but it is often by economists or lawyers who are insensitive to the demands of history, or by historians who are less than fully conversant with the relevant economic tools. How this program will play out is anyone’s guess, which is why the future of the field is so hard to predict. In a sense, Law and Economics has been a victim of its own success. Once its principles were understood, then only the task of mopping up remained. But given the vast array of social experiments, both past and future left to analyze, perhaps such a modest program will yield larger dividends than we skeptics may have guessed. Only time will tell.

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<sup>24</sup> See, for example, Robert Sugden, *Measuring opportunity: towards a contractarian measure of individual interest* (forthcoming Soc Pol & Phil), criticizing the idea of preference in, for example, John C. Harsanyi, *Morality and the Theory of Rational Behaviour*, 44 Soc Res 623 (1977), reprinted in Amartya Sen and Bernard Williams, eds, *Utilitarianism and Beyond* 39 (Cambridge 1982).