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The Future of Law and Economics: Looking Forward*

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The members of the American Law and Economics Association now number more than a thousand, and their work is done in many different places and extends across diverse areas of the law. Much of it, however, can trace its roots back to the University of Chicago and a wonderful collaboration between Aaron Director and Edward Levi. The two taught an antitrust course together, and their efforts to synthesize traditional legal reasoning and the principles of economics began the Law and Economics revolution in earnest. This legacy of Director and Levi lies in oral history and the work of their students, such as Robert Bork, John McGee, and Ward Bowman, and the many who followed in their footsteps.¹ Among them were four scholars, closely associated with Chicago, who did much of the foundational work in Law and Economics.² Their roundtable discussion, published in this volume,

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¹ The oral history is set out in Edmund W. Kitch, ed, *The Fire of Truth: A Remembrance of Law and Economics at Chicago, 1932-1970*, 26 J L & Econ 163, 180 (1983).

² Law and Economics, of course, owes much to other scholars as well. No list of central figures in Law and Economics should omit Guido Calabresi, William Landes, Henry Manne, or many others.

provides a wonderful sense of the different paths that the discipline is now taking.

When discussing the mission of Law and Economics, Ronald Coase often points to Ernest Rutherford's observation that science is either physics or stamp collecting.³ Physicists often begin by asking questions that everyone else thinks too obvious. Newton looked at falling objects; Einstein asked what he would see if he were to travel away from an object at the speed of light. Similarly, in Law and Economics, much is to be learned from simple questions. As different as Gary Becker, Ronald Coase, Merton Miller, and Richard Posner are from each other, they share a commitment to understanding the basic forces at work in our legal and economic systems.

Gary Becker's work has explored many areas of life once thought far removed from the domain of economics. By bringing the tools of economics to them, he has provided rigor and insight to fields that too often had neither. Becker's work on altruism, human capital formation, and discrimination has become an integral part of scholarship on family and employment law.⁴ We who teach law pride ourselves on our ability to push our students by showing them how the simplest questions uncover what is rich and interesting in law and life, but no law teacher has ever done it as well as Gary Becker. For example, the way we now think about deterrence in criminal law can be traced to a single day in the 1960s. Becker was late to a graduate student's oral examination. Tempted to park illegally, he was inspired to ask the graduate student to explain all of criminal law in economic terms. Not a great moment perhaps for the graduate student, but a great one for Law and Economics.⁵

After two years as an undergraduate at the London School of Economics, a twenty-one-year-old Ronald Coase was awarded a Cassel traveling scholarship.⁶ Coase took advantage of the scholarship to study the economy of the United States. He visited the stockyards in Chicago and toured the great factories of the Midwest, including Henry Ford's River Rouge works. Coase saw both markets and firms that worked with great efficiency. This led him to ask a simple question that had escaped others: Why do both

³ See R.H. Coase, *Law and Economics at Chicago*, 36 *J L & Econ* 239, 254 (1993).

⁴ See Gary S. Becker, *A Treatise on the Family* (Harvard 1981). Becker started his work on employment discrimination well before lawyers discovered the field. See Gary S. Becker, *The Economics of Discrimination* (Chicago 1957).

⁵ Becker sets out many of his insights in Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 *J Pol Econ* 169 (1968).

⁶ Coase recounts his experiences in R.H. Coase, *The Nature of the Firm: Origin, Meaning, Influence*, 4 *J L Econ & Org* 3, 7 (1988).

markets and firms exist at the same time? If markets are wonderful vehicles for organizing economic activity, there does not seem to be any need for large firms. All production can take place through the invisible hand of the market. But the opposite seems equally plausible. If firms are splendid ways of organizing production, there does not seem to be any need for markets. Each country could become one giant factory. The field of transaction cost economics grew out of the simple questions of why our economy had more than one firm and why there were not an infinite number. Few senior theses have been as revolutionary as *The Nature of the Firm*.⁷

For many years, Law and Economics has provided tools for scholars interested in understanding the law regulating the capital structure of firms.⁸ The simplest question one can ask about capital structure is why a firm should have more than one kind of investor. We see equity holders and many different kinds of creditors. Why should this be? Why should there even be debt and equity? Is an investor who holds debt more likely to be repaid only because an equity holder is less likely? Merton Miller unraveled this mystery with Franco Modigliani.⁹ Modern securities markets can be traced to their insights. Option and derivative trading rest solidly on the idea of put-call parity and in turn on the Modigliani and Miller irrelevance propositions.¹⁰ Miller's work has led to trillions of dollars of economic activity. If he enjoyed even the smallest royalty from the use of his work in securities markets, he would be the richest man in the world.

The use of assumptions in economics is perhaps the aspect of the field that lawyers understand the least. Economists aim to capture as much of the dynamics of behavior as they can with the fewest possible assumptions. The question is not whether economists' assumptions are unrealistic, but whether they capture enough of what is at work to allow us to see basic forces operating in an otherwise impenetrable maze. The wonder of modern price

⁷ Coase's observations from his year in the United States gave rise to R.H. Coase, *The Nature of the Firm*, 4 *Economica* 386 (1937).

⁸ See, for example, Walter J. Blum, *The Law and Language of Corporate Reorganizations*, 17 *U Chi L Rev* 127 (1950); Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Harvard 1991).

⁹ See Franco Modigliani and Merton H. Miller, *The Cost of Capital, Corporation Finance, and the Theory of Investment*, 48 *Am Econ Rev* 261 (1958). For an overview of the Modigliani and Miller irrelevance propositions, see Merton H. Miller, *The Modigliani-Miller Propositions after Thirty Years*, 2 *J Econ Persp* 99 (Fall 1988).

¹⁰ The seminal work is Fischer Black and Myron Scholes, *The Pricing of Options and Corporate Liabilities*, 81 *J Pol Econ* 637 (1973). For an accessible discussion of the influence of Miller's work, see Peter L. Bernstein, *Capital Ideas: The Improbable Origins of Modern Wall Street* (Free Press 1992).

theory is how much can be derived from propositions that are so simple. For example, once one accepts that, as a general matter, demand decreases as price increases, much else follows. Graduate students sometimes reduce all of microeconomics to only four words—people maximize, markets clear.

Richard Posner's achievement was to use these same axioms to illuminate the forces at work in the Anglo-American legal system. He laid bare the architecture of the common law by showing how much of it could be derived from the axioms of economics. The claim was never that only these mattered, but rather that even by themselves they showed that the law had a logic and coherence that before we had only known intuitively. After *Economic Analysis of Law*, no one wrote about the common law the same way again.¹¹

Law and Economics is now well into its seventh decade. It has always renewed itself, has always remained at the cutting edge, and has always kept first principles squarely in mind. Its practitioners remain committed to physics rather than stamp collecting. It is in that spirit that Gary Becker, Ronald Coase, Merton Miller, and Richard Posner reflect on the future of Law and Economics, under the strong hand of Richard Epstein, himself a formidable practitioner of the discipline.¹²

The Roundtable Discussion

RICHARD EPSTEIN: On this kind of occasion, there always is a temptation to turn back to history. Quite by coincidence, the other day Stephen Stigler gave me a sheaf of papers which included correspondence between Friedrich von Hayek and Henry Simons. It contained a proposal for the creation of the Institute of Political Economy at the University of Chicago. In describing this program in a letter to Hayek, this is what our friend Henry Simons wrote:

A distinctive feature of Chicago economics as represented recently by Knight and Viner, is its traditional liberal political philosophy, its emphasis on the virtues of the dispersion of economic power, free markets, and a political decentralization, real federalism for large nations and for supernational

¹¹ This landmark book, first published in 1973, is now in its fourth edition. See Richard A. Posner, *Economic Analysis of Law* (Little, Brown 4th ed 1992).

¹² Among many other works, his foundational book on property remains required reading for everyone in the law. See Richard A. Epstein, *Takings: Private Property and the Power of Eminent Domain* (Harvard 1985).