Chapter 1

The Lessons of 30 Years of Law and Economics – and the Prospects for its Future[1,2]

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1.1. INTRODUCTION

In many areas of scholarly life, one's most productive years are one's younger years. Mathematicians, for example, are said to have produced their best work before they are 35. By contrast, a recent study has suggested that geologists do their best work later in their academic lives – sometime in their 50s. The most common explanation for these differences is that brilliance in young-blooming fields like mathematics arises from flashes of pure ratiocinative insight, to which, it is alleged, the young are more prone. By contrast, brilliance in later-blooming academic subjects like geology arises from making connections

[1] I want to thank Katarzyna Metelska-Szaniawska and Jaroslaw Beldowski in Warsaw and Anna Guzik in Krakow for their hospitality and for organizing my wife's and my marvelous trip to Poland. I want to congratulate Katarzyna and Jarek on the remarkable work they have done to further Law and Economics in Poland and in Europe. Bob Cooter and I also owe them a very, very deep thank you for their translation of our text into Polish.

[2] These remarks were originally presented as a speech at the 3rd Polish Law & Economics Conference at the University of Warsaw on April 20, 2012. I am grateful to the attendees for their very insightful questions, which helped significantly in clarifying some of the points I was trying to make in the original speech. I want also to thank the Poland Ministry of Justice and the Minister of Justice. The Minister gave me a warm welcome and sponsored an educational workshop on law and economics that was a marvelous educational experience for me and, I hope, for the law professors. I would also like to thank the United States Department of State, the U.S. Embassy in Warsaw, and the U.S. Consulate in Krakow for their financial and scheduling support for our trip.

among large stores of information, which stores are said to be generated by experience and decades of study[3].

Law professors may be more like geologists than mathematicians in that they require great stores of experience and study before producing their best work.

I bring up these points to try to suggest to you that like geologists and law professors, my age may allow me to talk meaningfully about the long-run achievements of Law and Economics: I have been at this for 35 years. I began my scholarly career in 1977 at about the same time as law and economics appeared. And I am one of several people – Bob Cooter, Charlie Goetz, Vic Goldberg, Dave Haddock, Steve Shavell, Mitch Polinsky, and others also fall into this category – who, although trained professionally as economists, have spent most of their scholarly lives in law schools.

As a result of my age and experience, I would like to take this occasion to talk about what I think the major lessons of Law and Economics have been since 1980. I will identify three major lessons that I discern as emerging from law and economics over the last 30 years. I will offer some brief commentary on each point and then conclude with speculation about where Law and Economics might go to in the next 30 years.

1.2. THREE LESSONS FROM THIRTY YEARS OF LAW AND ECONOMICS

The lessons upon which I want to focus here are not particular conclusions in particular substantive areas of the law. They are, rather, broad scholarly developments about the study of law. My contention is that these developments or lessons are the result of the importation of economic concepts and methodology into the study and practice of law. But, further, these developments or lessons for the study of law have been so extensive that I perceive that we are moving beyond the era of Law and Economics to one of law and behavioral and social sciences.

1.2.1. Lesson 1: Law as a Science

The first lesson that I draw from my observation of the first 30 years of Law and Economics is this:

Legal scholarship is moving toward a more scientific method of studying law.

A related and important sub-lesson is that the movement toward a more scientific method of studying law has occurred because of Law and Economics.

[3] There are, of course, other factors that might explain these differences in the average age of highest productivity in different academic fields. For example, in a field that is undergoing a revolution, one might expect, all other things equal, younger scholars to do relatively more productive work.

By the *scientific method* I mean simply an organized method for acquiring reliable and accurate information about a subject by a two-step process. The first step is the articulation of consistent, coherent, and testable hypotheses and theories about the phenomenon under study. To use an example from law and economics, one might hypothesize that society's valuable resources will be most efficiently used if decisions about how to assign and protect property entitlements are done according to economic principles – for example, by choosing according to the rule of maximizing the net difference between benefits and costs. The theory would have to establish what efficiency means here and give examples of what assignments and protections would conduce to the better discovery and use of resources, and so on. The theory might also demonstrate how it applies among different kinds of property – real property, chattels, and intellectual property.

The second step in the scientific method is the confrontation of each hypothesis with data and analysis of those data that are well-designed to test the credibility of the hypothesis[4]. This is a potentially complicated process that requires careful attention to procedures, details, and some prevailing norms of scholarly investigation. I shall have much more to say on this matter below.

For a field that is moving from non-scientific to scientific methods of investigation, there are frequently significant impediments to the move that occur within this second step. For example, if the scientific method is new to this field, then there may well be no data with which to engage in hypothesis-testing. So, in addition to the burden of equipping oneself with the skills to do that testing, a scholar may also bear the additional burden of developing data. This burden can range from the relatively light – as would be the case, for instance, if there are publicly available archives or data sets – to the relatively heavy (including costly) – as would be the case if one had to gather the data over a number of years or across wide geographically dispersed jurisdictions or develop and administer laboratory, field, or on-line experiments. And once the data has been collected, it must be organized, checked for accuracy, analyzed so as to bring out aspects of central tendency and variability, and then further analyzed to find patterns, correlations, and (one hopes) causal explanations among the variables[5].

When Law and Economics began around 1980, its most significant scholarly innovation was the application of rational choice theory – the default theory of economic decision-making – to decision-making in the legal context. Legal decision-makers (in an analogy to economic decision makers) had stable, well-ordered preferences and allocated their resources (time, mental effort, and income and wealth) so as to maximize their utility.

[4] For an introduction, see Lawless, Robbennolt and Ulen (2011). See also Eisenberg (2011).

[5] I am a fan of quantitative data and their analysis. But I also recognize that qualitative empirical work can also be extremely informative. I do not mean to denigrate it by focusing on quantitative empirical analysis. Indeed, when quantitative data are not available – as often happens in the early stages of the scientification of an academic discipline, qualitative studies may be the only form of empirical work.

Law's role was to identify situations in which individual utility maximization and social well-being were at odds and to construct law so as to harmonize individual decision making and social desires. Early Law and Economics showed how the famous description of microeconomics – 'People respond to incentives' – applied to a wide variety of legal matters.

Consider a familiar example: In taking precautionary decisions, individuals have a keen regard for their own well-being. Presumably, they will take precaution that confers a benefit on them that is greater than the cost of the precaution. This is true, according to both common sense and to rational choice theory, regardless of the law's various obligations. But in most cases rational decision makers may consider *only* their own well-being in taking care. That is, they might not take into account the effects that their precautionary decisions may have on other parties, such as strangers.

There is no way in which potential injurers and their victims can identify one another *ex ante* an accident and bargain about their respective responsibilities. As a result, no one has much of an incentive to take precaution whose effect is to confer a benefit on someone else.

This state of affairs is likely to be socially inefficient because it may not minimize the social costs of accidents. If people took into account not only their own well-being but also that of those whom they might injure by failing to take reasonable care, then there would be an 'efficient' number and severity of accidents. That is, all accidents that could be avoided by taking cost-justified precaution would not take place[6]. But if there are no incentives to take care that confers a benefit on others, then there may be too many accidents; they may be too severe; and people may avoid risky activities.

Early law and economics – in what is still one of its most powerful reshapings of a traditional area of law – showed that tort law was a solution to this mismatch between individual and social desires. Simply put, Law and Economics showed that by making injurers liable for victims' accident losses, tort law created an incentive for individuals to alter their precautionary decisions so as to take account of other people's well-being, not just their own.

These tools from microeconomic theory were used to erect a complete account of all areas of law – property, contract, torts, litigation and settlement, and the many areas of public law, such as criminal law, legal procedure, corporations, antitrust, environmental law, administrative law, and more.

But those were the early days of Law and Economics. More recently, one of the most discernible trends in law-and-economics scholarship has been a move *away* from the application of microeconomic theory to legal analysis – even though the scientific method still holds. I do not mean to suggest that there has been a retreat away from Law and Economics and back toward a more doctrine-based, less scientific view of law.

To attempt to be clear, let me start with a bit of history. Having been present from the early days of Law and Economics, I am acutely aware of the

[6] 'Cost-justified precaution' is precaution that, in dollar terms, costs less than the expected benefit (the probability of an accident's occurring times the accident losses avoided).

fact that law and economics has not been received with open arms in the legal academy. Indeed, at many law schools there is still (as at my old employer, the University of Illinois College of Law) strong hostility to hiring any faculty in the area of law and economics.

What accounts for this hostility? Is it simply the well-known resistance to something new? It was this resistance, even in academia, that prompted the great German physicist Max Planck to note that "[s]cience advances funeral by funeral." Or is it a belief that law and economics is tied to a political philosophy that appeals only to some people and not to others? Or are there yet other factors that explain the hostility toward law and economics?

For what it is worth, I believe that the slow progress of law and economics within the legal academy is due to a combination of two factors – the general resistance to new paradigms and the perception (ludicrously mistaken, I believe) that the methodology of economics is by necessity conservative or what you in Europe might call "neoliberal."

These are powerful forces, even if they are mistaken, but I do not think that they are a cause for despair about the ultimate success of law and economics (and other scholarly innovations). First, I have a very strong faith – one supported, I believe, by facts – that the modern higher-education academy ultimately makes the right decisions about scholarly innovations. It is difficult to think of areas of scholarship that have been discredited – say, alchemy and astrology – that still have a position in the modern university. Eventually, scholarly innovations that work are kept and built upon, and those that do not work or are not helpful are discarded.

Second, there is only a limited amount that one can do to persuade people to pay attention to an innovation. Academics, like most people, have a disposition to cling to the views that they learned early in their education or from their parents and mentors. They tend to give greater weight to evidence that confirms their dispositions and prior beliefs and to discount evidence that disputes or calls into question their prior beliefs[7]. One might think that these tendencies would be less among academics, who are, after all, surrounded by bright people who are making interesting and belief-shaking discoveries all the time and who are presumably driven by reason. Alas, I have found that my fellow academics are just as reluctant to give up their prior beliefs as are non-academics.

I have worried about these issues for a long time and, in an effort to correct them, have tried my best to find a means of overcoming the objections that many of my colleagues and extramural audiences have had to Law and

[7] I have had occasion, since August, 2011, to try to talk to good friends who are not economists about the U.S. national debt and the federal budget deficit. The almost-universal view is that the debt is dangerously high, a "significant burden on our children and grandchildren," a "threat to the financial well-being of the nation," and the like. My belief is that most professional economists do not believe those things to be true. I have done my part to try to change views by sharing this economic analysis, but so far I have not succeeded in having one of my interlocutors say, "Wow! That's interesting. I see what you're saying. I'll change my views and quit worrying so much about the national debt and the budget deficit."

Economics. I offered to send, at my expense, any faculty member to the annual meetings of the American Law and Economics Association (which, incidentally, had its inaugural meeting at the University of Illinois College of Law). I had no acceptances. I have organized reading groups with my law faculty colleagues of important new articles in Law and Economics or important new books. I have organized semester-long workshops in which eight to ten of the most prominent scholars in Law and Economics come to Illinois to present work-in-progress. Those have been a mixed success. Most faculty are very busy with their own research and teaching: Trying to find some extra time to read articles or books or to attend a workshop is not easy, even if my faculty colleagues were eager to learn Law and Economics.

One area of combatting the hostility to Law and Economics in which I believe that I have seen some success has to do with teaching law and economics to extramural audiences. These are typically practitioners, government officials, judges, and others who have time for only a relatively short introduction to the topic – usually an hour or, at the most, a morning or an afternoon set of lectures. (By contrast, law students take a semester-long course lasting 14 or more weeks and have 40–45 hours of class during which to come to terms with law and economics.) With those external groups, I have tried to find a better way of conveying the gist of Law and Economics. In the past, I believe that I made the mistake of telling them – perhaps implicitly – that to understand Law and Economics fully they would have to devote a lot of time and effort to the study, that they would have to forget or displace from their working memory the doctrinal knowledge of law with which they were comfortable, and that Law and Economics would involve a new way of thinking. In looking back on that method of teaching, I am afraid that I sounded like a religious fanatic trying to convert a skeptical audience to a new form of worship. "Repent of your academic sins, and cleanse yourself in the healing waters of Law and Economics!"

This message, although I did not mean to sound apocalyptic, did not strike the right tone. Recently, I believe that I have discovered a better way to teach Law and Economics to these external audiences. A few years ago I was asked to give several hours of lectures on Law and Economics to appellate court justices in Illinois. I knew many of these justices from committees on which we had served together. And I knew from talking to them about Law and Economics that they had gone to judicial conferences to learn some Law and Economics and had been off-put by the religious fervor of their instructors at those conferences.

So, when I taught the appellate court justices in Illinois, I tried something very different. I avoided talking about Law and Economics as being closely tied to the field of economics. Nor did I seek to persuade them that Law and Economics is a complete philosophy to which they should subscribe. Rather, I told them something far less imposing and intimidating: *Law and Economics is a set of useful tools for analyzing the law.* For example, I told them that they should learn three tools: transaction costs, cost-benefit analysis, and the

elements of game theory. And I showed them how those tools might be useful in looking at a wide variety of legal topics.

Once we had discussed these tools (without any technicalities), I also told them about some broad new developments in Law and Economics (like behavioral law and empirical legal students, both of which I discuss below). The Illinois appellate court judges decided that if this is what Law and Economics is about, then it might be useful.

With that background, let me now return to the point I made above – namely, that I perceive a trend in Law and Economics of moving away from microeconomic theory. There are two important elements of this point.

First, I think that much modern law-and-economics scholarship is finding behavioral and psychological theories of human decision making more helpful in legal analysis than strictly microeconomic or rational-choice theories (RCT). Why is this the case? For two reasons, I think. One is that RCT has been helpful in some but not most analyses of legal rules and institutions. RCT has been found to be unhelpful in talking about some strictly economic decisions, and so it should not be surprising that it has been found to be unhelpful with respect to legal decision-making. Note that I am not saying that there is no more theorizing per se; just that the theorizing that is going on is removed from the strictly microeconomic theorizing that characterized the early days of Law and Economics. This move away from RCT has put a distance between Law and Economics and microeconomic theory.

Second, I think that one can observe among law students something that I would call "theory fatigue." Law students are bombarded with theories – mostly jurisprudential theories – as part of their introduction to the study of law. So, in its early days, when Law and Economics stressed its connections to microeconomic theory, many consumers thought of Law and Economics as *just another theory* – one among many that come and go with regularity in the legal academy.

And to many potential adopters (both faculty and students), it is difficult to choose among the many theories on offer in the legal academy. Certainly, some are more coherent or more elegant than others. But there is a surprising number of equally elegant theories: in addition to economic theories of crime and punishment, think of utilitarian and deontological theories and sociological theories, for example. And how is one to choose among them?

So, law students and law faculty may have grown tired of having more and more theories thrown at them. They want something else.

1.2.2. Lesson 2: Behavioral Law and Economics

The second lesson that I identify from the last 30 years is this:

Behavioral (or psychological) theories of decision-making are becoming increasingly important in legal analysis.

I noted earlier that Law and Economics derived much of its early power from its application of rational choice theory to legal decision-making. In the 1980s when I first began speaking of Law and Economics to law faculties,

I very often was asked, "Who are these rational people you're talking about?" I deflected the question by saying that this was the standard microeconomic theory of human decision-making with respect to economic matters and that, till we had evidence to suggest that it was an inappropriate assumption, we economists would continue to believe that people made choices rationally.

Beginning in the 1970s, Daniel Kahneman and Amos Tversky began to do careful experiments designed to find out the extent to which the predictions of rational choice theory were borne out in real behavior. And what they found is that RCT does not do a very good job of predicting human behavior.

How so? People are overoptimistic about their own circumstances (everyone is an above-average student); criminals do not think that objective statistics on criminal arrest and conviction apply to them. People do not ignore fixed costs (as economists believe that rational people do); they are, in fact, partially governed by fixed costs. Some people join fitness clubs for a year rather than pay on a visit-by-visit basis because they believe that having made a commitment for a year, they will be more likely to work out more frequently; otherwise, their money is wasted, as, in fact, it usually is. People do not understand how to assess and manipulate probabilities; consider what my spinning class instructor told my class several weeks ago: "If you know any men over the age of 50, urge them to take a yoga class because men who take yoga are less likely to get cancer." People may not make rational decisions about risky activities or take proper account of the future in their current decisions; they may not wear seat belts when they should; they may smoke cigarettes, eat the wrong foods, become obese, and fail to exercise regularly, ignoring or underweighting the later health costs of all these activities. In these and a host of other ways, we behave in predictable ways that do not conduce to our long-term well-being.

This conclusion has a profound impact on how we study law. Law, if it is to guide our behavior to be more socially beneficial, must take us as we are – flawed calculators of our own well-being, not as perfect calculators who are led astray, if at all, only by fraud, external costs and benefits, and other structural imperfections in the environment in which we live.

Let me give you an example of what I mean. Recent psychological literature on happiness suggests that there are two aspects of our experiencing of the world that might have legal implications. First, we human beings adapt to changes relatively quickly. And there are two aspects of this adaptation that are worth noting. We do not anticipate this adaptation accurately[8]. In fact, our typical assumptions are that we will not adapt very well to bad things and that we will enjoy good things much more than will, in fact, be the case. So, for example, if we contemplate what life would be like if we could no longer see, we imagine that our lives would be much less happy. It turns out that if this awful thing should come to pass, we would adapt so that the decline in our

[8] Making predictions about how events in the future will impact our well-being is known as "affective forecasting." The gist of the psychological literature on that topic is that we do not do a very good job of affective forecasting. See Gilbert (2006).

well-being would not be so great, if perceptible at all. Similarly, if we imagine that winning several million dollars in the state lottery would make us happy, we are almost certainly wrong. We would not be better off[9]. Good things may temporarily improve our well-being and bad things depress it, but typically and with only a few, identifiable exceptions, we return to our pre-change level of subjective well-being within a year of the change's occurring[10].

Second, in remembering things that have happened to us, we tend to ignore how long those things lasted, a phenomenon known as "duration neglect." In addition, when we summarize experiences, we put particular emphasis on the peak (or trough) of the experience and on what happened at the end. So, to use an example from Daniel Kahneman, suppose that you have taken a vacation during the winter to a warm, sunny Caribbean island. You stay at a delightful resort at which the beaches are lovely, the waters are warm, the food is spectacularly good, the staff is cheerful and helpful, and the other guests are interesting, friendly, and enjoying themselves as much as you are. You spend some time shopping in town and buy presents for friends and family at home. On your flight home, however, the airline loses your luggage containing all the presents.

What is your memory of that vacation? Kahneman's research suggests that we summarize the experience not by remembering what happened moment by moment, adding up all the good things and subtracting the bad things. Rather, we ignore whether we were on the island one week or two weeks and give disproportionate weight to what happened at the end and not enough weight to all the wonderful days before that. So, we might say that the vacation was merely OK.

Think about the implications of these two points for our analysis of the deterrent effect of criminal sanctions. We have predicted – for at least 40 years – that more certain and longer punishments will deter criminals from committing crime. And it may be true that those of us who have never been to prison believe that imprisonment would be awful and are, therefore, deterred from committing crime.

But those who have committed crime and have been sent to prison may not be deterred in the future.

Criminals may adapt to imprisonment. And indeed, that appears to be the case. Within six months of being imprisoned, most criminals believe that they are back at the level of well-being that they had before they went to prison. As a result, criminals may report to their friends, neighbors, and family that being in prison "is not so bad." And that may dilute the deterrent effect on the criminals and their families and friends.

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[9] See McNay (2008, 2012).

[10] One way of putting this is to suggest that we have a "set point" of happiness. Events may push us away from that set point (just as open doors and windows can temporarily displace the temperature away from the temperature at which we have set our home thermostats) but we will return to that set point in time (just as the ambient temperature in a house or room will return to the temperature set on the thermostat). It is difficult to change one's set point, but it can be done.

Duration neglect suggests that in remembering their imprisonment, criminals might not distinguish between a short and a long term in prison. Rather, they remember the experience by weighing the best or worst that happened and what happened at the end. These things imply that the duration of imprisonment may not deter criminals in the future. Moreover, these considerations suggest that the most lasting method of getting deterrence is to treat criminals hideously on the last day of incarceration.

While I am aware that behavioral conclusions do not yet amount to a coherent picture of human behavior, they do suggest that it would be rash to take rational choice theory as a guide to human decision-making.

1.2.3. Lesson 3: Empirical Legal Studies

The third lesson that I identify is this:

Empirical work is becoming increasingly important in legal analysis.

One reason for the rise of empirical studies is Lesson 1 from above – the rise of the scientific method in the study of law. Recall that the second step in the application of that method is to gather data and subject hypotheses to evaluation. Are there other reasons? Has data become more available and accessible? Are younger scholars bringing a set of empirical skills to the legal academy that an older generation did not have?[11]

While I believe that these factors may have had some impact, I think that there are other factors that are just as important in explaining the rise of empirical legal studies. First, law is ultimately a very practical discipline. It is more deeply concerned with making society work than with elegant theory. So, there is among even the most jurisprudentially minded legal scholars – and certainly among nearly all practitioners, lawmakers, judges, and others – a profound interest in seeing to it that the law works to achieve our collective goals. And with that interest comes an incipient and not-very-deeply-buried interest in knowing whether law is succeeding in achieving its goals. And if it is not working, in reforming law. That information can only come from careful empirical work.

I have already noted that within the legal academy there is an increasing impatience with purely theoretical argumentation on legal matters. Is strict liability or negligence better? Does the death penalty deter? These are vital issues in the law and in social governance, but they are also issues that simply cannot be answered by theoretical argumentation. And even if there was a compelling theoretical argument in favor of one particular view (as some claim that there is with regard to the deterrent effect of the death penalty), anyone committed to the scientific method would certainly want to see the empirical evidence. I sense that in addition to the increasing impatience with mere theoretical

[11] It is worth noting that the importance of empirical work – or statistical analysis – is a general phenomenon in the U.S. today, not just a legal phenomenon. See, for example, Bialik (2013) (explaining that the rise of business analytics and the widespread collection and publication of lots of data ("big data") have led to a vigorous job market for statisticians and, as a result, a remarkable increase in the number of college students who are majoring in statistics).