

# Law and Economism

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## Abstract

Classical law and economics was the most important movement in legal scholarship in the past half century, producing innovative new approaches to many subjects such as antitrust, torts, and contracts. It also had tremendous influence outside the academy by reshaping the way many judges interpreted the law. As a historical phenomenon, law and economics was part of the larger story of economism—the belief that simplistic economic models accurately describe reality and should serve as the basis for policy. Law and economics, like economism in general, was cultivated and propagated by conservative foundations and think tanks. It paid off by providing a conceptual vocabulary that judges could use to advance various conservative causes, such as limiting plaintiffs’ rights and rolling back government regulations.

## I. Introduction

“Law and economics” was the most important movement in legal thinking in the United States in the past half century. As early as 1986, it was hailed by prominent law professor Bruce Ackerman as “the most important thing in legal education since the birth of Harvard Law School.”<sup>1</sup> Its founding generation included towering figures such as Guido Calabresi, who reconceived tort law in terms of achieving an efficient level of accident prevention; Robert Bork, who redefined antitrust law as the maximization of consumer welfare; and Richard Posner, who showed how the common law embodied principles of economic efficiency. When I entered the famously liberal Yale Law School in 2008, my torts and contracts professors both explained that they were teaching us from a law and economics perspective because it was the dominant approach to those fields; my business organizations professor began his course with a lecture on economist Ronald Coase’s theory of the firm.

Although there are many flavors of economics present in legal academia today, this article focuses on classical or “first generation” law and economics: the analysis of legal questions using a few simple but powerful tools drawn from any first-year microeconomics course. One such tool is the assumption that people behave rationally in response to incentives. Another is the competitive market model, according to which price signals coordinate the behavior of individuals and firms, leading to an optimal outcome in which markets clear and resources are allocated to their most valuable uses.

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<sup>1</sup> Quoted in Paul M. Barrett, *Influential Ideas: A Movement Called “Law and Economics” Sways Legal Circles*, *Wall St. J.*, Aug. 4, 1986, at 1.

Classical law and economics scholars applied these basic concepts, along with a healthy dose of logical reasoning (but little empirical testing), to virtually every area of the law, a practice epitomized by Posner in his encyclopedia *Economic Analysis of Law*, first published in 1973.

The power of this type of thinking lies in its ability to generate new insights about the law—and, on that basis, to suggest how the law should be interpreted or changed. To take an example from tort law: we know that defendants are liable for negligent behavior, which is traditionally defined (more or less) as a failure to take the care that a reasonable person would take under the circumstances. From the standpoint of overall economic welfare, we do not want companies to take safety precautions whose costs exceed their expected benefits; in that case we would be overproducing safety, leading to an inefficient resource allocation. Therefore, the normative implication is that it would be optimal to define negligence as the failure to take safety precautions whose costs do not exceed their expected benefits. Since companies are presumed to respond rationally to the incentives created by the legal system, this would result in the production of the optimal amount of safety. (As an important practical matter, it would also protect businesses from the potential for juries to hold them liable for accidents without taking the cost of prevention into account.) Given the power of judges to shape the common law, it is only a small step from such a normative implication to the positive conclusion that the law must already observe the dictates of economic rationality—a step that Judge Learned Hand famously took, in the case of negligence, in *United States v. Carroll Towing Co.*<sup>2</sup> (Since, according to one belief, the common law tends to perfection, it necessarily must already encode the indubitable laws of economic reasoning.) The same can be true of laws that are ostensibly based on statutes. In antitrust law, for example, the distrust of large, powerful businesses that originally motivated the Sherman Act of 1890 and the Clayton Act of 1914 has been washed away by a single-minded concern for economic efficiency, expressed primarily in terms of the prices charged to consumers.

Because of its tremendous influence both inside and outside law schools, there is a voluminous literature on classical law and economics. Much of that literature is critical of the movement, in particular for its reliance on questionable assumptions about how people, companies, and markets behave. In an intellectual sense, the legal academy has largely moved beyond the first generation of law and economics scholarship, although it still casts its shadow over how many classes are taught. Today, top law schools are full of professors with Ph.D.s in economics,<sup>3</sup> but their work is usually similar to that done by

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<sup>2</sup> 159 F.2d 169 (2d Cir. 1947). In another well-known example, Judge Posner concluded that shipping hazardous chemicals by rail is not abnormally dangerous (and therefore subject to strict liability) because, in part, it would be prohibitively expensive to route such shipments around populated areas—and, therefore, that not holding the shipper liable would give people the proper economic incentive not to live near rail yards. *Indiana Harbor Belt R.R. Co. v. Am. Cyanamid Co.*, 916 F.2d 1174, 1181 (7th Cir. 1990).

<sup>3</sup> Economics is by far the most common Ph.D. held by professors at top U.S. law schools. Lynn M. LoPucki, *Dawn of the Discipline-Based Law Faculty*, 65 *J. Legal Educ.* 506, 538 (2016).

economics professors—developing sophisticated new models and testing them using empirical data.

The purpose of this article is not to further analyze the substance of classical law and economics, but to assess its place in recent American history and in the development of the contemporary political landscape. The question I address is why classical law and economics became so influential precisely when it did. The success of an intellectual movement generally depends not solely on its intrinsic merits, but also on the role it can play for important interest groups in society. To take one obvious example, communism flourished in late-nineteenth-century Europe because it paralleled the emergence of the manufacturing working class, for which it provided a unifying ideology. Similarly, classical law and economics succeeded not simply because of its intellectual power, but also because of the role it played in a larger story: the conservative counter-revolution that challenged and eventually overthrew the New Deal consensus. After the Great Depression and World War II, both major parties agreed on the need for a large government that would actively manage the economy and ensure basic necessities for the vast majority of Americans. Virtually shut out of the traditional corridors of power, the business executives and other wealthy individuals who led the conservative resistance recognized that their long-term viability required an alternative narrative about the relationship between individuals, the economy, and the state. Only by making long-term investments in a new vision of society could they lay the groundwork for an eventual return to power. A central element of that vision was what I have called *economism*: a worldview that interprets society through the narrow lens of simplistic economic models, leading to the reflexive conclusion that unregulated markets are the best way to solve all of society's problems.<sup>4</sup> The story of classical law and economics is but one chapter of the story of economism.

## II. Economism

Economism, at its core, is the naive or disingenuous belief that a few concepts from an introductory economics course accurately describe the real world. As students learn in first-year courses around the world, competitive markets (under certain assumptions) can produce optimal outcomes (defined in a certain way) for society. In such a market, price signals ensure that goods are produced as cheaply as possible and are allocated to the

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<sup>4</sup> James Kwak, *Economism: Bad Economics and the Rise of Inequality* 6-7 (2017). “Economism” is a somewhat obscure term, generally used to criticize someone for overvaluing economics—by overestimating the importance of material conditions, focusing exclusively on economic metrics, applying economic methodologies when they are inappropriate, or accepting economic theory too readily. See, e.g., G. Warren Nutter, *On Economism*, 22 *J. Law & Econ.* 263 (1979); John Braithwaite, *The Limits of Economism in Controlling Harmful Corporate Conduct*, 16 *Law & Soc’y Rev.* 481 (1981); Richard K. Ashley, *Three Modes of Economism*, 27 *Int’l Stud. Q.* 463 (1983); Teivo Teivainen, *Enter Economism, Exit Politics: Experts, Economic Policy, and the Damage to Democracy* 1-5 (2002); Des Gasper, *The Ethics of Development: From Economism to Human Development* 80-81 (2004); Howard Brody, *The Golden Calf: Economism and American Policy* (2011). I use “economism” in a more specific sense, as the belief that a few isolated introductory economics lessons accurately describe the real world.

individuals and firms willing to pay the most for them, maximizing social welfare (defined in a specific way). On the level of the economy as a whole, competitive markets ultimately ensure that all resources—including financial, physical, and human capital—are dedicated to their most valuable purposes, maximizing overall production. (Distributional questions are typically either assumed away or left for a later chapter.)

In economics, the model of competitive markets driven by supply and demand is a useful analytical tool; in economism, it becomes a complete representation of reality and the sole blueprint for public policy. For example, every first-year student learns that a minimum wage is simply a price floor in the labor market and, like any such distortion, necessarily creates a shortage. In this case, the shortage is called unemployment, and so raising the minimum wage will only cause more low-skilled workers to lose their jobs. Among professional economists who study the topic, however, it's not at all clear that a modestly higher minimum wage actually increases unemployment;<sup>5</sup> there are numerous more complex models that show why companies might not respond by shrinking their workforces, and empirical studies of the question are deeply divided.<sup>6</sup> In this case, the simple lesson of the competitive market model turns out to be misleading in the real world. In the media and political debate, however, the idea that a minimum wage necessarily increases unemployment and harms poor people has taken on a life of its own. Not only is it simple, elegant, and compelling, it is above all *useful*, particularly to the industries that rely on cheap labor—and that fund the current PR campaign against raising the minimum wage.<sup>7</sup> The Republican Party has fully embraced this argument, insisting that it is simply obeying basic laws of economics.<sup>8</sup> As Senator Rand Paul said during his presidential campaign, “This is an economic argument. This is something that should be done in a rational way, not an emotional way.”<sup>9</sup> For a politician, this kind of

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<sup>5</sup> In one panel of economists, 34% thought a modestly higher minimum wage would make it harder for low-skilled workers to find jobs, while 32% did not (the rest were undecided or had no opinion). IGM Forum, Minimum Wage, University of Chicago Booth School of Business, Feb. 26, 2013 (<http://www.igmchicago.org/surveys/minimum-wage>). The same panel was also divided over whether an increase in the minimum wage to \$15 would increase unemployment: 26% thought it would and 24% thought it would not. IGM Forum, \$15 Minimum Wage, University of Chicago Booth School of Business, Sept. 22, 2015 (<http://www.igmchicago.org/surveys/15-minimum-wage>).

<sup>6</sup> See David Neumark & William Wascher, Minimum Wages and Employment: A Review of Evidence from the New Minimum Wage Research 121 (Nat'l Bureau of Econ. Research, Working Paper No. 12663, 2006); Hristos Doucouliagos & T.D. Stanley, Publication Selection Bias in Minimum-Wage Research? A Meta-Regression Analysis, 47 *Brit. J. Indus. Rel.* 406 (2009); Dale Belman & Paul J. Wolfson, What Does the Minimum Wage Do? 147-82 (2014); Arindrajit Dube, T. William Lester & Michael Reich, Minimum Wage Effects Across State Borders: Estimates Using Contiguous Counties, 92 *Rev. Econ. & Stat.* 945, 961 (2010); David Neumark, J.M. Ian Salas & William Wascher, Revisiting the Minimum Wage-Employment Debate: Throwing out the Baby with the Bathwater?, 67 *ILR Rev.* 608 (Supp. 2014).

<sup>7</sup> Eric Lipton, Fight Over Wage Illustrates Web of Industry Ties, *N.Y. Times*, Feb. 10, 2014, at A1.

<sup>8</sup> Kwak, *supra* note 4, at 73.

<sup>9</sup> Transcript: Freedom Partners Forum: Ted Cruz, Rand Paul and Marco Rubio in Conversation with ABC's Jonathan Karl, ABC News, Jan. 26, 2015 (<http://abcnews.go.com/Politics/transcript-freedom-partners->

rhetoric sounds better than saying that you are carrying water for the businesses and business owners supporting your campaign—which is a central function of any successful ideology.

Although the basic theory of competitive markets had been codified by the late nineteenth century, economism as a social phenomenon only developed in the decades following World War II. After the Great Depression and the war, the competitive market model was viewed more as a useful analytical starting point than as a blueprint for social organization. The original 1948 edition of Paul Samuelson’s introductory textbook, which dominated the field for decades, focused instead on macroeconomic questions—avoiding depressions and ensuring full employment—and buried supply and demand curves, the price mechanism, and producer and consumer surplus more than four hundred pages in.<sup>10</sup>

At the time, however, a handful of leading economists, including Friedrich Hayek and Milton Friedman in particular, saw in the theory of competitive markets the kernel of a political program that could challenge the postwar consensus around an activist government and a robust social safety net. Both men believed that ideas were crucial to long-term political change. In his 1949 essay “The Intellectuals and Socialism,” Hayek wrote, “What to the contemporary observer appears as the battle of conflicting interests has indeed often been decided long before in a clash of ideas confined to narrow circles.”<sup>11</sup> The outcome of this clash, he believed, would be determined by what he called “secondhand dealers in ideas”: “They are the organs which modern society has developed for spreading knowledge and ideas and it is their convictions and opinions which operate as the sieve through which all new conceptions must pass before they can reach the masses.”<sup>12</sup> In the early 1950s, when liberal conceptions of society seemed at their most dominant, Friedman wrote, “The stage is set for the growth of a new current of opinion to replace the old, to provide the philosophy that will guide the legislators of the next generation.”<sup>13</sup>

That new current of opinion would be largely based on introductory economic principles. In relatively popular books such as Hayek’s 1944 bestseller *The Road to Serfdom* and Friedman’s 1960 *Capitalism and Freedom*, they explained how free markets were not only the best way to organize production, but also a necessary rampart against what they saw as the encroaching threat of socialism and communism. Friedman in particular was adept at using simple economic models to show that virtually any form of government interference—public schools, a minimum wage, professional licensing, and so on—is

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[forum-ted-cruz-rand-paul/story?id=28491534](https://www.washingtonpost.com/forum-ted-cruz-rand-paul/story?id=28491534)).

<sup>10</sup> Paul A. Samuelson, *Economics: An Introductory Analysis* 3 (1948).

<sup>11</sup> F.A. Hayek, *The Intellectuals and Socialism*, 16 *U. Chi. L. Rev.* 417, 418 (1949).

<sup>12</sup> *Id.* at 418, 421.

<sup>13</sup> Daniel Stedman Jones, *Masters of the Universe: Hayek, Friedman, and the Birth of Neoliberal Politics* 153 (2012).

likely to backfire and harm even those people whom it is supposed to help.

Although both Hayek and Friedman had the gift of communicating with mass audiences, their influence was vastly magnified by precisely those “secondhand dealers in ideas” that Hayek acknowledged. A loose network of foundations and think tanks, controlled by a relatively small group of current and former businessmen but also funded by major corporations, adopted, industrialized, and weaponized the free market critique of New Deal liberalism. The pioneering think tanks were the Foundation for Economic Education, which funded and distributed publications arguing that economic affairs should be left to the market, and the American Enterprise Institute (AEI), which mass-produced policy proposals and analyses for legislators, bridging the gap between ideological principles and the halls of power. They were followed after 1970 by a flood of newer, more militant think tanks including the Heritage Foundation, the Cato Institute, and the Manhattan Institute.

Collectively, these organizations served several important purposes in the conservative movement. First, they sponsored the development of new ideas. For example, Charles Murray’s *Losing Ground* was written while the author was a fellow at the Manhattan Institute;<sup>14</sup> the book helped propel the anti-welfare movement that culminated in President Bill Clinton’s welfare reform in 1996. The think tanks also supported public relations and marketing campaigns to promote those ideas to broader audiences. They built relationships with state and federal legislators, helping translate ideas into policy. And they provided a home for conservative intellectuals and politicians when out of office.

Several conservative think tanks enjoyed considerable support from major U.S. corporations. The Foundation for Economic Education received money from companies including Consolidated Edison, U.S. Steel, General Motors, and Chrysler, and from executives at DuPont, B.F. Goodrich, Republic Oil, and General Motors.<sup>15</sup> By the late 1950s, more than half of the country’s largest industrial corporations were donors to the American Enterprise Institute.<sup>16</sup> They also depended, however, on funding from conservative foundations established by wealthy businessmen. The William Volker Fund, an early pioneer, financed Hayek’s position at the University of Chicago;<sup>17</sup> supported a “Free Market Study” research project at Chicago, which helped establish the university as the intellectual center of the movement;<sup>18</sup> and organized conferences of sympathetic

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<sup>14</sup> Michael Barone, *Losing Ground*, in *Turning Intellect into Influence: The Manhattan Institute at 25*, 50 (Brian C. Anderson ed., 2004).

<sup>15</sup> Kim Phillips-Fein, *Invisible Hands: The Making of the Conservative Movement from the New Deal to Reagan* 54 (2009); Stedman Jones, *supra* note 13, at 155.

<sup>16</sup> Phillips-Fein, *supra* note 15, at 65.

<sup>17</sup> *Id.* at 42.

<sup>18</sup> Bruce Caldwell, *The Chicago School, Hayek, and Neoliberalism*, in *Building Chicago Economics: New Perspectives on the History of America’s Most Powerful Economics Program* 303 (Robert Van Horn et al. eds., 2011); Rob Van Horn & Philip Mirowski, *The Rise of the Chicago School of Economics and the Birth of Neoliberalism*, in *The Road from Mont Pèlerin: The Making of the Neoliberal Thought Collective* 139

academics, at which Friedman gave the lectures that became *Capitalism and Freedom*.<sup>19</sup>

The Volker Fund was followed by several major foundations that also saw the importance of ideas in the campaign against postwar American liberalism. For their grantors and executives, free market economic principles—as distilled by Hayek and Friedman from the introductory curriculum—were an invaluable weapon. As billionaire and political entrepreneur Charles Koch said in 1974, “Any program adopted should be highly leveraged so that we reach those whose influence on others produces a multiplier effect. That is why educational programs are superior to political action, and support of talented free-market scholars is preferable to mass advertising.”<sup>20</sup> Charles Koch and his brother David have become the best-known financiers of conservative political causes, but in the 1970s and 1980s several other families made equally important investments in the conservative idea infrastructure. Joseph Coors (of the beer company) put up the money to start the Heritage Foundation.<sup>21</sup> English businessman Antony Fisher, who had earlier founded the Institute of Economic Affairs in the United Kingdom, provided initial funding for the Manhattan Institute as well as an international network of think tanks.<sup>22</sup> Richard Mellon Scaife, an heir of the Mellon, Alcoa, and Gulf Oil fortune, gained control of the Sarah Scaife Foundation, which then donated more than \$600 million (adjusted for inflation) to conservative causes; the foundation was at various times the leading donor to AEI, Heritage, and Manhattan.<sup>23</sup> The Lynde and Harry Bradley Foundation was an initial supporter of William F. Buckley’s *National Review* in 1955;<sup>24</sup> after a corporate merger vastly increased its assets in the 1980s, it contributed more than \$280 million, with a majority going to fund conservative intellectuals.<sup>25</sup> The explicit goal, according to foundation head Michael Joyce, was “to use philanthropy to support a war of ideas.”<sup>26</sup>

These investments in ideas, and in the infrastructure to distribute them, fueled the growth and spread of economism. The simplistic arguments of economism have played a crucial role in many areas of public policy: weakening labor unions, cutting taxes, deregulating the financial system, shifting toward higher copayments and deductibles in

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(Philip Mirowski & Dieter Plehwe eds., 2009).

<sup>19</sup> Milton Friedman, *Capitalism and Freedom* xv (40th anniversary ed. 2002).

<sup>20</sup> Quoted in Jacob S. Hacker & Paul Pierson, *American Amnesia: How the War on Government Led Us to Forget What Made America Prosper* 232 (2016).

<sup>21</sup> Lee Edwards, *The Power of Ideas: The Heritage Foundation at 25 Years* 7-9 (1997).

<sup>22</sup> Brian Doherty, *Radicals for Capitalism: A Freewheeling History of the Modern American Libertarian Movement* 454, 478 (2007); Nicole Hoplin & Ron Robinson, *Funding Fathers: The Unsung Heroes of the Conservative Movement* 156 (2008).

<sup>23</sup> Jane Mayer, *Dark Money: The Hidden History of the Billionaires Behind the Rise of the Radical Right* 77, 80 (2016).

<sup>24</sup> John Micklethwait & Adrian Wooldridge, *The Right Nation: Conservative Power in America* 79 (2004).

<sup>25</sup> Mayer, *supra* note 23, at 113.

<sup>26</sup> *Id.* at 119.

health plans, and promoting international trade agreements, to name a few. This worldview thrived in the American political landscape not because it is good economics, but because it is good politics—for people and groups that prefer a low minimum wage, low tax rates, fewer regulations, and other causes dear to conservatives. Economism became successful not only because of its intrinsic intellectual appeal, but also because it was useful to the interest groups that sought to roll back the New Deal—interest groups with the money and networks necessary to launch a decades-long assault against postwar liberalism.

### III. Law and Economics

Under any circumstances, the classical law and economics movement would have constituted an important chapter in the history of legal scholarship. Its full significance, however, can only be fully understood within the context of economism. Like economism, law and economics relied heavily and sometimes naively on the competitive market model and tended to generate insights with conservative policy implications. This is no coincidence: simple models that assume rational behavior and well-functioning markets are likely to conclude that private actors should be left to themselves and the government should stay out of the way. For these reasons, the law and economics approach attracted ideologically motivated, conservative foundations that recognized its importance and helped incubate and propagate the movement.<sup>27</sup>

According to the conventional narrative, the institutional history of law and economics began at the University of Chicago Law School in 1946 with the arrival of economist Aaron Director (Friedman's brother-in-law). His position was supported by the Volker Fund, thanks in part to Hayek's efforts "to establish a center that would promote private enterprise," as Director later recalled.<sup>28</sup> At Chicago, Director's teaching inspired many students to adopt economic approaches to the law. One of them was future judge Robert Bork, who said many years later, "A lot of us who took the antitrust course or the economics course underwent what can only be called a religious conversion. It changed our view of the entire world."<sup>29</sup> Another disciple was Henry Manne, who would later become a central figure in the institutionalization of law and economics. In addition to supporting Director, the Volker Fund also financed fellowships in law and economics, exposing more budding academics to the movement.<sup>30</sup>

By the late 1960s, law and economics was an emerging field of academic inquiry. Its leading practitioners included Ronald Coase and Richard Posner at the University of

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<sup>27</sup> See, e.g., Mayer, *supra* note 23; Steven M. Teles, *The Rise of the Conservative Legal Movement: The Battle for Control of the Law* (2008); Thomas O. McGarity, *Freedom to Harm: The Lasting Legacy of the Laissez Faire Revival* (2013).

<sup>28</sup> Teles, *supra* note 27, at 93-94.

<sup>29</sup> Quoted in *id.* at 94.

<sup>30</sup> *Id.* at 95.

Chicago and Guido Calabresi at the Yale Law School. Without additional institutional and financial support, it might have remained trapped in the ivory tower. But at the time, conservatives were looking for a way to stem and ultimately reverse the leftward shift in American courts, symbolized by the Warren Court in the 1960s. In his then-confidential but now-famous 1971 memo calling on the business community to band together against a supposed “attack on the free enterprise system,” future Supreme Court Justice Lewis Powell aimed squarely at the legal system: “The judiciary may be the most important instrument for social, economic, and political change.”<sup>31</sup>

The increasingly militant conservative foundations answered the call, along with large corporations that felt threatened by the growth of the regulatory state in the Lyndon Johnson and Richard Nixon administrations. When Henry Manne started his Economics Institute for Law Professors—a short course in basic economics that eventually reached more than 650 professors—he received funding from all eleven corporations that he solicited.<sup>32</sup> The Law and Economics Center, which Manne founded at the University of Miami in 1974 (and which is currently housed at George Mason University) was largely funded by corporations, along with the Scaife, Earhart, and John M. Olin Foundations.<sup>33</sup> It was there that Manne launched the Economics Institute for Federal Judges, which taught introductory economics to, at one point, more than 40 percent of the federal judiciary.<sup>34</sup>

The example of the Olin Foundation, which is most closely associated with the history of the law and economics movement, demonstrates what was at stake. “Ideas are weapons,” wrote foundation president William Simon, “indeed the only weapons with which other ideas can be fought.”<sup>35</sup> The rethinking of the law according to economic principles was the perfect idea for the task at hand. As executive director James Piereson later said, “I saw it as a way into the law schools. . . . Economic analysis tends to have conservatizing effects.”<sup>36</sup> Olin devoted \$68 million to the cause, funding law and economics programs at several top law schools, helping to popularize the field among a generation of students who would go on to important positions in government and the judiciary.<sup>37</sup>

These investments paid off handsomely. Law and economics colonized numerous fields of legal inquiry, particularly those that lacked a fundamental organizing principle

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<sup>31</sup> Phillips-Fein, *supra* note 15, at 158-60.

<sup>32</sup> Teles, *supra* note 27, at 105-08.

<sup>33</sup> *Id.* at 109-17.

<sup>34</sup> *Id.* at 112-13.

<sup>35</sup> Quoted in Mayer, *supra* note 23, at 102.

<sup>36</sup> Jason DeParle, Goals Reached, Donor on Right Closes Up Shop, *N.Y. Times*, May 29, 2005 (<http://www.nytimes.com/2005/05/29/politics/goals-reached-donor-on-right-closes-up-shop.html>).

<sup>37</sup> *Id.*

able to withstand (or provide immunity against) the onslaught of Chicago-style economic theorizing.<sup>38</sup> More important was the movement's success in the public sphere. By the mid-1980s, the *Wall Street Journal* cited law and economics as a significant force for change across the legal system—not only reshaping antitrust law, but also helping to limit businesses' liability for defective products, defend corporate executives from shareholder lawsuits, allow prosecutors to introduce illegally obtained evidence, and protect landlords from tenants' assertion of their rights.<sup>39</sup>

Coase, Posner, Calabresi and other early law and economics scholars generated numerous academic insights of lasting value, just as Hayek and Friedman were two of the greatest economists of the century. But the idealization of competitive markets and reliance on theory to the exclusion of empirical evidence—in short, the assumption that simple models adequately describe reality—could sometimes produce debatable results. As classical law and economics expanded from the academy into the public sphere and in particular into the judiciary, those shortcomings only became more pronounced.

Posner's *Economic Analysis of Law* was a central text of classical law and economics because it addressed almost the entire spectrum of the law from the perspective of microeconomic theory. Posner drew on a small set of elementary axioms—people rationally maximize their utility, prices allocate goods and resources to their most valuable uses, and hence competitive markets generate optimal outcomes for society—and mixed them with a healthy dose of logical reasoning.<sup>40</sup> As economist A. Mitchell Polinsky wrote in a review of the first edition, “His basic premises are that legal rules and institutions should be designed to facilitate economic efficiency, that they should make the greatest use of competitive markets, and, in the absence of such markets, should ‘mimic’ what competitive markets would do.”<sup>41</sup> On that basis, Posner set out to explain what the law was.

From the beginning, however, critics have pointed out that Posner's inventive propositions were often simply not good economics. For example, at common law it was more difficult for a wife to divorce a husband for adultery than vice-versa; Posner explained this rule on the grounds that a wife's adultery does greater harm to the husband than a husband's adultery does to the wife, because the former (but not the latter) can cause a spouse to become the parent of a child who is not his own. In 1987, John Donohue and Ian Ayres—both of whom had Ph.D.s in economics—pointed out that this glib analysis overlooked various significant factors, such as the social cost of children born as a result of the husband's adultery.<sup>42</sup> More generally, in their assessment, “Posner's

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<sup>38</sup> See Spencer Weber Waller, *The Law and Economics Virus*, 31 *Cardozo L. Rev.* 367 (2009).

<sup>39</sup> Barrett, *supra* note 1.

<sup>40</sup> Simon Deakin, *Law Versus Economics? Reflections on the Normative Foundations of Economic Activity*, in *The Second Wave of Law and Economics* 31 (Megan Richardson & Gillian Hadfield eds., 1999).

<sup>41</sup> A. Mitchell Polinsky, *Economic Analysis as a Potentially Defective Product: A Buyer's Guide to Posner's "Economic Analysis of Law,"* 87 *Harv. L. Rev.* 1655, 1657 (1974) (book review).

<sup>42</sup> John J. Donohue III & Ian Ayres, *Posner's Symphony No. 3: Thinking About the Unthinkable*, 39 *Stan.*

reductionist one-way theory of the common law that assumes that whatever *is* is efficient constitutes bad economics and bad science. . . . Posner’s conclusory *ex post* efficiency rationales seem all too pat and convey the feeling that Posner could justify any rule on efficiency grounds.”<sup>43</sup>

Donohue and Ayres made two other criticisms of Posner’s approach, which have often been leveled at classical law and economics more generally. One was failing to grapple with more advanced economic thinking than simple parables about supply, demand, and incentives. For example, Posner asserted that a progressive income tax reduces risk-taking. A famous paper published in 1944, however, showed that a progressive tax can increase risk-taking relative to a no-tax world.<sup>44</sup> The second shortcoming was ignoring empirical evidence that contradicted his clever logical conclusions—such as research studies of the impact of taxation on risk-taking, or recent income inequality data from Sweden.<sup>45</sup>

All people make mistakes, and no methodology is foolproof. But in this case, the unspoken prejudices of Posner’s approach all lean in the same direction. A conception of economics that assumes rational individuals with perfect information interacting freely with no imbalances of power, unencumbered by empirical evidence, will always lead to the conclusion that free markets generate optimal outcomes and government intervention is unnecessary or harmful. As Donohue and Ayres concluded, “economic reductivism systematically favors Posner’s conservative platform.”<sup>46</sup>

Posner has always been something of an intellectual *provocateur*, whose writings have provoked considerable academic discussion and criticism. Legal scholars today are amply familiar with the shortcomings of *Economic Analysis of Law*. Indeed, within the ivory tower, the classical law and economics movement is over; to be hired as a “law and economics” professor today requires a Ph.D. in economics—a degree that one cannot get simply by hypothesizing about how perfectly rational individuals will interact in abstract markets. Law and economics now displays all the methodological diversity of economics; its practitioners have absorbed the behavioral economics revolution and embraced the shift to empirical research characteristic of the broader field.<sup>47</sup>

But ideologies are rarely constrained by the bounds of academic rigor. Economism became unmoored from contemporary economic research, nurtured by foundations and think tanks and flourishing in the echo chamber of the popular media. In

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L. Rev. 791, 803 (1987) (reviewing Richard A. Posner, *Economic Analysis of Law* (3d ed. 1986)).

<sup>43</sup> Id. at 804.

<sup>44</sup> Id. at 810.

<sup>45</sup> Id. at 811, 795.

<sup>46</sup> Id. at 812.

<sup>47</sup> Justin Fox, *How Economics Went from Theory to Data*, Bloomberg, Jan. 6, 2016 (<https://www.bloomberg.com/view/articles/2016-01-06/how-economics-went-from-theory-to-data>).

the same way, classical law and economics continues to thrive in the policy world and in the judiciary, despite its known shortcomings: a reliance on occasionally shallow logical reasoning; a failure to consider more complex economic models than those taught in introductory courses; and a blindness to empirical research. Indeed, Polinsky predicted that Posner's mode of analysis would suffer this fate in the larger world:

*Economic Analysis of Law* is likely to cause the greater damage through misuse by its readers than through any inherent defects. The competitive market paradigm, which is the basis of Posner's approach, requires a number of stringent assumptions, many of which are likely to fail in the context of the real world problems which Posner analyzes. . . . Because Posner does not make the limitations of the paradigm sufficiently explicit, readers not fully aware of them may accept his conclusions uncritically or may extrapolate his analysis to draw conclusions unwarranted in reality.<sup>48</sup>

Classical law and economics was a seemingly objective, relatively approachable way of thinking about legal questions that could easily be used to generate facile but misleading conclusions about the law. Those conclusions had the effect of promoting the conservative agenda of free markets, small government, and low taxes—making it a perfect intellectual weapon for interest groups with a political axe to grind. Programs such as the Economics Institute for Federal Judges taught participants enough economics to appreciate and reproduce simple arguments against government intervention or regulation—but not enough to recognize their shortcomings. As a result, classical law and economics has spread far and wide in the American legal establishment, the judiciary, and therefore the law itself.

#### IV. Law and Economism in Action

Economism's classic genres include the think tank white paper, the newspaper op-ed article, and the politician's talking point. Law and economism can be found in some of the same habitats, but its most important form of expression is the judicial opinion, which gives a small number of judges (two in a federal court of appeals; five in the Supreme Court) the opportunity to change the law on the basis of their understanding of economic theory.

##### A. Form Contracts

Eulala Shute was a passenger on the *Tropicale* when she slipped and was injured during a tour of the ship's galley.<sup>49</sup> She and her husband sued Carnival Cruise Lines, the operator of the ship, in federal court in Washington, where they lived. The district court granted summary judgment to the defendant, but the Court of Appeals for the Ninth Circuit allowed the suit to proceed, despite a forum selection clause in the cruise contract specifying that any disputes had to be litigated in the state of Florida.<sup>50</sup> In *Carnival Cruise*

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<sup>48</sup> Polinsky, *supra* note 41, at 1680.

<sup>49</sup> *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 588 (1991).

<sup>50</sup> *Id.* at 588-89.

*Lines, Inc. v. Shute*, however, the Supreme Court reversed the Ninth Circuit, effectively holding that forum selection clauses—even when included in non-negotiated form contracts—are generally enforceable unless they violate fundamental fairness.<sup>51</sup> One of the Court’s arguments was a standard appeal to transaction costs: forum selection clauses, by providing clarity, reduce the cost of pretrial litigation.<sup>52</sup> Another, however, is straight from classical law and economics: “[I]t stands to reason that passengers who purchase tickets containing a forum clause like that at issue in this case benefit in the form of reduced fares reflecting the savings that the cruise line enjoys by limiting the fora in which it may be sued.”<sup>53</sup>

Although many people steeped in law and economics will recognize and endorse this line of reasoning instantly,<sup>54</sup> it bears a moment’s inspection. *Carnival Cruise Lines* was decided on the basis of *M/S Bremen v. Zapata Off-Shore Company*, in which the Supreme Court upheld a forum selection clause in a contract actively negotiated between two businesses.<sup>55</sup> In that case, it is at least plausible to assume, as the Court did, that the parties thought about the forum selection clause—and, therefore, that since Unterweser (the owner of the Bremen) preferred that clause, Zapata must have obtained some corresponding advantage in the negotiation, such as a lower price.<sup>56</sup> In *Carnival Cruise Lines*, by contrast, it was obvious that there was no active negotiation between the parties.<sup>57</sup> The Court sidestepped this difficulty by assuming that customers *as a group* must have gained some benefit by accepting Carnival’s forum selection clause. This is an unstated application of the competitive market model. If there were an infinite number of cruise lines offering every possible cruise itinerary on every possible type of ship *and* every possible set of contract clauses, then, yes, customers who were willing to accept Carnival’s forum selection clause would get a discount—because some other operator would offer the exact same cruise but without the forum selection clause. (Carnival would be willing to offer the discount because of the lower anticipated costs of litigation, since it is based in Florida.) But, of course, this is posterous. In the real world, there is a relatively small

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<sup>51</sup> Id. at 593-95.

<sup>52</sup> Id. at 593-94.

<sup>53</sup> Id. at 594.

<sup>54</sup> For a quick summary, see Jeff Sovern, Free-Market Failure: The Wells Fargo Arbitration Clause Example, St. John’s Legal Studies Research Paper No. 17-0004 (May 1, 2017), at 9–10.

<sup>55</sup> 407 U.S. 1 (1972).

<sup>56</sup> Id. at 14 (“[I]t would be unrealistic to think that the parties did not conduct their negotiations, including fixing the monetary terms, with the consequences of the forum clause figuring prominently in their calculations.”) I must say, however, having been at least tangentially involved in the negotiation of several multi-million-dollar contracts, that the price is almost always decided on *first*, before the negotiation of issues like forum selection, indemnification, assignability, etc., and remains unchanged throughout those further negotiations.

<sup>57</sup> 499 U.S. at 593.

number of cruise lines offering more or less the itinerary you want, more or less when you want to travel, and forum selection clauses are absolutely irrelevant to customers. Theoretically, a new company could enter the market offering the exact same products as Carnival, but without the forum selection clause and at a slightly higher price—but, again, this is preposterous.

So at least one of the Supreme Court’s rationales for upholding forum selection clauses in form contracts, though superficially rational, makes no sense in the context of the real world that we live in. Of course, that problem has not limited its importance, thanks in particular to the role of precedent in the legal world. In *IFC Credit Corporation v. United Business & Industrial Federal Credit Union*,<sup>58</sup> Judge Frank Easterbrook of the Seventh Circuit—perhaps second only to Posner among federal judges practicing law and economism—expanded on the Supreme Court’s logic in *Carnival Cruise Lines*. *IFC Credit Corporation* dealt with a forum selection clause in a contract written by Norvergence, a supplier of telecommunications equipment. In his opinion, Easterbrook spelled out the argument in refreshingly clear terms:

Lots of firms participate in the telecom-equipment business, and all a customer need do is say no to any given offer and let the competition continue. Norvergence wanted the customers’ money; to get it, Norvergence had to propose terms that the customers were willing to accept. . . . As long as the market is competitive, sellers must adopt terms that buyers find acceptable; onerous terms just lead to lower prices. If buyers prefer juries, then an agreement waiving a jury comes with a lower price to compensate buyers for the loss . . . .<sup>59</sup>

Easterbrook assumes that the market is “competitive,” but his argument really rests on the premise that it is perfectly competitive and *complete*—that there are suppliers offering every possible combination of product and contract attributes. “Lots of firms” may manufacture and sell telecommunications equipment, but the market is still a long way from being complete, and therefore it is pure speculation that seller-friendly forum selection clauses result in lower prices for buyers.

Why does this matter? In *Carnival Cruise Lines*, there was evidence that the plaintiffs were “physically and financially incapable” of suing the cruise line in Florida, and would therefore “for all practical purposes be deprived of [their] day in court.”<sup>60</sup> Well-crafted forum selection clauses, in other words, enable businesses to escape liability for virtually all customer losses that are not large enough to attract plaintiffs’ attorneys willing to work on a contingency fee basis. As Professor Jeff Sovern warns, the logic of *Carnival Cruise Lines* could apply just as well to mandatory arbitration clauses (and has been so

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<sup>58</sup> 512 F.3d 989 (7th Cir. 2008).

<sup>59</sup> *Id.* at 992-93 (citations omitted).

<sup>60</sup> *Shute v. Carnival Cruise Lines*, 863 F.2d 1437, 1448 (9th Cir. 1988) (alteration in original) (quoting *The Bremen*, 407 U.S. at 18).

applied by some commentators).<sup>61</sup> These clauses are routinely inserted into form contracts; Wells Fargo, for example, recently used such clauses to defend against lawsuits brought by customers for whom the bank had fraudulently opened unauthorized accounts.<sup>62</sup> As Sovern discusses, recent empirical studies have shown that consumers are blissfully unaware of mandatory arbitration clauses, even when specifically asked about them, and fail to take them into account when choosing financial products.<sup>63</sup> The idea that buyers might be compensated for agreeing to seller-friendly forum selection or mandatory arbitration clauses, although reasonable or even necessary according to simple economic models, has little grounding in reality. Yet it is enough of a basis for courts to uphold those clauses, systematically favoring businesses over consumers.

### B. Prices

Judge Easterbrook authored another classic example of economic theory justifying a business-friendly rule without regard for economic fact. In *Jones v. Harris Associates L.P.*,<sup>64</sup> investors in Oakmark mutual funds sued the funds' investment adviser for charging what they claimed were excessive management fees. For all practical purposes, mutual funds (Oakmark, here) are products created and marketed by fund companies (Harris). Legally, however, a mutual fund is a separate entity, with its own board of trustees, which "negotiates" a management agreement with the fund company; but since the fund company selects the trustees, it has the ability to set whatever price it wants. In this case, the plaintiffs claimed that the trustees were violating their fiduciary duty to investors (shareholders in the fund) by agreeing to excessive fees.

In one of his arguments for upholding summary judgment in favor of Harris, Easterbrook brushed aside the argument that the trustees' fiduciary duty required them to agree only to "reasonable" fees. Competition between mutual funds, he argued, made such a rule unnecessary:

Mutual funds rarely fire their investment advisers, but investors can and do "fire" advisers cheaply and easily by moving their money elsewhere. Investors do this not when the advisers' fees are "too high" in the abstract, but when they are excessive in relation to the results—and what is "excessive" depends on the results available from other investment vehicles . . . .

Mutual funds come much closer to the model of atomistic competition than do most other markets. Judges would not dream of regulating the price of automobiles, which are produced by roughly a dozen large firms; why then should 8,000 mutual funds seem "too few" to put competitive pressure on advisory fees?<sup>65</sup>

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<sup>61</sup> Sovern, *supra* note 54, at 11 n.54.

<sup>62</sup> *Id.* at 4-5.

<sup>63</sup> *Id.* at 12-15.

<sup>64</sup> 527 F.3d 627 (7th Cir. 2008), *rev'd*, 559 U.S. 335 (2010).

<sup>65</sup> *Id.* at 634.

This is the classic argument that market forces do a better job of setting prices than government regulators. If investors are willing to pay the fees charged by a given mutual fund, those fees cannot be excessive—or else no one would choose to pay them in the first place.

This line of reasoning, however, assumes that customers are able to rationally compare the prices of different mutual funds and their relevant attributes—in particular, their expected returns and expected levels of risk. One might object that this is a rather tenuous assumption, given what we know about general financial literacy. Easterbrook has a response, however: “It won’t do to reply that most investors are unsophisticated and don’t compare prices. The sophisticated investors who do shop create a competitive pressure that protects the rest.”<sup>66</sup>

Again, this is a theoretically plausible line of argument. The idea is that even if some investors do not compare prices—and are therefore unaware that they could invest in a different mutual fund that is similar in all respects but charges lower fees—there are some investors who do; and mutual funds must set their prices to attract these “sophisticated” investors, or face being out-competed by those that do. But it is also an empirically testable proposition, and the evidence is not in its favor. The best example is given by mutual funds that track the same index—products that are identical in virtually all relevant aspects. It was well known by 2008, when Easterbrook wrote his opinion in *Jones v. Harris Associates*, that different S&P 500 index funds charge wildly different prices. As of 2000, the most expensive of these funds available to retail investors cost twenty-eight times as much as the cheapest—even though, by construction, they attempt to generate the exact same investment results.<sup>67</sup> Price dispersion has actually *increased* since this effect was first discovered.<sup>68</sup> Clearly, mutual fund prices are not being set by a perfectly competitive market, since they violate one of the most fundamental assumptions of such a market: that identical goods must exchange hands at the same price. In fact, when it comes to mutual funds generally, it seems to be precisely the case that low-performing funds target or attract unsophisticated investors and charge them higher fees.<sup>69</sup>

In theory, given the right assumptions, competitive markets set prices optimally; no company ever rips off any consumer, because it would lose too many sales to sophisticated buyers. We know that this is not actually true about the real world, especially not when it comes to financial services. But for judges eager to ward off the specter of

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<sup>66</sup> Id.

<sup>67</sup> Ali Hortaçsu & Chad Syverson, Product Differentiation, Search Costs, and Competition in the Mutual Fund Industry: A Case Study of S&P 500 Index Funds, 119 Q.J. Econ. 403, 406 (2004). The most expensive fund also had almost as many assets under management as the cheapest fund. Id.

<sup>68</sup> Michael J. Cooper et al., The Mutual Fund Fee Puzzle (Swedish House of Finance, Research Paper No. 14-11, 2016).

<sup>69</sup> Javier Gil-Bazo & Pablo Ruiz-Verdú, The Relation Between Price and Performance in the Mutual Fund Industry, 64 J. Fin. 2153, 2154 (2009).

administrative or judicial price regulation, theory is enough. To support his claim about “sophisticated investors,” Easterbrook simply cited a twenty-five-year-old law review article that presented a theoretical model of the markets for warranties and security interests (as contract terms).<sup>70</sup> Judge Posner, of all people, objected that Easterbrook’s elegant reasoning amounted to “an economic analysis that is ripe for reexamination,” given recent empirical studies of how boards of directors set executive compensation.<sup>71</sup> In this case, the Supreme Court ultimately overruled Easterbrook’s attempt to leave prices solely to markets, choosing instead a muddy standard based on the law of fiduciary duties established earlier by the Second Circuit.<sup>72</sup> Still, *Jones v. Harris Associates* remains an example of the power of superficial economic analysis unchecked by empirical reflection.

### C. Regulation

Judge Posner has had something of a change of heart in recent years. In his recent book *Divergent Paths*, Posner singles out for ridicule *Edwards v. District of Columbia*,<sup>73</sup> in which the Court of Appeals for the D.C. Circuit reviewed a challenge to a regulation requiring tour guides to pass a competency examination.<sup>74</sup> In that case, the plaintiffs claimed that the examination requirement infringed on their freedom of speech under the First Amendment.

Accepting for the moment that the regulation does regulate speech (although, as Posner says, “The person remains free to say what he wants, though not as a Washington tour guide, if he flunks the test”<sup>75</sup>), the central question is whether it is narrowly tailored to further the District’s interest in promoting the tourism industry.<sup>76</sup> After considering and rejecting several arguments that the examination would help the industry,<sup>77</sup> Judge Janice Rogers Brown gets to the crux of the matter:

Perhaps most fundamentally, what evidence suggests market forces are an inadequate defense to seedy, slothful tour guides? To state the obvious, [the plaintiffs’ company], like any other company, already has strong incentives to provide a quality consumer experience—namely, the desire to stay in business and maximize a return on its capital investment.<sup>78</sup>

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<sup>70</sup> 527 F.3d at 634 (citing Alan Schwartz & Louis Wilde, *Imperfect Information in Markets for Contract Terms*, 69 Va. L. Rev. 1387 (1983)).

<sup>71</sup> *Jones v. Harris Assocs.*, 537 F.3d 728, 730 (7th Cir. 2008) (Posner, J., dissenting from denial of rehearing *en banc*).

<sup>72</sup> *Jones v. Harris Assocs.*, 559 U.S. 335 (2010).

<sup>73</sup> 755 F.3d 996 (D.C. Cir. 2014).

<sup>74</sup> Richard A. Posner, *Divergent Paths: The Academy and the Judiciary 192-96* (2016).

<sup>75</sup> *Id.* at 193.

<sup>76</sup> 755 F.3d at 1003.

<sup>77</sup> *Id.* at 1003-05.

<sup>78</sup> *Id.* at 1006.

In Brown's opinion, the threat of bad Yelp and TripAdvisor reviews gives tour operators all the incentive necessary to provide high-quality services.<sup>79</sup> To underscore this proposition, she adds the following rhetorical flourish:

That the coal of self-interest often yields a gem-like consumer experience should come as no surprise. In his seminal work, *The Wealth of Nations*, celebrated economist and philosopher Adam Smith captured the essence of this timeless principle: "It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest."<sup>80</sup>

Whenever the butcher, the brewer, the baker, or the invisible hand is invoked, the reader should hear alarm bells going off. As first-year law students learn to say, it proves too much: the combination of Adam Smith and Yelp can be equally used to discredit any regulation of any consumer-facing business. This is what Paul Samuelson had to say about this facile incantation in his 1948 textbook:

Right here in the beginning it is just as well to slip the antidote to those who, in reacting away from the extreme view of the economic system as chaos, go to the opposite extreme and regard it as perfection itself, the essence of providential harmony.

Even Adam Smith . . . was so thrilled by the recognition of an order in the economic system that he proclaimed the mystical principle of the "invisible hand": that each individual in pursuing only his own selfish good was led, as if by an invisible hand, to achieve the best good of all, so that any interference with free competition by government was almost certain to be injurious. This unguarded conclusion has done almost as much harm as good in the past century and a half, especially since too often it is all that some of our leading citizens remember, 30 years later, of their college course in economics.<sup>81</sup>

The theoretical principle that Smith identified in 1776 and that centuries of economists have since formalized is correct as far as it goes: the pursuit of self-interest does motivate people to build better products more cheaply and trade them with other people for things that they value. Unfortunately, the pursuit of self-interest also motivates people to pretend their products are better than they actually are, or promise to deliver services that they have no intention of delivering, or try any number of other ploys to separate people from their money. Simple models—reputation effects, expected cost of sanctions, and so on—can be created to show why businesses might choose to compete on price and quality rather than engaging in fraud. But it remains necessary to show why that happy outcome would actually occur in a given market. In Posner's words, "The court's claim that an unregulated market can ensure that Washington tour guides are competent overlooks the distinctive character of a tourist market."<sup>82</sup> Instead of considering the question, however,

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<sup>79</sup> Id. at 1006-07.

<sup>80</sup> Id. at 1007 (quoting Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* 12 (Digireads.com Publishing 2004) (1776)).

<sup>81</sup> Samuelson, *supra* note 10, at 36.

<sup>82</sup> Posner, *supra* note 74, at 194.

Judge Brown simply assumes that her point is proven<sup>83</sup> and moves on to criticizing the examination requirement as a less effective means of ensuring good behavior by tour operators.

*Edwards v. District of Columbia* is but a recent salvo in a long battle against occupational licensing requirements—one begun by Milton Friedman in the 1950s that has recently gained popularity even among moderate Democrats, as evidenced by a 2015 report issued by the Obama administration.<sup>84</sup> While Brown’s treatment of the issue is particularly shallow, it is also a manifestation of the larger issue: a failure to consider the real effects of occupational licensure or other forms of professional standards apart from the simple economic model. As Sandeep Vaheesan and Frank Pasquale have argued, the underenforcement of licensing regimes currently imposes serious harms on consumers, and eliminating existing requirements would have the effect of reducing workers’ wages.<sup>85</sup> These real-world consequences are noticeably absent from the perfect world of law and economism.

Brown’s contextless assumption of all-powerful, benevolent competitive forces epitomizes economism’s assumption that elementary economic models accurately describe the real world. Whether or not tour guides have to pass an exam is hardly the most important question in the world, but *Edwards v. District of Columbia* is part of a larger historical trend: the undermining of government regulatory authority on the basis of economic theory. Unquestioning faith in the disciplinary power of competition and self-interest was a major factor in the deregulation of the financial sector beginning in the 1980s. Politicians and agency officials agreed that homebuyers would only take out mortgages that they could afford, lenders would only extend credit to borrowers who could pay them back, and investment banks would manage their risk prudently. According to Federal Reserve Chair Alan Greenspan, “the self-interest of market participants generates private market regulation,” and so “regulation of derivatives transactions that are privately negotiated by professionals is unnecessary.”<sup>86</sup> The emptiness of these

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<sup>83</sup> 755 F.3d at 1007 (“There is little mystery, therefore, that tour guides possess every incentive to provide quality tours.”).

<sup>84</sup> Department of the Treasury Office of Economic Policy, Council of Economic Advisers, & Department of Labor, Occupational Licensing: A Framework for Policymakers (July 2015) ([https://obamawhitehouse.archives.gov/sites/default/files/docs/licensing\\_report\\_final\\_nonembargo.pdf](https://obamawhitehouse.archives.gov/sites/default/files/docs/licensing_report_final_nonembargo.pdf)).

<sup>85</sup> Sandeep Vaheesan & Frank Pasquale, The Politics of Professionalism: Reappraising Occupational Licensure and Competition Policy, *Ann. Rev. L. & Soc. Sci.* (forthcoming) ([https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2881732##](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2881732##)); see also Marc T. Law & Sukkoo Kim, Specialization and Regulation: The Rise of Professionals and the Emergence of Occupational Licensing Regulation, 65 *J. Econ. Hist.* 723 (2005).

<sup>86</sup> Alan Greenspan, Government Regulation and Derivative Contracts, Remarks at the Financial Markets Conference of the Federal Reserve Bank of Atlanta (Feb. 21, 1997) (<http://www.federalreserve.gov/boarddocs/speeches/1997/19970221.htm>); Alan Greenspan, The Regulation of OTC Derivatives, Testimony Before the House Committee on Banking and Financial Services (July 24, 1998) (<http://www.federalreserve.gov/boarddocs/testimony/1998/19980724.htm>).

assumptions was laid catastrophically bare by the financial crisis of 2008, yet six years later Judge Brown could confidently assert the superiority of market regulation over government regulation; after all, propositions founded entirely on theory remain impervious to rebuttal by facts.

Within the legal realm, *Edwards v. District of Columbia* is part of a larger crusade by a significant subset of the D.C. Circuit to replace government regulation with supposed market forces. Professors Cass Sunstein and Adrian Vermeule have given the label “libertarian administrative law” to this body of doctrine, which seeks to restrain government infringement on market ordering, which is assumed to be primary and fundamental.<sup>87</sup> Economic theory plays a central role in this project, as in *Edwards*, by drastically narrowing the set of issues that warrant government regulation. Devoid of context, Adam Smith can be used to prove that self-interest and markets *always* generate optimal outcomes, rendering the state virtually unnecessary except for the usual small handful of concessions (national defense, courts, and so on). In this setting, classical law and economics is particularly useful because it allows courts to achieve an ideological outcome with clear economic winners and losers—the restriction of the scope of government—while appealing to the neutral, technical, and easy-to-understand language of basic economics.

## V. Conclusion

One of the goals of the John M. Olin Foundation was to penetrate the ivory tower and break what its founder saw as the liberal stranglehold on elite law schools. That mission more or less failed. While Olin money may have helped some conservative (or, more often, conservative-leaning) professors establish footholds in top schools, law and economics as an academic field long ago shed any partisan bias. Looking at the long sweep of history, however, Olin (as well as Hayek and Friedman, the Koch brothers, Richard Mellon Scaife, and many others) largely won the war of ideas where it mattered. Appeals to simple economic models have become part of the basic vocabulary of a significant segment of the judiciary, and are routinely used to protect business interests and constrain the reach of government.

The lasting influence of classical law and economics derives not just from its undeniable intellectual merits, but also from its practical importance to the decades-long campaign to reduce the size and scope of government in favor of unrestricted markets. It follows that stemming or reversing that campaign will require more than a simple rebuttal of individual articles, white papers, or judicial opinions. What is necessary is an alternative conception of how the law should reflect or address economic concerns. To return to our earlier examples, in no statute is it written that the rules of tort law must be interpreted in such a way as to minimize the sum of the cost of prevention plus the cost of accidents; neither the Sherman Act nor the Clayton Act says that accumulation of economic power

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<sup>87</sup> Cass R. Sunstein & Adrian Vermeule, *Libertarian Administrative Law*, 82 U. Chi. L. Rev. 393, 398 (2015).

is excused if it lowers end consumer prices. In antitrust, for example, scholars today are developing a new, more expansive, and more explicitly political vision of the purposes that the law should serve.<sup>88</sup> But distributing and marketing these ideas to non-academic audiences, including the media, politicians, and the policy elite, will require money, institutions, and time. That is the landscape on which this war of ideas will ultimately be settled.

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<sup>88</sup> See, e.g., Zephyr Teachout & Lina Khan, *Market Structure and Political Law: A Taxonomy of Power*, 9 *Duke J. Const. L. & Pub. Pol'y* 37 (2014); Sabeel Rahman, *Challenging the New Curse of Bigness*, *Am. Prospect*, Fall 2016 (<http://prospect.org/article/challenging-new-curse-bigness>).