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Dedicated to Henry G. Manne

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## KEYNOTE ADDRESS: IS THERE A GEORGE MASON SCHOOL OF LAW AND ECONOMICS?

*Todd J. Zywicki\**

Well thank you Henry Butler, and thank you everyone for coming out on this great occasion—which in everyone’s book is a very happy occasion, and in some sense a little bit of a sad occasion. It is a happy occasion because we are here to celebrate the fortieth anniversary of the founding of the Law and Economics Center (LEC), founded by Henry Manne at the University of Miami; it is also the tenth anniversary of the *Journal of Law, Economics & Policy* (*JLEP*).<sup>1</sup> I’ve been the faculty advisor since the journal was started up, and I remember the moment when that first happened. I do remember the founding of *JLEP*—I was eight when the LEC was founded, so I don’t remember that one, but I do remember the founding of *JLEP*—when one of my students came to me and said, “Professor Zywicki, this is *the* law and economics law school, isn’t it ridiculous that we don’t have a student run journal on law and economics?”<sup>2</sup> And I said, “You know what, you’re right—that is ridiculous, go do something about it!” And sure enough he did; the journal has prospered in the intervening period and I think it has been an extraordinary addition to the George Mason University School of Law (GMUSL), and it is my privilege to be associated with it.

One of the reasons why that incident was so significant to me was that it showed the way in which law and economics has become so embedded in the culture at George Mason; so much so that its students have come to embrace its place in the law school, and I think that the story of this journal’s founding is a really good symbol of that. Although of course it is also a little bit of a mixed occasion, because when they came and asked me for an idea for a symposium, I had just been looking through the masthead of the *Supreme Court Economic Review* (*SCER*). A lot of people on the faculty have been the editors of the *SCER*: today it’s Michael Greve and Thomas Hazlett, before that it was Josh Wright and Ilya Somin, and before that it was a variety of George Mason University (GMU) professors, most notably Lloyd Cohen, Bruce Kobayashi, Dean Dan Polsby, and others. I was look-

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\* George Mason University Foundation Professor of Law; Senior Scholar, Mercatus Center at George Mason University; Editor, *Supreme Court Economic Review*, Faculty Adviser to the *Journal of Law, Economics & Policy*. I would like to thank Henry Butler and Henry Manne for many helpful comments and Chaim Mandelbaum for research assistance.

<sup>1</sup> For a useful scholarly history of the Law and Economics Center, see STEVEN M. TELES, *THE RISE OF THE CONSERVATIVE LEGAL MOVEMENT: THE BATTLE FOR CONTROL OF THE LAW* (2008).

<sup>2</sup> That student was Erik Newton who has fittingly gone onto a career as a serial entrepreneur.

ing, and we lost these three titans of law and of law and economics, all of whom were on the board of advisors of the *SCER*. Bork, Alchian, and James Buchanan were all members of the *SCER* editorial board, and of course all three of them, as you heard this morning and will hear again this afternoon, made quite significant contributions to the GMUSL in their time.

Alchian, of course, was the workhorse of the judicial education program. Judge Bork taught here in the 1980s—and I was trying to pin down the exact dates, so I asked Max Stearns, “do you know when Bork worked here?” And he said, “Yes, I do, because I was hired to replace him.” So, he was here for a few years, and for many people the first time they ever heard of GMU was at the Supreme Court hearing in which he was occasionally identified as a GMUSL Professor. And of course, Jim Buchanan, as Henry Manne suggested this morning, was very instrumental, first bringing the public choice center here to George Mason, and then in bringing Henry Manne himself to George Mason. The great combination and synergies we’ve had with the economics department and the Center for the Study of Public Choice are obviously part of the reason why the university has prospered. So I think, in looking forward and at where we are today, it’s important to look back at this.

It might also be useful in framing my remarks, perhaps, to talk a little bit about myself and how I ended up here, because I think in many ways I might represent the second generation of GMUSL. How I ended up here is an example of how Henry Manne, as the Johnny Appleseed of law and economics, planted trees of law and economics around the country that have come to fruition in the current generation of law and economics scholars, which include myself, Josh Wright, Geoffrey Manne, Max Stearns, and many others. I first got into this world by working as an intern at the Foundation for Economic Education and the Institute for Humane Studies, where I discovered the Austrians and the public choice school, and as a result of that I did my undergraduate thesis on Hayek. At the time, on the entire Dartmouth campus I couldn’t find a single professor who knew a single thing about Hayek, which I think is a statement in itself. Somewhere there I met Don Boudreaux and we started a long relationship where Don has introduced me to a lot of ideas, and we took turns being at Clemson. After college I ended up at Clemson, which was a pinnacle moment for me partly because Clemson itself is a satellite of what Henry Manne had set up. There I met Dan Benjamin, who we heard from this morning, Roger Meiners, Bob Staaf, and others; all of whom had some contact with the LEC and ended up teaching in economics programs. So, we’re talking about law schools today, but there is a whole other body, which is those economists who came through Henry Manne’s Olin Fellows program at Miami and Emory, as well as the Economics for Law Professors program. I didn’t know that much about Clemson, so Roger Meiners said the guy you need to talk to is Fred McChesney. Fred McChesney sold me on going to Clemson to get my master’s degree in economics and to study with these

guys, and I've been blessed personally as he is a great friend and intellectual mentor. I think my experience at Clemson shows the hybrid that emerged at GMU. I was exposed to the Chicago Tradition through guys like Bill Dugan and Donald Gordon; Public Choice by a lot of guys from Virginia, Virginia Tech, and GMU; the UCLA Tradition by Dan Benjamin, Matt Lindsey, and others; and the Washington Tradition of Douglass North, which is the one notable absence on today's program. I was talking to Terry Anderson here today about how, I guess in some sense, it is unfortunate for the Washington Tradition that Douglass North couldn't be part of this conversation because that tradition has been an important part of the George Mason school, as best personified today by Bruce Johnsen.

From there I went to University of Virginia (UVA) law school and encountered the first generation of people that Henry Manne sent through his summer program—people like Bob Scott and Tom Jackson who were members of that first generation of law and economics—and then here to GMU to teach. I should also specifically mention my law school antitrust professor Charlie Goetz, who was affiliated with the public choice center at Virginia Polytechnic Institute and State University (VPI), then moved to UVA where he was the first pure economist in the law school and co-authored with Bob Scott many of the foundational articles in the economic analysis of contract law, and was a frequent lecturer in the LEC's judicial education seminars. Somewhere in there was an important part of this story—the creation of the Federalist Society, which has helped propagate law and economics generally and to retail the ideas of law and economics to students across the country. The Federalist Society is important in this story because it has knit together some different intellectual traditions in an important way. And it's not insignificant that it was right around the era when I was going through school that the massacre of Judge Bork occurred on television—that was quite an experience for law students at the time who believed in these ideas, and in many ways highlighted things that became significant.

I feel like I have lived the tradition that we are talking about here today, and I'm going to generalize in a few minutes. I'm going to take as my task the question of: "Is there a George Mason School of Law and Economics—a distinct tradition that has evolved here at GMU and with my fellow travelers here today, in which Henry Butler and the LEC have become the hub of activity, and, if so, what can the important roles played by Alchian, Bork, and Buchanan's relationship with the law school tell us about that tradition?" Alchian is the stand-in for the UCLA Tradition, Bork is the stand-in for the Chicago Tradition, and Buchanan is the stand-in for the Virginia Tradition here.

In asking this question, I want to first credit my colleague Jeff Parker, who first mentioned this idea to me and started me thinking about it. Jeff



has written some things on this and has gone a long way in answering this question; he takes it up and focuses it on Hayek.<sup>3</sup> Jeff's view is that the distinct contribution of the George Mason School is basically bringing Hayek and information discovery into law and economics. He associates this view with Henry Manne, including his ideas on insider trading and other issues of corporate governance, which bring the idea of information generation and transmission front and center into a world where it had not previously existed. Even though Hayek isn't on the program today, I think Jeff is exactly right in that an important part of the George Mason School of Law of Economics—whatever it is—would be the influence of Hayek and information economics and information discovery in the Austrian tradition that also obviously overlaps with the other people who we are talking about today.

As I focus on the UCLA, Virginia, and Chicago Schools, I don't want to suggest that we slight Hayek and the Austrians because they don't happen to have someone on the program—I think Buchanan overlaps with a lot of these guys in particular. I don't want to slight other schools but I think there is something significant, like in Posner's recent article where he compares Hans Kelsen and Hayek and says that Kelsen is a better law and economics scholar than Hayek.<sup>4</sup> He has a long, elaborate view of why that is, but I think it says something about one view of the world of law and economics. Posner's view of who, as between Kelsen and Hayek, is a "better" law and economics scholar is different from the view here at GMU—here, Posner's view wouldn't carry a majority vote among our faculty, I suspect.

So let's start off with the UCLA School. We heard some of this this morning and in many ways, empirically looking at things, if you had to pick, looking down our faculty roster, what has been the dominant influence, you'd have to start with the UCLA School. Obviously you'd have to start with the influence of Armen Alchian, but there are a number of UCLA products who are on our faculty who were referred to this morning, beginning with Tim Muris, but also Bruce Kobayashi, Tom Hazlett, and Josh Wright. In many ways it's kind of funny—I know that Henry Manne went to the University of Chicago, but he really gained his economics education

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<sup>3</sup> Jeffrey Parker, *The Method of Law and Economics: Lectures on the George Mason School* (1999) (unpublished manuscript) (on file with author), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2456826](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2456826); Jeffrey Parker, *Learning Law and Economics: Chapter One of Fundamentals* (unpublished manuscript) (on file with author), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2456800](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2456800).

<sup>4</sup> Judge Posner originally produced this essay for a conference sponsored by the European Law and Economics Association in Vienna in 2001. Richard A. Posner, *Lecture at the Eighteenth Annual Meeting of the European Association for Law and Economics: Kelsen, Hayek, and the Economic Analysis of Law* (Sept. 14, 2001). The essay was then included as Chapter 7 of Posner's 2003 book *Law, Pragmatism and Democracy*. See RICHARD A. POSNER, *LAW, PRAGMATISM AND DEMOCRACY* (2003). It was again used in a symposium article in the *New York University Journal of Law and Liberty* in 2005. See Richard A. Posner, *Hayek, Law, and Cognition*, 1 N.Y.U. J.L. & LIBERTY 147 (2005).

from UCLA. I don't know how else we can put it. What does GMU draw from UCLA? This was first alluded to in Josh Wright's comments and I first heard this from Peter Boettke, who had a similar view, which is a "looking out the window" rather than a "looking at the blackboard" type of question. Pete says that economists get their ideas for questions to study from one of two different places—either looking out the window or looking at the blackboard. There is a world out there in which people talk to other academics and develop more and more elaborate models, which rely on more and more assumptions that don't really tell us much about the real world. I've always gotten the sense that that's not what we're about here; that's not the type of thing that captures the imagination of people here at GMU. I think some of the most influential ideas we've had here are good applications of price theory and supply and demand. A lot of that comes from Alchian, Demsetz, Klein, Leffler and the like. I remember this question as sort of a classic style this morning, from when I was in grad school and I had UCLA graduate Matt Lindsay for industrial organization. He posed the question, "Why does Coca-Cola still advertise? Everyone in the world at some point has had a Coca-Cola, and they have decided whether they like it or not. So why does Coke still advertise?"<sup>5</sup> This is a classic type of UCLA question that spins off in a lot of different sorts of ways. What this leads us to, with what UCLA has contributed to GMU, is sort of a proto-new institutional economics sort of view which I hope comes out in a paper Jeff and I have done for this conference in understanding what institutions are doing in this system and not abstracting from institutions, but understanding the way in which institutions market processes.

The second thing that I get from UCLA Tradition, again overlapping with Hayek and the Austrians, is that there is a respect for decentralized evolutionary processes and private ordering here.<sup>6</sup> Geoff and I bring this out in our paper for this conference—it is implied in Hayek—and apply it to a lot of the ideas which we have. Demsetz, for example, set his view on the spontaneous evolution of property rights—this notion of decentralized evolutionary processes and a skepticism, to some extent, of top-down ordering is a strand that has been particularly prominent of Mason's faculty over time.<sup>7</sup> Just to give a couple of examples, Bruce and Larry Ribstein's work

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<sup>5</sup> For the answer, see Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).

<sup>6</sup> As Henry Manne wrote to me in an e-mail commenting on an earlier manuscript of this speech, "In your discussion of Alchian . . . you come close to saying that he was 'par' or 'near' or 'quasi' Austrian. I think he was far more Austrian than he let on or that most people appreciate, though you come close. Did you know that his theory of property rights was stimulated by his reading Mises's *Human Action* or that his 'Evolution' paper is very much in the tradition of market process economics, not Chicago equilibrium stuff." E-mail from Henry Manne to Todd Zywicki (Apr. 16, 2014) (on file with author).

<sup>7</sup> See generally Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347 (1967).

on the evolution of LLCs and those institutions;<sup>8</sup> Erin O'Hara's work with Larry Ribstein on the law market, choice of law, and the sort of emergence of efficient rules on private ordering;<sup>9</sup> Adam Mossoff's work today on the historical analysis of thickets about people actually solving theoretical problems, which I think are consistent with this;<sup>10</sup> Frank Buckley's work on freedom of contract<sup>11</sup> and his recent important book on the economic consequences of the decline of the rule of law in America;<sup>12</sup> Francisco Parisi's work while he was here on rulemaking institutions, which I also think fits in this.<sup>13</sup> In a series of papers, Henry Butler has examined the making of law as a spontaneous order and evolutionary process, especially law developed through the process of interjurisdictional competition, in a variety of areas ranging from corporate law,<sup>14</sup> to environmental law,<sup>15</sup> to choice of law and the evolution of rules conducive to economic growth.<sup>16</sup> Also, I think my coauthor Max Stearns's work on the evolution of Supreme Court precedent<sup>17</sup> is a really powerful analytical tool for bringing disciplined economics—as opposed to what my colleagues call a political free for all—to identify evolutionary patterns in Supreme Court decision making.

The third idea, which relates to that—as we discussed this morning—is the importance of property rights and basically getting the micro foundations correct and aligning incentives with decision-making power. This is in line with Henry Butler's work and we see this in GMU's tradition.<sup>18</sup>

Second, now, let me turn to the Virginia School and Buchanan because I think this is another thing which is very prominent in the George Mason Law School Tradition—and perhaps less so elsewhere. The public choice tradition; the importance of subjective value in a way which Buchanan overlaps with the Austrians (another neglected part of his legacy); and the

<sup>8</sup> See generally Bruce H. Kobayashi & Larry E. Ribstein, *Evolution and Spontaneous Uniformity: Evidence from the Evolution of the Limited Liability Company*, 34 ECON. INQUIRY 464 (1996).

<sup>9</sup> See generally ERIN A. O'HARA & LARRY E. RIBSTEIN, *THE LAW MARKET* (2009).

<sup>10</sup> See generally Adam Mossoff, *The Rise and Fall of the First American Patent Thicket: The Sewing Machine War of the 1850s*, 53 ARIZ. L. REV. 165 (2011).

<sup>11</sup> See generally *THE FALL AND RISE OF FREEDOM OF CONTRACT* (F. H. Buckley ed., 1999).

<sup>12</sup> See generally *THE AMERICAN ILLNESS: ESSAYS ON THE RULE OF LAW* (F. H. Buckley ed., 2013).

<sup>13</sup> See generally FRANCESCO PARISI & VINCY FON, *THE ECONOMICS OF LAWMAKING* (2008).

<sup>14</sup> See generally Henry N. Butler, *Smith v. Van Gorkom, Jurisdictional Competition, and the Role of Random Mutations in the Evolution of Corporate Law*, 45 WASHBURN L.J. 267 (2006).

<sup>15</sup> See generally Henry N. Butler, *A Defense of Common Law Environmentalism: The Discovery of Better Environmental Policy*, 58 CASE W. RES. L. REV. 705 (2008).

<sup>16</sup> See generally Henry N. Butler & Larry E. Ribstein, *Legal Process and the Discovery of Better Policies for Fostering Innovation and Growth* (Ill. Pub. Law and Legal Theory, Research Paper No. 10-26, 2011).

<sup>17</sup> MAXWELL L. STEARNS, *CONSTITUTIONAL PROCESS: A SOCIAL CHOICE ANALYSIS OF SUPREME COURT DECISION MAKING* (2000).

<sup>18</sup> See generally HENRY G. MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966).

idea of economics as an exchange—I think these are all ideas which we have incorporated here.

Like UCLA, Virginia and Virginia Tech (which was VPI, but at some point became Virginia Tech) are very prominent in this history, with Henry Butler being there and Fred McChesney—who we’ve always considered part of the George Mason diaspora—a Virginia School product at heart and a fellow traveler of the George Mason School. The importance of the Virginia School of public choice is an important part of this history. Again, I think this is best captured in the fact that, to the best of my knowledge, when Max first started teaching law here in the early 1990s, I suspect that we were the only law school in America that had a “Public Choice and the Law” class—and this has been a staple of our curriculum ever since. And that doesn’t even count the several years in which Gordon Tullock served as a faculty colleague and taught law and economics. Judging by the fact that nobody at other law schools seems to want to adopt Max and my book (with a few exceptions), apparently we are still pioneers in seeing the value of having a public choice in law class in the curriculum.<sup>19</sup> But I think this is a notable indication of the way in which these ideas that have come into the George Mason Tradition. The idea, recognized by economists, that we have to be aware of the possibility of government failure or the cost of collective decision making and not just focus on market decision making, is very much a part of the George Mason Tradition. This also, in many ways, reflects the unique research interests of our faculty, whether it is David Bernstein’s extraordinary work on the history around the *Lochner* case and bringing public choice schools to bear on legal history,<sup>20</sup> or whether it’s Bruce and Larry Ribstein’s work on the public choice questions associated with model codes rather than allowing spontaneous order and evolution of rules.<sup>21</sup> I place my work on the Seventeenth Amendment<sup>22</sup> and that sort of thing in there and the responses I’ve gotten from GMU faculty in the same thing. And Jonathan Adler—one of our most distinguished alumni, of course—his work on environmental economics and environmental regulations, which reflects much of this as well.<sup>23</sup>

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<sup>19</sup> See MAXWELL L. STEARNS & TODD J. ZYWICKI, *PUBLIC CHOICE CONCEPTS AND APPLICATIONS IN LAW* (1st ed. 2009).

<sup>20</sup> See generally DAVID E. BERNSTEIN, *REHABILITATING LOCHNER: DEFENDING INDIVIDUAL RIGHTS AGAINST PROGRESSIVE REFORM* (2011).

<sup>21</sup> See generally Bruce H. Kobayashi & Larry E. Ribstein, *The Non-Uniformity of Uniform Laws*, 35 J. CORP. L. 327 (2009).

<sup>22</sup> See generally Todd J. Zywicki, *Senators and Special Interests: A Public Choice Analysis of the Seventeenth Amendment*, 73 OR. L. REV. 1007 (1994).

<sup>23</sup> See generally Jonathan Adler & Ilya Somin, *The Green Costs of Kelo: Economic Development Takings and Environmental Protection*, 84 WASH. U. L. REV. 623 (2006); Jonathan H. Adler, *Judicial Federalism and the Future of Federal Environmental Regulation*, 90 IOWA L. REV. 377 (2005); Jonathan H. Adler, *The Green Aspects of Printz: The Revival of Federalism at Its Implications for Environmental Law*, 6 GEO. MASON L. REV. 573 (1998).

Another place we see this is in subjective value and its role, which is also associated with the Austrians—but we can also credit Buchanan for his extraordinary book *Cost and Choice*.<sup>24</sup> In this sense, we can see this in Tim Muris's early contributions to economics of contracting, where his analysis of contracts and contract damages brings subjective value and subjective cost into the discussion in a way in which it hadn't been done before that.<sup>25</sup> In preparation for this lecture, it was a delight for me to go back and reread Henry Manne's book review about *The Calculus of Consent* when it first came out and to see the significant idea that comes out of his book reviews—taking the ideas developed about the calculus of voting and applying them to corporate voting and the like, which I think is very consistent with what we get here.<sup>26</sup>

Finally, for Buchanan, the idea of economics as exchange—and we'll be hearing about this after lunch with Pete Boettke's paper which I think captures this really nicely—emerges out of this idea of subjective value. That'll segue us into Bork—that is, one of the things I find prominent and important in Buchanan is thinking of economics as the science of exchange rather than the science of maximization. We kind of heard that implicitly in our discussion of Alchian this morning. If you think about economics as the science of exchange, instead of the science of individual maximization, that focuses you on a different set of questions. It focuses you on the type of institutional questions that I think we addressed in the Alchian session, and I think that idea is something GMU picked up from Buchanan and the Virginia School.

So, let me turn to Robert Bork and then finish with some closing remarks. I think of Bork as a stand-in for the Chicago Tradition, which I neglect a little bit, but obviously is the core intellectual tradition of law and economics, and which is well-represented here. Bork's work on antitrust law, as I read it, is pretty much straight Chicago School—that is, defining the Chicago School of Law and Economics, and we do a lot of that here. GMU's influence on antitrust is really quite profound: Tim Muris, who was the chair of the Federal Trade Commission (FTC); Josh Wright who is on the FTC; Maureen Ohlhausen, an alum who is on the FTC; and Bill Kovacic, the former FTC chairman who taught at GMU for many years, just to name a few—indeed, apparently it is now a necessary condition to have a GMU connection in order to be a Republican appointee to the FTC (so sorry to break your hearts if any of you non-Mason folks in the audience had your heart set on that). And in some sense it sort of reaches its apotheosis today because with Judge Ginsburg on our faculty, along with Josh and

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<sup>24</sup> JAMES M. BUCHANAN, *COST AND CHOICE* (1999).

<sup>25</sup> See generally Timothy J. Muris, *Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value*, 12 J. LEGAL STUD. 379 (1983); Timothy J. Muris, *The Costs of Freely Granting Specific Performance*, 1982 DUKE L.J. 1053 (1982).

<sup>26</sup> See generally Henry G. Manne, Book Review, 31 GEO. WASH. L. REV. 1065 (1963).

Tim, GMU now has the top assemblage of antitrust faculty in the world, and perhaps the greatest assemblage of antitrust talent that has ever existed at any law school.

A second, maybe slightly less obvious, strain—I was talking with Jeremy Rabkin about this—is that there is a sense that over time as GMU has matured, as Henry Manne said, we used to not have any constitutional law professors, but as we've matured over time we have brought in more of a public law prong into our tradition. Doug Ginsburg made an off-the-cuff joke this morning in his session on Bork about the difficulty of finding constitutional law people who could teach at GMU. There are two different ways you can think about constitutional law through the lens of the George Mason Tradition of law and economics. One way is the important work that Max has done in applying economic reasoning to Supreme Court decision making: Max took constitutional law and put it into an economic framework, and basically gave us an analytical construct about teaching and understanding constitutional law. But the problem is that Max is kind of *sui generis*. I don't know if there is any other constitutional law person out there that brings the intellectual chops and rigor that Max brings into it.

The other half of it though is this uneasy or nonobvious alliance where people like Nelson Lund and the idea of originalism are married up with law and economics. And it's kind of taken for granted within the Federalist Society coalition that there is a natural alliance between constitutional originalism and law and economics, but it's not obvious that that necessarily is the case. What is it that leads originalism in constitutional law to link up with law and economics as sympathetic intellectual traditions? I think what it is, is that the economic mindset makes us aware of the potential agency costs problems with judges; that taking economics and applying it to everyone in the political system makes much more prominent the potential for agency costs with judges, and that they're using their powers to read their views into law. One approach, Max's approach, is that despite the appearance of judicial chaos there is an underlying economic logic there—that judges are constrained much in the way the efficiency of the common law hypothesis posits that private law reflects an underlying economic logic.<sup>27</sup> Another view leads toward somewhat of an originalist idea that also marries up with some of the other things we said. I'm reading this marvelous paper by John McGinnis that we'll hear about after lunch talking about Bork, Buchanan, and originalism, but I think that it's important because it gets us to some of these ideas. For example, if you see politics as a science of exchange, an application of exchange framework as opposed to a maxi-

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<sup>27</sup> For a recent summary of the debate over the efficiency of the common law, see Todd J. Zywicki & Edward Peter Stringham, *Common Law and Economic Efficiency*, in *ENCYCLOPEDIA OF LAW AND ECONOMICS* (Francesco Parisi & Richard Posner eds., 2010); see also Todd J. Zywicki & Edward Peter Stringham, *Common Law and Economic Efficiency* (George Mason Univ. Law & Econ., Research Paper No. 10-43), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1673968](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1673968).

mization-type framework, then you have a very different view of the political process and where judges might fit in the process. For a George Mason law and economics scholar, it is natural to approach the Constitution as a sort of contract where the judge's responsibility is to enforce its terms rather than rewriting the contract according to the judge's preferences or sense of "the good."

The second idea that I think is interesting related to this is this: I'm going to take you back to Jim Buchanan's review of the first edition of Posner's *Economic Analysis of Law*, it's called *Good Economics–Bad Law*, where Buchanan essentially says, "Look Posner, you've got the economics right, but you've misunderstood the role of the judge. The judge is not a legislator; it's not your job to make the law what you think it should be, it's your job to provide a framework and to not get too big for your britches."<sup>28</sup> I think that might be the idea that knits this all together in the George Mason Tradition. It does not make us originalist necessarily, but it gravitates us in a direction, a Buchanan-like direction, to basically say that "we think economics is powerful and really powerful in particular places," but at the same time we are concerned about agency costs of judges, and that sort of thing. While everyone here is a fan of Posner and grateful and admiring of the intellectual achievements of his career, I think that Buchanan's somewhat skeptical review of *Economic Analysis of Law* speaks to the George Mason Tradition in some sense.

Finally, I would be remiss to overlook the many important contributors to the George Mason School who spent time here and contributed to the growth of the law school, even if they moved on from here. The thirty-fourth Nobel Laureate in Economics, Vernon Smith, who served as a member of the faculty from 2001 to 2008<sup>29</sup> and Kevin McCabe, with whom I co-taught a law and economics seminar many years ago (or more accurately, in whose seminar I was an enthusiastic student). During Vernon's tenure at the law school, I believe that GMUSL was one of only two law schools with a Nobel Laureate economist on the faculty, the other being Ronald Coase at Chicago. I also mentioned Gordon Tullock, who many believe should have joined that esteemed club. Distinguished Federal Circuit Judge Pauline Newman for many years co-taught a marvelous course on patents and property rights with Bruce Kobayashi and was the impetus for GMU's stellar intellectual property program now anchored by Eric Claeys, Adam Mossoff, T.J. Chiang, and Chris Newman (among others). I should also recognize Leonard Liggio, who not only played an instrumental role in bringing Henry Manne to GMU, but also for many years taught a seminar in legal history centered on Harold Berman's work. Finally, we were fortu-

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<sup>28</sup> See generally James M. Buchanan, *Good Economics–Bad Law*, 60 VA. L. REV. 483 (1974).

<sup>29</sup> See *Vernon L. Smith - Facts*, NOBELPRIZE.ORG, [http://www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/2002/smith-facts.html](http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2002/smith-facts.html).

nate to have Mark Grady, one of the leading law and economics scholars of torts, for almost a decade during which he served as Dean of the law school.

I want to close by saying one final thing about the George Mason Tradition that I think is cultural and important to think about along with what the future of the George Mason Tradition might be. There's this marvelous story that Henry Manne tells. I read it as I was preparing for this by reading an interview from the Securities and Exchange Commission Historical Society. Henry received a call from Ralph Winter at Yale Law School offering him a teaching position there. To which Henry responded that Ralph was "five years and two weeks too late": two weeks earlier he had "agreed to establish what would eventually be called the Law and Economics Center, at the University of Miami Law School," and "it was five years too late for [Henry] to give a damn [about teaching at Yale Law School]."<sup>30</sup>

I think there's something in Henry Manne's answer to Ralph Winter that says something about the spirit of GMUSL and the George Mason School of Law and Economics which is very important, which is that we've always had a bit of an outsider culture here. We are a place that holds ourselves to our own norms of excellence and standards of excellence; our workshop culture is a very sharp workshop culture, as people routinely tell us if they've done workshops in other places—it's not show-and-tell. And I think related to this is something that Max reminded me of on the break earlier today: at the heart of the George Mason School is that we see economics as being methodological and not political. This means that what we are interested in is the analytical process of creating and testing hypotheses, and even if that leads you to some place that is politically incorrect and controversial, that is secondary to the analytical rigor of the argument and understanding of what the argument is and thinking about how you would test it.

In the end, the great aspect of this is that I think a lot of the things I've been talking about wouldn't ever have been written at any other law school in America. The type of products that come out of this school are the product of the synergy, sort of growing up around this law school. They are unique contributions of alumni of the law school, such as the collaboration of Erin O'Hara and Larry Ribstein, and others. But for the unique intellec-

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<sup>30</sup> Henry G. Manne, *How Law and Economics Was Marketed in a Hostile World: A Very Personal History*, in *THE ORIGINS OF LAW AND ECONOMICS: ESSAYS BY THE FOUNDING FATHERS* 309-27 (Francesco Parisi & Charles K. Rowley eds., 2005); Henry G. Manne, *How Law and Economics was Marketed in a Hostile World: A Very Personal History* (George Mason Law & Economics Research Paper No. 06-49), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=745944](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=745944). See also Interview by James Stocker with Henry Manne, in Naples, Fla. (August 6, 2012), available at [http://www.sechistorical.org/collection/oral-histories/20120806\\_Manne\\_Henry\\_T.pdf](http://www.sechistorical.org/collection/oral-histories/20120806_Manne_Henry_T.pdf). This memorable antiestablishment quip by Henry is rivaled only by his characterization of the treatise by famed securities law professor Louis Loss, who he said "[d]id one of the great tour de forces of all time. He wrote a six-volume treatise without a single thought in it." Interview with Henry Manne, *supra*, at 51.



tual culture that was created and has been sustained at GMU, there is a great deal of insightful scholarship that never would have been created.

Why does that matter? In the end, what does GMUSL look like going forward? I think the culture is important. We heard this morning, for instance, what I'd characterize as the disappearance of the UCLA Tradition in economics and the decline of law and economics at the University of Chicago—today I think it is just another law school that law and economics is a part of, like any other law school. Whether it's the UCLA School of Economics, the Austrian outpost at NYU, or the University of Washington and the tradition that grew up around there; these distinct traditions seem to be difficult to sustain. One of the things I think is very gratifying about being here at GMU is that as we turned over the faculty—the LEC has been around for forty years, Henry Manne took over the law school in 1986—and what I think is the gratifying thing is that the tradition continues today and our young faculty are better than us old guys. It is extraordinary, the talent that we have in our young faculty, the talent that they bring to the table.

Finally, I'll close on this note: one of the gratifying things about this is the way that it has filtered down to the students. The fact that we have *JLEP* and so many of these students here today that are engaged in this speaks volumes to what this law school is and the distinctive tradition that we have developed here.

## UNCERTAINTY, EVOLUTION AND BEHAVIORAL ECONOMIC THEORY

*Geoffrey A. Manne & Todd J. Zywicki\**

### INTRODUCTION

Armen Alchian had a dramatic impact on law and economics through his scholarship and teaching. While it is said, perhaps incorrectly,<sup>1</sup> that he did not write a lot compared with many of his peers, the quality of his major papers has left many with the opinion that he was one of the great economists of the twentieth century. One of his most important contributions was his 1950 paper, *Uncertainty, Evolution, and Economic Theory*,<sup>2</sup> which was published in the *Journal of Political Economy*.

The basic thesis of the paper is that economists can make useful predictions, “with a modified use of [their] conventional analytical tools,”<sup>3</sup> even in a world of uncertainty and incomplete information. Because market environments “adopt” those firms that best fit the conditions, modeling firms *as if* they are rational economic actors, even if the epithet is descriptively inaccurate, is appropriate. In other words, market economics is much like survival of the fittest in evolutionary biology: those best suited to the conditions of the (business) environment survive. Firms that do not make at least a positive profit will exit the marketplace. As a result, firms can often be modeled as “profit maximizers” even if “profit maximization” was not—could not be—their goal, or even if they did not intentionally choose an optimal path to get there.

This insight has implications for the debate today over the usefulness of behavioral economics. Behavioral economists have criticized the law and economics paradigm, alleging that its proponents wrongly assume that individuals in the marketplace act rationally and in their self-interest. Drawing on psychological literature, behavioral economists argue that consumers and firms fail to act in the way that neoclassical economic models would predict. But, as we discuss, Alchian’s explanation of the role of market forces in shaping outcomes poses a serious challenge to the behav-

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<sup>1</sup> See David Henderson, *Alchian Didn’t Do a Lot of Work?*, LIBR. OF ECON. & LIBERTY (Feb. 21, 2013), [http://econlog.econlib.org/archives/2013/02/alchian\\_didnt\\_d.html](http://econlog.econlib.org/archives/2013/02/alchian_didnt_d.html).

<sup>2</sup> Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211 (1950).

<sup>3</sup> *Id.* at 211.

ioralists' claims. Alchian's (and our) analysis is borne out of the same realization that preoccupies the behavioralists—that uncertainty pervades economic decision making—but suggests a very different conclusion. The evolutionary pressures identified by Alchian may have led to seemingly inefficient firms and other institutions that, in actuality, *constrain* the effects of bias by market participants. In other words, the very “defects” of profitable firms—from conservatism to bureaucratic problems to agency costs, etc.—may actually support their relative efficiency and effectiveness, even if they appear problematic, costly, or inefficient. In fact, their very persistence argues strongly for that conclusion.

This paper will proceed as follows: In Part I, we offer a short summary of *Uncertainty, Evolution, and Economic Theory*. In Part II, we explain the implications of Alchian's paper for behavioral economics. Part III looks at some findings from experimental economics and the banking industry regarding how biases are constrained by firms and other institutions. In Part IV, we consider what Alchian's model means for government regulation and the place of behavioral economics in guiding it.

## I. SUMMARY OF UNCERTAINTY, EVOLUTION, AND ECONOMIC THEORY

Alchian began *Uncertainty, Evolution, and Economic Theory* by stating that “[a] modification of economic analysis to incorporate incomplete information and uncertain foresight as axioms is suggested here.”<sup>4</sup> Alchian's main target was not behavioral economics, but his argument has direct bearing on many of its criticisms of neoclassical economics.

Alchian argued that profit and utility maximization are not good guides for predicting individual human action. Part of the difficulty is that individuals act in the face of uncertainty. Under such conditions, profit maximization does not really make sense as a goal because there is a distribution of possible outcomes. At best, this means that one can choose an action which brings an optimal distribution given constraints, rather than a “maximizing” outcome.

Instead, Alchian pointed to *ex post* positive profit realization within the market process, rather than “rational” profit-maximization, as the lynchpin of economic efficiency in markets. Firms that realize positive profits will succeed, and those that fail to make positive profits will disappear. *Ex post*, it will appear as if economic decision makers acted rationally. Much like in biological evolution, those choices that tend to result in positive profits under given conditions will survive in the marketplace, leading to a marketplace that looks like one would expect if actors were

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<sup>4</sup> *Id.*

rational profit maximizers, even though *actual* profit maximization need not be economic actors' intention.<sup>5</sup>

As Milton Friedman put it:

[U]nder a wide range of circumstances individual firms behave *as if* they were seeking rationally to maximize their expected returns (generally if misleadingly called "profits") and had full knowledge of the data needed to succeed in this attempt; *as if*, that is, they knew the relevant cost and demand functions, calculated marginal cost and marginal revenue from all actions open to them, and pushed each line of action to the point at which the relevant marginal cost and marginal revenue were equal. Now, of course, businessmen do not actually and literally solve the system of simultaneous equations . . . any more than leaves or billiard players explicitly go through complicated mathematical calculations or falling bodies decide to create a vacuum. . . .

. . . [U]nless the behavior of businessmen in some way or other approximated behavior consistent with the maximization of returns, it seems unlikely that they would remain in business for long. Let the apparent immediate determinant of business behavior be anything at all—habitual reaction, random chance, or whatnot. Whenever this determinant happens to lead to behavior consistent with rational and informed maximization of returns, the business will prosper and acquire resources with which to expand; whenever it does not, the business will tend to lose resources and can be kept in existence only by the addition of resources from outside. The process of "natural selection" thus helps to validate the hypothesis—or, rather, given natural selection, acceptance of the hypothesis can be based largely on the judgment that it summarizes appropriately the conditions for survival.<sup>6</sup>

Many behavioral economists criticize neoclassical economics on the grounds that individuals do not always act rationally. But, as Alchian argued, "[e]ven in a world of stupid men there would still be profits."<sup>7</sup> Chance and luck could play as big of a role as conscious adaptation in finding success. While some successful business models may be adopted by firms in pursuit of profits, Alchian found it at least as likely that the *environment* adopted those business models.

Uncertainty does not imply randomness, though. Economic models criticized by behavioral economists can still make useful—and often accu-

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<sup>5</sup> Fred McChesney also notes the relevance of Alchian's evolutionary model to behavioral economics for understanding market outcomes. See Fred S. McChesney, *Behavioral Economics: Old Wine in Irrelevant New Bottles*, 21 S. CT. ECON. REV. 43 (2014).

<sup>6</sup> Milton Friedman, *The Methodology of Positive Economics*, in *ESSAYS IN POSITIVE ECONOMICS* 3, 21-22 (1953) (emphasis in original) (footnotes omitted). McChesney notes that while behavioral economists frequently justify the relevance of their conclusions on the basis that the *assumptions* of the model matter to make valid predictions, Friedman's insight was that the assumptions of the model are not independently important—what is important is the accuracy of the *predictions*, not the assumptions. Because the assumptions of any economic model must be some simplification of the full range of factors involved, all assumptions by definition are "unrealistic." See McChesney, *supra* note 5; see also, Geoffrey A. Manne & E. Marcellus Williamson, *Hot Docs vs. Cold Economics: The Use and Misuse of Business Documents in Antitrust Enforcement and Adjudication*, 47 ARIZ. L. REV. 609, 616-19 (2005) (discussing the simplifying assumptions used in antitrust analysis).

<sup>7</sup> Alchian, *supra* note 2, at 213.

rate—predictions, even if perfect rationality and self-interest are not good guides to intentional action.

As a consequence, only the method of use, rather than the usefulness, of economic tools and concepts is affected by the approach suggested here; in fact, they are made more powerful if they are not pretentiously assumed to be necessarily associated with, and dependent upon, individual foresight and adjustment. They are tools for, at least, the diagnosis of the operation of an economic system, even if not also for the internal business behavior of each firm.<sup>8</sup>

This is not to completely denigrate the participants in the market process, either. Alchian recognized that there is significant, intentional adapting behavior. In particular, he emphasized trial and error and imitation. He argued that the uniformity often observed in the marketplace could have much to do with imitation, and that innovation is often the result of a trial and error process.

The big takeaway from the paper is that even if businesses are not trying to maximize profits, their behavior can still be modeled effectively by that assumption. There is a survivor bias in the marketplace. If firms do not make a positive profit, they will eventually have to leave the market. The firms that remain will be those that *did* succeed in making a positive profit, regardless of their motivations.

## II. SOME IMPLICATIONS OF ALCHIAN'S MODEL

Alchian's model of economic survival suggests that *even if* individuals suffer from universal biases—the overoptimism bias, the endowment effect, and the like—this may have limited implications for allocative efficiency. In short, just as Alchian's model suggests that firms act *as if* they are seeking to maximize profits—even if they are not consciously seeking to do so—his model also suggests that firms can be modeled *as if* they are rational actors—even if they are comprised of entirely irrational decision makers.

There are two elements to an evolutionary model—variation and selection. Alchian argued that even if variation is entirely random, if the selection process is sharp enough, then it will *seem* that the variation itself was purposeful—intended to produce the result it seems to solve. Of course, if the variation itself is also intentional, then it might converge to the efficient process more rapidly. For example, Steve Jobs might be particularly good at coming up with new “variations—new products or ways of doing things—but it isn't necessary to have purposeful variation to bring the end result about. In other words, somewhat non-intuitively, for Alchian the process of selection mattered more than the process by which variation is

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<sup>8</sup> *Id.* at 217.

produced. In particular, many important variations in the economic market bear no relationship to the intent of those who produced them in any given case.

A key implication is that it is not necessary for those who work within a firm to be rational in order for the *firm* to act as if it is rational. A firm might simply stumble upon some innovation that provides it with a competitive advantage against its rivals. If so, then that firm will prosper while other firms decline, regardless of whether the firm understands the source of its competitive advantage, although Alchian made it clear that firms that do understand their competitive advantages will gain still larger advantages against their rivals. Thus, assuming that behavioral economics findings about individual biases are sound, the real lasting contribution of behavioral economics to the study of firms and markets may be positive, rather than normative. The presence of behavioral biases might explain certain anomalies observed in the marketplace, but rather than implying market failures in need of corrective intervention, these insights might actually explain the sometimes curious institutions that have grown up to ameliorate any inefficiencies that might arise a result of behavioral biases.

This insight has several implications.

First, it suggests that even if there is widespread irrational behavior in the world, this simply creates a profit opportunity for producers that are comparatively less irrational in their decision making. Thus, over time, less irrational firms should outcompete more irrational firms, suggesting that only the most relatively rational firms will persist. Thus, the overall impact on allocative efficiency of even widespread irrationality may be minor if the marginal surviving firms are the most relatively rational firms in the market.

Second, Alchian's model suggests that even in a world of irrationality, the number of market failures that require government intervention may be smaller than expected. In other words, although it is theoretically possible that certain biases could lead to market failures requiring governmental correction, it may be more accurate to presume that those firms that survive are those that have done the comparatively best job of creating internal structures designed to mitigate the costs of those biases to the firm's operations. Thus, through the evolutionary process of competition, firms that survive can be presumed to be the ones that have best solved the possible problems arising from irrational biases among their employees. This implies that before governmental intervention is urged as a response to a purported behavioral bias, a regulator should first determine whether the effects of the bias *have already been addressed* through the structure of firms themselves before making a persuasive case for intervention. Moreover, it implies that corrective action directed toward existing, successful firms will necessarily be directed against the very structures that have proved most successful in ameliorating the biases that government intervention might

otherwise hope to address. This would turn the justification for government intervention on its head.

Finally, as a corollary to the second point, the intersection of behavioral economics and Alchian's model of evolution suggests the possibility that certain practices of successful firms, which appear to be inefficient, may actually be efficient if assessed more "holistically" in terms of their ability to ameliorate the effects of behavioral biases and uncertainty. In other words, viewed against a more realistic but-for world rather than a fanciful ideal, apparent relative inefficiency—or even apparently harmful conduct—may actually be relative efficiency.<sup>9</sup> More simply, compared to firms that failed because they made different decisions, a firm's very existence is some evidence of its relative efficiency and something of a *prima facie* reason to refrain from deterring its particular conduct or structure. For example, it may be that certain apparent redundancies in decision making within a firm appear to be inefficient, and the organization is in need of streamlining. But that conclusion may be dependent on the fanciful assumption that those working within the firm are rational. If, on the other hand, they suffer from various biases, then it may be that the firm's operational redundancies are actually an adaptation designed—or happened upon by accident—to check the aggregate impact of those biases.

In some sense, then, behavioral economics provides no new fundamental challenge to the economic understanding of firms and markets. In particular, the issues raised by behavioral economics appear little different than long understood limitations on perfect rationality such as ignorance and constrained decision making under uncertainty—the very focus of Alchian's 1950 article (recall that the first word of the title is *Uncertainty*).

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<sup>9</sup> Thus, the concept of X-inefficiency, which purports to measure the difference between observed behavior and optimal efficiency given certain inputs—attributing persistent inefficiency to the absence of competition—is misguided. It falls prey to the Nirvana fallacy of assuming perfect information so aptly skewered in Alchian's article. As George Stigler quipped (citing Alchian and Demsetz), "[o]utput and utility would be larger if resources were not necessary to the enforcement of contracts, but output and utility would also be larger if water boiled at 180°F or a day had 25 hours." George J. Stigler, *The Xistence of X-Efficiency*, 66 AM. ECON. REV. 213, 213-14 (1976) (citing Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972)). Resources "wasted" on "inefficient" structures that result in greater productivity net of their costs than could be achieved (in the real world) without them are neither wasted nor inefficient. Their persistence is perfectly consistent with the existence of robust competition; properly understood, they are, in fact, hallmarks of efficient behavior. This leads also to the idea, discussed below, that variations in output given certain inputs may be explained by necessary variations in entrepreneurial capacity. In other words, the process of trial and error that describes very nearly every moment in time when evolution is in progress, not yet having reached some theoretical equilibrium and weeding out the relatively inefficient. *Id.* at 215-16.

### III. THE BEHAVIORAL ECONOMICS BACKGROUND: EXAMPLES FROM THE LITERATURE

This Part of the article describes some prior contributions to the economics literature that illustrate these concepts. In particular, we focus on two lines of analysis that are consistent with our understanding of the intersection of behavioral economics and Alchian's theory of evolution.

Subpart III.A details findings from experimental economics supporting the understanding of certain forms of economic organization, such as firms, as functioning in a manner that is—observationally if not intentionally—less irrational than alternatives. Following Alchian, this would suggest that, over time, the relevant types of economic activity will tend to be organized around these less inefficient structures, which is precisely what is observed in practice. In turn, this suggests that markets may be more rational (efficient) than the people who operate within them.

Subpart III.B describes the notable contribution of Robert Rasmussen, whose positive analysis of the organization of activity within a firm provides an example of the possible use of behavioral economics to explain the evolution of certain market or firm practices that might appear irrational but for, perhaps, serving to mitigate the effect of individual irrationality—making the firm (economy) more rational than the individuals within it.

#### A. *Context and the Manifestation of Behavioral Biases*

Alchian's theory of evolution suggests that the presence of inefficient institutions in markets creates a profit opportunity for entities that do not suffer from those biases. As a result, the most efficient provider of a service in a market will end up in the role in which it has a comparative advantage. The presence of irrational individuals at some, or even most, firms will not affect overall allocative efficiency because the market will be dominated by those firms that develop institutions that ameliorate those problems. Indeed, if behavioral biases actually exist, it may be that certain institutions within a market exist precisely to compensate for the presence of those biases in the market.

It is easy to point to numerous market institutions that might be explained in some degree as a response to compensate for behavioral biases. For example, if there is such thing as an “endowment effect”—which appears to be highly context dependent<sup>10</sup>—one could easily imagine that it might apply in the context of the sale of one's home—as might other pur-

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<sup>10</sup> See, e.g., Charles R. Plott & Kathryn Zeiler, *The Willingness to Pay–Willingness to Accept Gap, the “Endowment Effect,” Subject Misconceptions, and Experimental Procedures for Eliciting Valuations*, 95 AM. ECON. REV. 530 (2005).



ported biases such as the overoptimism effect. If there are biases that uniquely apply to the seller of a home—the so-called “willingness to pay–willingness to accept” gap—then this would suggest that the number of home sales would be suboptimal and that it should take longer to sell a home than is optimal. If there is an endowment effect with respect to the sale of one’s home, real estate agents could easily be imagined as serving at least in part to counterbalance this bias by providing a less biased, or at least differently biased, check on the value of the home, bringing the two parties together.

Notably, the presence of the endowment effect appears to be highly dependent on context. For example, in a famous study, Kahneman, Knetsch, and Thaler claimed to have found the presence of an endowment effect, but not when goods are purchased for resale rather than use.<sup>11</sup> Moreover, they also found that the endowment effect is primarily a problem for sellers, not buyers. Finally, they concluded that the endowment effect is primarily a problem only in thin markets without a lot of competing sellers in the market. In short, Kahneman, et al., find that, in theory, there is potential for the endowment effect to disrupt market efficiency if sales are made in contexts similar to those that they describe.

Franciosi, et al., describe the findings of Kahneman, et al., as, “[t]hus there is no endowment effect for the retail firm, only for the consumer purchasing the firm’s goods.”<sup>12</sup> The implications of this finding are clear for predicting the organization of market activity: It would be expected that an institution might arise whose primary comparative advantage would be that it did not suffer from an endowment effect as strongly as other institutions, perhaps by specializing in *buying* goods for *resale*. We could call this institution “Wal-Mart,” if we like, but essentially any sort of middleman or intermediary of that type could serve the function of counterbalancing the bias of the endowment effect. Thus, rather than conducting all retail activity via consumer-to-consumer sales, or relying on craftsmen to sell—as well as make—their own goods, various intermediaries might arise to solve this problem.

For much the same reason, Levitt and Syverson’s famous paper demonstrating that real estate agents systematically “cheat” their clients, selling their own houses for a higher price and keeping them on the market longer than those of their clients, and the puzzle of the persistence of real estate agents in the face of this bias, may not be so puzzling.<sup>13</sup> Levitt and

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<sup>11</sup> Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325, 1343 (1990).

<sup>12</sup> Robert Franciosi, Praveen Kujal, Roland Michelitsch, Vernon L. Smith & Gang Deng, *Experimental Tests of the Endowment Effect*, in VERNON L. SMITH, *BARGAINING AND MARKET BEHAVIOR: ESSAYS IN EXPERIMENTAL ECONOMICS* 25, 25 (2000).

<sup>13</sup> See Steven D. Levitt & Chad Syverson, *Market Distortions When Agents Are Better Informed: The Value of Information in Real Estate Transactions*, 90 REV. ECON. & STAT. 598 (2008).

Syverson evaluate *completed sales* in their analysis, but do not account for the possibly much larger deadweight loss from uncompleted sales that might arise in the absence of real estate agents. In other words, real estate agents may appear to introduce inefficiency into housing markets, but conceived more broadly, they may in fact do the opposite. Lawyers may serve a similar function in settlement negotiations if their clients suffer from biases that might cause them to overestimate the value of their claims at trial.<sup>14</sup>

The behavioral literature also points toward other mitigating forces. In his famous study of sports memorabilia collectors and Disney World pin collectors,<sup>15</sup> John List found that, although the endowment effect could be identified among participants in those markets, more experienced market participants—such as professional dealers—exhibited less of an endowment effect than less experienced participants. List concluded that because of the presence of these experienced traders in the market, the efficiency of those markets converge to that predicted by neoclassical economics. Moreover, this suggests that the role of dealers in this market could be consistent with providing a mechanism for trades to occur without the blockages caused by the endowment effect.

Building on Kahneman, et al., Arlen, Spitzer, and Talley found that although individuals display an endowment effect, the framing of their economic roles can affect the manifestation of the bias.<sup>16</sup> For example, in their experimental study, they asked participants to imagine themselves as agents—trading goods on behalf of another person (the principal). They found that under this framing of the issue, the endowment effect largely disappeared. Again, the implications for understanding economics is clear—if there is an endowment effect, that simply creates an opportunity for institutions to arise that have a comparative advantage in alleviating the effects of that bias. In that sense, the market responses to purported behavioral biases are no different than the existence of market institutions as proof that they are responsive to the problems of imperfect information or strategic behavior.

To be sure, retailers, middlemen, and the like also serve additional functions. But if the endowment effect does exist, it does not follow that it will necessarily produce market inefficiencies. Instead, it can be expected to produce market pressures for entrepreneurs to create institutions that will exhibit less of an endowment effect than others, and thus will survive in the

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<sup>14</sup> Cf. Ronald Gilson, *Lawyers as Transaction Cost Engineers*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 508 (Peter Newman ed., 1998).

<sup>15</sup> See generally John A. List, *Does Market Experience Eliminate Market Anomalies?*, 118 Q.J. ECON. 41 (2003).

<sup>16</sup> See generally Jennifer Arlen, Matthew Spitzer & Eric Talley, *Endowment Effects Within Corporate Agency Relationships*, 31 J. LEGAL STUD. 1 (2002).

market process.<sup>17</sup> It should also be noted that the absence of such innovations at any given moment does not imply inefficiency nor require intervention to correct, given the scarcity of entrepreneurial talent and the messiness of the evolutionary process. Rather, at any given moment, entrepreneurial inputs may simply be employed elsewhere to correct even more significant inefficiencies, and any given intervention may or may not improve overall market efficiency.<sup>18</sup>

### B. *Robert Rasmussen and the Organization of Loan Decisions Within Banks*

Robert Rasmussen's observations on the nature of bank lending operations provides a second example of how potential individual irrationalities might explain the organization of certain markets and the internal organization of firms within them—and how apparent defects of these markets may actually be *solutions* to rather than *causes* of problems.

Indeed, although not citing Alchian, Rasmussen's observations on this point begin with Alchian's logic. Rasmussen writes:

It is easy to articulate why there might be institutional constraints that reduce the impact of behavioral biases in the transactions that are the subject of bankruptcy scholarship. Firms ultimately have to compete in the market, and firms that continually make inefficient choices will not stay in business. The imperative of competition gives firms an incentive to develop internal structures which may be effective at reducing or even eliminating at least some of the types of biases in decision making discovered by behavioral economics. The firms that

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<sup>17</sup> This point also precludes the generalization of other "evidence" of bias like that identified by Buccafusco and Sprigman in two papers. Christopher Buccafusco & Christopher Jon Sprigman, *The Creativity Effect*, 78 U. CHI. L. REV. 31 (2011); Christopher Buccafusco & Christopher Sprigman, *Valuing Intellectual Property: An Experiment*, 96 CORNELL L. REV. 1 (2010). Their analysis claims that observed biases in the direct sales of poetry and art imply certain policy correctives (like broader fair use rules and weaker property rights in intellectual property). But because their analysis finds results in a stylized experiment without intermediaries or the possibility of bias-mitigating structural innovations, it has little or no implications for actual real world policies. See also Geoffrey Manne, Comment to *Sprigman and Buccafusco on Valuing Intellectual Property*, TRUTH ON THE MARKET (Dec. 6, 2010), <http://truthonthemarket.com/2010/12/06/sprigman-and-buccafusco-on-valuing-intellectual-property/#comment-20496>.

<sup>18</sup> Cf. Stigler, *supra* note 9, at 215-16 ("The latter assumption of competitive selection coolly ignores the problem of general equilibrium (where do the driven-out entrepreneurs go?, and where do the efficient entrepreneurs come from?), and fails to demonstrate (or even to argue) that inflows and outflows of entrepreneurs of various qualities will converge on a high-efficiency equilibrium in each competitive industry."). See also Jonathan Klick & Gregory Mitchell, *Government Regulation of Irrationality: Moral and Cognitive Hazards*, 90 MINN. L. REV. 1620, 1625 (2006) ("In particular, we argue that there will often be long-run costs of paternalistic regulations that offset short-run gains because of the negative learning and motivational effects of paternalistic regulations.").

develop the better internal practices may well be the firms that have a better chance of surviving in the market.<sup>19</sup>

Given the nature of the bank lending business, Rasmussen observes that the most dangerous bias relevant “to the long-term health of a financial institution would be excessive optimism.”<sup>20</sup> This is because the risk of a loan is biased for the bank—the bank’s upside of the loan is capped at the repayment amount, but the downside is the complete loss on the loan. The overoptimism bias is one that behavioral economics scholars claim to be extremely widespread in the population. Taken at face value, this would suggest that the overoptimism bias would also be widespread in banks, leading to a chronic epidemic of overoptimistic risk taking by banks and a need for government intervention to curb this chronic problem.

The reality, of course, should be very different. Alchian’s model suggests that even if overoptimism is widespread in the market, those banks that survive will be those that are the most prudent and the least overoptimistic of all banks. Thus, the problem of overoptimism and excessive risk taking by banks should be a much smaller problem than behavioral economics might suggest, if we assume that the operation of banks is consistent with the cognitive deficiencies of the public at large and subject to Alchian’s evolutionary dynamic.

First, the overoptimism bias is not universal in the population, suggesting that not everyone will be overoptimistic (indeed, the National Institute of Mental Health estimates that approximately 6.7% of the population suffers from depression, the antithesis of overoptimism).<sup>21</sup> Second, even among those who are overoptimistic, not everyone is overoptimistic to the same degree—some are relatively less overoptimistic than others. Thus, it is more likely that the frequency and degree of optimism bias can be best described by a *distribution* of optimism bias in the population rather than a single homogeneous point.

This heterogeneity in the frequency and degree of cognitive biases suggests that the banking industry would tend to select those least prone to suffering from the overoptimism bias. Thus, those individuals in the population who are less prone to the overoptimism bias will hold a competitive advantage over those who are more prone to those biases. As a result, people who work in banks should be those with less of an overoptimism bias than the population at large, thereby making the tendency for overoptimism and excessive risk taking less threatening than it might appear at first glance

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<sup>19</sup> Robert K. Rasmussen, *Behavioral Economics, the Economic Analysis of Bankruptcy Law and the Pricing of Credit*, 51 VAND. L. REV. 1679, 1688-89 (1998) (footnote omitted).

<sup>20</sup> *Id.* at 1693.

<sup>21</sup> *The Numbers Count: Mental Disorders in America*, NAT’L INST. OF MENTAL HEALTH, <http://www.nimh.nih.gov/health/publications/the-numbers-count-mental-disorders-in-america/index.shtml> (last visited Nov. 3, 2013).

(perhaps there is a reason why bankers have traditionally been stereotyped as staid, conservative pessimists instead of exuberant optimists).<sup>22</sup> By contrast, some fields, such as entrepreneurship, might be expected to attract those of above average levels of optimism.<sup>23</sup> Rasmussen observes that banks will not want to hire the “overly pessimistic” either, as they would be unwilling to make even safe loans at reasonable rates. But it nevertheless suggests that less overly optimistic people will be hired by successful banks.<sup>24</sup>

But Alchian’s insight also speaks to the nature of the firms that will survive in the market. Those banks that are most effective in screening and promoting applicants based on their relative degree of resistance to the overoptimism bias would have a competitive advantage over those firms that are less effective in identifying these employees and therefore would be required to incur higher costs monitoring their employees or absorbing losses from overly risky activity. This suggests that in a competitive market those banks that do the best job screening for and promoting the most prudent employees will survive, thus reinforcing the tendency of banking operations to be disproportionately run by individuals who are less prone to the overoptimism bias.

But Rasmussen suggests still another point. Successful banks will likely establish internal operating structures in order to avoid the distorting effects of persistent overoptimism bias at the lowest cost. For example, the use of impersonal statistical devices, such as credit scores, may temper the overoptimism of any particular loan officer. Rasmussen also notes that once a loan officer starts working on a file, she might become unduly attached to that file and that borrower and thus less likely to take an unbiased look at whether the loan should or should not be made. Again, an impersonal check such as a credit score, especially at the outset of the loan application process, can serve to temper that bias. In addition, if individuals suffer from a “confirmation bias,” loan officers who initially determine that

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<sup>22</sup> Of course, changing the evolutionary dynamics would likely change the composition of the individuals and firms that survive. For example, if the financial system evolves to allow bankers to retain any gains that they earn (including unusually outsized gains) while being able to externalize any large losses that they suffer (such as through bailouts of massively bad investments), then this will likely produce a population of bankers who are highly risk seeking and willing to exploit the moral hazard implicit in these nonsymmetrical payoff structures.

<sup>23</sup> See James M. Buchanan, *Resource Allocation and Entrepreneurship*, SWED. J. POL. SCI. 285, 288 (1980).

<sup>24</sup> This same “selection effect”—heterogeneous members of a pool self-selecting to take advantage of their particular competitive advantage—arises in a multitude of situations. See, e.g., Geoffrey A. Manne, *The Hydraulic Theory of Disclosure Regulation and Other Costs of Disclosure*, 58 ALA. L. REV. 473, 502-03 (2007). As in other areas, the assumption of homogeneity obscures important dynamics that can undermine policy prescriptions based on the assumption. *Id.* at 497-503; see also Harold Demsetz, *The Structure of Ownership and the Theory of the Firm*, 26 J.L. & ECON. 375, 382 (1983).

a loan should be granted may tend to overweight subsequent confirmatory evidence and underweight new contrary evidence as it arises. Thus there must be some sort of check to counteract those tendencies. Confirming the wisdom of a loan by reference to a credit score may provide a reality check to offset these biases.

Thus, Rasmussen suggests, the use of credit scores in the loan application process may not simply serve an information function about the borrower's creditworthiness; if there are various biases that might be triggered through the personalized process of a loan application, the credit score may also provide a mechanism for tempering those biases. Collecting credit score information may seem redundant, wasteful, and even harmful—after all, the loan officer can collect more information from the borrower than a standard-form credit score—nevertheless, they might serve an additional function not observed at first glance.

Rasmussen also argues that in situations where credit scores are not available, such as in commercial loans, other institutions might arise that serve a similar function, likewise tempering the effects of biases. Rasmussen notes:

The risk of a loan officer becoming too committed to a client's loan request exists in situations where credit scoring may not be feasible. . . . In [the commercial loan] context, some large banks have taken other actions that have the effect of reducing biases in the lending decision. In these banks, the loan officer who solicits the loan application has no responsibility for deciding whether or not the loan is made. Rather, the loan application and the company's financial statements are sent to another office that decides whether or not to make the loan. The loan officer exercises no independent judgment on whether or not to make the loan. Rather, the officer is in the nature of a salesperson. Her compensation is based on how many products—loans, deposits, treasury management services—she is able to sell each year. The office that actually makes the lending decision is evaluated on the performance of the loans that it makes. This office, however, has little or no actual relationship with the customer, and is not responsible for servicing the loan or deciding when the loan is in danger of not being repaid.<sup>25</sup>

At first glance, this arrangement appears peculiar and inefficient. Why two people to do the job that one person could do—both soliciting and approving the loan? Moreover, why have someone with little specialized knowledge of the loan applicant, compared to the loan officer who originally worked with the loan applicant, make the final decision on the loan approval? In short, the bank's lending practices appear to be redundant. Rasmussen suggests, however, that one possible explanation for this seeming redundancy is to address certain biases and irrationalities that might arise in the loan application process. He writes:

This decoupling of loan application solicitation from the loan approval process both reduces the risk of bias and provides appropriate economic incentives for those who solicit

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<sup>25</sup> Rasmussen, *supra* note 19, at 1695-96.

loans and those who approve them. The risk of cognitive bias is reduced by ensuring that the bank officer who makes the lending decision does not have a prior relationship with the client. . . . The loan officer who solicits loans has the incentive to procure as many loan applications as possible, whereas the officer who approves the loan has the incentive to only approve loans that she expects to be profitable.<sup>26</sup>

Rasmussen argues that other similar checks and balances operate within banks that might also be justified as responses to concerns about irrational biases. For example, banks also divide responsibility later in the process between those who are responsible for originating and servicing the loan and those who are responsible for dealing with distressed loans. “Most banks transfer a loan from the operating division to a workout division once the loan becomes distressed.”<sup>27</sup> One effect of this decision, Rasmussen notes, is to transfer to a new person the decision whether to permit a troubled loan to continue, whereas the original loan officer may have a bias in favor of continuation because of a tendency not to question his previous commitment to the loan. “Thus, one would expect that loan officers who made the original loan would be more likely to opt for continuation than an objective assessment of the facts would suggest. By transferring the loan to a new person, such bias may be counteracted [sic].”<sup>28</sup>

To be sure, there is a “just-so” element of Rasmussen’s analysis that is characteristic of much behavioral law and economics literature.<sup>29</sup> But that problem is endemic to the literature itself. More relevant to the current discussion is the implication of Rasmussen’s analysis that *even if* the behavioral law and economics speculative approach to identifying potential problems is taken, the implications that follow from this are different when viewed in an Alchianian light. While behavioral law and economics can be used to define a potentially serious problem potentially suitable for regulation—an apparent bias toward overoptimism and excessive risk taking in banks—it may not follow that regulation is required because there are strong competitive pressures for banks to solve those problems on their own. Thus, regulation may be unnecessary or even counterproductive if regulators ignore the systems that successful banks have evolved to confront the problem.

Moreover, the insight that successful banks have likely developed internal mechanisms for dealing with any behavioral biases—as well as problems of imperfect information, agency costs, and other potential problems—suggests a corollary proposition: that we may be able to infer that other apparent anomalies within firms may actually exist in order to restrain the effect of these biases. Thus, institutions that appear to be inefficient or

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<sup>26</sup> *Id.* at 1696 (footnote omitted).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 1697.

<sup>29</sup> See generally Todd Zywicki, *The Behavioral Law and Economics of Fixed-Rate Mortgages: And Other Just-So Stories*, 21 SUP. CT. ECON. REV. 157 (2014).

redundant could potentially serve some function within the successful firm of offsetting the influence of behavioral biases that might otherwise negatively impact the operation of the firm.

#### IV. IMPLICATIONS FOR GOVERNMENT INTERVENTION

As noted above, an important implication of Alchian's insight is that government interventions aimed at "correcting" inefficiencies in firm behavior will necessarily, if inadvertently, be systematically aimed at firms and specific conduct that have evolved—whatever apparent inefficiencies remain—to *best* address inefficiencies. Given also the informational and psychological constraints of regulators themselves as well as the problems of intervening "well" in a complex environment, Alchian's article provides a powerful caution against intervention.

In Subpart IV.A we will apply the lessons of this article to the attempt to extend behavioral economics to antitrust analysis. In Subpart IV.B we will consider the model's implications for consumers and regulators more generally.

##### A. *Antitrust, Behavioral Economics, & Evolution*

But what of behaviors that *harm* consumers—those that earn positive profits not through marginal efficiency improvements but rather through the systematic redistribution of rents, and imposing a concomitant deadweight efficiency loss, say through fraud or anticompetitive conduct?

Where alleged abuses are based on evidence of *intent* to abuse, Alchian's article makes clear that there is no necessary connection between intent and outcome. As Alchian notes:

The pursuit of profits, and not some hypothetical undefinable perfect situation, is the relevant objective whose *fulfilment* is rewarded with survival. Unfortunately, even this proximate objective is too high. Neither perfect knowledge of the past nor complete awareness of the current state of the arts gives sufficient foresight to indicate profitable action. Even for this more restricted objective, the pervasive effects of uncertainty prevent the ascertainment of actions which are supposed to be optimal in achieving profits.<sup>30</sup>

In other words, while it is appropriate to view firms as if they are rational actors for analytical purposes, it is inappropriate to view them as intentional actors for purposes of assigning liability.

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<sup>30</sup> Alchian, *supra* note 2, at 218.



[G]iven the very limitations on knowledge that some commentators point to, there is no reason to believe that even a pervasive ethos (whether in business school or in business itself) of market dominance enables those who pursue market dominance to actually attain it. It is hard to know how to be efficient; it is hard to know how to attain lasting dominance, as well.<sup>31</sup>

In most industries, over 50% of firms fail within four years; for some industries the rate is much higher.<sup>32</sup> Given the difficulties of merely avoiding insolvency, the fraction of firms that succeed in intentional efforts to exclude competitors must be substantially lower. Nevertheless, anticompetitive outcomes are *possible*. Antitrust intervention might even deter it or correct it. Alchian's insights do not undermine the *logic* of antitrust law; rather, they undermine this common basis for deciding to enforce it.

This is true not only for reasons discussed above—even seemingly inefficient institutions may actually be solving some other, greater, unappreciated inefficiency—but also because intervention based on the appearance of a connection between firm conduct and undesirable outcomes systematically risks deterring the *best* of firm behavior, which may nevertheless also be correlated with undesirable outcomes. In other words, just as the classic error cost problem of distinguishing beneficial aggressive competition from anticompetitive behavior in antitrust often counsels against antitrust enforcement, the problem of distinguishing static, beneficial residual inefficiencies from truly harmful ones counsels the same.

The FTC's closing of the recent Google antitrust case presents an illustration. Although the FTC closed the case without taking action, the Commission's justification for its decision was, in part, based upon the flawed logic of the presumed connection between intentions and outcomes:

To determine whether Google violated Section 5 with respect to these search bias allegations, the Commission considered whether Google manipulated its search algorithms and search results page *in order to impede* a competitive threat posed by vertical search engines.

A key issue for the Commission was to determine whether Google changed its search results *primarily to exclude* actual or potential competitors and inhibit the competitive process, or on the other hand, to improve the quality of its search product and the overall user experience. The totality of the evidence indicates that, in the main, Google adopted the design changes that the Commission investigated *to improve the quality* of its search results, and that any negative impact on actual or potential competitors was incidental to that purpose.<sup>33</sup>

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<sup>31</sup> Manne & Williamson, *supra* note 6, at 624.

<sup>32</sup> *Startup Business Failure Rate by Industry*, STATISTIC BRAIN (Jan. 1, 2014), <http://www.statisticbrain.com/startup-failure-by-industry/>.

<sup>33</sup> FED. TRADE COMM'N, F.T.C. FILE NO. 111-0163, STATEMENT OF THE FEDERAL TRADE COMMISSION REGARDING GOOGLE'S SEARCH PRACTICES (Jan. 3, 2013) (emphasis added), *available at* [http://www.ftc.gov/sites/default/files/documents/public\\_statements/statement-commission-regarding-googles-search-practices/130103brillgooglesearchstmt.pdf](http://www.ftc.gov/sites/default/files/documents/public_statements/statement-commission-regarding-googles-search-practices/130103brillgooglesearchstmt.pdf).

Whether Google intended to exclude rivals or not is beside the point as a matter of both law and economics; what matters is whether Google actually foreclosed competition without procompetitive justification—whether its conduct had actual anticompetitive effect.

Extending the problems of inferring outcome from intention, behavioral economics has gained (controversial) ground in the antitrust literature recently.<sup>34</sup> The argument is that monopolists can use the behavioral biases of consumers and other firms against them in an attempt to capture consumer surplus and earn supra-competitive profits. The problem is that behavioral economics is primarily backward-looking and poor at predicting future behavior. As noted by Devlin and Jacobs:

To explain observed departures from strict rationality, behavioral economists appeal to a wide variety of psychological biases of the kind introduced above. Doubtless, these biases possess considerable explanatory power in elucidating ex post why certain firms and consumers failed to behave “rationally.” A distinct and far more formidable question, however, is whether the identified quirks that accompany human decision making can inform a coherent theory producing more-accurate market predictions than price and game theory. Behavioral economics has not yet proposed such a theory, and likely cannot ever propose one. The sheer number of cognitive biases upon which the discipline focuses confounds predictability, not least because their effect on behavior is multi-directional. Any policy prescription based on those biases will inevitably be incoherent and capricious.<sup>35</sup>

Alchian’s theory, on the other hand, allows economists to have some predictive power, even in light of uncertainty. An evolutionary understanding of the marketplace should make regulators wary of assuming behavior is anticompetitive. What succeeded yesterday in making profits may not succeed tomorrow. The competitive landscape could change for a variety of reasons: competitors remove the advantage, technology may change, consumer preferences change, etc. Markets are not static; there’s never an equilibrium. Activity intended to maximize profits will not always be profit

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<sup>34</sup> Compare Joshua D. Wright & Judd E. Stone II, *Misbehavioral Economics: The Case Against Behavioral Antitrust*, 33 CARDOZO L. REV. 1517 (2012) (arguing that behavioral economics does not yet offer an antitrust-relevant theory of competition), and Joshua D. Wright & Douglas H. Ginsburg, *Behavioral Law and Economics: Its Origins, Fatal Flaws, and Implications for Liberty*, 106 NW. U. L. REV. 1033 (2012) (arguing that behavioral law and economics poses significant risks to economic welfare and individual liberty), with Max Huffman, *Commissioner Wright and Behavioral Antitrust*, ANTITRUST SOURCE, Apr. 2013, at 10 (reviewing several of FTC Commissioner Wright’s scholarly articles commenting on behavioral antitrust), available at <http://leconcurrentialiste.files.wordpress.com/2013/09/commissioner-wright-and-behavioral-antitrust.pdf>.

<sup>35</sup> Alan Devlin & Michael Jacobs, *The Empty Promise of Behavioral Antitrust*, 37 HARV. J.L. & PUB. POL’Y 1009, 1024 (2014) (footnotes omitted); see also Joshua D. Wright, *Antitrust, Multidimensional Competition, and Innovation: Do We Have an Antitrust-Relevant Theory of Competition Now?*, in COMPETITION POLICY AND PATENT LAW UNDER UNCERTAINTY 228 (Geoffrey A. Manne & Joshua D. Wright eds., 2011) (highlighting the limitations of antitrust enforcers’ abilities to calculate welfare trade-offs).

maximizing, or else all it would take is imitation and every firm would succeed.

Alchian's theory of evolutionary competition adds another interesting twist to these arguments. For instance, one could argue that monopolization could be a useful strategy to earn positive profits and survive economic natural selection. This might imply that Alchian's thesis could give support to heightened antitrust intervention.

On the other hand, evolutionary market pressures are surely the best defense against sustained monopoly power. In a world of uncertainty, it seems likely that most efforts to monopolize will fail; again, the connection between intent and outcomes is tenuous:

Wisdom lags far behind the market. It is useful for many purposes to think of market behavior as random. Firms try dozens of practices. Most of them are flops, and the firms must try something else or disappear. Other practices offer something extra to consumers—they reduce costs or improve quality—and so they survive. In a competitive struggle the firms that use the best practices survive. Mistakes are buried.

Why do particular practices work? The firms that selected the practices may or may not know what is special about them. They can describe *what* they do, but the *why* is more difficult. Only someone with a very detailed knowledge of the market process, as well as the time and data needed for evaluation, would be able to answer that question. Sometimes no one can answer it.<sup>36</sup>

In the valuable service of supporting those few innovations that succeed, and the firms that implement them, regulators should limit enforcement actions to those few cases where actual observed effects indicate a problem—not where evidence exists that some “ununderstandable”<sup>37</sup> practice was intended to have anticompetitive effect.<sup>38</sup> It is well-accepted that the striving for monopoly rents by business firms is an important inducement for them to expend resources to enter into new markets, innovate, and compete. The mistaken punishment of competitive conduct is “especially costly, because [it] chill[s] the very conduct the antitrust laws are designed to protect.”<sup>39</sup>

Alchian's article offers an additional warning to the commonly made point that the informational limits of regulators create a risk of type I errors

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<sup>36</sup> Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 5 (1984) (footnote omitted).

<sup>37</sup> Ronald Coase, *Industrial Organization: A Proposal for Research*, in POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION 59, 67 (Victor R. Fuchs ed., 1972) (“[I]f an economist finds something—a business practice of one sort or another—that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of ununderstandable practices tends to be very large, and the reliance on a monopoly explanation, frequent.”).

<sup>38</sup> See Manne & Williamson, *supra* note 6, at 646-51.

<sup>39</sup> Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 594 (1986).

in enforcement.<sup>40</sup> As Alchian notes, in an adaptive, evolving environment, “decisions and criteria dictated by the economic *system* [are] more important than those made by the individuals in it.”<sup>41</sup> Intervention to correct decisions made by individuals risks disrupting the system in unpredictable ways—not only deterring aggressive competition, but impairing the rewards to imitation, trial and error, innovation, and entrepreneurship generally (as well as economic actors’ already tenuous ability to anticipate them).<sup>42</sup>

## B. *Consumer Protection and Behavioral Economics*

A similar caution applies in the context of consumer protection regulation and the inference of market failure where none is present. Consider, for example, the theory of “fee shrouding,”<sup>43</sup> which has been invoked to purportedly explain pricing and other business decisions in markets ranging from computers, to hotel rooms, to airline ticketing policy, to credit cards.<sup>44</sup> Based on a theoretical paper by Gabaix and Laibson, the theory argues that there can be “hidden” or “shrouded” fees in contracts that consumers do not fully incorporate into their decision making, focusing instead on only the “up-front” cost and ignoring subsequent add-on fees. Such overcharges will not be competed away because, the argument goes, consumers do not make consumption choices based on these “shrouded” fees. From a policy perspective, then, the argument concludes that consumer protection enforcement is necessary to protect consumers from businesses that prey upon their biases.

Gabaix and Laibson provide the example of a Hilton Hotel, which rather than quoting an up-front “all-in” price of, say, \$100, instead quotes an up-front price of \$80 and then supplements it with a variety of later-imposed fees for parking, Internet access, etc. Gabaix and Laibson argue that this multipart pricing scheme is best explained as “shrouded” pricing that reduces the transparency of price information and will not be competed out of the market because, by definition, consumers are not aware of the

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<sup>40</sup> See Geoffrey A. Manne & Joshua D. Wright, *Innovation and the Limits of Antitrust*, 6 J. COMPETITION L. & ECON. 153, 166-68 (2010); Easterbrook, *supra* note 36.

<sup>41</sup> Alchian, *supra* note 2, at 213.

<sup>42</sup> See generally Klick & Mitchell, *supra* note 18.

<sup>43</sup> See Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, 121 Q.J. ECON. 505, 512 (2006).

<sup>44</sup> See, e.g., Haiyan Shui & Lawrence Ausubel, *Consumer Time Inconsistency: Evidence from an Experiment in the Credit Card Market* (Jan. 24, 2004) (unpublished manuscript), available at [http://editorialexpress.com/cgi-bin/conference/download.cgi?db\\_name=NASM2004&paper\\_id=176](http://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=NASM2004&paper_id=176); Stefano Della Vigna & Ulrike Malmendier, *Contract Design and Self-Control: Theory and Evidence*, 119 Q.J. ECON. 353 (2004); Sharon M. Oster & Fiona M. Scott Morton, *Behavioral Decision-Making: An Application to the Setting of Magazine Subscription Prices* (Nat’l Bureau of Econ. Research, Working Paper No. 10120, 2003), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=467222](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=467222).

trick and so do not choose among their competing sellers based on that choice.

In theory, Gabaix and Laibson's dire outcome is consistent with Alchian's model of competitive evolution. For if it is the case that consumers can repeatedly be fooled by price trickery, only the most ruthless and unscrupulous firms would survive.<sup>45</sup> But as a result, their model also implies that shrouded fee pricing would be uniform in competitive markets, as only those firms that sunk to the lowest level would survive and all other firms would be forced to adopt their practices.

But, in fact, the truth is far different. For example, while it is true that many hotels charge add-on fees for additional services, such as parking and Internet access, others do not. Although we have not conducted a systematic empirical study, our experience is that high-end luxury hotels, such as the Ritz-Carlton, are much more likely to charge add-on fees for additional services, such as Internet access, and exorbitant prices for food and mini-bars, than are "budget" hotels such as Super 8 or Motel 6, which frequently and prominently offer free parking, free Internet service, and free breakfast. Indeed, not only is this result inconsistent with the implication of the hypothesis that all firms would adopt shrouded pricing policies, it is also inconsistent with the implication that those firms with the lowest up-front fees would have the most back end—add-on fees.

Similarly, while major airlines have added a variety of fees to their pricing, such as baggage fees and high reservation change fees, Southwest Airlines—a budget airline—has eschewed doing so, retaining a simplified, up-front price policy, free baggage, and even free peanuts. Indeed, contrary to the predictions of Gabaix and Laibson's model, Southwest has made its price transparency the cornerstone of its marketing program, with its colorful and entertaining "bags fly free" commercials. Again, the perseverance of a variety of price strategies within a particular market is flatly inconsistent with the predictions of the shrouded fees model—and the persistence of up-front pricing by a discount carrier is even more so.

This suggests a recurring alternative hypothesis to the unsubstantiated "shrouded fees" theory: price discrimination. Why does the Ritz-Carlton have more hidden fees than Super 8? Probably because the Ritz-Carlton caters more to business travelers, who in general have more inelastic demand curves when choosing where to stay. In addition, business travelers—who are frequently reimbursed for their expenses—are more likely to have inelastic demand for amenities such as parking, Internet service, and high-priced restaurant meals. Tourists, by contrast, are likely to be highly price elastic and more alert to the cost of hidden fees and other add-ons.

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<sup>45</sup> Indeed, this is the idea that implicitly underlies their model as illustrated by their example that firms that price transparently would be competed out of the market by those that exploit consumer biases.

Thus, ironically and utterly contradicting the shrouded fees model, it is the ordinary consumer who is *least* likely to pay hidden fees, such as Internet access, and sophisticated business people who are most likely to do so. In short, the “market” has divided itself into two distinct markets—for those who are sophisticated about prices (ironically ordinary consumers) and those who are unsophisticated (powerful CEOs and high-powered business executives).

But, what about Gabaix and Laibson’s concern that “transparent” pricing firms eventually will be competed out of the market by unscrupulous firms? Southwest estimates that because of its refusal to impose new fees on customers, it has foregone approximately \$500 million per year in new revenues.<sup>46</sup> But as a story in *Forbes* magazine summarized:

In the end it was a genius move and typical Southwest: unconventional, brash, unabashed. By refusing to nickel-and-dime customers, Southwest added two percentage points of market share, increased passenger loads by 10% and brought in \$2 billion in incremental annual revenue—at a cost of \$500 million or so in forgone bag fees. “We added 24% more revenue per mile without buying another plane,” says [Southwest’s CEO].<sup>47</sup>

In short, while the “shrouded fees” theory is interesting, it seemingly fails on its own terms, as a simple economic theory of price discrimination between tourist and business travelers provides a much more robust explanation of observed market behavior.<sup>48</sup> Once again, the assumption that seemingly problematic intentions are *actually* problematic based on behavioral assumptions is undermined by Alchianian insights that counsel restraint.

More generally, Fred McChesney notes that many of the claims of behavioral law and economics have not been sufficiently well defined and empirically tested to reject alternative hypotheses. For example, McChesney observes that many of the biases supposedly identified by behavioral law and economics scholars can actually be explained more persuasively by traditional economic models, such as bounded rationality.<sup>49</sup>

Similarly, Todd Zywicki observes that many key elements of the behavioral law and economics hypothesis are rejected by available evidence. Thus, for example, while behavioral economics predicts that consumers will systematically err in their propensity to revolve debt on their credit

<sup>46</sup> See Todd J. Zywicki, George Mason University, Presentation at the Public Policy Conference on the Economics of Consumer Protection: The Institutions of Consumer Protection: Competitive Markets, Common Law, and Regulation (Oct. 22, 2012) (on file with the authors).

<sup>47</sup> David Whelan, *All Grown Up*, FORBES, Jul. 18, 2011, at 98, 98, available at <http://www.forbes.com/forbes/2011/0718/features-southwest-airlines-gary-kelly-midway-grown-up.html>.

<sup>48</sup> One suspects that similar patterns would be observed across other markets. For example, casual empiricism suggests that discount menswear stores such as Men’s Wearhouse charge lower fees for services such as alterations than higher priced clothiers such as Brooks Brothers.

<sup>49</sup> McChesney, *supra* note 5.

cards—by systematically underestimating their likelihood of revolving—in fact, while consumers do make errors, their errors are unbiased: they are just as likely to overestimate as underestimate their likelihood of revolving, rebutting the hypothesis of behavioral law and economics.<sup>50</sup> Meanwhile, not only do most payday loan customers accurately estimate how long it will take them to pay off their loans, the distribution of errors by those who make mistakes is also systematically unbiased, as consumers are just as likely to overestimate as underestimate how long it will take them to pay off their loan.<sup>51</sup>

### C. *Unevolved Species: Government Regulators and Behavioral Economics*

As discussed above, Alchian's model suggests that antitrust and consumer protection intervention against successful firms is misguided because the ones that exist by definition are doing presumptively as well as the market allows. The only reason to intervene is if we think individuals in government could possibly know better. Of course, even in the best of circumstances, governments likely cannot.<sup>52</sup>

In fact, if biases exist—and surely they do—and if firms that survive do so in part because they mitigate the negative effects of bias better than their failed brethren—as must also often be true—then there is a perverse irony in government intervention challenging the business practices of successful firms.

Alchian focuses us on the dynamic of an evolutionary model comprising two evolving elements: variation and selection. Behavioral biases (irrationality) produce considerable variation in conduct. For Alchian, if variation is random and if the selection process is sharp enough, then it will seem that the variation itself was purposeful—rational or intended to produce the successful result it produced. If selection pressure is weak, then fundamental human irrationality, ignorance, and uncertainty will dominate.

What matters, then, for our confidence in regulatory policy, which is also the product of imperfect humans acting in an uncertain environment, is what and how strong the selection pressures are on government actors—to what extent “bad” variations get weeded out in political and regulatory processes.

In other words, the key question in assessing the propriety of government intervention to correct perceived market problems is whether bureau-

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<sup>50</sup> See Zywicki, *supra* note 29.

<sup>51</sup> See Ronald Mann, *Assessing the Optimism of Payday Loan Borrowers*, 21 S. CT. ECON. REV. 105 (2014).

<sup>52</sup> Ludwig von Mises, *Economic Calculation in the Socialist Commonwealth*, in COLLECTIVIST ECONOMIC PLANNING 87 (F. A. Hayek ed., Lowe and Brydone 2009) (1935).

cracies face selection pressures to abandon failed policies and adopt good ones relative to markets. For several reasons the answer to this is most likely, “no.”

Justifying government intervention on the basis of biases identified by behavioral economics highlights a further problem: there is no reason to expect the regulators themselves to be bias-free. In fact, scholars have identified many biases which seem to affect regulators: bounded rationality, action bias, availability and hindsight biases, motivated reasoning, affect heuristics, overconfidence, focusing illusions, confirmation bias, and groupthink.<sup>53</sup>

Moreover, government actors are subject to rent-seeking and the well-known concentrated benefits/diffuse costs problems that affirmatively reward bad policies.<sup>54</sup> Second, there is a selection effect in government, as well, that favors individuals susceptible to these pressures—with a comparative advantage in maximizing their own return in such an environment. Third, there is a severe attenuation between regulatory results and a regulator’s compensation that limits the feedback—and ability to profit—from “good” conduct. Moreover, what feedback there is has the perverse effect of rewarding excessive risk aversion or empire building. As Steve Choi and Adam Pritchard said of the SEC:

If both investors and regulators operate under the influence of behavioral biases, . . . regulation may well do more harm than good. . . . Investors that perform poorly will either learn . . . or exit the market. Private institutions face similar market pressures to serve the interests of their client-investors or perish. . . . The market may not function perfectly, but regulators under the present regime face no such pressures. To the extent regulators themselves make the decision whether to intervene into markets, the risk of ill-conceived intervention is even more acute.<sup>55</sup>

While Alchian’s paper focused primarily on firms, there are reasons to believe even consumers overcome biases in ways behavioral economists often miss. Behavioral economists often point to lack of willpower on behalf of consumers as the reason they cannot remain on diets or quit drinking alcohol. In effect, “internalities” occur when individuals in their present self, impose costs on their future self. This, in turn, is often used to justify essentially Pigouvian regulations such as bans, regulations, and taxes on foods and drinks thought to contribute to such problems. But this story fails to recognize the basic Coasean point: if transaction costs are low, individu-

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<sup>53</sup> See, e.g., Slavisa Tasic, *Are Regulators Rational?*, 17 JOURNAL DES ECONOMISTES ET DES ETUDES HUMAINES, no., 2011, art. 3 (2011).

<sup>54</sup> See generally MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (2d ed. 1971).

<sup>55</sup> Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC*, 56 STAN. L. REV. 1, 72 (2003); see also James C. Cooper & William E. Kovacic, *Behavioral Economics and Its Meaning for Antitrust Agency Decision Making*, 8 J.L. ECON. & POL’Y 779 (2012).



als will likely find a beneficial bargain between their present and future selves.<sup>56</sup> Thus, for instance:

The short-run self could reduce its Twinkie consumption, eat a Twinkie Lite instead, or have it with a Diet Coke instead of a Coke. Alternatively, the long-run self could adopt measures designed to reduce the Twinkie's future effects. It could, for instance, commit to exercising more often (or more vigorously) by joining a gym or making agreements with workout partners. Or the long-run self might resign itself to taking heart medications. Which route is most efficient depends on the subjective cost of the different options. If the future-oriented self were the least cost avoider, a Twinkie tax would not improve matters. It would induce the present self to eat fewer Twinkies, even though the future self could have avoided or reduced the harm at a lower cost.<sup>57</sup>

The ability of a consumer to enact such a bargain with himself is limited only by transaction costs. Generally, one will know one's self better than an outside party does. Even though contract enforcement is likely unavailable, weak-willed persons can find external enforcement if needed, such as by joining Alcoholics Anonymous or Weight Watchers, or by advertising resolutions to family and friends who can keep them accountable. Like real estate agents and credit scores, these devices serve to mitigate biases. Precommitment strategies can also be an effective way to raise costs of deviation from an agreement between present and future selves, like by banning soda from the house and making it necessary to go buy and consume it elsewhere.

Consumers have an incentive to constrain biases in their private lives. Whether it is simply to save money or enjoy a healthier lifestyle, both the costs and benefits will accrue directly to individuals as they work to find an equilibrium between their present and future selves. Whether these practices are consciously adapted by consumers in attempts to overcome biases or the market environment adopts these practices by rewarding those who better constrain biases, one can predict that most consumers will generally act as if they are more rational than given credit for by behavioral economists.

Scholars have warned regulators about behavioral biases and encouraged them to overcome them (through conscious adaptation).<sup>58</sup> But, as noted, the fact that regulators suffer from the same biases as everyone else will not be an obstacle to implementation of rational policies if regulators and politicians are subject to selection pressures that cause them to act as if they are rational.

As we have argued, Alchian's evolutionary model implies that firms that remain in the marketplace over time will likely have found way to con-

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<sup>56</sup> See GLEN WHITMAN, AGAINST THE NEW PATERNALISM: INTERNALITIES AND THE ECONOMICS OF SELF-CONTROL (CATO Pol'y Analysis No. 563, 2006), available at <http://www.cato.org/sites/cato.org/files/pubs/pdf/pa563.pdf>.

<sup>57</sup> *Id.* at 6.

<sup>58</sup> See generally Cass Sunstein, *Cognition and Cost Benefit Analysis*, 29 J. LEGAL STUD. 1059 (2000).

strain biases. Unfortunately, regulators are not subject to the same evolutionary pressures. And to the extent that they are, those pressures appear to be highly attenuated compared to the gale of market pressures that Alchian describes for competitive markets. Without the mechanism of profit and loss, government regulators have no feedback mechanism to constrain biases. The consequence is that political actors do not face selection pressures likely to eliminate poor variations in the regulatory policy “market.”

Voters, the residual claimants of government regulation, often lack the information and ability to successfully choose the regulators in charge.<sup>59</sup> Polls consistently show Americans lack the basic information about current events, policy, and government to effectively hold government officials accountable. In fact, some scholars claim that such ignorance is rational since it is costly to search out information compared to the marginal benefit of casting an informed vote. Further, cognitive biases appear to prevent even the most motivated and informed citizens from successfully interpreting available information. Scholars call this rational irrationality, as it is often psychologically costly for people to overcome beliefs that make them feel good, even if the evidence is against it. Thus, there is little reason to expect government “firms” to develop ways to constrain biases as private firms have in pursuit of positive profits.<sup>60</sup>

Moreover, far from ameliorating irrational biases, regulatory processes appear to exacerbate some of these irrationalities or to add additional ones. For example, political scientists have identified multiple pathologies to which bureaucracies are susceptible when unconstrained, such as inefficient levels of risk aversion, tunnel vision emphasis on their agency’s mission at the expense of other social goals, and irrationality in the estimation of the marginal costs and benefits of their agency’s agenda.<sup>61</sup> Thus, for example, although the FDA is frequently criticized for its inefficient risk aversion in permitting new products to come to market, there appears to be little incentive for the agency to correct this tendency in light of the institutional context in which it finds itself.

There is little reason to expect government to evolve ways to constrain its biases as Alchian describes private firms doing in pursuit of positive profits; the inefficient decision making we see in government is not likely masking a hidden, efficient organizational response to counteract costly biases. Thus irrational regulators in this situation are unlikely to outperform the market—to consistently identify truly inefficient behavior and organization faced with, and measured against, the market’s selection

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<sup>59</sup> See, e.g., ILYA SOMIN, *DEMOCRACY AND POLITICAL IGNORANCE: WHY SMALLER GOVERNMENT IS SMARTER* (2013); BRYAN CAPLAN, *THE MYTH OF THE RATIONAL VOTER: WHY DEMOCRACIES CHOOSE BAD POLICIES* (2008).

<sup>60</sup> Tasic, *supra* note 53, at 10.

<sup>61</sup> See MAXWELL L. STEARNS & TODD J. ZYWICKI, *PUBLIC CHOICE CONCEPTS AND APPLICATIONS IN LAW* 324-405 (2009) (chapter 6).

mechanism that presents them with *apparent* inefficiency that is really the market's own response to the irrationality of market actors.

## CONCLUSION

Contrary to the bold claims made by some behavioral economists, models which assume rationality and self-interest on behalf of market participants are still useful for predicting future behavior. Alchian's model, expounded in *Uncertainty, Evolution, and Economic Theory*, helps to explain why: evolutionary pressures of the marketplace select those most fit for survival under given conditions, which often means those best at constraining behavioral biases. It also implies that seemingly inefficient market and firm structures may exist to ameliorate these biases and thus confer unappreciated efficiency. With this in mind, regulators should be wary of making the leap from diagnosing biases in a laboratory to intervening in the marketplace.

SOME REFLECTIONS ON ARMEN ALCHIAN'S CONTRIBUTIONS TO  
GEORGE MASON UNIVERSITY SCHOOL OF LAW AND THE  
FEDERAL JUDICIARY

*Joshua D. Wright\**

INTRODUCTION

There are precious few economists whose contributions to their field—pick any field—leave one stymied as to where to begin a proper appreciation. Economists of considerable talents have already documented the importance of Armen Alchian's contributions, ranging from statistical methods to understanding inflation, but especially surrounding the creative and rigorous application of price theory to property rights. Others who knew Armen for much longer than I are better suited to illuminate the man's great character, personality, and his immense humility even in the face of his authentically giant contributions to economics. There are some here at this Symposium in his honor who experienced Armen's style and skill in the classroom firsthand; by the time I began my Ph.D. at UCLA, Armen no longer taught the graduate microeconomics sequence.

I nonetheless feel qualified to share my views on Alchian's contributions to George Mason School of Law (GMUSL). I am Armen's last doctoral student and have been at George Mason in some capacity or another since 2004. My mentor and dissertation advisor, Ben Klein, suggested Armen and Harold Demsetz for my committee; Klein told me that I would learn more economics that way than any other. He was right. Alchian, Klein, and Demsetz taught me more economics, individually and collectively, than all of my graduate coursework combined. As I have mentioned, I did not take any courses from Armen. What I learned from him I gathered in whatever free time he was willing to share with me during visits to his office and an occasional walk around campus. Armen had extended an open invitation for me to drop by the office and ask questions and I certainly took advantage of the opportunity. My questions always inspired a volley of return questions. Armen was a true master of the Socratic Method

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\* Wright: Commissioner, Federal Trade Commission, and Professor of Law (on leave), George Mason University School of Law. The views expressed here are my own and do not represent those of the Federal Trade Commission or any of its Commissioners. I am grateful to Bruce Kobayashi, Henry Manne, Fred McChesney, and participants at the Symposium on the Unique Contributions of Armen Alchian, Robert Bork, and James Buchanan to George Mason University School of Law for helpful comments on an earlier draft. I thank Henry Butler for graciously providing me access to the archives of the George Mason University Law and Economics Center. Samantha Morelli provided valuable research assistance.

who possessed a skill in that technique that many, if not all, of my law school colleagues would envy.<sup>1</sup>

My anecdotal account of Armen's contributions focuses on two often overlooked dimensions of his legacy: his influence upon the intellectual culture of GMUSL's own faculty and the federal judiciary through his many years at the Law & Economics Center (LEC), teaching economics to judges.

I begin with a personal tale from the legal academic job market to shed some light on Armen's influence on the George Mason University School of Law faculty. I reluctantly stumbled into an interview with George Mason Law in the fall of 2003 after I had earned my J.D. from UCLA in 2002 and with my Ph.D. forthcoming in a few months, with what I hoped would be a successful dissertation defense. Like most twenty-something-year-olds, I wasn't exactly sure what I wanted to be when I grew up—maybe an academic, maybe a practicing antitrust lawyer, maybe something else altogether. As some of my friends and George Mason colleagues in the room know, I spent a disproportionate amount of time in those days applying statistical analysis in Las Vegas and other venues rather than pursuing the next frontier of my research agenda. I had passed on putting myself on the legal academic job market more formally. The interview was largely the fortuitous circumstance of a longstanding connection between the UCLA Economics Department and George Mason—owed to Henry Manne and the LEC—that resulted in the George Mason hiring committee folks hearing about my “strong interest” in teaching law. To tell you the truth—I hadn't heard about my strong interest in teaching either. But my UCLA advisors must have been inclined to see me get a “real” job.

I landed in the fall of 2003 to give my George Mason job talk. The talk was pure economics: an economic theory of shelf space contracts—some antitrust implications followed from the central economic contribution of the analysis, to be sure, but it is safe to conclude that the presentation could be described accurately as containing all economics and no law. I thought I had done well in the talk. I had not. I had missed the point. I had not understood that the job talk was largely an opportunity for the faculty to figure out: (1) whether I was intellectually interesting enough for them to keep around; and (2) to answer pressing questions about whether I was going to be a good fit. In my case, one of the important questions was whether I had any real interest in the law. By paper selection—not that I had a choice of other papers—and my neat, model-driven, economics-bound responses, I had failed this second test miserably.

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<sup>1</sup> I recall one of his first questions regarding the distribution of men to women across various parts of UCLA's campus. The question was an economics test, of course. He hinted that a correct answer would fully incorporate the university's role in facilitating marriage markets. I leave the rest as an exercise for the reader.

The faculty vote came down on a tenure-track offer and I wasn't close to the requisite number of votes. A few law and economics faculty who managed to hold onto some small degree of hope for my prospects as a law professor asked whether the faculty might entertain a term appointment in the form of a short tryout period instead. In support of this motion, Bruce Kobayashi—a fellow UCLA Economics Ph.D.—assured the faculty that the short term commitment meant exit costs would be low if I was a bust but that he suspected it would work out just fine. I hasten to add that this was not because Bruce thought I had proven myself worthy of a tenure-track appointment: he didn't, and never fails to remind me! Rather, Bruce's support came because, as he announced to the faculty without further explanation, "He's a Bruin." The tryout offer came by way of a unanimous vote. It turns out that being a "Bruin" meant something here at GMUSL. And it's that connection—a deep connection between Armen and the intellectual roots of UCLA—I want to explore a bit more.

#### I. ARMEN ALCHIAN, THE UCLA SCHOOL, AND ITS LASTING INFLUENCE ON GMUSL

Celebrating the contributions of Armen here at George Mason makes it especially appropriate to reflect a bit upon what he means to this particular law school and to this faculty. Having already confessed that I owe my good fortune of joining the George Mason faculty in 2004 to free-riding on the brand-name capital Armen created at UCLA over the decades prior, it is worth pointing out just how deep the UCLA–GMU connection runs. Professors Kobayashi and Hazlett were also Ph.D. students at UCLA during the 1980s; Professor Muris was an undergraduate student of Armen's at UCLA as well. Armen Alchian, Harold Demsetz, and Ben Klein all taught in the LEC programs and remained close to Henry Manne, the LEC, or both.

But I would suggest the intellectual association between the Alchian-created UCLA School of Economics—which I would characterize for our purposes as Chicago Price Theory with an emphasis on application to property rights and institutions—and George Mason School of Law is much closer than it might first appear from the list of associations described above. Alchian's UCLA School runs through this institution's intellectual DNA for a fundamental reason: its influence on Dean Emeritus Henry Manne.

Henry Manne himself learned most of his economics—at least, the economics he would apply to solve legal problems in his own seminal scholarship—from Armen Alchian. Despite his exposure to Aaron Director and Chicago Price Theory at the University of Chicago, I speculate that it was the uniqueness of Armen's approach to economics that had far greater influence on Manne's thinking. And while there are many unique strands

within the UCLA School, as is the case with Chicago or Virginia, what makes the UCLA approach unique is its rigorous application of price theory and its analytical tools to *property rights*. Without the influence that Alchian's approach to price theory and property rights had on Dean Manne, I doubt George Mason would enjoy the vibrant intellectual culture it does today or have been nearly as successful or remotely as interesting for its students. I am the fortunate beneficiary of Armen's intellectual and personal contributions to George Mason, UCLA, and Henry Manne many times over and have been incredibly fortunate to teach here in a place that found its own intellectual voice around his work.

## II. ARMEN ALCHIAN, THE LAW AND ECONOMICS CENTER, AND JUDICIAL EDUCATION

Armen was fond of invoking predatory pricing as an example to teach the judges to think like an economist about the pricing tactics of firms. The example comes up again and again in his teaching materials: *University Economics* for students,<sup>2</sup> *Universal Economics*,<sup>3</sup> and his teaching notes.<sup>4</sup> Usually this discussion took the form of explaining that the profit-maximizing firm equates marginal revenue to marginal cost across markets or products with a number of entertaining examples. The examples worked well to illuminate the economics of pricing. Consider these two examples that illustrate Armen's influence on judges through his lessons on predatory pricing alone.

One judge publicly stated that he had written but not published an anti-trust opinion involving allegations of predatory pricing before attending an LEC program. After attending and gaining a better understanding of pricing and the concept of marginal costs, the judge set aside a \$15 million (in 1978 dollars) antitrust verdict in a sophisticated opinion explaining—with footnote material including cost curves and all—why average variable cost was a poor proxy for marginal cost in an industry with excess capacity.<sup>5</sup>

The second example comes from a textbook hypothetical in Armen's teaching materials that any antitrust lawyer would quickly recognize as a stylized version of the facts of *Zenith v. Matsushita*, the famous antitrust case involving allegations of collusive predatory pricing (collusion in Japan to predate in the United States). Alchian quickly scolds readers who would conclude “incorrectly that the Japanese producers and customers are subsidizing U.S. customers by selling at prices ‘below cost,’” reminding them

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<sup>2</sup> ARMEN ALCHIAN & WILLIAM R. ALLEN, *UNIVERSITY ECONOMICS* (3rd ed. 1972).

<sup>3</sup> ARMEN ALCHIAN, WILLIAM R. ALLEN & ARLINE HOEL, *UNIVERSAL ECONOMICS* (2005).

<sup>4</sup> Teaching notes from Armen Alchian (on file with author).

<sup>5</sup> See *William Inglis & Sons Baking Co. v. I.T.T. Cont'l Baking Co.*, 461 F. Supp. 410, 419 n.7 (1978).

that “[y]ou’d have to conclude the Japanese producers were being deliberately charitable to U.S. customers—if you believed the subsidization story.”<sup>6</sup> He then turns to the economics,

Instead, every unit is covering the cost of production. The lower priced units, like the higher prices ones, each bring marginal revenues that exceed their associated marginal costs. The American customers are delighted. Within the U.S., the objectors are those who own resources, and sources of income, specialized to the manufacturer of the domestic products competing with imports.<sup>7</sup>

With the specific example came more general skepticism about the likelihood of success of a predation strategy and the conclusion that “below-cost selling as a predatory tactic is not as smart as it is alleged to be.”<sup>8</sup>

And what about *Zenith v. Matsushita*?<sup>9</sup> The case is well known in antitrust circles primarily for its holding with respect to the evidence a plaintiff is required to proffer in order to avoid summary judgment in a case alleging conspiracy. But it has also long been a critical case in modern predatory pricing jurisprudence. The district court judge who wrote the opinion before his promotion to the Third Circuit—the opinion ultimately upheld by the Supreme Court—was an LEC student. The opinion bears Armen’s intellectual signature a la *University Economics*.

These two vignettes illustrate not just Armen’s influence in two cases, but how Armen helped discipline a paradoxical and incoherent legal outpost. Armen’s lessons on costs, pricing, competition, and monopoly were shared with hundreds of federal judges. Some of my work with Michael Baye suggests that the LEC’s influence—no doubt attributable in large part to Armen’s teaching—on the federal judiciary in antitrust cases has been remarkably positive.<sup>10</sup> There, we examined all antitrust decisions in federal court cases from 1996 to 2006. Controlling for case-specific and judge-specific characteristics as well as other factors, we found the federal judges exposed to LEC training produced antitrust decisions that are significantly less likely to be appealed or reversed than their untrained counterparts. Indeed, basic economic training—and in our sample, this meant exposure to a serious dose of Armen—had a greater impact on appeal and reversal rates than a marginal increase in judicial experience in deciding similar cases. Apparently, early LEC efforts to train Federal Trade Commission (the Commission) staff were not quite as successful—subsequent research shows that even untrained federal district court judges outperform the

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<sup>6</sup> ALCHIAN & ALLEN & HOEL, *supra* note 3, at 354-55.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Zenith Radio Corp. v. Matsushita Elec. Indus.*, 513 F. Supp. 1100 (E.D. Pa. 1981), *aff’d in part, rev’d in part*, 723 F.2d 238 (3d Cir. 1983), *rev’d*, 475 U.S. 574 (1986).

<sup>10</sup> Michael R. Baye & Joshua D. Wright, *Is Antitrust Too Complicated for Generalist Judges? The Impact of Economic Complexity and Judicial Training on Appeals*, 54 J.L. & ECON. 1, 30 (2011).



Commission by these measures.<sup>11</sup> I must conclude even Armen's brilliance has some limits, lest I comment on my colleagues.

These conclusions provide hope for those devoted to the institution of the generalist judge but skeptical of individual judicial capabilities. Even exposure to basic economic training can have profoundly positive effects on outcomes and, in the case of antitrust, perhaps on a field. Credit is often given—and appropriately so—to the Supreme Court and to prominent judges in the Courts of Appeals such as Bork, Easterbrook, Ginsburg, and Posner, for the economic revolution in antitrust law. Given the quantity—over 600 judges, by one count—and quality of Armen's interactions with the federal bench, it would be a mistake not to recognize his subtle but profound influence in facilitating that revolution. The empiricist in me, however, cautions that there is also serious cause for pessimism with regard to the hopes for judicial education in antitrust. There is just one Alchian in front of the classroom. I know many of Armen's former students and have collected hundreds of anecdotes about the application of his teaching styles and methods to undergraduates and judges—and maybe even a few anecdotes about intellectually torturing graduate students with economic puzzles and challenges at the blackboard—but I have never heard anyone, even in passing, claim to have seen his superior in the classroom.

Nobel Laureate and Alchian student William F. Sharpe captures some of this in his autobiographical exposition explaining Alchian's influence on his own career:

Armen Alchian . . . was my role model at UCLA. He taught his students to question everything; to always begin an analysis with first principles; to concentrate on essential elements and abstract from secondary ones; and to play devil's advocate with one's own ideas. In his classes we were able to watch a first-rate mind work on a host of fascinating problems. I have attempted to emulate his approach to research ever since.<sup>12</sup>

Sharpe captures nicely the essence of Alchian's approach to teaching and research—an approach that subtly but indelibly changed the professional lives of a long line of Alchian students both inside and outside of Westwood, much of the federal bench, and the intellectual foundation of GMUSL.

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<sup>11</sup> Joshua D. Wright & Angela M. Diveley, *Do Expert Agencies Outperform Generalist Judges? Preliminary Evidence from the Federal Trade Commission*, 1 J. ANTITRUST ENFORCEMENT 82, 101 (2013).

<sup>12</sup> *William F. Sharpe - Biographical*, NOBELPRIZE.ORG, [http://www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/1990/sharpe-bio.html](http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1990/sharpe-bio.html) (last visited July 13, 2014).

## CONCLUSION

I want to close on an optimistic note by sharing a recent encounter that suggests—Nobel Prize or otherwise—the reach of Armen's influence in the global marketplace for economic ideas. In my new job as a Federal Trade Commissioner I am fortunate enough to have the opportunity to do some international travel, including a number of speaking engagements over the last nine months on antitrust economics at academic conferences and universities in China. During one recent trip to Beijing, after I gave my talk on the economics of antitrust in high-tech markets or some other topic, the question-and-answer session meandered from question to question but largely focused not upon the economic substance of the talk but institutional details about the antitrust regime in the United States compared to China. I feared the talk had failed. Or perhaps something had been lost in translation. In any event, that was until one graduate student asked me, "I understand that you were a student of the great Armen Alchian. What was that like? What was he like? Don't you think he should have won a Nobel Prize?" The session took an immediate turn for the better. The students in the room not only knew Alchian's work, but he was a rock star! For the rest of the session we talked about the economics of property rights, team production, brand-name capital, rights of first refusal, the theory of the firm, and the great days of the UCLA School of Economics. We went thirty minutes over the allotted time. It was a great day. And the best part about it was that I knew that day, from meeting those students, that George Mason would face fierce competition in the market for spreading the Alchian approach to teaching and research to the next generation of law and economics scholars.



MAGNUS MAGISTER: AN AFFECTIONATE APPRECIATION OF  
ARMEN ALCHIAN

*Fred S. McChesney\**

When my life is through  
And the angels ask me to recall  
The thrill of them all  
Then I will tell them I remember you.<sup>1</sup>

The story of Hayek's prediction that neither Ronald Coase nor Armen Alchian would ever win the Nobel Prize in economics is now familiar to most economists.<sup>2</sup> Hayek was, of course, proven half wrong when Coase was awarded the prize in Stockholm, but alas, he was half right. Armen Alchian never acceded to Nobelism.

At least the Scandinavian gods sometimes get it right—their recognition of Jim Buchanan is another such example.<sup>3</sup> It is hardly obvious that Armen's exclusion from Valhalla means much, if anything. A review of those honored with the prize, since it was first awarded in 1969 to Ragnar Frisch and Jan Tinbergen, indicates that laureate status is not a sufficient condition for truly long-run economic greatness or even for durable impact in the profession.

Nor is it a necessary condition, as the life of Armen Alchian proves. His manifest durability is a function, of course, of his numerous and important contributions to our economic understanding.<sup>4</sup> But Armen's continued greatness is assured not just by his creating a new way of thinking

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<sup>1</sup> VICTOR SCHERTZINGER & JOHNNY MERCER, I REMEMBER YOU (1941). The song, supposedly written by Johnny Mercer for Judy Garland, was first recorded in the early 1940s by Jimmy Dorsey and has been sung by many. It was a big success for Frank Ifield, reaching number 1 on the British and number 5 on the American charts in 1962.

<sup>2</sup> It was recently retold by the economist whose question to Hayek prompted the prediction. David R. Henderson, *An Economist Who Made the Science Less Dismal*, WALL ST. J., Feb. 19, 2013, available at <http://online.wsj.com/news/articles/SB10001424127887323495104578314253161656148>.

<sup>3</sup> Per my commission, this paper largely concerns Armen Alchian. However, I cannot write about Armen without some mention of another honoree at this conference, Jim Buchanan. Knowing Jim has likewise been a memorable part of my life as an economist. He was, of course, one of the few greats in economics. But he was also a delightful person, except, perhaps in some seminars at the University of Virginia, and later at Virginia Tech, in which Jim did not suffer fools gladly. And he was just a wonderful raconteur. He was a Southerner, after all.

<sup>4</sup> "If time is the ultimate test of the value of these ideas, Armen's work has met that test." John R. Lott, Jr., *Armen A. Alchian's Influence on Economics*, 34 ECON. INQUIRY 409, 411 (1996).

about economic problems, but also by his work to pass it on to the next generation. Even among Nobelists, there can have been no better, more patient a teacher than Armen Alchian.<sup>5</sup>

That is an empirical claim, and so empirical evidence of Armen's pedagogic talents and influence are desirable. In this short piece, I offer a slight bit of evidence that I hope is convincing. It is based on a small sample: myself. Unlike many Alchian acolytes, I was not a teaching colleague or graduate student of his, although I was the beneficiary of learning from many who were: Louis De Alessi, Dave Haddock, Ken Clarkson, Roland McKean, Don Martin (bless him), just to name some.<sup>6</sup> And so I came to understand, indirectly, what a careful and patient teacher Armen was. But I was fortunate to have more direct, unforgettable experiences with Armen Alchian.

Indeed, my induction into the ranks of card-carrying economists is partly due to him. While a fellow at Henry Manne's Law & Economics Center at the University of Miami in the 1970s, I read Armen's justly celebrated article with Harold Demsetz on the firm.<sup>7</sup> The focus of the Alchian–Demsetz article was the problem of worker shirking in firms and how to mitigate it. One way to do so, they noted, was profit sharing. Profit sharers have a reduced incentive to shirk themselves and, in particular, have greater motivation to monitor shirking by nonsharers.

The fundamental Alchian–Demsetz thesis today is routinely acknowledged for its insights, and at the time (still short of my doctorate), I had no quarrel with it, for the most part. The idea of profit sharing to mitigate shirking made complete sense. However, it did not, I thought, explain all profit sharing. To me, in a brief and rather inconsequential application of their model to law firms, the authors had erred.

I did not think that law firms' general use of the partnership form, with multiple owners sharing profits, was explained by shirking. Lawyers had

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<sup>5</sup> A notable exception is James Buchanan. Although Buchanan promoted public choice and Alchian promoted property rights, both sought to create a new way of economic thinking and to inspire a generation of adherents to spread the word to the profession.

<sup>6</sup> As Jim Buchanan is also being feted at this conference, I should note that I have learned much from Jim's students, as well, including Richard Higgins, Jim Miller, Bob Tollison and, particularly, from Charles Goetz, whom Jim always singled out as "the best graduate student I ever had." Charlie was the first reader on my dissertation (i.e., chairman of my committee at the University of Virginia) and has been a long-time coauthor and close friend. Few people are aware that after Jim's expulsion from the University of Virginia, and during his year as a colleague of Armen Alchian's at UCLA, it was Charlie Goetz who realized that the student uprisings at UCLA would greatly upset Jim, and he seized the opportunity to call Jim to suggest that heading back to the calmer academic world in the Commonwealth of Virginia might make sense. Jim quickly agreed and moved back East to join Charlie at Virginia Tech.

<sup>7</sup> See generally Armen A. Alchian & Harold Demsetz, *Production, Information Costs and Economic Organization*, 62 AM. ECON. REV. 777 (1972) (discussing mitigation of the shirking problem within firms).

many ways of monitoring intrafirm performance, I argued (and detailed with descriptive evidence). Moreover, if shirking explained resort to partnership, the number of partners should increase at an increasing rate as the total number of lawyers (including associates) rose, increasing the ease of, and so the amount of, shirking. However, my econometric tests showed that the number of partners *decreased* as the number of lawyers rose and so the supposed amount of shirking was increasing.

Instead, I claimed, profit-sharing status in law firms reflected a division of labor in the firm. Those who were essentially producers remained nonsharing associates; those who could market the firm (“rainmakers”) became partners, where they shared in the profits from clients they generated. There is little opportunity for shirking in landing clients; the source of the firm’s clients is easily tracked.

I had written all this in a paper that Henry Manne, then Director of the University of Miami’s Law & Economics Center (LEC) had read. It so happened that Armen was about to come spend some time at the LEC, as he often did. I was an Olin Fellow at the Center, and Henry urged me to talk to Armen about my alternative hypothesis for profit sharing in law firms.<sup>8</sup> I tried unsuccessfully to beg off, fearing that an interchange with such a famous economist (whom I had never met) would be too demoralizing.

I was therefore stunned by Armen’s reaction. I told him I thought he and his coauthor were wrong about the reasons for profit sharing in law firms. He instantly brightened and asked me to explain. When I did, he at first said nothing—confirming my fears of discouragement. He finally responded, speaking carefully and slowly. He said he did not think he and Demsetz really knew that much about law firms and that my alternative hypothesis (buoyed with actual empirics) made more sense to him.

My head was spinning as I left the room—I was so thrilled. I was pleased, of course, by his positive “take” on my idea. But more stunning was his genuine interest in what I proposed, my economic thinking behind it, and especially his great patience throughout our conversation. I thought to myself that Armen seemed to actually enjoy our exchange and hearing what I was thinking.

So encouraged, I successfully submitted the paper, my first publication of any significance.<sup>9</sup> And, at the suggestion of the first reader on my dissertation committee—Charles Goetz—I included the article, once accepted for publication, in my dissertation as a way to convince my balky third reader

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<sup>8</sup> The importance of Armen Alchian in sparking Manne’s perception of the power of economics to elucidate law remains a largely untold tale, but one worth telling. See *infra* note 23 and accompanying text.

<sup>9</sup> Fred S. McChesney, *Team Production, Monitoring, and Profit Sharing in Law Firms: An Alternative Hypothesis*, 11 J. LEGAL STUD. 379, 379 (1982). Inexcusably, I forgot to include Alchian in the acknowledgements! Armen was famous for advising authors to mention anyone who might deserve it, pointing out that acknowledgements were free.

to approve it. Charlie was right as usual—if peer-refereed professional journals were accepting my work, how could that third reader object? As I was awarded the doctorate, I silently thanked Armen Alchian.

Part of my surprise had been Armen's interest in my statistics, as rudimentary as they were (*t*-tests of differences in means, "multiple" regressions—*two* independent variables!). From his work, I had assumed that he was closer to the Buchanan attitude toward empirics: "I don't need statistics to prove that water runs downhill." At the time, I was unaware of Alchian's deep background in statistics. He had been trained statistically by several extraordinary teachers (e.g., Allen Wallis) while a graduate student. Then, while in the Air Force, he did statistical evaluations of Air Force cadets as part of their training for pilot and other positions. When he came to UCLA, he was given the choice of joining the economics or the statistics department. He taught statistics for years in the economics department. I learned all this from subsequent conversations with Armen.

As I would encounter him over the ensuing years, I realized that my experience was hardly atypical. Ronald Coase was right: Alchian "is classical in manners as well as thought."<sup>10</sup> He truly enjoyed imparting economics to those who could carry it further. Fortunately for me, our future encounters were frequent, thanks again to Henry Manne and the Law & Economics Center. Alchian visited the Center often, sometimes as part of a conference but often just to be in residence. But perhaps most frequently, Alchian was at the LEC as part of its economics institutes for law professors. This aspect of Alchian-the-Teacher's life is less familiar, perhaps, to many, but was enormously influential.

There is another facet to Alchian's career that is less known but of huge significance outside of purely academic economics. In 1971 Professor Manne . . . organized a summer institute in economics for law professors . . . These "summer camps" for law professors continued at various universities for a total of 23 years and were attended by a total of over 600 law professors from the United States and abroad. Armen Alchian did the lion's share of the teaching in every single one of these programs and thus maybe said to be, in a way, not generally recognized a founder of the field of Law and Economics.<sup>11</sup>

Based on the success of the law professors program, Manne and the Center moved on to establish a similar program for federal judges. Once again, the bulk of the teaching came from Armen Alchian (with "assistants" like Harold Demsetz, Martin Feldstein, Milton Friedman, and Paul Samuelson).

Alchian always said that the judges were the best students he ever taught and, if that was so, the judges certainly reciprocated in their appreciation for him. Many of the judges developed

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<sup>10</sup> Ronald A. Coase, *Introduction* to ARMEN A. ALCHIAN, *ECONOMIC FORCES AT WORK* 7, 7 (Liberty Press, 1977).

<sup>11</sup> *Armen Alchian: Obituary*, L.A. TIMES, Feb. 24, 2013, available at <http://www.legacy.com/obituaries/latimes/obituary.aspx?n=armen-alchian&pid=163245781&fhid=11024>.

a special bond with Professor Alchian and stayed in touch with him for years . . . . Alchian continued to be the faculty mainstay of that program for over 25 years and thus had an influence on law which is probably greater than that of any non-legal academic.<sup>12</sup>

Alchian's prolonged participation in the two Center programs, for over two decades, illustrates his indefatigable interest in and energy for economic education, with a particular gusto for those who knew little but were keen to learn more. But in terms of this personal essay, his participation in the lawyers-and-judges institutes was particularly important. Because his lectures were at the Law & Economics Center, first at the University of Miami (where I had been) and then moved with the Center to Emory University (whose faculty I joined), I was always able to stay in touch with Armen by attending many of his lectures as a very interested spectator over the years.<sup>13</sup>

Those continued contacts were in themselves enlightening, but also led later to a wonderful collaboration. I had conceived an idea that, in 1994, I pitched to the Western Economic Association, to put together for *Economic Inquiry* a series of essays by "sub-laureate" economists of great eminence, in which they would identify and discuss what they viewed as their most important works. I mentioned that the series would begin with Armen Alchian. The Association was uninterested in a series, but was already planning an Alchian *Festschrift*. The editors would be pleased to have me work with Armen to produce the sort of précis I had described, with him to focus on the three articles he thought his best.

I contacted Armen to see if he would be interested in such a thing, with him supplying the conversations, e-mails, and so forth, and me turning it all into a finished article. At first, he demurred. But finally, he agreed, writing, "After my first inclination to say No, I've softened. It probably won't be so hard after all." Thus did I become the avid amanuensis of an economic giant.<sup>14</sup>

Typical of him, Alchian was reluctant to speak of his work directly. He decided to talk about the three works he thought his best, but only to illustrate points what he thought would be helpful to young economists coming into the trade. He thus titled his essay *Principles of Professional Advancement*, using his three chosen articles as a springboard to discuss

<sup>12</sup> *Id.*

<sup>13</sup> My Emory colleague David Haddock, who had taught at UCLA with Armen, often accompanied me to observe the master's techniques.

<sup>14</sup> My role is described in *An Introduction to Alchian's "Principles of Professional Advancement."* Fred S. McChesney, *An Introduction to Alchian's "Principles of Professional Advancement,"* 34 *ECON. INQUIRY* 519, 519 (1996). This time the acknowledgements were done right, with Louis De Alessi, Tom Borcherding, Frank Wykoff, and Mark Zupan appropriately thanked for their input, through me, of points Alchian covered. *Id.* at 519 n.\*.



five basic suggestions for success in the profession.<sup>15</sup> The articles concerned uncertainty and evolution in the theory of the firm,<sup>16</sup> measurement of costs and outputs,<sup>17</sup> and information costs.<sup>18</sup> Our work proceeded in fits and starts, as his busy schedule dictated (“Hello Fred. Life has been hectic here the past couple of weeks.”), but was completed in three months.

As we worked on the draft, there were any number of surprises in Alchian’s *Principles* and in his choice of articles to illustrate them. First, the articles he chose were in two cases predictable: his notable pieces on uncertainty and costs and outputs. But his third choice, on information costs, was relatively obscure. Yet, Alchian wrote, “I like to regard this paper as my best.”<sup>19</sup>

It is interesting that, although Alchian does not mention it, this paper almost never saw the light of day. His UCLA colleague Axel Leijonhufvud recalled years later:

[Alchian] heard some tape of mine where I was worrying about price adjustments in competitive markets . . . . And so he came to me . . . . [And] [t]hen he gave me out of his desk drawer his classical paper on “Information Costs, Pricing and Resource Unemployment” . . . .

. . . Why was that paper in his desk-drawer? I have no idea how long it had been there, but the version I got was pretty yellow. I think of this every week . . . .<sup>20</sup>

Armen explained to me why it was still in a drawer: “I just started to try to write up the idea in an expository paper, for my own information and understanding.”<sup>21</sup>

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<sup>15</sup> Armen A. Alchian, *Principles of Professional Advancement*, 34 *ECON. INQUIRY* 520, 521–22, 525 (1996) [hereinafter Alchian, *Principles*] (identifying the referenced articles).

<sup>16</sup> Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 *J. POL. ECON.* 211, 219–20, (1950).

<sup>17</sup> Armen A. Alchian, *Costs and Outputs*, in *THE ALLOCATION OF ECONOMIC RESOURCES* 23, 23–24 (1959).

<sup>18</sup> Armen A. Alchian, *Information Costs, Pricing, and Resource Unemployment*, 7 *W. ECON. J.* 109, 116–23 (1969) (describing unemployment as an effect of information costs).

<sup>19</sup> Alchian, *Principles*, *supra* note 15, at 525.

<sup>20</sup> Axel Leijonhufvud et al., *In Celebration of Armen Alchian’s 80th Birthday: Living and Breathing Economics*, 34 *ECON. INQUIRY* 412, 421 (1996).

<sup>21</sup> The story brings to mind Alchian’s *Uncertainty and Evolution* article, which initially was just a manuscript that he had written for a classroom handout, but was urged to send to the *Journal of Political Economy* by a UCLA colleague. Alchian, *Principles*, *supra* note 15, at 521. It is also reminiscent of how Jim Buchanan’s close colleague, Gordon Tullock, came to publish his most important contribution. Alice Vandermeulen, coeditor of the fledgling *Western Economic Journal* for the Department of Economics at UCLA, called Gordon in the mid-1960s inquiring whether he had anything he would like to submit to the new journal. Gordon reached into his drawer and sent Vandermeulen a manuscript that had been rejected so many times elsewhere that he had stopped circulating it. Vandermeulen published

Leijonhufvud's account illustrates another recurring part of Alchian's pedagogical life. Not just his graduate students, but his colleagues were also among the educated.<sup>22</sup> His ability to enlighten the *cognoscenti* stemmed in part from his talent at applying economics to matters that, substantively, were new to him but that, methodologically, were just grist for the economist's mill. Wielding the economic tool kit permitted Alchian to size up and to begin providing answers to questions brought to him by others who had already been pondering them for some time.<sup>23</sup>

Alchian's including the *Information Costs* paper on his list in a world without scarcity would make some sense. But given the limit of just three articles to discuss that of which he was most proud, Armen's third and final choice foreclosed mention of anything for which he is probably most famous: the theory of property rights and insistence on their importance (therefore almost totally neglected) in economics.<sup>24</sup> The first two articles he identified made clear contributions to economists' (a) theory of the firm and (b) theory of costs. But what of Alchian's work in property rights, a

it. See generally Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 W. ECON. J. 224 (1967) (identifying the concept of "rent-seeking" behavior).

<sup>22</sup> Armen's colleague Dave Haddock was teaching the industrial organization course at UCLA, and wanted to talk to his class about basing-point ("delivered") pricing. He naturally turned to the then-definitive article on the subject: George J. Stigler, *A Theory of Delivered Price Systems*, 39 AM. ECON. REV. 1143, 1143 (1949). Haddock wanted to convert Stigler's reasoning into economic diagrams, but found that was impossible because, as he tells the story, "Stigler was wrong." Haddock then put together some notes and diagrams of his own, and took them to discuss with Alchian. Alchian agreed with Haddock's analysis (he, too, had thought Stigler wrong). Thus encouraged, Haddock formalized and published his work. See generally David D. Haddock, *Basing-Point Pricing: Competitive vs. Collusive Theories*, 72 AM. ECON. REV. 289 (1982) (analyzing uniform-price auction rules and creating a strategic means to underprice when the seller has an interest in ownership dispersion).

<sup>23</sup> In the late 1950s, Henry Manne heard Armen present a paper on property rights at a Volker Fund conference at Claremont College. He approached Alchian to talk about property rights and corporations, a subject famously misanalysed in Berle and Means' *The Modern Corporation and Private Property*. See generally ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932) (discussing corporations, stock ownership, and property rights in the private enterprise context). Armen suggested he read Anthony Downs's *An Economic Theory of Democracy*, and thereafter Manne developed his path-breaking theory of the market for corporate control. See, e.g., Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 110 (1965). That article's influence can be seen in the enormous number of citations it continues to generate. See generally William J. Carney, *The Legacy of "The Market for Corporate Control" and the Origins of the Theory of the Firm*, 50 CASE W. RES. L. REV. 215 (1999) (describing the whole of Henry Manne's contribution). Manne later remarked, "I have no doubt that if [Alchian] had really turned attention to the topic, we would have understood the market for corporate control much earlier than we did. It all seemed so obvious to me six years later that I am sure he saw the connection even then." Letter from Henry Manne to author (on file with the author).

<sup>24</sup> Perhaps some mitigation of scarcity still would not have caused Armen to include his work on property rights. He wrote to me that he had enjoyed writing about the three articles discussed in his *Principles*, and said he was ready to add commentary on two more. Neither of them had anything to do with property rights.

field he practically defined? As Coase wrote, “He played the leading role in the development of a theory of property rights.”<sup>25</sup> The *Fortune Encyclopedia of Economics* selected him to write the entry on property rights, stating, “Most of his major scientific contributions are in the economics of property rights,” repeating later that, “Alchian’s large impact was in the economics of property rights.”<sup>26</sup>

So, why was Armen’s (admittedly short) list devoid of any article on property rights? Only one reason has ever occurred to me: because his seminal property rights pieces appeared in somewhat obscure places.<sup>27</sup> But this cannot be the entire explanation; as one would expect of him, Alchian was relatively indifferent to publishing pedigrees. But still, it may explain some of the failure to mention his property rights work. Apropos of the second article he chose for his *Principles of Professional Advancement*, he wrote,

“Costs and Outputs” . . . was accepted for publication in the American Economic Review. But then I was asked instead to include it in a collection of papers being prepared by Moses Abramovitz and others of their Stanford colleague—and my old teacher—Bernard Haley. I declined the invitation to publish in the AER in favor of the Haley festschrift. I regret that it did not get into the AER where more people would have seen it.<sup>28</sup>

Collaboration with him on the *Principles* yielded a third surprise—I am tempted to say shock—when Armen sent me an e-mail having nothing to do with the subjects of the three articles he had chosen.<sup>29</sup> Out of the blue, he wrote, “Fred: I like to brag I did the first ‘event’ study in corporate finance, back in the 50s and 60s.” He then recounted how at RAND he was

<sup>25</sup> Coase, *supra* note 10, at 8.

<sup>26</sup> THE FORTUNE ENCYCLOPEDIA OF ECONOMICS 73, 774 (D. Henderson, ed., 1993).

<sup>27</sup> See generally Armen A. Alchian, *Corporate Management and Property Rights*, in POLICY AND THE REGULATION OF CORPORATE SECURITIES (H. Manne, ed. 1969) (pointing out that property rights are defined differently in different institutional contexts and that such differences matter); Armen A. Alchian, *Private Property and the Relative Cost of Tenure*, in THE PUBLIC STAKE IN UNION POWER (P. Bailey, ed., 1958) (arguing that the relative cost of tenure is lower at nonprofit than at for-profit institutions); Armen A. Alchian, *Some Economics of Property Rights*, 30 IL POLITICO 816 (1965) (examining property rights for risk bearing and incentive reasons, and the inefficiencies arising from common ownership).

<sup>28</sup> Alchian, *Principles*, *supra* note 15, at 524. He adds, “[b]ut I don’t regret having had the opportunity to express appreciation for the help Professor Haley gave me while I was a student at Stanford.”

<sup>29</sup> One surprise not worth highlighting was Alchian’s e-mail concerning a paper that David Haddock and I had recently published, praising it for having successfully applied his theory of cost to explain analogous puzzles in demand theory. David D. Haddock & Fred S. McChesney, *Why Do Firms Contrive Shortages?: The Economics of Intentional Underpricing*, 32 ECON. INQUIRY 39, 39 (1994); e-mail from Armen Alchian to David Haddock & author (on file with author). I was excited; I would be included in his discussion of one of his three best articles! Bursting my bubble, Louis De Alessi suggested that I take this with a grain of salt. “Armen has a charming tendency to wax eloquent about the last paper he has read that he really likes.” Armen agreed to have his points greatly shortened and placed in a footnote.

curious what metal would be necessary for the forthcoming H-bomb, as it was being engineered and tested. The engineers and physicists would not tell the economists, of course, so “I told them I would find out.” Which he did, by studying the stock prices of firms making the various possible bomb ingredients. One firm specializing in lithium had recently exhibited a remarkable run up in share price. Alchian wrote up his findings and conclusions in a memo circulated at RAND, *The Stock Market Speaks*, which he was immediately ordered to withdraw. As far as anyone knows, no copy survives. But for Armen’s casual mention of the episode to me, no one would know it ever existed.

This was truly exciting. Well before the use of stock-market event studies became common, Armen had already figured it out—but was not including it in the summary of his achievements. Just as impressive, he was assuming that stock markets were efficient, long before Eugene Fama and others had propounded efficient-market hypotheses more formally.<sup>30</sup> I called him to insist that his account go into his *Principles*, which it did, just as he had written about it to me. I never discerned any reason why he had to be prodded—except that this was Armen. The notion that one could conceive of and successfully employ the event-study methodology and the efficient-market hypothesis, yet make almost nothing of it, says much about the man.

I have recounted from a sample of one—myself—the evidence in favor of the hypothesis that Armen Alchian, in addition to his clear contributions to economic science, was an extraordinary expositor thereof who ensured that his contributions would be passed along to subsequent generations. But the sample size could be multiplied. Just to double the number of data points, consider Armen’s exceptional importance in the emergence of law and economics, beginning in the later 1960s. His influence on Henry Manne, and Manne’s economics and judges institutes multiplies the sample size considerably. And then there are the dozens of colleagues and graduates who acknowledge their debts to Armen Alchian.

At the end of the day, was the denial of Nobel status to Armen Alchian unjust? Yes, to many of us at least. But the issue is really of little consequence. More importantly, did non-Nobelism detract from his status among his peers—the only ones who could knowledgeably judge—or his own principal concerns? Almost certainly not. Axel Leijonhufvud spoke of what impressed his colleagues:

What always comes first to my mind in thinking about him is his personal lack of pretentiousness, lack of self-importance and pomposity. I learned from Armen to (I hope) take economics seriously, but not to take economists too seriously. Armen always had this toler-

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<sup>30</sup> It is fascinating that Alchian’s work validates the strong form of the efficient-market hypothesis, since it shows markets reacting to seemingly nonpublic information.

ant amusement at the overweening ambition and pretentiousness, and what the British call puffery, of economists . . . .<sup>31</sup>

It is appropriate to close on that note. To know Armen Alchian was to love him, and I was privileged to know him. Helping him write his *Principles* fortunately was not the end of our association. I would sometimes cross paths with him at a conference; occasionally he would write to congratulate me on something I had just published that struck his fancy.

But the episodes recounted here remain the most cherished memories. With our work on the *Principles* reaching an end, he wrote to me. “Best wishes and I hardly need say I appreciate all your interest and efforts.” But the appreciation was all mine, for all those years.

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<sup>31</sup> Leijonhufvud, *supra* note 20, at 419.

## SINCE BORK

*Douglas H. Ginsburg\* & Taylor M. Owings\*\**

## INTRODUCTION

Robert Bork's magnum opus, *The Antitrust Paradox*, was published in 1978. The book was widely and critically reviewed by a generation of antitrust scholars who were comfortable with the idea—long embraced by the Supreme Court—that the antitrust laws were intended to be and should be enforced so as to further a number of diverse and sometimes conflicting goals. The critics variously instanced such goals as “preserv[ing] small business as a way of life,”<sup>1</sup> “preserv[ing] numerous business units in order to prevent excessive political power from falling into the hands of a small group of managers of very large businesses,”<sup>2</sup> and “preserving consumer choice.”<sup>3</sup> In contrast, Bork had argued consumer welfare, achieved through economic efficiencies wrought by vigorous competition, should be the only goal—and hence the sole criterion for interpretation and application—of the antitrust laws.<sup>4</sup> The Supreme Court had never eschewed economic efficiency as a goal for antitrust,<sup>5</sup> but it had endorsed an admixture of goals that included protecting small, locally owned businesses against absorption or displacement by large national corporations;<sup>6</sup> preventing the aggregation of capital into firms so large they could unduly influence, if not dominate or

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<sup>1</sup> Donald Dewey, *Antitrust and Economic Theory: An Uneasy Friendship*, 87 YALE L.J. 1516, 1516 (1978) (reviewing ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* (1978)).

<sup>2</sup> Joseph E. Fortenberry, Book Review, 78 COLUM. L. REV. 1347, 1351 (1978).

<sup>3</sup> James R. Silkenat, Book Review, 127 U. PA. L. REV. 273, 279 (1978).

<sup>4</sup> For an understanding of “consumer welfare” versus “total welfare,” how Bork conflated the two, and how insignificant the distinction has been in the case law, see generally Herbert Hovenkamp, *Implementing Antitrust's Welfare Goals*, 81 FORDHAM L. REV. 2471 (2013).

<sup>5</sup> See, e.g., *Mandeville Island Farms, Inc. v. Am. Crystal Sugar Co.*, 334 U.S. 219, 242 (1948) (“The uniform agreement’s effect, when added to this, is to deprive the grower of the advantage of the individual efficiency of the refiner with which he deals, in this case the most efficient of the three, and of the price that refiner receives.”).

<sup>6</sup> See *United States v. Trans-Missouri Freight Ass’n.*, 166 U.S. 290, 324 (1897) (“[I]t is not for the real prosperity of any country that . . . changes [in the ways of doing business] should occur which result in transferring an independent business man, the head of his establishment, small though it might be, into a mere servant or agent of a corporation . . . .”); *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962) (“[W]e cannot fail to recognize Congress’ desire to promote competition through the protection of viable, small, locally owned businesses.”).

displace, democratic politics;<sup>7</sup> and maintaining the number of choices offered to consumers by the few firms that might otherwise come to dominate each line of commerce.<sup>8</sup> The purpose of this essay is to pose the question: What has happened since Bork—not just in the courts, but in the world in which we live? That is, what view should we take in hindsight of critics' contemporaneous fears that if the Court gave up on goals other than consumer welfare, then disastrous consequences would ensue?

## I. THE COURT SINCE BORK

Over the course of the thirty-five years since publication of *The Antitrust Paradox*, the Supreme Court went from an initial and quite general endorsement of Bork's thesis that antitrust is "a 'consumer welfare prescription,'" to a full-throated endorsement of consumer welfare as the sole purpose of antitrust, in consequence of which it has overruled one after another of its pre-*Paradox* cases.<sup>10</sup>

Nonetheless, the hue and cry raised by reviewers when first exposed to Bork's single-minded focus upon economic efficiency has never entirely abated. There are still adherents to the pre-Borkian view that antitrust should serve a variety of goals—consumer welfare being but one amongst them; we cannot help but notice that most of the scholars adhering to that position are the very same people who were doing so in 1979 or before.<sup>11</sup>

<sup>7</sup> See *United States v. Columbia Steel Co.*, 334 U.S. 495, 535 (1948) ("The philosophy of the Sherman Act is that . . . all power tends to develop into a government in itself. Power that controls the economy . . . should be scattered into many hands so that the fortunes of the people will not be dependent on the whim or caprice, the political prejudices, the emotional stability of a few self-appointed men.").

<sup>8</sup> See, e.g., *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 368, 371-72 (1963) (enjoining merger because it might harm choice in banking, such as the "variety of credit arrangements, convenience of location, attractiveness of physical surroundings, credit information, [and] investment advice").

<sup>9</sup> *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) (quoting ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 66 (1978)).

<sup>10</sup> See, e.g., *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 907 (2007) (overruling *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911)); *State Oil Co. v. Kahn*, 522 U.S. 3, 21-22 (1997) (overruling *Albrecht v. Herald Co.*, 390 U.S. 145 (1968)); *Brooke Grp. Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 220-22 (1993) (implicitly overruling *Utah Pie Co. v. Cont'l Baking Co.*, 386 U.S. 685 (1967)); see also *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 408-11 (2004) (confining to its facts *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985)); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977) (overruling *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967)).

<sup>11</sup> Compare Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051 (1979), with ROBERT PITOFSKY, *HOW THE CHICAGO SCHOOL OVERSHOT THE MARK* (2008). Compare Louis B. Schwartz, *The Schwartz Dissent*, 1 ANTITRUST BULL. 37 (1955), with Louis B. Schwartz, Book Review, *Regulation and Its Reform*, by Stephen Breyer, 35 HASTINGS L.J. 233 (1983), and LOUIS B. SCHWARTZ, JOHN JOSEPH FLYNN & HARRY FIRST, *PROBLEMS IN ANTITRUST* (1983). Compare Joseph F. Brodley, *Potential Competition Mergers: A Structural Synthesis*, 87 YALE L.J. 1, 33-40 (1977), with Joseph F.

The Supreme Court became so thoroughly committed to Bork's consumer welfare thesis that in the second edition of *The Antitrust Paradox*, published in 1993, just fourteen years after the first edition, Bork could write a new introduction expressing his satisfaction that "antitrust has moved a long way in the direction urged by this book . . . . Today, antitrust has been downsized. It is merely law, not a farrago of amorphous and leftist political and sociological propositions."<sup>12</sup> Indeed, he continued:

If by no means perfect, the policy today *is* intellectually respectable, both as law and as economics. Moreover the decisive but disguised political content in the decision of cases seems completely to have disappeared. Where the mistakes are made in the decisions of cases, they seem no more than that—mistakes, not disingenuous politics.<sup>13</sup>

The trend Bork celebrated continued unabated, as has been documented elsewhere.<sup>14</sup> As shown in Figure 1, the Supreme Court's decisions in the decade before publication of *The Antitrust Paradox* favored antitrust plaintiffs almost two-thirds of the time. An inevitable consequence of the Court's conversion to the Borkian thesis, in which a company can be held in violation of the law only for conduct inimical to consumer welfare and not for conduct merely inconsistent with a judge's notions of political economy, was to narrow the scope of liability. Indeed, defendants won all thirteen cases decided in the third post-Borkian decade.

In the last seven terms, the Court has decided only two cases bearing upon the scope of antitrust liability.<sup>15</sup> In *Pacific Bell Telephone Co. v. LinkLine Communications, Inc.*<sup>16</sup> the Court held a "price-squeeze" by a seller charging a rival wholesale prices barely below its retail prices does

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Brodley, *The Economic Goals of Antitrust: Efficiency, Consumer Welfare, and Technological Progress*, 62 N.Y.U. L. REV. 1020 (1987). Compare Eleanor M. Fox, *The Modernization of Antitrust: A New Equilibrium*, 66 CORNELL L. REV. 1140 (1981), with Eleanor M. Fox, *The Politics of Law and Economics in Judicial Decision Making: Antitrust as a Window*, 61 N.Y.U. L. REV. 554 (1986). See generally Harry First & Spencer Weber Waller, *Antitrust's Democracy Deficit*, 81 FORDHAM L. REV. 2543 (2013).

<sup>12</sup> Robert H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* ix-x (Free Press 1993) (1978) [hereinafter BORK, *ANTITRUST PARADOX*].

<sup>13</sup> *Id.* at xiv.

<sup>14</sup> Leah Brannon & Douglas H. Ginsburg, *Antitrust Decisions of the U.S. Supreme Court, 1967 to 2007*, COMPETITION POL'Y INT'L, Autumn 2007, at 3.

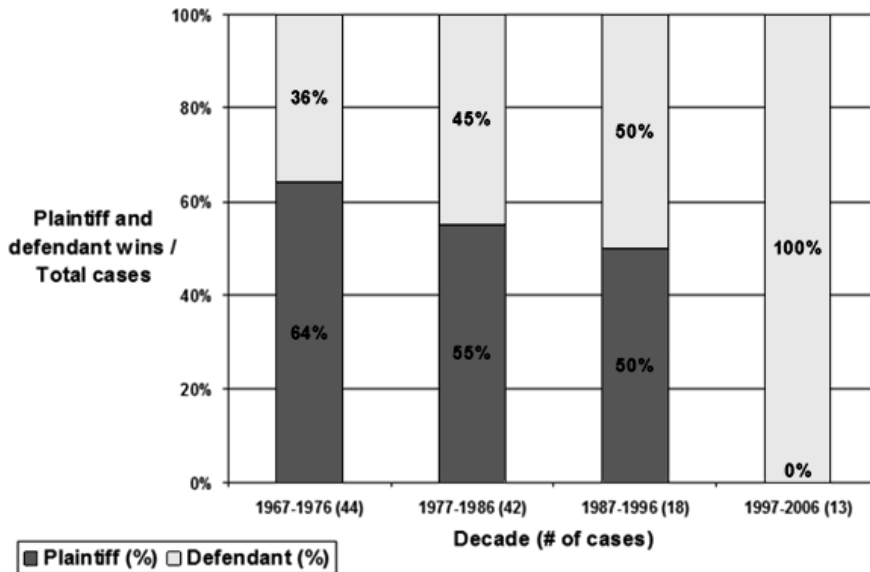
<sup>15</sup> The other two cases in which the Court decided an issue of antitrust liability were fact-specific applications of established doctrines. In *Am. Needle, Inc. v. NFL*, 560 U.S. 183 (2010), the Court rejected the defense that an association of football teams acting in concert with respect to their trademarked logos was a single entity for the purpose of avoiding Section 1 liability; and in *FTC v. Phoebe Putney Health Sys., Inc.*, 133 S. Ct. 1003 (2013), the Court denied the defendant's claim to state-action immunity where the legislature had not sufficiently endorsed the anticompetitive effects of its legislation allowing the hospital merger at issue.

<sup>16</sup> 555 U.S. 438 (2009).



not violate the Sherman Act; and in *FTC v. Actavis, Inc.*,<sup>17</sup> the Court held “reverse payments” made by a plaintiff pharmaceutical company to settle a patent dispute were neither per se unlawful, as the FTC had long maintained, nor per se lawful, as the plaintiff had argued, but rather subject to potential liability for monopolization pursuant to the rule of reason. The lesson of these most recent Terms may just be that antitrust plaintiffs now have the guidance they need to avoid bringing cases the Court would not find beneficial to consumers.

**Figure 1. Percentage of Antitrust Cases Before the Supreme Court Won by Plaintiffs and Defendants, by Decade.**

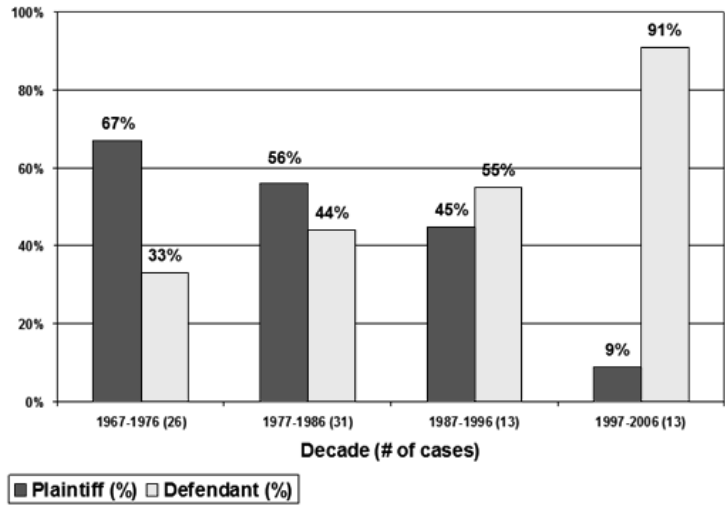


This change in the understanding of antitrust law did not occur solely at the elevated level of the Supreme Court; on the contrary, Bork swept the board intellectually, to the point that his approach very much affected what was taught in the law schools and was adopted by the next generation of scholars. The pervasiveness of his thesis is reflected in Figure 2, which shows the position taken by the United States as amicus in private antitrust cases: The Government went from favoring the plaintiff in two-thirds of the cases during the decade before *The Antitrust Paradox* to favoring the defendant in 91% of the cases in the third post-Bork decade.<sup>18</sup>

<sup>17</sup> 133 S. Ct. 2223 (2013).

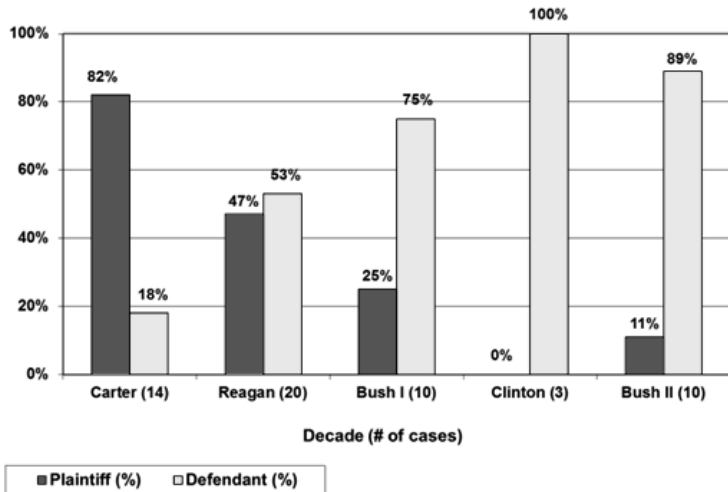
<sup>18</sup> Brannon & Ginsburg, *supra* note 14, at 14.

**Figure 2. Percentage of Antitrust Cases Before the Supreme Court in Which the Solicitor General Supported Plaintiffs and Defendants, by Decade.**



Although the trend in the Solicitor General’s amicus briefs is not quite as dramatic as the trend in Supreme Court decisions, it is worth pointing out because it was a distinctly bipartisan evolution that is essentially uncorrelated with the party of the incumbent administration, as shown in Figure 3.

**Figure 3. Solicitor General’s Position of Support by Presidential Administration.**



## II. THE REAL WORLD SINCE BORK

This symposium marking the thirty-fifth anniversary of Judge Bork's thesis is an appropriate context in which to look back on this sea change and ask whether Bork's critics were right to be fearful of its consequences. What, as an empirical matter, has happened since Bork?

### A. *Whither Small Business?*

If the antitrust laws were needed to protect “small dealers and worthy men” from large corporations that would drive them out of business by fair means or foul<sup>19</sup>—that is, by superior efficiency or by exclusionary practices—then, *ceteris paribus*, the Supreme Court's narrowed interpretation of antitrust law not to embrace that goal should have had an untoward effect upon small businesses. The United States should have become a place in which small business played an ever-decreasing role in the economy and the opportunities for entrepreneurs diminished over time. That demonstrably has not occurred.

Small businesses persist as an important part of our national identity for reasons not sentimental, as for family farms,<sup>20</sup> but empirical. As President Obama mentioned in his 2014 State of the Union Address, “entrepreneurs and small business owners . . . create most new jobs in America. . . . [They are] ninety-eight percent of our exporters . . . .”<sup>21</sup> The President's figures were no doubt produced by the Small Business Administration (SBA), which defines a business as small only if its annual turnover and number of employees both fall below a stated threshold for the industry of which it is a part<sup>22</sup> and if it is “independently owned and operated and . . . not dominant in its field of operation.”<sup>23</sup> As of 2011, 99.7% of all U.S. employers were small business; they accounted for 48.5% of all private-sector employment and 63% of new private-sector jobs.<sup>24</sup> They pro-

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<sup>19</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290, 323 (1897).

<sup>20</sup> As of 2007, “small family farms produced only 16 percent of agricultural output.” ROBERT A. HOPPE & DAVID E. BANKER, U.S. DEPT. OF AGR., EIB-66, *STRUCTURE AND FINANCES OF U.S. FARMS: FAMILY FARM REPORT IV* (2010), available at <http://www.ers.usda.gov/publications/eib-economic-information-bulletin/eib66.aspx#.U0sclj9QCjg>.

<sup>21</sup> Barack Obama, President of the United States, State of the Union Address (Jan. 28, 2014), available at <http://www.whitehouse.gov/the-press-office/2014/01/28/president-barack-obamas-state-union-address>.

<sup>22</sup> *Small Business Size Regulations*, SMALL BUS. ADMIN., [://www.sba.gov/content/small-business-size-regulations](http://www.sba.gov/content/small-business-size-regulations) (last visited Apr. 5, 2014) (referencing 13 C.F.R. § 121).

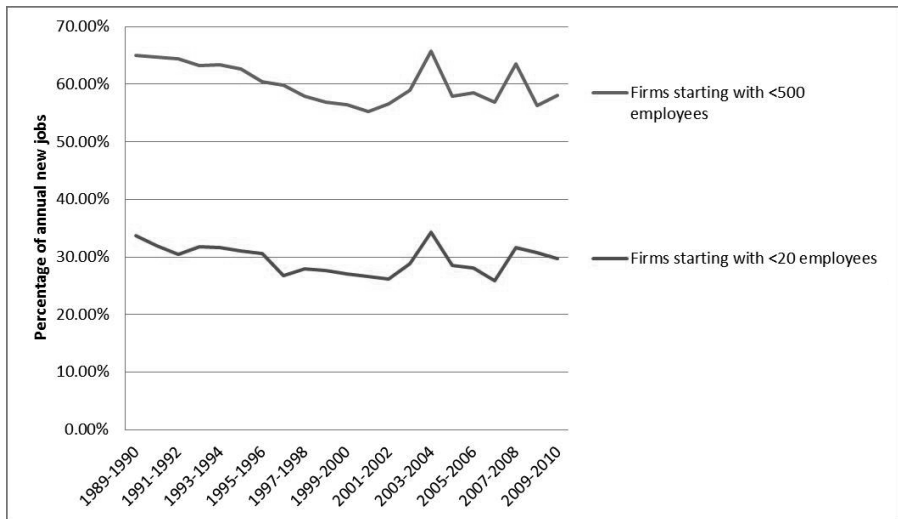
<sup>23</sup> 15 U.S.C. § 632(a)(1) (2006).

<sup>24</sup> SMALL BUS. ADMIN. OFFICE OF ADVOCACY, *FREQUENTLY ASKED QUESTIONS ABOUT SMALL BUSINESS 1* (2014), available at [http://www.sba.gov/sites/default/files/FAQ\\_March\\_2014\\_0.pdf](http://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf).

duced 46% of all private-sector output and accounted for 33% of the value of goods exported from the United States.<sup>25</sup>

From these statistics it is obvious that small business has not been squelched by the loss of such protection as the antitrust laws used to provide. Indeed, as Figure 4 shows, small businesses have accounted for a steady, and quite substantial, portion of the new jobs added to the economy each year since 1989, when the U.S. Census Bureau began collecting such data. Of course, it is possible that small businesses would have accounted for an even larger part of the, perhaps smaller, economy if only the antitrust laws had continued to protect them from the supposed depredations of larger firms. Although we will never be able to determine what that counterfactual universe would have looked like, we can surely take comfort from the existing data, which show that small business continues to account for a major part of the economic activity in the United States.

**Figure 4. Annual Job Growth Attributable to Small Businesses<sup>26</sup>**



#### B. *Do Large Firms Have “Excessive Political Power”?*

What about the concern of old-school antitrust that large companies would acquire political influence sufficient to threaten democratic self-governance? Measuring the political influence of big business in any way more reliable than collecting anecdotes is a challenging, indeed perhaps an

<sup>25</sup> *Id.*

<sup>26</sup> Figure 4 was created using raw data available at *U.S. Dynamic Data*, SMALL BUS. ADMIN. OFFICE OF ADVOCACY, <http://www.sba.gov/advocacy/849/12162#susb> (last visited Jan. 25, 2015).

impossible, task. We may glean some insights, however, from statistical or other empirical evidence. First, consider the influence of vertically related large and small firms.

The smaller but more numerous firms at a lower level in the chain of distribution are regularly able to obtain legislation to the disadvantage of the much larger but fewer firms at the higher levels in the supply chain. For example, there are only a few automobile manufactures and they are very large companies; nonetheless, automobile dealers, typically franchised by manufacturers, have consistently exerted greater influence in state legislatures.<sup>27</sup> Dealers also exerted leverage over the manufacturers in the negotiations leading to the federal government's bailouts of General Motors and Chrysler.<sup>28</sup> Similarly, in the insurance industry, the far more numerous agents obtain legislation at the expense of the much larger but fewer insurance companies, whose products they distribute.<sup>29</sup> The same is true of gas station owners, who have succeeded in obtaining legislation constraining the oil companies whose products they distribute.<sup>30</sup>

There is some evidence of a positive correlation between firm size and the amount of money a company spends on political activity.<sup>31</sup> Whether that activity is designed to obtain favorable or to fend off unfavorable legislation and regulation remains unknown. There is empirical evidence, how-

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<sup>27</sup> See generally Francine Lafontaine & Fiona Scott Morton, *Markets: State Franchise Laws, Dealer Terminations, and the Auto Crisis*, 24 J. ECON. PERSP. 233 (2010) (discussing the reasons for automobile dealers' political leverage over state legislatures and their relative advantage over automobile manufacturers).

<sup>28</sup> Jessica Higashiyama, *State Automobile Dealer Franchise Laws: Have They Become the Proverbial Snake in the Grass?* 1-2 (Soc. Sci. Research Network, Working Paper No. 1394877, 2009) (discussing automobile dealers' leverage over manufacturers in the bailout negotiations); see also *Automobile Dealers Day in Court Act*, 15 U.S.C. § 1222 (allowing dealers to sue manufacturers when they fail to act in good faith either in performing and complying with the provisions of an automobile franchise or in terminating the franchise); *Hanley v. Chrysler Motors Corp.*, 433 F.2d 708, 710-11 (10th Cir. 1970) ("The [Act] is an attempt to equalize, at least to some extent, the economic advantages which automobile manufacturers have over their dealers. It creates a new cause of action, other than for breach of contract, which did not theretofore exist, in cases where a manufacturer is guilty of coercion and intimidation in its dealings with its franchise holders, regardless of whether the franchise is terminated." (citation omitted)).

<sup>29</sup> The independent insurance agents' lobby, the IIABA, which "represent[s] more than a quarter of a million agents, brokers, and their employees," regularly testifies before the Congress on insurance regulations and raised over \$1 million in PAC money in 2013. See *2014 Press Releases*, INDEP. INS. AGENTS & BROKERS OF AM., <http://www.independentagent.com/News/PressReleases/Pages/2014/default.aspx> (last visited April 5, 2014) (e.g., "Big 'I' Testifies Before Congress on Modernizing Insurance Regulation").

<sup>30</sup> The gas station owners' lobby, the Association for Convenience and Fuel Retailing (also known as "NACS"), lobbies successfully and testifies before the Congress on a host of issues that put it at odds with the oil companies, including renewable fuel standards and the fuel excise tax. See *Motor Fuels*, NACS, <http://www.nacsonline.com/Issues/MotorFuels/Pages/default.aspx> (last visited Apr. 5, 2014).

<sup>31</sup> See, e.g., Matthew D. Hill et al., *Determinants and Effects of Corporate Lobbying*, 42 FIN. MGMT. 931, 932 (2013).

ever, that apart from certain industries, such as defense, in which firms' well-being is closely linked to government decision making, corporate political expenditures do not translate into shareholder wealth.<sup>32</sup> This suggests the activity either is defensive or is undertaken to advance the interests of senior managers rather than those of shareholders.

As for the amount of political donations made by large corporations, presumably in order to influence the election of officials favorable to their interests, large corporations have not even outspent countervailing constituencies, let alone exerted a dominant influence on campaign finance. In particular, the twenty largest donors during the twenty-five years ending in 2014 included only five corporations, three of which are financial institutions; the rest were unions and associations representing primarily small businesses, such as the Nation Association of Realtors and the National Auto Dealers Association.<sup>33</sup>

In sum, regardless whether large size translates into political influence, it does not appear that the redirection of antitrust from a hostile to an indifferent stance on corporate size has enabled large corporations to undermine or dominate democratic politics. The principle but arguable exception is surely the financial services industry. The largest financial firms in the nation, particularly commercial banks, have long been known to enjoy an advantage in raising capital because of the implicit guarantee, notwithstanding official denials of any guarantee, that they would not be allowed to fail.<sup>34</sup> During the recent financial crisis, the market's assessment that there was an implicit guarantee was fully vindicated when the government came to the rescue of virtually all of the largest financial institutions in the country. Whether to think of the government bailout as an exercise of the banks' political influence or as an aspect of the government's prudential regulation, however, is not at all clear.<sup>35</sup> In any event, the government's

<sup>32</sup> John C. Coates IV, *Corporate Politics, Governance and Value Before and After Citizens United*, 9 J. EMPIRICAL LEGAL STUD. 657, 676 fig.2 (2012). *But see* Hill et al., *supra* note 31, at 932–33 (finding shareholders value the lobbying activities pursued by management and that the result is “consistent with lobbying providing a means to strengthen operations and/or improve competitiveness”).

<sup>33</sup> *Heavy Hitters: Top All-Time Donors, 1989-2014*, OPENSECRETS.ORG, <http://www.opensecrets.org/orgs/list.php> (last visited Apr. 5, 2014). In fact, the largest single donor, which has been in existence only since 2004, was ActBlue, a conduit for individuals' online contributions to Democratic candidates and committees. *See About ActBlue*, ACTBLUE, <https://secure.actblue.com/about> (last visited Oct. 8, 2014).

<sup>34</sup> For a primer on this subject, see Frederic Lambert et al., *How Big is the Implicit Subsidy for Banks Considered Too Important to Fail?*, in GLOBAL FINANCIAL STABILITY REPORT: MOVING FROM LIQUIDITY- TO GROWTH-DRIVEN MARKETS, 101 (2014). *See also* Brendan Greely, *The Price of Too Big to Fail*, BLOOMBERG BUSINESSWEEK (July 5, 2012), <http://www.businessweek.com/articles/2012-07-05/the-price-of-too-big-to-fail>; Zoe Tsesmelidakis & Robert C. Merton, *The Value of Implicit Guarantees* (Sept. 1, 2012) (unpublished manuscript), available at [https://papers.ssrn.com/sol3/Data\\_Integrity\\_Notice.cfm?abid=2231317](https://papers.ssrn.com/sol3/Data_Integrity_Notice.cfm?abid=2231317).

<sup>35</sup> In a few instances, the banks being “bailed out” were not seeking government funds, but regulators insisted they participate in the Troubled Asset Relief Program. U.S. Dep't of Treasury documents

support for the financial industry was clearly predicated upon the unique risk to the economy presented by the possibly simultaneous failure of most of the largest commercial and investment banks. Thus, in the Dodd-Frank legislation directed at preventing future such crises, large banks and other intermediaries were officially deemed “systemically important” financial institutions because the failure of any one such institution would impose significant risks upon its counterparties throughout the financial system as a whole.<sup>36</sup>

Might the financial crisis have been avoided by an antitrust regime dedicated to preventing the emergence of great aggregations of capital so that a small number of large firms would not acquire undue political influence?<sup>37</sup> Some of these financial institutions, particularly commercial banks, were the product of a succession of mergers that could have been prevented if the Bank Merger Act<sup>38</sup> had made absolute size, in addition to the likely effect upon competition, a criterion for determining the lawfulness of a proposed merger; but it did not. Whether precluding those mergers would have precluded the organic growth of the most efficient institutions to the size they achieved by merger is of course, unknowable. There is certainly reason to doubt that stricter merger control for banks would have prevented the emergence of banks “too big to fail.”<sup>39</sup> A natural experiment suggests the problem arose instead from the failures of prudential regulation: the financial crisis was barely felt in Canada, where concentration in commercial banking is much greater than in the U.S.<sup>40</sup> Regulators had prevented

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obtained by media outlets through FOIA requests tend to prove this version of events, widely rumored in the popular press. See Joe Weisenthal, *Documents Reveal How Paulson Forced Banks to Take TARP Cash*, BUS. INSIDER (May 13, 2009), <http://www.businessinsider.com/uncovered-tarp-docs-reveal-how-paulson-forced-banks-to-take-the-cash-2009-5> (posting the documents obtained from the U.S. Department of Treasury).

<sup>36</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act § 804, 12 U.S.C. § 5463 (2012).

<sup>37</sup> Some commentators certainly think so. See, e.g., Krishna Guha, *Opening Salvo on Banks Has Yet to Come*, FIN. TIMES, (Jan. 18, 2010, 9:57 PM), <http://www.ft.com/intl/cms/s/0/8302b178-047a-11df-8603-00144feabdc0.html#axzz2z00IMoBr>.

<sup>38</sup> 12 U.S.C. § 1828(e) (2012).

<sup>39</sup> One recent proposal to reform banking law suggests an antitrust-like approach based not upon restricting mergers but upon restraining growth in all forms by putting a cap on liabilities. Jonathan R. Macey & James P. Holdcroft, Jr., *Failure Is an Option: An Ersatz-Antitrust Approach to Financial Regulation*, 120 YALE L.J. 1368, 1391-96, 1403-04 (2011) (arguing a “change in focus” is needed in antitrust’s application to the banking system and that banks should be broken up or prevented from amassing liabilities in an amount greater than five percent of the targeted value of the FDIC’s Deposit Insurance Fund). The Canadian example is equally appropriate in response to this sort of proposal because the problem does not seem to be concentration, but inadequate supervision.

<sup>40</sup> The six largest Canadian banks hold 88.5% of all bank assets (equal to 156% of Canada’s GDP), whereas in the United States, the six largest banks account for only 50.8% of all bank assets (equal to 47% of U.S. GDP). D.J. Masson, *Commercial Banking in the U.S. Versus Canada*, 10

Canadian banks from taking on certain risks, particularly those associated with mortgage-backed securities, which U.S. regulators had not done.<sup>41</sup> On the contrary, the Congress had encouraged such risk-taking in the name of making home ownership affordable to borrowers who were not credit-worthy by conventional lending standards.<sup>42</sup>

Another tenet of the pre-Borkian ethos of antitrust was that large companies exercised a good deal of control over the markets in which they operated; indeed, it was—and to some extent still is—conventional to speak of a firm as “controlling” whatever its share of a market might be.<sup>43</sup> In context, the idea was that the largest companies in their market, and indeed large companies in an absolute sense, were substantially impervious not only to political control but also to the discipline of the market, which is populated by large numbers of readily manipulable individual consumers. If that were true, it would follow that a large firm with a large market share would have a certain longevity if not, perhaps, seeming immortality. Politicians would be either naturally disinclined or affirmatively influenced to leave these large firms unbridled, and changes in consumer taste would not be a threat because those too could be manipulated by producers.<sup>44</sup> The inevitable corollary seems to be that large firms would persist from decade to decade, growing ever more entrenched and ever more secure in their own destiny. Contrary to the pre-Borkian supposition, that clearly is not what has happened since Bork.

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GRAZIADIO BUS. REV. (2007), available at <http://gbr.pepperdine.edu/2010/08/commercial-banking-in-the-u-s-versus-canada/>.

<sup>41</sup> Kevin Lynch, *Avoiding the Financial Crisis: Lessons from Canada*, POL’Y OPTIONS, May 2010, at 12, available at <http://policyoptions.irpp.org/wp-content/uploads/sites/2/assets/po/the-fault-lines-of-federalism/lynch.pdf>.

<sup>42</sup> See generally PETER J. WALLISON, DISSENT FROM THE MAJORITY REPORT OF THE FINANCIAL CRISIS INQUIRY COMMISSION (Am. Enter. Inst. 2011), available at <http://www.aei.org/files/2011/01/26/WallisonDissent.pdf>.

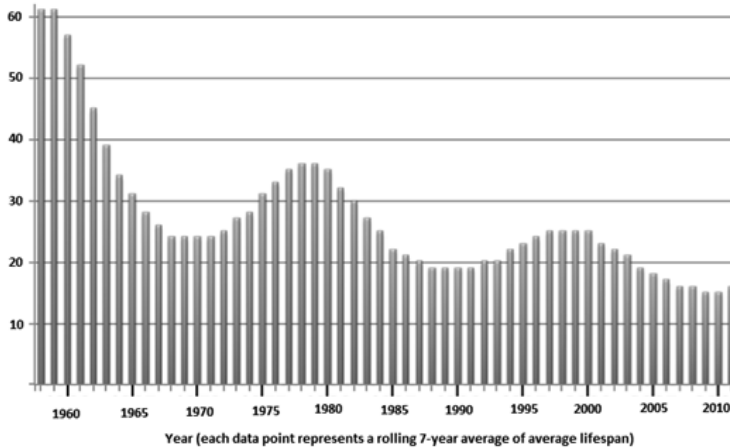
<sup>43</sup> See, e.g., *United States v. Phila. Nat’l Bank*, 374 U.S. 321, 364 (1963) (“The merger of appellees will result in a single bank’s controlling at least 30% of the commercial banking business in the four-county Philadelphia metropolitan area.”); *Prometheus Radio Project v. F.C.C.*, 373 F.3d 372, 403 n.28 (3d Cir. 2004) (“In a market where one company controls 50% of the market share, two control 20%, and another controls 10%, the HHI formula is  $50^2 + 20^2 + 20^2 + 10^2 = 3400$ .”). The equivalent European usage is to deem a firm with a large market share “dominant,” which means it is able “to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.” *Case 27/76, United Brands Co. v. Comm’n*, 1978 E.C.R. 207, ¶ 65.

<sup>44</sup> See, e.g., VANCE PACKARD, *THE HIDDEN PERSUADERS* (1959), which *The New Yorker* described as an “authoritative and frightening report on how manufacturers, fundraisers and politicians are attempting to turn the American mind into a kind of catatonic dough that will buy, give or vote at their command.”



Of the 100 largest companies in 1978, when *The Antitrust Paradox* was published, only 29 were still among the 100 largest 10 years later.<sup>45</sup> Of the 100 largest companies in 1988 and 1998, respectively, only 31 and 24 remained on the list 10 years later.<sup>46</sup> The same volatility can be seen in the S&P 500 list of companies with the largest U.S. stock market capitalization. As Figure 5 shows, the average number of years a company remains on the S&P 500 list has decreased dramatically over time:

**Figure 5. Average Company Lifespan (in years) on the S&P 500 Index<sup>47</sup>**



It had already declined from more than sixty to about thirty-five years before Bork; it has been halved again since Bork. Indeed, the rate of “creative destruction” among publicly traded firms—as measured by big-business turnover, changes in market share, and difference in growth rates between firms that gain and firms that lose market share—increased consistently in the United States during the period from 1960 to 2009.<sup>48</sup> “This

<sup>45</sup> Data on file with the author and sourced from *Fortune 500 Companies*, CNN MONEY, [http://money.cnn.com/magazines/fortune/fortune500\\_archive/full/1955/index.html](http://money.cnn.com/magazines/fortune/fortune500_archive/full/1955/index.html) (last visited Apr. 5, 2014). Although General Motors appears on both lists, it had gone through bankruptcy, and so we have not treated it as the same company at the two different times.

<sup>46</sup> *Id.*

<sup>47</sup> INNOSIGHT LLC, CREATIVE DESTRUCTION WHIPS THROUGH CORPORATE AMERICA, EXECUTIVE BRIEFING 2 (2012), available at [http://www.innosight.com/innovation-resources/strategy-innovation/upload/creative-destruction-whips-through-corporate-america\\_final2012.pdf](http://www.innosight.com/innovation-resources/strategy-innovation/upload/creative-destruction-whips-through-corporate-america_final2012.pdf).

<sup>48</sup> See generally Claire Y.C. Liang, R. David McLean & Megxin Zhiao, Creative Destruction and Finance: Evidence from the Last Half Century (June 2011) (unpublished manuscript), available at <http://sites.kauffman.org/efic/resources/Creative-Destruction-and-Finance.pdf>.

effect is observed among the largest public companies, public companies in general, and both within- and across-industries.”<sup>49</sup>

Even if the concentration of political power in the hands of big business is indeed a problem, or is perceived to be a problem notwithstanding the mixed but predominantly contrary evidence, ever since the Watergate affair policy makers have turned their attention away from antitrust and toward direct regulation of the political process.<sup>50</sup> In other words, insofar as people are concerned about the political influence of large companies, the modern approach has been not to keep companies from growing—subject, of course, to the efficient behavioral constraints of antitrust, such as the prohibitions on collusion<sup>51</sup> and attempted monopolization<sup>52</sup>—and to focus instead directly upon issues of campaign finance.<sup>53</sup> Even when that approach to regulation has been curtailed, as it was by the Supreme Court’s decision in *Citizens United v. FEC*,<sup>54</sup> policy makers have not called upon antitrust to constrain the growth of large companies but rather continue to deal directly with reform of the political process.<sup>55</sup>

### C. *Has Consumer Choice Suffered?*

What about the critics’ concern that antitrust law be applied with a goal of “preserving consumer choice”? One direct measure of consumer choice is the number of distinct products carried in the average supermarket. When *The Antitrust Paradox* was published, that number was roughly 10,000, as can be seen in Figure 6 below. That number grew consistently

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<sup>49</sup> *Id.* at 14.

<sup>50</sup> In 1974 the Congress amended the Federal Election Campaign Act of 1971, newly regulating campaign contributions and spending, parts of which were held unconstitutional in *Buckley v. Valeo*, 424 U.S. 1 (1976).

<sup>51</sup> RICHARD POSNER, *ANTITRUST LAW* ch. 1 (2d ed. 2001) (“Strict enforcement of laws against overt price fixing is a public policy widely supported by economists and legal scholars of all stripes. They may differ as to the causes giving rise to collusive behavior and as to the likelihood of long-term success, but they are unified in their evaluation of the negative economic effects of cartels. Effective cartels cause unrecoverable losses in production and consumption, transfer income from customers to the stakeholders of cartel members, and often engage in wasteful rent-seeking expenditures.”).

<sup>52</sup> *See, e.g.*, *United States v. Microsoft*, 253 F.3d 34 (D.C. Cir. 2001).

<sup>53</sup> The only exception of which we are aware is by Professor Zephyr Teachout, *viz.*, *Corporate Rules and Political Rules: Antitrust as Campaign Finance Reform* (2014) (unpublished manuscript), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2384182](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2384182) (arguing that in the wake of *Citizens United*, “policy makers should explore new antitrust laws with absolute size caps”).

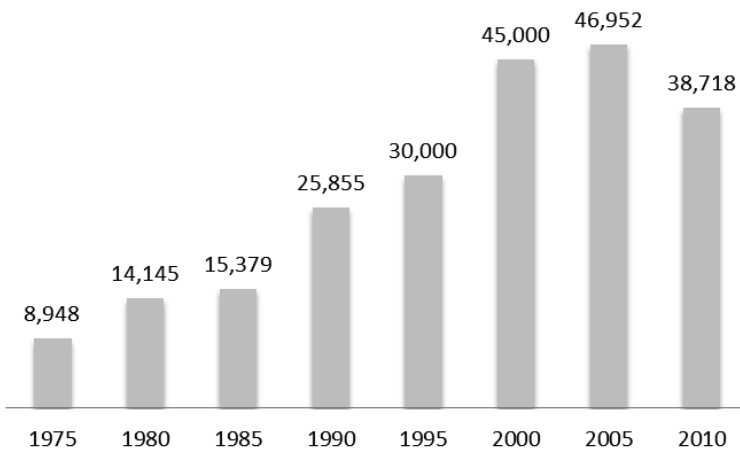
<sup>54</sup> 558 U.S. 310 (2010); *see also* *McCutcheon v. FEC*, No. 12-536, 2014 WL 1301866 (U.S. Apr. 2, 2014).

<sup>55</sup> Increased disclosure requirements have been of particular interest to the Congress. For a report on the legislative and regulatory response to *Citizens United*, *see* R. SAM GARRETT, CONG. RESEARCH SERV., R41542, *THE STATE OF CAMPAIGN FINANCE POLICY: RECENT DEVELOPMENTS AND ISSUES FOR CONGRESS* (2014).

until the recent recession and is still nearly 40,000. From 1980 to 2003, supermarkets increased their shelf space per dollar of sales by almost 40%, reflecting the proliferation of products and brands.<sup>56</sup> As Benjamin Klein and Joshua Wright have pointed out,

A supermarket that increases its shelf space and takes on an increased number of new products, increasing its costs by decreasing its sales per square foot, is producing benefits for consumers in terms of increased product variety. . . . [I]f there were no consumer demand for increased variety, competition among supermarkets would not have led to an increased number of SKUs and higher retailer costs in terms of lower sales per square foot.<sup>57</sup>

**Figure 6. Average Number of SKUs in Supermarkets, by Year.<sup>58</sup>**



Or consider the automobile market. In 1978, the Ford Motor Company sold ten noncommercial models; today it sells twenty.<sup>59</sup> Other examples of increased consumer choice since Bork abound.<sup>60</sup>

<sup>56</sup> Benjamin Klein & Joshua D. Wright, *The Economics of Slotting Contracts*, 50 J.L. & Econ. 421, 444 (2007) (discussing the growth in SKUs over the last three decades as a product of competition among supermarkets and consumer demand for increased variety). It should not be forgotten that pre-Bork, the FTC charged Kellogg, General Mills, and General Foods with having created a “shared monopoly” in breakfast cereals, in part by proliferating their product offerings. *See* Compl., Kellogg Co., No. 8883, (FTC Apr. 26, 1972). *But see* Kellogg Co., 99 F.T.C. 8 (1982) (dismissing the case on appeal with the comment, “we should not undertake to restructure an industry under Section 5 of the FTC Act without a clear supportive signal from Congress”). *See also* Amil Petrin, *Quantifying the Benefits of New Products: The Case of the Minivan*, 110 J. POL. ECON. 705 (2002) (using statistical analysis to show competition drives growth in consumer choice and, thus, in consumer welfare).

<sup>57</sup> Klein & Wright, *supra* note 56, at 445.

<sup>58</sup> *The Food Retailing Industry Speaks*, FOOD MKTG. INST., various years, <http://www.fmi.org/research-resources>.

### III. GOING FORWARD

In view of the history recounted above, it is tempting to join Bork in the triumphalism of his forward to the 1993 edition of *The Antitrust Paradox*. After all, so far as the courts are concerned, Borkian antitrust is simply antitrust today<sup>61</sup> and the public seems to be well served by the large number of small businesses, by the inability of large corporations to control the democratic process, and by the ever-increasing proliferation of consumer goods. Perhaps, as he himself speculated in 1993, the Bork of 1978 may have been overly pessimistic about the ability of ideas to influence antitrust thinking.<sup>62</sup>

Ironically, he may also have been overly optimistic in 1993 about the enduring nature of the new consensus that had formed around his ideas when he mused that “for reasons that are not entirely clear, the socialist drive that powered much of antitrust’s more pernicious doctrines abandoned this branch of the law and moved on to establish [itself] elsewhere.”<sup>63</sup> In the 20 years since that assessment, commentators have not failed to dream up new proposals to incorporate noncompetition concerns into antitrust,<sup>64</sup> seemingly forgetting the wisdom of Bork that many policy or market failures affecting consumer welfare are better addressed by measures tailored to those problems than by constricting the antitrust laws to a task for which they are ill suited.

Most recently, antitrust scholars have been dreaming up theories by which to stretch the antitrust laws to solve perceived problems created by so-called “patent assertion entities” (PAEs).<sup>65</sup> As has been pointed out

<sup>59</sup> The 1978 sales brochure is available at <http://paintref.com/cgibin/brochuredisplay.cgi?manuf=Ford&year=1978> (last visited Apr. 4, 2014). The 2014 vehicle lineup is available at <http://www.ford.com/vehicles/> (last visited Apr. 4, 2014).

<sup>60</sup> For example, despite the oft-heard concern that “the print media are dying,” the number of new books published, as reflected in the number of new ISBNs, has grown steadily from 215,138 in 2002 to 301,642 in 2012. Bowker Data, *ISBN 2002-2012 Output*, available at [http://www.bowker.com/assets/downloads/products/isbn\\_output\\_2002\\_2012.pdf](http://www.bowker.com/assets/downloads/products/isbn_output_2002_2012.pdf). Additionally, clothing retailer Zara is lauded as one of the biggest success stories in the industry precisely for being able to move new products to its customers rapidly—to the tune of 300,000 new SKUs per year. See Kasra Ferdows, Michael A. Lewis & Jose A.D. Machuca, *Zara’s Secret for Fast Fashion*, excerpted from *Rapid-Fire Fulfillment*, HARVARD BUS. REV., vol. 82, no. 11 (Nov. 2004), available at <http://hbswk.hbs.edu/archive/4652.html>.

<sup>61</sup> Douglas H. Ginsburg, *Bork’s “Legislative Intent” and the Courts*, 79 ANTITRUST L.J. 941 (2014).

<sup>62</sup> BORK, ANTITRUST PARADOX, *supra* note 12, at x (“[M]y pessimism resulted from a serious underestimation of the power of ideas, a consequence, it may be, of attending too many faculty meetings.”).

<sup>63</sup> *Id.* at xiii.

<sup>64</sup> See Guha, *supra* note 37; Macey & Holdcroft, Jr., *supra* note 39; Teachout, *supra* note 53 (identifying recent proposals in response to “too big to fail” and *Citizens United*).

<sup>65</sup> See, e.g., Michael A. Carrier, *Patent Assertion Entities: Six Actions the Antitrust Agencies Can Take*, 1 CPI ANTITRUST CHRON., No. 2, Winter 2013, at 1, 11-12; Ilene Knable Gotts & Scott Sher, *The*

elsewhere, however, the problems in question arise from features of our patent and litigation systems.<sup>66</sup> The tendency of the Patent and Trademark Office to issue overly broad patents—particularly for computer software—make it possible for PAEs successfully to demand royalties for patents of doubtful validity. President Obama and the Congress have responded respectively with policy proposals and bills now pending that address these problems by reforming the patent and litigation systems, and have done so entirely without reference to the possible application, let alone amendment, of the antitrust laws.<sup>67</sup>

In politics, it is said there are no permanent victories; so it is with policies. Still, some policies are more enduring than others, and the reforms prompted by *The Antitrust Paradox* have endured without significant backsliding in either the courts or the academic literature. As times change and society faces new problems, though, proposals to adapt the antitrust laws to new purposes seem inevitable. Until such time as Bork's analysis itself is substantially superseded by advances in economics, however, there is reason to believe that antitrust's exclusive focus upon consumer welfare and (or as) economic efficiency will endure.

## CONCLUSION

In closing, we turn to one of the more supportive reviews of *The Antitrust Paradox*, that of Ernest Gellhorn, a distinguished member of the George Mason law faculty for many years:

I do not join those who will contend that Bork and others of like mind have improperly ignored production externalities, equity considerations, humanistic values, or other purposes of antitrust. . . . His point is that the Sherman Act is not the proper framework for deciding which value is to be preferred—more goods or less pollution. That, Bork says, is the job of Congress and was not decided in 1890.<sup>68</sup>

No one has said it better, since Bork.

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*Particular Antitrust Concerns with Patent Acquisitions*, 8 COMPETITION L. INT'L 19, 30, 36 (2012); Mark S. Popofsky & Michael D. Laufert, *Patent Assertion Entities and Antitrust: Operating Company Patent Transfers*, ANTITRUST SOURCE 1-2 (Apr. 2013), [www.americanbar.org/content/dam/aba/publishing/antitrust\\_source/apr13\\_full\\_source.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/apr13_full_source.authcheckdam.pdf).

<sup>66</sup> See generally Joshua D. Wright & Douglas H. Ginsburg, *Patent Assertion Entities and Antitrust: A Competition Cure for a Litigation Disease*, 79 ANTITRUST L.J. 501 (2014).

<sup>67</sup> See, e.g., H.R. 3309, 113th Cong. (2013-2014); S. 1013, 113th Cong. (2013-2014); Press Release, White House, White House Task Force on High-Tech Patent Issues (2013), available at <http://www.whitehouse.gov/the-press-office/2013/06/04/fact-sheet-white-house-task-force-high-tech-patent-issues>.

<sup>68</sup> Ernest Gellhorn, Book Review, 92 HARV. L. REV. 1376, 1383 (1979) (citations omitted).

## ROBERT BORK &amp; COMMERCIAL SPEECH

*Jonathan H. Adler\**

## INTRODUCTION

Before he redefined antitrust,<sup>1</sup> Judge Robert Bork took aim at the First Amendment.<sup>2</sup> Though his work in this area was not nearly as influential, it received substantial attention, particularly after President Ronald Reagan nominated Judge Bork to replace Justice Lewis Powell on the Supreme Court in 1987.<sup>3</sup> Judge Bork's 1971 article, *Neutral Principles and Some First Amendment Problems* challenged the prevailing wisdom on the proper scope of First Amendment protections.<sup>4</sup> In this article, published seven years before *The Antitrust Paradox*, Bork maintained that only "explicitly political" speech warranted constitutional protection.<sup>5</sup> Other types of speech or expression, including much indisputably valuable speech, were not entitled to First Amendment protection. Judge Bork's perspective on the freedom of speech would moderate over time, but he would continue to write critically of existing First Amendment doctrine and the Supreme

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<sup>1</sup> See generally, ROBERT H. BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* (1978). On Bork's influence, see George H. Priest, *The Abiding Influence of the Antitrust Paradox*, 31 HARV. J.L. & PUB. POL'Y 455 (2008); see also Dylan Matthews, 'Antitrust was defined by Robert Bork. I cannot overstate his influence,' WONKBLOG (Dec. 20, 2012), <http://www.washingtonpost.com/blogs/wonkblog/wp/2012/12/20/antitrust-was-defined-by-robert-bork-i-cannot-overstate-his-influence/>.

<sup>2</sup> Bork's most significant work on constitutional law was Robert H. Bork, *Neutral Principles and Some First Amendment Problems*, 47 IND. L.J. 1 (1971) [hereinafter Bork, *Neutral Principles*]. Much of Bork's later writing on constitutional interpretation, and the First Amendment in particular, draws or expands upon this work.

<sup>3</sup> Each time he was nominated for a significant position, Senators quizzed Bork about the meaning of his article, and whether he adhered to the views he espoused in 1971. See Stephen Gillers, *The Compelling Case Against Judge Robert H. Bork*, 9 CARDOZO L. REV. 33, 47-52 (1987) (discussing questioning of Bork during the hearings on his confirmation to be Solicitor General and a judge on the U.S. Court of Appeals for the D.C. Circuit).

<sup>4</sup> Critics would regularly cite this article as evidence of Bork's "extreme" views and Bork would be questioned extensively about this article when he was subsequently nominated to be Solicitor General, a judge on the U.S. Court of Appeals for the D.C. Circuit, and an Associate Justice on the Supreme Court. See, e.g., Gillers, *supra* note 3.

<sup>5</sup> Bork, *Neutral Principles*, *supra* note 2, at 20.

Court. So much so that, at the time of his death, many would know Judge Bork more for his writing on constitutional law than on antitrust.<sup>6</sup> Judge Bork returned to the subject of his 1971 article frequently over the course of his career, particularly after retiring from the bench. Though his views evolved some over time, he consistently criticized the Supreme Court for inverting the meaning of the First Amendment and extending constitutional protection to forms of speech and expression that had little to do with political discourse.<sup>7</sup> Though he eventually conceded that some nonpolitical speech should be protected, Judge Bork consistently maintained that political speech was at the core of constitutionally protected speech, even as he rejected the Supreme Court's expansive notion of what constituted protected expression. On practical grounds, if for no other reason, Judge Bork believed it was too difficult to distinguish "political speech from other varieties."<sup>8</sup> Thus if the First Amendment were to fulfill its purpose of protecting political speech, some other forms of speech would need to be protected too.

Although Judge Bork wrote a substantial amount about the First Amendment and the regulation of commercial activity, particularly in the area of antitrust, he wrote relatively little on the intersection of these subject areas. Questions concerning commercial speech, as such, rarely captured his attention. Indeed, it was not until the 1990s that he focused on commercial speech at all. By that time, Bork believed government regulation of product advertising or other forms of commercial speech was subject to constitutional constraints. In a 1996 monograph he argued the proposed regulation of cigarette advertising was "patently unconstitutional."<sup>9</sup> Whatever its merits, this position is at odds with the approach he articulated in 1971.

This brief essay explores the evolution of Judge Bork's views on commercial speech and considers possible explanations for the change. It is

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<sup>6</sup> See, e.g., Ethan Bronner, *A Conservative Whose Supreme Court Bid Set the Senate Afire*, N.Y. TIMES, Dec. 19, 2012, available at [http://www.nytimes.com/2012/12/20/us/robert-h-bork-conservative-jurist-dies-at-85.html?\\_r=0](http://www.nytimes.com/2012/12/20/us/robert-h-bork-conservative-jurist-dies-at-85.html?_r=0) (noting "it was as a symbol of the nation's culture wars that Judge Bork made his name").

<sup>7</sup> See, e.g., Robert H. Bork, *What To Do about the First Amendment*, COMMENTARY (Feb. 1, 1995), available at <http://www.commentarymagazine.com/article/what-to-do-about-the-first-amendment/>; Robert H. Bork, *Adversary Jurisprudence*, NEW CRITERION (May 2002) [hereinafter Bork, *Adversary Jurisprudence*], available at <http://www.newcriterion.com/articles.cfm/Adversary-jurisprudence-1962>. Bork would also discuss First Amendment doctrine in his various books on constitutional law and American political culture. See, e.g., ROBERT H. BORK, *THE TEMPTING OF AMERICA: THE POLITICAL SEDUCTION OF THE LAW* 333-36 (1990) [hereinafter BORK, *TEMPTING*]; ROBERT H. BORK, *SLOUCHING TOWARDS GOMORRAH: MODERN LIBERALISM AND AMERICAN DECLINE* 96-103 (1996) [hereinafter BORK, *SLOUCHING*].

<sup>8</sup> ROBERT H. BORK, *A TIME TO SPEAK: SELECTED WRITINGS AND ARGUMENTS* 219 (2008) [hereinafter BORK, *A TIME TO SPEAK*].

<sup>9</sup> Robert H. Bork, *Activist FDA Threatens Constitutional Speech Rights*, 11 LEGAL BACKGROUNDER, no. 2, 1996, at 1 [hereinafter Bork, *Activist FDA*].

possible that Judge Bork's later advocacy of protection for commercial speech was a part of the broader evolution of his First Amendment views. It may also have been the result of his consideration of historical materials and scholarship suggesting that the founding generation saw commercial speech as worthy of protection.<sup>10</sup> Alternatively, Judge Bork may have come to appreciate that the line between commercial and political speech is less clear than some might suppose, particularly if one does not adopt a state-centered conception of political speech. Whatever the cause, there is little question that Judge Bork's view of commercial speech did change.

## I. NEUTRAL PRINCIPLES AND FIRST AMENDMENT PROBLEMS.

"Constitutional protection should be accorded only to speech that is explicitly political," Bork proclaimed in his famous—perhaps infamous—1971 *Indiana Law Journal* article.<sup>11</sup> If there were any doubt about what this meant, Judge Bork made it clear: "There is no basis for judicial intervention to protect any other form of expression, be it scientific, literary or that variety of expression we call obscene or pornographic," he explained.<sup>12</sup> In Judge Bork's view, this was the only view of the First Amendment that was consistent with its founding purpose.

In his 1971 article, Judge Bork adopted the view that the First Amendment's protection of speech could only be understood as a protection of that speech which informs the political process and thus assists in the process of self-government.<sup>13</sup> The "freedom of speech" did not extend to any and all utterances, let alone all forms of expressive activity. It concerned that speech which was essential to democratic governance. Political speech, to be protected, had to be "explicitly political."<sup>14</sup> Such speech would include "criticisms of public officials and policies, proposals for the adoption or repeal of legislation or constitutional provisions and speech addressed to the conduct of any governmental unit in the country."<sup>15</sup> It did not, however, extend to "any speech that concerns government and law," let alone broader social commentary with potential political implications.<sup>16</sup>

Judge Bork recognized the difficulty of distinguishing political speech from nonpolitical speech, particularly at the margin. Yet for him this was a reason to *restrict* the scope of First Amendment protections, not expand it, as had been done by the Supreme Court. As he explained:

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<sup>10</sup> *Id.* at 2.

<sup>11</sup> Bork, *Neutral Principles*, *supra* note 2, at 20.

<sup>12</sup> *Id.* at 20.

<sup>13</sup> *See generally id.*

<sup>14</sup> *Id.* at 20.

<sup>15</sup> *Id.* at 29.

<sup>16</sup> *Id.*



[T]he rationale of the first amendment cannot be the protection of all things or activities that influence political attitudes. Any speech may do that, and we have seen that it is impossible to leave all speech unregulated. . . . The line drawn must, therefore, lie between the explicitly political and all else.<sup>17</sup>

Whereas other commentators have concluded that the difficulty in distinguishing political speech from nonpolitical speech counsels for broader protection of speech—lest government regulations trammel political expression—Judge Bork took the opposite tack.

Judge Bork argued that protected political speech should not be understood to include “any speech that advocates forcible overthrow of the government or the violation of any law.”<sup>18</sup> Insofar as the amendment “indicates that there is something special about speech,” it is that speech and discourse concerning political matters is necessary to the maintenance of representative government.<sup>19</sup> Indeed, Judge Bork suggested the First Amendment itself was superfluous, in that constitutional protection for political speech “could and should be inferred even if there were no first amendment.”<sup>20</sup>

As Judge Bork saw it, only this understanding of the First Amendment could justify robust, judicially enforced protection of speech. Personal preferences for the freedom of nonpolitical expression were no more important than preferences for economic liberty or laissez-faire. “The objection ‘I like it,’ is sufficiently rebutted by ‘we don’t.’”<sup>21</sup> That a given sort of speech is “valuable,” was not enough to justify constitutional protection, in part because there was no “neutral” basis upon which to evaluate the worth of nonpolitical speech. The only available neutral principle was that provided by the constitution itself. Focusing on the alleged social or other value of speech “confuses the constitutionality of laws with their wisdom.”<sup>22</sup>

Judge Bork, like Alexander Meiklejohn, argued that the focus of the First Amendment was not the individual, but the polity.<sup>23</sup> Only speech related to self-governance merited constitutional protection, as only such speech “can be distinguished as serving ends over and above any other form

<sup>17</sup> *Id.* at 28.

<sup>18</sup> *Id.* at 20.

<sup>19</sup> *Id.* at 23.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.* at 29 (citing Walter Berns, *Pornography vs. Democracy: The Case for Censorship*, 22 THE PUB. INT. 3, 23 (1971)).

<sup>22</sup> *Id.* at 28.

<sup>23</sup> See Alexander Meiklejohn, *The First Amendment is an Absolute*, 1961 SUP. CT. REV. 245, 255 (1961) (“The First Amendment does not protect a ‘freedom to speak.’ It protects the freedom of those activities of thought and communication by which we ‘govern.’ It is concerned, not with a private right, but with a public power, a governmental responsibility.”). Bork endorses this passage in Bork, *Neutral Principles*, *supra* note 2, at 26. See also ROBERT C. POST, *DEMOCRACY, EXPERTISE, & ACADEMIC FREEDOM: A FIRST AMENDMENT JURISPRUDENCE FOR THE MODERN STATE* 16 (2012) (Bork, like Meiklejohn “believed that First Amendment coverage should not extend to the autonomy interests of speakers, but only to the rights of voters to receive information.”).

of self-gratification.”<sup>24</sup> Many activities can produce pleasure, enlightenment, or self-improvement.<sup>25</sup> This is not what makes speech special.<sup>26</sup> Rather, what is special about speech is its ability to enlighten and inform the political process and facilitate democratic governance.

If only political speech is protected by the First Amendment—and “explicitly political” speech at that—commercial speech would not be protected. This is particularly so given Judge Bork’s narrow conception of what it meant for speech to be “political.” If political speech is protected because it aides in self-governing through the democratic process—and the only relevant political activity and efforts at self-government that are relevant are those that involve the democratic process and efforts to influence the state—commercial speech is unworthy of protection.

As Judge Bork saw it, there was no reason to believe the state was any more constrained in its ability to regulate commercial speech than commercial activity. In Judge Bork’s words, “constitutionally, art and pornography are on a par with industry and smoke pollution.”<sup>27</sup> In either instance, the state would have relatively free rein. Although Judge Bork was, personally, an advocate of laissez-faire economic policies, particularly in the area of antitrust, he consistently stressed throughout his career that there were few constitutional barriers to extensive economic regulation. His “generally libertarian” policy preferences “have nothing to do with the behavior proper to the Supreme Court.”<sup>28</sup> Judge Bork categorically rejected claims made by libertarians, for instance, that the Constitution should be understood to protect liberty of contract or the right to pursue a profession. He had no room for a “presumption of liberty” and saw *Lochner v. New York* as the epitome of lawless judicial activism.<sup>29</sup> If commercial speech were to be protected, such protection would have to come through the political process. The Constitution had little to say about it. Though Judge Bork did not emphasize the original understanding of the First Amendment as much as he would in later writings, he noted that the contemporary Supreme Court’s generally libertarian approach to speech “would have been strikingly at odds” with those who ratified the First Amendment.<sup>30</sup>

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<sup>24</sup> RODNEY A. SMOLLA, *FREE SPEECH IN AN OPEN SOCIETY* 9 (1992).

<sup>25</sup> See Bork, *Neutral Principles*, *supra* note 2, at 25.

<sup>26</sup> SMOLLA, *supra* note 24, at 12 (“Judge Bork does not accept individual self-fulfillment, even when related to political participation, as an adequate basis for treating speech as a preferred value.”).

<sup>27</sup> Bork, *Neutral Principles*, *supra* note 2, at 29.

<sup>28</sup> *Id.* at 21.

<sup>29</sup> See BORK, *TEMPTING*, *supra* note 7, at 44 (noting *Lochner v. New York* is “the symbol, indeed the quintessence, of judicial usurpation of power”).

<sup>30</sup> Bork, *Neutral Principles*, *supra* note 2, at 22.

## II. ADVERTISEMENTS AND THE FREEDOM OF THE PRESS

Judge Bork may not have advocated the protection of commercial speech in 1971, but he would a quarter-century later. In August 1995, the Food and Drug Administration (FDA) proposed new regulations severely curtailing the advertising and promotion of cigarettes and other tobacco products.<sup>31</sup> The proposed restrictions, which included a prohibition on cigarette-brand sponsorship of sporting events and the distribution of branded promotional items and a requirement that many advertisements consist of no more than black-and-white text, were aimed at preventing the marketing of tobacco products to children. Such lofty aims notwithstanding, Judge Bork decried the regulations as an assault on “the First Amendment rights of American companies and individuals who . . . have any connection with tobacco products.”<sup>32</sup> Whether one relied upon contemporary First Amendment doctrine or the original understanding of the First Amendment, Judge Bork declared such restrictions were “patently unconstitutional.”<sup>33</sup> As he wrote in a monograph published by the Washington Legal Foundation, “these restrictions on truthful speech about lawful products are unconstitutional no matter what mode of analysis is adopted.”<sup>34</sup>

According to Judge Bork, the original understanding of the First Amendment should preclude such regulation. The First Amendment’s admonition against laws “abridging the freedom of speech, or of the press” was understood to include commercial speech, including advertising for lawful products such as cigarettes.<sup>35</sup> To the founding generation, “ads were news.”<sup>36</sup> The dominant political philosophy of the founding era also “generally equated liberty and property rights.”<sup>37</sup> Based upon his review of others’ research on the historical understanding of the freedom of speech and of the press,<sup>38</sup> Judge Bork concluded that “the development of the concept

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<sup>31</sup> See Food & Drug Admin., Regulations Restricting the Sale and Distribution of Cigarettes and Smokeless Tobacco Products to Protect Children and Adolescents, 60 Fed. Reg. 41,314 (proposed Aug. 11, 1995).

<sup>32</sup> Bork, *Activist FDA*, supra note 9, at 1.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 2.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.* at 3. Despite reaching this conclusion, there is no evidence that Judge Bork came to believe that economic liberty, more broadly, was subject to constitutional protection.

<sup>38</sup> Bork referenced a white paper written by several attorneys at Wiley, Rein & Fielding as his primary source in this regard. See generally RICHARD E. WILEY ET AL., COMMERCIAL SPEECH AND THE FIRST AMENDMENT (Nat’l Legal Ctr. for the Pub. Interest, White Paper vol. 6, no. 1 1994), referenced in Bork, *Activist FDA*, supra note 9, at 2 n.1. One of the authors of this white paper, Daniel Troy, was a former clerk to Judge Bork and would later author an extensive treatment on the original understanding of commercial speech. See generally Daniel E. Troy, *Advertising: Not “Low Value” Speech*, 16 YALE J. ON REG. 85 (1999).

of a free press and the rise of a commercial, advertising-driven text were linked.”<sup>39</sup> Further, “the ‘press’ which the Framers specifically sought to protect encompassed truthful communications about commercial matters.”<sup>40</sup> As he recounted, “America’s first sustained defense of a free press, and of the very notion of a ‘marketplace of ideas,’ came in response to an attack on an advertisement printed by Benjamin Franklin” that referenced “Sea Hens” and “Black Gowns,” displeasing local clergy.<sup>41</sup> As a consequence, Judge Bork maintained, “the First Amendment, as historically understood, would permit the regulation of commercial messages concerning lawful products and services only to ensure that they are truthful and not misleading.”<sup>42</sup>

Even if one rejected the original understanding of the First Amendment in favor of contemporary doctrine, Judge Bork claimed the result would be the same. In 1975, the Supreme Court first held that commercial speech, including advertisements and product promotions, was “not stripped of First Amendment protection merely because it appears in that form.”<sup>43</sup> Since then, the Court has held that commercial speech receives First Amendment protection, albeit a slightly lower level of protection than does political speech or other core protected speech.<sup>44</sup> In 2001, for example, the Court stated clearly that “[t]he fact that the speech is in aid of a commercial purpose does not deprive respondent of all First Amendment protection.”<sup>45</sup> Nor does it matter whether such speech is made by an individual or a corporation.<sup>46</sup> Though the justices have not always agreed on the precise scope of the protection commercial speech should receive, the Court has become increasingly protective of commercial speech over time.<sup>47</sup> If the First Amendment extends to commercial speech, such as advertising that promotes a lawful product, then restrictions on cigarette advertising and promotion must satisfy the relevant First Amendment tests.<sup>48</sup> The

<sup>39</sup> Bork, *Activist FDA*, *supra* note 9, at 2.

<sup>40</sup> *Id.* at 4.

<sup>41</sup> *Id.* at 3.

<sup>42</sup> *Id.* at 2.

<sup>43</sup> *Bigelow v. Virginia*, 421 U.S. 809, 818 (1975). The Court had noted the value of commercial speech in earlier cases. *See, e.g., Pittsburgh Press v. Pittsburgh Comm’n on Human Relations*, 413 U.S. 376, 388 (1973) (“[T]he exchange of information is as important in the commercial realm as in any other.”).

<sup>44</sup> *See, e.g., Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n of N.Y.*, 447 U.S. 557, 566 (1980); *see also Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council*, 425 U.S. 748, 761 (1976).

<sup>45</sup> *United States v. United Foods, Inc.*, 533 U.S. 405, 410 (2001).

<sup>46</sup> *First Nat’l Bank v. Belotti*, 435 U.S. 765, 783 (1978).

<sup>47</sup> *See, e.g., 44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 496-500 (1996).

<sup>48</sup> The prevailing test is provided by *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n*, 447 U.S. 557, 566 (1980). It should be noted that while the Court continues to apply the *Central Hudson* test, several Justices on the Court have signaled their disagreement with *Central Hudson*, and their desire to see greater protection for commercial speech. *See, e.g., 44 Liquormart, Inc. v. Rhode Island*,

FDA's proposed restrictions failed, Judge Bork concluded, because the FDA failed to show that its proposed restrictions would "reduce underage smoking in 'a direct and material way,'" as required under the *Central Hudson* test for restrictions on commercial speech.<sup>49</sup> Further, Judge Bork argued, the FDA's proposed rules were not sufficiently narrowly tailored to the FDA's stated goal of protecting children.<sup>50</sup> Insofar as the federal government sought to reduce underage smoking, there were far more direct—and less speech-restrictive ways—to achieve this goal.

### III. EVOLUTION

The approach to the First Amendment Judge Bork espoused in 1971 provided no rationale for the protection of commercial speech, as such speech is not explicitly political. Yet twenty-five years later, Judge Bork forcefully defended commercial speech against federal government regulation. What explains this shift? Throughout his later writings on the First Amendment and his explanation for the evolution of his views, Judge Bork said very little about commercial speech. He was more concerned with the Court's insistence on protecting offensive and sexually-related speech while failing to protect campaign-related speech than he was with the Court's invention and application of *Central Hudson*.<sup>51</sup> Nonetheless, it is clear that, at some point, Judge Bork's views on constitutional protection for commercial speech had evolved. Something happened to convince him that commercial advertising was worthy of constitutional protection, despite its lack of explicit political content. More broadly, Judge Bork moderated his restrictive view of the "freedom of speech," conceding that judges should protect much speech that is not explicitly political. Yet while Judge Bork

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517 U.S. 484 (1996) (holding that Rhode Island's ban on advertising for alcohol abridged speech in violation of the First Amendment); see also *Thompson v. W. States Med. Ctr.*, 535 U.S. 357, 367-68 (2002) (noting "doubts" of the *Central Hudson* test by multiple Justices); *United States v. United Foods*, 533 U.S. 405, 409-10 (2001) (noting "criticism" of the *Central Hudson* test by multiple Justices); Robert Post, *Transparent and Efficient Markets: Compelled Commercial Speech and Coerced Commercial Association in United Foods, Zauderer, and Abood*, 40 VAL. U. L. REV. 555, 558-59 n.15 (2006) ("More than a majority of the Justices have at one time or another indicated their dissatisfaction with the test. . . . Yet the Court has continued to apply the test with increasing severity.").

<sup>49</sup> Bork, *Activist FDA*, *supra* note 9, at 5. Bork cited research noting the lack of evidence that cigarette advertising encourages underage smoking and concluding that such advertising, like brand advertising in general, "'mainly shifts consumers among brands.'" *Id.* (quoting ECONOMIC REPORT OF THE PRESIDENT 186 (1987); Joint Statement of Commissioners Mary L. Azcuenaga, Deborah K. Owen, & Roscoe B. Starek, III, *R.J. Reynolds Tobacco Co.*, F.T.C. File No. 932-3162 (June 6, 1994), available at <http://legacy.library.ucsf.edu/tid/lqm56a00/pdf>).

<sup>50</sup> Bork, *Activist FDA*, *supra* note 9, at 6.

<sup>51</sup> See, e.g., Bork, *Adversary Jurisprudence*, *supra* note 7; Bork, *What To Do About the First Amendment*, *supra* note 7.

offered explanations for this general evolution, he said relatively little about how he came to reconsider his view of commercial speech in particular.

One might suppose that Judge Bork's defense of commercial speech grew out of laissez-faire sympathies. This is unlikely. Judge Bork had long since abandoned the belief that the Constitution embodied a laissez-faire economic philosophy. In the early 1960s he had argued Title VII of the Civil Rights Act unconstitutionally infringed upon individual liberty and freedom of association,<sup>52</sup> but he grew to reject this view, and to reject the broader claim that economic liberties were constitutionally protected.<sup>53</sup> By the early 1970s Judge Bork had concluded that judges had no role in constraining economic regulation and by the 1980s he would join those who considered *Lochner v. New York* the epitome of judicial activism.<sup>54</sup> Though Judge Bork's critique of government failure in competition policy might have suggested a similarly skeptical view of government speech regulation,<sup>55</sup> he never sought to constitutionalize these views.

Judge Bork may have gained some appreciation for the value of commercial speech during his time in the federal government. In 1976, as Solicitor General, Judge Bork authored an amicus brief in *Bates v. State Bar of Arizona*, a case that combined questions of antitrust and commercial speech.<sup>56</sup> Arizona had imposed a ban on lawyer advertising. Such restrictions, it was well understood, served to constrain competition in the market for legal services and made it more difficult for new entrants to compete with established firms. On behalf of the federal government, Judge Bork argued that these limits were not precluded by the Sherman Act, despite their anticompetitive effects. Under *Parker v. Brown*,<sup>57</sup> such state action was permissible and not preempted by the federal antitrust laws. Yet Judge Bork also argued that Arizona's limits violated the First Amendment, relying upon the Supreme Court's then-recent decisions in

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<sup>52</sup> See Robert H. Bork, *Civil Rights—A Challenge*, THE NEW REPUBLIC, Aug. 31, 1963, at 21, 23. According to one account, Bork also authored a “75-page critique” of the Civil Rights Act at the behest of then-Senator Barry Goldwater. See JAMES PERRY, BARRY GOLDWATER: A NEW LOOK AT A PRESIDENTIAL CANDIDATE 25 (1964).

<sup>53</sup> See generally, Robert H. Bork, *On Constitutional Economics*, REGULATION, Sept.–Oct. 1983, at 14 (claiming that an exclusively philosophical or economic approach to Constitutional amendments is likely unworkable).

<sup>54</sup> See BORK, TEMPTING, *supra* note 7, at 44.

<sup>55</sup> See, e.g., Ilya Somin, *The Borkean Case Against Robert Bork's Case for Censorship*, 31 HARV. J.L. & PUB. POL'Y 511 (2008) (suggesting that Judge Bork's criticisms of antitrust regulation also apply to the government's regulation of culture).

<sup>56</sup> Brief for the United States as Amicus Curiae Supporting Appellants, *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977) (No. 76-316).

<sup>57</sup> *Parker v. Brown*, 317 U.S. 341, 352 (1943) (holding that the Sherman Act does not apply to the state's regulation of California raisin crops).

*Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council*<sup>58</sup> and *Bigelow v. Virginia*.<sup>59</sup> As then-Solicitor General Bork advised the Court, “there is a strong public interest in the free flow of accurate information about commercial services and commercial products, and that the flow of information cannot be staunched simply because it has a ‘commercial’ subject matter.”<sup>60</sup> This was a relatively easy position for the Solicitor General’s office to take, given the thrust of the Court’s initial commercial speech opinions. It was also Nixon Administration policy to combat anti-competitive regulations adopted by state governments. Judge Bork said almost nothing about this case in his later writings. If his work on *Bates* informed his views of commercial speech, Judge Bork kept that to himself.<sup>61</sup>

What about Judge Bork’s time on the federal bench? As a judge on the U.S. Court of Appeals for the D.C. Circuit, Judge Bork faithfully applied relevant precedent in First Amendment cases.<sup>62</sup> Although Judge Bork’s record on the D.C. Circuit was generally supportive of First Amendment speech and press claims,<sup>63</sup> there is little in these opinions that reflects his writing on the First Amendment, and even less that suggests any growing affinity for commercial speech beyond what was already embraced by existing Supreme Court doctrine. “Both consumers and society have a strong interest ‘in the free flow of commercial information,’” Bork explained in *Federal Trade Commission v. Brown & Williamson Corp.*<sup>64</sup> Yet this was no more than a restatement of existing law.<sup>65</sup> His opinion limiting the scope of an injunction against tobacco company advertisements for the

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<sup>58</sup> *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council*, 425 U.S. 748, 748 (1976) (holding that a Virginia statute banning the advertisement of prescription drug prices violated the First Amendment’s protection of commercial speech).

<sup>59</sup> 421 U.S. 809 (1975).

<sup>60</sup> Brief for the United States, *supra* note 56, at 22-23.

<sup>61</sup> The more notable brief filed by Bork as Solicitor General was the second brief for the United States in *Buckley v. Valeo*. One brief was filed by the Solicitor General’s office defending the newly enacted federal campaign finance law and the constitutionality of the Federal Election Commission. This second brief, however, did not expressly defend the federal government’s interests and suggested reasons why the Court should suspect that the post-Watergate restrictions on campaign-related activities unconstitutionally trampled on First Amendment rights. Brief for the Attorney General and the Federal Election Comm’n at 19, *Buckley v. Valeo*, 424 U.S. 1 (1976) (Nos. 75-436 & 75-437).

<sup>62</sup> See generally Michael W. McConnell, *The First Amendment Jurisprudence of Judge Robert H. Bork*, 9 CARDOZO L. REV. 63 (1987). For a more critical view, see Arthur L. Fox II et al., *The Judicial Record of Judge Robert H. Bork*, 9 CARDOZO L. REV. 297, 338-45 (1987) (emphasizing an apparent reluctance to protect nonpolitical speech).

<sup>63</sup> See McConnell, *supra* note 62, at 64 (“Judge Bork expanded the protections for freedom of the press beyond those yet recognized by the Supreme Court.”); *Id.* at 68 (“Judge Bork has been in the forefront of extension of free speech and press rights to broadcasters.”).

<sup>64</sup> *FTC v. Brown & Williamson Tobacco Corp.*, 778 F.2d 35, 43 (D.C. Cir. 1985) (quoting *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council*, 425 U.S. 748, 763 (1976)).

<sup>65</sup> See *Va. State Bd.*, 425 U.S. at 463.

amount of tar in different cigarette brands evinced no particular sympathy for commercial speech, as such, and stopped far short of embracing all of the corporate appellant's commercial speech claims.

*Brown & Williamson* was Judge Bork's most important commercial speech opinion on the D.C. Circuit, but it was not his only case to touch on the intersection of economic regulation and corporate speech. In *Telecommunications Research and Action Center v. Federal Communications Commission*, for example, Judge Bork critiqued the rationale (or lack thereof) underlying the Supreme Court's "scarcity" rationale for broadcast regulation.<sup>66</sup> In such opinions some saw a hint that Bork would have voted to invalidate the Federal Communications Commission's "fairness doctrine" had he been confirmed to the Supreme Court.<sup>67</sup> Yet there was little evidence that he had adopted a substantially broader view of what speech should be protected, let alone a particular solicitude for commercial speech.

Reviewing Judge Bork's First Amendment jurisprudence in 1987, Professor Michael McConnell concluded that "Judge Bork's commitment to freedom of speech, even outside the political arena, now extends as far or farther than current constitutional doctrine."<sup>68</sup> However reasonable such an assessment may have been in 1987, Judge Bork's subsequent writing makes it clear that his commitment to protecting nonpolitical speech was not so broad. Although he would later argue that the Court had become too willing to allow government regulation of political speech under the guise of controlling the appearance of corruption in campaign finance, Judge Bork would remain harshly critical of the Court's decisions protecting sexually-themed speech and expressive activities.<sup>69</sup> Judge Bork has never championed a remotely libertarian view of the First Amendment.

Contrary to some perceptions, Judge Bork does not appear to have moderated his views on the First Amendment at his Supreme Court confirmation hearings. He had revealed a softening of his stance well before he was tapped by President Reagan for a seat on the High Court. During his nomination hearings for Solicitor General and circuit judge, he explained that he saw his 1971 article as an academic exploration, rather than as a firm statement of his views.<sup>70</sup>

Judge Bork's position as a federal judge—and potential Supreme Court nominee—invited greater scrutiny of his views. In 1984, Bork responded forcefully to an *ABA Journal* item providing an "Attila-the-Hun characterization" of his prior writing, largely based upon a liberal opinion

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<sup>66</sup> See *Telecomm. Research & Action Ctr. v. FCC*, 801 F.2d 501, 504-05 (D.C. Cir. 1986).

<sup>67</sup> See McConnell, *supra* note 62, at 69.

<sup>68</sup> *Id.* at 71.

<sup>69</sup> See, e.g., Bork, SLOUCHING, *supra* note 7, at 98-103.

<sup>70</sup> See Gillers, *supra* note 3.



writer's interpretation of his 1971 article.<sup>71</sup> Judge Bork categorically rejected his former position that "First Amendment protection should apply only to speech that is explicitly political."<sup>72</sup> Such a characterization was "both seriously out of date and seriously mistaken."<sup>73</sup> As he explained:

As the result of the responses of scholars to my article, I have long since concluded that many other forms of discourse, such as moral and scientific debate, are central to democratic government and deserve protection. I have repeatedly stated this position in my classes.<sup>74</sup>

He made no mention of commercial speech but did reaffirm that, even under this view, there was still no rationale for protecting either obscenity or pornography.

After leaving the federal bench, Judge Bork would continue to write about the First Amendment, reiterating his view that the freedom of speech concerned political expression, while also accepting a need for somewhat broader judicial protection of expressive activity. In 1995, for instance, he reiterated his view that "the existence of the amendment implies that there is something special about speech, something that sets it apart from other human activities that are not accorded constitutional protection."<sup>75</sup> For Judge Bork this was the "discovery and spread of political truth."<sup>76</sup> Sexually explicit materials, whether or not considered "obscene," and much expressive activity, were not part of the "freedom of speech."

Although ensuring the "discovery and spread of political truth" was the reason for constitutional protection of speech, Judge Bork conceded the need to provide broader constitutional protection of speech so as to ensure it could fulfill its purpose. "In a previous writing," he noted, he had "mistakenly arrived at the proposition that the only explicitly political speech should be protected by the speech clause."<sup>77</sup> The mistake, as he saw it, was not in his construction of the First Amendment, but in how this understanding should inform judicial review of speech restrictions. As Judge Bork would explain:

[P]olitical speech does have a special claim to protection: a representative democracy would be nonsense without it. But there is both a practical and a theoretical objection to limiting protection to explicitly political speech. The practical objection is that other forms of speech could find protection if the speaker added the admonition that we pass a law on the subject,

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<sup>71</sup> See generally Arthur John Keffe, *Here Comes Attila the Hun of the Constitution*, 69 A.B.A. J. 1935 (1983); Jamie Kalven, *Reagan's Next Justice?*, THE NATION, Oct. 1, 1983, at 262.

<sup>72</sup> Robert H. Bork, *Judge Bork Replies*, 70 A.B.A. J. 132, 132 (1984).

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> Robert H. Bork, *What To Do about the First Amendment*, COMMENTARY, Feb. 1995, at 23, 26, available at <http://www.commentarymagazine.com/article/what-to-do-about-the-first-amendment/>.

<sup>76</sup> *Id.*

<sup>77</sup> *Id.* at 27.

whatever it was. The theoretical objection is that speech is both valuable and unique, whatever kind of truth it seeks to discover and spread. There is thus reason to conclude that the protection of speech clause extends to many other types of speech that express ideas.<sup>78</sup>

Judge Bork accepted that judges needed to afford constitutional protection to more than “explicitly political” speech but not nearly so much speech as was protected by the Supreme Court. Much of his later commentary on the First Amendment stressed the “stunning inversion of the First Amendment’s guarantee of freedom of speech, protection of the worst forms of pornography and vulgarity but approval of even prior restraints on political speech, historically at the heart of the Amendment.”<sup>79</sup> Campaign-related speech was clearly deserving of protection, in Bork’s view, as it consisted of core political speech. Sexually explicit television programming, on the other hand, was not, as it lacked any meaningful connection to political discourse and did not communicate any ideas that could not be expressed just as effectively in other ways. In protecting the latter while failing to protect the former, the Supreme Court was applying an inverted First Amendment.

Judge Bork would repeatedly stress the “practical” nature of his evolving position. “Discussion with colleagues has led me to abandon the proposition that only political speech should be accorded constitutional protection,” he would write later, adding that his “shift” was “only on grounds of practicality, not any difficulty with the underlying principle. The practical difficulty lies in distinguishing political speech from other varieties.”<sup>80</sup> Combing through artistic and other materials to discern whether they contained much political content would be “an administrative and legal nightmare.”<sup>81</sup> There would also be a substantial chilling effect because “No speaker or writer could proceed with confidence that the unknown judge and jury he would one day face would draw the political/nonpolitical line correctly or consistently with the determinations of other tribunals.”<sup>82</sup> Thus, he would explain the *Chaplinsky* framework of identifying “certain well-defined and narrowly limited classes of speech” that are “no essential part of any exposition of ideas” and could be excluded from First Amendment protection<sup>83</sup> was likely the “best” approach for the judiciary to take.<sup>84</sup> Although the Court did not confer First Amendment protection on commercial speech at the time *Chaplinsky* was decided, it was not included in the list of those “utterances” that “are of such slight social value as a step to truth”

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

<sup>79</sup> See, e.g., Robert H. Bork, Introduction, in “A COUNTRY I DO NOT RECOGNIZE”: THE LEGAL ASSAULT ON AMERICAN VALUES xiii (Robert H. Bork ed., 2005).

<sup>80</sup> BORK, A TIME TO SPEAK, *supra* note 8, at 219.

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Chaplinsky v. New Hampshire*, 315 U.S. 568, 571-72 (1942).

<sup>84</sup> BORK, A TIME TO SPEAK, *supra* note 8, at 219.

that their regulation or prohibition did not threaten First Amendment values.<sup>85</sup>

While Judge Bork never said as much, it is also possible that his experience in government, and as a judge, informed his views of how judges should apply constitutional protections as it may have laid plain the difficulty of demarcating the boundary of protected speech. This would explain Judge Bork's repeated reference to the "practical" problems of adopting a particularly narrow conception of the "freedom of speech." Such line drawing may be relatively easy in the abstract. It is more difficult to operationalize a doctrine that accounts for the complexities, indeterminacies, and nuances that arise in individual cases. Thus a broader, and somewhat more prophylactic, doctrine would ensure that the First Amendment's protection of speech would serve its actual purpose better than any effort to strictly confine speech protections to their proper bounds.

Judge Bork was concerned with the ability of judges to apply the doctrine in a principled and consistent fashion. At the same time, it appears he was swayed by a greater understanding of the original intent underlying the First Amendment. In his 1996 monograph challenging the constitutionality of the FDA's proposed limits on tobacco advertising Judge Bork stressed "the original understanding of the First Amendment"<sup>86</sup> and cited evidence supporting the claim that those in the founding generation experienced the "press" as a commercial enterprise and recognized advertisements as a form of news.<sup>87</sup>

This would suggest that the evolution of Judge Bork's view of commercial speech was driven, at least in part, by the evidence. In arguing for a more constrained conception of the freedom of speech subject to constitutional protection, Judge Bork had simply assumed that such protection could only be justified with a reference to the need for political discourse to facilitate democratic self-government. Though a proponent of originalist methodology, Judge Bork did not himself engage in the extensive historical inquiry such approaches to constitutional interpretation require. Confronted with the evidence compiled by others, however, Judge Bork may have recognized the implications for judicial review.

#### IV. WHEN THE COMMERCIAL IS POLITICAL

Judge Bork came to appreciate the need for protecting much speech that is not expressly political, and forcefully advocated for the protection of commercial speech, albeit late in his career. Beyond noting that the founding generation may not have distinguished political and commercial speech,

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<sup>85</sup> *Id.* (quoting *Chaplinsky*, 315 U.S. at 572).

<sup>86</sup> Bork, *Activist FDA*, *supra* note 9, at 1.

<sup>87</sup> *See infra* notes 88, 93, and accompanying text.

and that some had vigorously defended commercial printing as part of the “freedom of the press,” Judge Bork never made much connection between the two. Had he delved more deeply into the nature of commercial speech, however, he may have come to recognize that the reason for such protection is not simply that the line between political and nonpolitical speech is more difficult to draw than he had supposed. Commercial speech, like much public discourse, is directly relevant to self-government even when not directed at the political issues of the day. By adopting an unduly state-centered view of what constitutes “political” speech, or of what constitutes speech relevant to self-governance, Judge Bork was led to an unduly restrictive conception of the freedom of speech worthy of First Amendment protection.

Much commercial speech is of undoubted political relevance, particularly if one does not take a state-centered view of speech. As the Supreme Court explained in its *Virginia State Board of Pharmacy* decision, a free flow of commercial information “is indispensable to the proper allocation of resources in a free enterprise system, it is also indispensable to the formation of intelligent opinions as to how that system ought to be regulated or altered.”<sup>88</sup> Commercial information about all sorts of goods and services—ranging from the price of gasoline or milk to the availability of affordable health insurance policies or information about the sourcing of raw materials—influences political debates. Commercial decisions are often freighted with political content, as when a retailer refuses to stock a dairy product due to the treatment of livestock or when a manufacturer decides to source its materials from a given country or source of labor. Similarly, consumer decisions about what products to buy or stores to frequent may also have political content.

As other First Amendment scholars have noted—perhaps some of the same who convinced Judge Bork to moderate his views—even if one believes the First Amendment’s speech and press clauses are exclusively concerned with political speech and self-government, this requires allowing individuals to communicate about both how they want to be governed by the state and how they wish to govern themselves. Not all self-government entails participation in the democratic process. Not all speech of political relevance is expressly political, as not all political discourse is directed at the state. Much of political debate concerns what matters should be addressed by government action and what concerns can be left to nongovernmental institutions, whether families, community organizations, or other parts of civil society. Speech and expression that reinforces community values or implores citizens to engage in public concerns is directly relevant to the political debate over what government should do and how it should do it.

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<sup>88</sup> *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council*, 425 U.S. 748, 765 (1976).

In his various writings, Judge Bork was somewhat dismissive of the argument that the freedom of speech is important insofar as it facilitates self-expression and the creation of individual identities. Yet individual identity creation is extremely important in politics. It affects how individuals develop and exhibit their political commitments and helps arrange and define the group affinities that spawn the formation of coalitions and groups, whether we are speaking of Madisonian factions, Buchananite clubs, or other collective institutions.

Commercial speech cannot be separated from the process of individual identity creation or political discourse. People both engage in acts of self-definition and communicate political views through their economic choices.<sup>89</sup> The choice of what products to buy and what labels to display is often a political choice.<sup>90</sup> Consider the person who buys a Toyota Prius or insists upon shopping at a particular “socially responsible” store. This may be a personal preference, but it also has an expressive component.<sup>91</sup> Consumption can be a political act and consumption decisions can play a role in a broader discourse with political implications. Producers and advertisers are well aware of this, and regularly seek to take advantage of the extent to which political or cultural views influence purchasing habits. The consequence is that much commercial speech relates to and informs political discourse about the role of government in economic life, the extent to which certain activities should be regulated, and so on.<sup>92</sup>

As Martin Redish notes “speech concerning commercial products and services can facilitate private self-government in much the same way that political speech fosters collective self-government, and that both forms of self-government foster the values of democracy.”<sup>93</sup> Properly understood, commercial speech is as intermingled with political speech as much of the other speech Bork would have protected. If, in the end, the reason we pro-

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<sup>89</sup> See, e.g., Craig J. Thompson, *Understanding Consumption as Political and Moral Practice*, 11 J. CONSUMER CULTURE 139 (2011); see also Craig J. Thompson, Aric Rindfleisch & Zeynep Arsel, *Emotional Branding and the Strategic Value of the Doppelgänger Brand Image*, 70 J. MKTG. 50, 63 (2006) (noting research indicating “consumers’ most valued brands are those whose symbolic meanings play an important role in their self-conceptions.”).

<sup>90</sup> See, e.g., Yesim Ozalp, *Symposia Summary: Politics and Consumption*, 35 ADVANCES IN CONSUMER RES. 213 (2008); Michele Micheletti, *Consumer Choice as Political Participation*, 105 STATSVETENSKAPLIG TIDSKRIFT 218, 218 (2002) (“[U]nder certain conditions shopping for services and material goods is political participation.”).

<sup>91</sup> See, e.g., Marius K. Luedicke, Craig J. Thompson & Markus Giesler, *Consumer Identity Work as Moral Protagonism: How Myth and Ideology Animate a Brand-Mediated Moral Conflict*, 36 J. CONSUMER RES. 1016 (2010); Craig J. Thompson & Zeynep Arsel, *The Starbucks Brandscape and Consumers’ (Anticorporate) Experiences of Globalization*, 31 J. CONSUMER RES. 631 (2004).

<sup>92</sup> See, e.g., Dietlind Stolle, Marc Hooghe & Michelle Micheletti, *Politics in the Supermarket: Political Consumerism as a Form of Political Participation*, 26 INT’L POL. SCI. REV. 245 (2005) (noting effect of “political consumerism” on both corporate and government decisions).

<sup>93</sup> MARTIN H. REDISH, *THE ADVERSARY FIRST AMENDMENT: FREE EXPRESSION AND THE FOUNDATIONS OF AMERICAN DEMOCRACY* 86 (2013).

tect speech is to facilitate democracy and foster self-government, commercial speech must be protected too.<sup>94</sup> After all, in a democratic system, it is the people in their private lives, not the government, who determine what is desirable or good.<sup>95</sup>

## CONCLUSION

In 1971 Judge Bork articulated an unusually narrow conception of the constitutionally protected freedom of speech. He would not maintain this view for long. As he broadened his understanding of what speech and expression should receive constitutional protection in the courts, he eventually concluded that the First Amendment protects commercial speech too. While we do not fully know why Judge Bork came to appreciate the importance of commercial speech and advocate its robust protection, the view aligns with his concern for the original understanding of those who drafted and ratified the constitution, as well as his later expressed concern for the difficulty in discerning political from nonpolitical speech. Had Judge Bork delved further into the subject, and focused more on commercial speech as such, it is possible he may have deepened his understanding of how commercial discourse affects political debates, and vice versa. Whether or not the personal is political, much that is commercial certainly is. Yet because such questions were never the focus of Judge Bork's work, he never articulated, nor fully embraced, this view.

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<sup>94</sup> The point here is not to dismiss other accounts of the "freedom of speech" protected by the First Amendment, but to evaluate the implications of Judge Bork's claim that First Amendment protection is centered on political speech.

<sup>95</sup> See REDISH, *supra* note 93, at 106 ("The First Amendment focus is on allowing the private individual or entity, not the government, to decide what ideas are normatively appropriate.").



## PUBLIC CHOICE AND JUDICIAL VIRTUE

*John Harrison\**

Public choice theory, including constitutional theory based on public-choice principles, assumes that individuals are rational maximizers in their public as well as their private conduct. That assumption does not deny that individuals may value the public interest and may have public virtue, but it does raise prominently the possibility that public virtue is in short supply—in both citizens and officials. The problem of public virtue is especially delicate with respect to judges because attitudes that are virtue in most officials are vice in judges: a legislator who pursues the public interest instead of private interests does right, but a judge who pursues the judge's own vision of the public interest legislates from the bench and is a bad judge. Constitutional systems like that of the United States that use judicial enforcement of constitutional rules call for judicial virtue, which is a particular form of public virtue: an ideological commitment either directly to the principles of the constitutional regime, or directly to the rule of law and indirectly to the principles of the regime that is the law. In the actual American constitutional system, federal judges, and in particular Justices of the Supreme Court, tend to be selected for a very specific form of public virtue: attachment to the constructions of the Constitution espoused by the party coalition that appoints judges. Whether judges and Justices so selected will also be committed to the aspects of the Constitution that are relatively clear, and hence do not call for construction through constitutional politics, is therefore one of the great questions posed by actual American constitutional practice. There is some reason to hope that judges chosen through the actual process of constitutional politics will be so committed, and so will possess a form of public virtue that is not limited to the constructions of ruling coalitions.

Robert Bork and James Buchanan were both constitutional theorists, though they addressed quite different issues.<sup>1</sup> Bork was mainly concerned

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<sup>1</sup> The version of this essay presented at the conference also referred to the third person honored at that event, Armen Alchian. That version began by observing that I never met Alchian, although I used his textbook in an intermediate microeconomics course at the University of Virginia's Economics Department when I was an undergraduate. That is the department from which two future winners of the Prize in Economic Sciences in Memory of Alfred Nobel departed before winning the prize. One of them was James Buchanan. The other was Ronald Coase, who moved to the University of Chicago and joined the law and economics group at its law school where Robert Bork developed his interest in that topic.



with interpretive and normative questions concerning the actual constitution this country has, which he more or less identified with the written document. When he discussed questions of constitution drafting, his approach was that of a lawyer. His discussion of a balanced-budget amendment to the Constitution provides an example. Having substantial sympathy with the goals of such an amendment, Bork gave some thought to whether it would be possible to draft one that would work properly and came to have serious doubts whether it could be done. If a proposal cannot be translated into working law, its practical use is very limited. And lawyers know something about what can be translated into working law.<sup>2</sup>

James Buchanan was an economist and constitutional theorist who certainly was concerned about the workability of proposed constitutional rules. But he mainly thought about the questions that Bork hardly ever did, as far as I know: what should a constitution seek to achieve, subject to the constraints of workability? Buchanan believed, or at least hoped, that it is possible to entrench rules for the conduct of political institutions that will guide those institutions toward making policy that will produce net benefits, and away from policy that will produce net losses. In particular, he believed, or at least hoped, that it was possible to limit the use of policy for purely distributional ends. So-called rent-seeking activity wastes the effort that goes into it, can diminish incentives to create wealth due to the fear that the wealth will be expropriated, and often accomplishes its distributional goals in ways that are inefficient, even given those goals.<sup>3</sup>

Both Bork and Buchanan worked in a Madisonian vein. In his major contribution to constitutional theory, Bork characterized the Constitution's combination of majority rule and minority rights as Madisonian.<sup>4</sup> Buchanan and Tullock, in *The Calculus of Consent*, attributed their economic ap-

<sup>2</sup> As Bork observed:

Problems in implementation are not to be regarded as minor matters that some lawyer adept at conveyancing can deal with. There is a temptation among the philosophers of this subject to walk away from such mundane considerations, muttering that they don't do windows. But lawyers and judges do windows. They know from experience that not all policies can be made into effective law. There is a tendency to think that constitutional rules execute themselves and that they accomplish precisely what was intended, but that is not by any means always the case.

Robert H. Bork, *On Constitutional Economics*, AM. ENTER. INST. J. ON GOV'T & SOC'Y, Sept.–Oct. 1983, at 14, 15.

<sup>3</sup> According to Buchanan, the case in favor of “constitutional constraints on the exercise of political authority by governments as carried out in what we may call ‘ordinary politics,’ reflected in the operation of elected parliamentary or legislative majorities,” rests in part on the benefits from constraining redistributive “rent seeking” activity that “uses up resources that might otherwise be put to value producing employment.” JAMES M. BUCHANAN & RICHARD A. MUSGRAVE, *PUBLIC FINANCE AND PUBLIC CHOICE: TWO CONTRASTING VISIONS OF THE STATE* 109, 117 (1999).

<sup>4</sup> “[O]ne essential premise of the Madisonian model is majoritarianism. The model has also a counter-majoritarian premise, however, for it assumes there are some areas of life a majority should not control.” Robert H. Bork, *Neutral Principles and Some First Amendment Problems*, 47 IND. L.J. 1, 3 (1971) [hereinafter Bork, *Neutral Principles*].

proach to politics to Madison, in particular to *Federalist No. 10*.<sup>5</sup> Like Madison, both Bork and Buchanan wrestled with the problem of public virtue, in both rulers and ruled.<sup>6</sup>

For Bork, the task of the judge was to apply the law, and even more challengingly, to develop it so that it fit new circumstances without drawing on the judge's own views of the public good.<sup>7</sup> He thus was centrally concerned with one particular form of public virtue, that exhibited by the good judge. Public choice theorists also face fundamental questions about virtue, a question that must be asked both of the people and their rulers: just how much public virtue is needed for any system of government to work, and just how much public virtue is actually available? A standard formulation says that virtue is in short supply, and so it is necessary to economize on virtue.<sup>8</sup> It cannot simply be taken for granted.

<sup>5</sup> On Madison's economics, they remark:

There is, in fact, evidence which suggests that Madison himself assumed that men do follow a policy of utility maximization in collective as well as private behavior and that his desire to limit the power of both majorities and minorities was based, to some extent at least, on a recognition of this motivation. His most familiar statements are to be found in the famous essay, *The Federalist No. 10*, in which he developed the argument concerning the possible dangers of factions.

JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* 25 (1962). Years later, Buchanan explained that when he and Tullock used "the tools and methods of the economic analysis and concepts available at the time in application to the constitutional organization of a polity," they were "translating some of the philosophical ideas of James Madison and the other founding fathers." BUCHANAN & MUSGRAVE, *supra* note 3, at 20-21.

<sup>6</sup> In referring to public virtue, I mean a limited but important set of personal characteristics that bear on how people behave with respect to public and not private decisions, either as public officials, like judges or as individuals participating in politics in more limited ways, like voting. Public virtue here means the kind of devotion to "the rights of other citizens" and "the permanent and aggregate interests of the community," that Madison indicated derived from the "enlightened views and virtuous sentiments," of those whose election would be favored by the extended sphere of a large republic. *THE FEDERALIST NO. 10*, at 57, 64 (James Madison) (Jacob E. Cooke ed., 1961). This is the same set of dispositions Hamilton referred to when he said "[t]he institution of delegated power implies that there is a portion of virtue and honor among mankind, which may be a reasonable foundation of confidence." *Id.* No. 76, at 514 (Alexander Hamilton). Hamilton's measured view of human nature is displayed in that discussion of the Constitution's appointments process. In support of the Senate's role in confirmation, he explained that a "man disposed to view human nature as it is, without either flattering its virtues or exaggerating its vices" would have enough confidence in the Senate to think that it would not easily be led astray by a designing President. *Id.*

Virtue in this sense is only one part of a person's character. Because that kind of virtue is my concern, I am not seeking to use or contribute to the contemporary "virtue theory" that Professor Claeys discussed in his insightful comments. I expect that an exploration of the connections between today's virtue theory and the ideas of public and private virtue in circulation at the time of the founding would be very enlightening, but am not seeking even to approach that topic here.

<sup>7</sup> In one of Bork's best-known opinions on the court of appeals, he clashed with then-Judge Scalia on the extent to which courts should adapt constitutional principles to changing circumstances. *See Ollman v. Evans*, 750 F.2d 970, 995 (D.C. Cir. 1984) (en banc) (Bork, J., concurring).

<sup>8</sup> *See, e.g.*, Geoffrey Brennan & Alan Hamlin, *Economizing on Virtue*, 6 CONST. POL. ECON. 35 (1995) (discussing the principle).

This essay is about judicial virtue as a form of public virtue. It undertakes to flesh out that concept and then to address two questions about the Constitution and judicial virtue. The first question is interpretive, and asks what form of judicial virtue has a valuable role to play in the political and legal system the Constitution creates. The second is more descriptive, and asks about the form of judicial virtue that one might expect to be found in actual federal judges who are appointed pursuant to the document, in light of the political system that it partly creates and that has developed under it. The essay will conclude with a brief discussion of the connection between the two earlier parts, which together raise a profound question about the American Constitution: does the system of judicial selection that it produces generally lead to the appointment of judges who will enforce it?

Public virtue means attachment to the public good, as opposed to narrower goods. In constitutional public-choice theory, virtue means attachment to the constitutional rules that are designed to constrain the government so that it will produce substantial net benefits rather than wealth-reducing contests over redistribution.<sup>9</sup> Those rules are useful precisely because public virtue is in short supply. If policy makers simply favored the public interest over their own narrow interests and their immediate constituents' narrow interests, the only constitutional rules needed would be about elections.

The suggestion that judges can play an important role in ensuring compliance with constitutional bargains, bargains that protect the general interest by imposing structural or substantive limits on the ordinary government's ability to pursue private interests, encounters a difficulty concerning judicial virtue. The problem is that the very characteristic that is virtue in a legislator is vice in a judge. For legislators, commitments to political principles like small government or equality of income are virtuous precisely because principles are different from simple material interests. Public-choice theory must treat ideological or interest-driven politicians quite differently from so-called transactional politicians, who simply want to advance their narrow material interests, including their interest in reelection by serving their constituents.

But the model of the bad judge is one who "legislates from the bench," pursuing the judge's own view of the public interest instead of following the law. As to legislators, one might say: if only they pursued their own views of the public interest, rather than pursuing pork for their constituents. But as to judges, that is a vice because some other process is supposed to

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<sup>9</sup> Virtue cannot be understood simply as the subjective belief that one's views are in the public interest. Such beliefs are very easy to generate. But it would be strange to identify virtue simply as a set of views about what good policy is; virtue is about character, not about (or not just about) one's views. The most plausible way to resolve this difficulty is to say that public virtue is the ability to see that there often is a difference between the public interest and private interests, and to act on that distinction in important cases.

produce law that is in the public interest, and the judges are supposed to enforce that law.<sup>10</sup>

If commitment to the public good, already rare enough that it must be hoarded and used sparingly, is vice in a judge, then is actual judicial virtue—the ability to see and routinely act on the distinction between one’s own ideology and the law, including especially the Constitution—so rare that courts and judges cannot be used in a constitutional design based on realistic assessments of human beings and governments? A moderately optimistic answer is that they can be effective, despite that problem. The first move in the answer is to see that judges, like anyone else, can have principled attachments to all sorts of principles. The fact that some people, for reasons unrelated to their material interests, favor much more economic equality than others provides just one striking example of that fact. Perhaps that is just because, once untethered from their narrow material interests, people’s ideological views just wander about at random, as it were, alighting here and there. But the optimistic argument does not have to rely on mere random walks. Americans revere their Constitution. So it is certainly possible to have an ideological commitment to the Constitution, and many people might well have one. If someone can believe in the dictatorship of the proletariat, why not believe in the Electoral College?

The next step is to say that there is a role in a system of constitutional enforcement for expert lawyers who have an ideological commitment to the Constitution as such. Consider a discussion of judges’ work by a colleague of Robert Bork on the D.C. Circuit, Judge Harry Edwards. Judge Edwards said that 50% of the appeals that came before him and his colleagues were easy for a good lawyer.<sup>11</sup> All the judges would agree. Perhaps more interesting was his next statement: Another 35% to 45% involved questions that were not easy for a good lawyer because they required considerable research and careful thought.<sup>12</sup> But after doing the research and the thinking, good lawyers again agreed, and the panels were unanimous. Only in 5% to 15% of the cases, with some ideological aspect, did ideology matter.<sup>13</sup> Most of the work was lawyer’s work.<sup>14</sup>

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<sup>10</sup> It is a tribute to the personal integrity of the American bench, especially the federal bench, that the great danger is thought to be the judge who is lawless in the sense of pursuing an ideological agenda, not lawless by being venal or corrupt. No doubt in many countries people would say, if only we had the problem of judges enacting their vision of the public good, rather than taking bribes.

<sup>11</sup> Harry T. Edwards, *Public Misperceptions Concerning the “Politics” of Judging: Dispelling Some Myths About the D.C. Circuit*, 56 U. COLO. L. REV. 619, 631 (1985).

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 632.

<sup>14</sup> Judge Edwards, speaking qualitatively, said that about 50% of the D.C. Circuit’s cases are easy in that “the relevant legal rules and their application to the facts seem clear.” *Id.* at 631. Such cases rarely gave rise to controversy on the court. *Id.* Another 35% to 45% are hard in that each party had at least one plausible argument, but “after research, reflection, and discussion, one party’s arguments seem to me demonstrably stronger than the other’s.” *Id.* Although such cases present “a greater possibility

With Judge Edwards's estimates in mind, it is possible to say that judges can play an important role in ensuring that the government complies with the Constitution on the following plausible conditions: First, there is a substantial supply of expert lawyers who have an ideological commitment to the Constitution, and who have a strong attachment to doing technical lawyer's work well.<sup>15</sup> Second, there are a substantial number of important constitutional questions to which the answer is *not* obvious to a layperson, but that nevertheless fall into Judge Edwards's 85% to 95% of cases in which expert lawyers, with either a little work or a lot of work, will come to the same conclusion. These problems involve what might be called attempts at constitutional evasion: a plan that looks to the layperson like it might be constitutional, but is not.<sup>16</sup>

Is the actual Constitution anything like this? From *Federalist 78*<sup>17</sup> and *Marbury*,<sup>18</sup> one might think so. They present judicial review as a fairly simple enforcement problem, and assume that judges, being judges, will carry out the law.<sup>19</sup>

that a judge's political beliefs will color his views," in Judge Edwards' judgment "most of the judges on our court feel bound to decide such cases according to their view of the law, and make a sincere effort to put aside any political views that they may have." *Id.* Only in the 5% to 15% of very hard cases, "in which . . . the relevant legal materials seem to yield no conclusive answer" do judges exercise discretion, and find themselves in "basic disagreement" because of differing views on moral and social philosophy. *Id.* at 632.

<sup>15</sup> Judge Posner makes a similar, but I think not identical, attachment part of the utility function in his model of judicial behavior: a desire to play by the rules, but in his model the rules of the game of judging, not the rules of the substantive law. Richard A. Posner, *What Do Judges and Justices Maximize? (The Same Thing Everybody Else Does)*, 3 SUP. CT. ECON. REV. 1, 29 (1993). I think that much the same is true of judges with respect to the substantive rules. "If, however, the U[SA] Trial is not a game, it is not a game either." Arthur Allen Leff, *Law and*, 87 YALE L.J. 989, 1005 (1978).

<sup>16</sup> I focus on evasion because the role of the courts with respect to enforcing the Constitution is different from their role in applying and enforcing the ordinary law. Ordinary law is applied by the government to private people. But constitutional law, or at least important parts of it, establishes the terms of social cooperation that make government possible in the first place—that, one might say, constitute it. Despite what one might think from conventional discussions of American constitutionalism, the courts are not an over-government, coercing the executive branch, for example, the way a government can coerce the people. The courts' power comes from other government actors' willingness to abide by their decisions. To some extent, that willingness comes from a recognition that if other parts of the government defy the courts, the people might withdraw the cooperation that makes government possible. Hence, in the cases in which constitutionalism is seriously put to the test, the role of the courts is to identify for the people attempts by other parts of the government to get around the constitution, which sets out the conditions on which the people are prepared to accept the government. This line of thinking is important only when there is some degree of popular sovereignty in a substantive and not just a formal sense, that is, when the government is to some extent dependent on acceptance by the people.

<sup>17</sup> THE FEDERALIST NO. 78, at 525 (Alexander Hamilton) (Jacob E. Cooke ed., 1961).

<sup>18</sup> *Marbury v. Madison*, 5 U.S. 137, 178 (1803).

<sup>19</sup> "Those then who controvert the principle that the Constitution is to be considered, in court, as a paramount law, are reduced to the necessity of maintaining that courts must close their eyes on the Constitution, and see only the law." *Id.* When he came to give examples of federal statutes that should

A more realistic view of the actual Constitution could also say that something like what *Marbury* describes was the plan, but that the presumed attachment to the principles of the Constitution had some more substance to it, as it were. Quite possibly, the main principle that the actual framers thought actual judges would actually enforce was that debtors should pay their debts. They may well have expected that the judicial-selection system, based on the indirectly selected President and Senate, would produce judges who were committed to that principle to some extent independently of their commitment to the Constitution (though in fact the two would reinforce one another).<sup>20</sup>

One designer's judicial virtue may be another's capture by elites: the possibility that the Constitution in general and the federal judiciary in particular were designed to favor the interests of well-off creditors is one of the leading themes of constitutional history.<sup>21</sup> Whatever the framers had in mind, the possibility that the national government they designed is subject to capture by self-interested elites has troubled Americans from the beginning.<sup>22</sup> Being troubled is one thing; doing something about it is another. Probably the most important effort to do something about elite capture of the national government was the work of the most influential American

be disregarded by the courts, Marshal did not discuss any that involved difficult judgments. He asked, for example, what the courts should do if Congress were to pass a bill of attainder, and the person named were prosecuted under it. *Id.* at 179. In *The Federalist*, Hamilton treated judicial review as straightforward enforcement of the law. Judicial review rested, he said, not on the assumption that the courts are superior to the legislature, but that the "power of the people is superior to both." THE FEDERALIST NO. 78, *supra* note 17, at 525 (Alexander Hamilton). Perhaps because he was not a judge, Hamilton went on to consider the objection that the judges might substitute their own views for the law. *See id.* He responded that the danger comes with having judges not with having judicial review, because they can misconstrue statutes just as they can misconstrue constitutions. *Id.* at 526.

<sup>20</sup> This is the sort of thing that may require some reading between the lines, and between the lines of *The Federalist* it is not hard to find such a message. Hamilton praised the Constitution's appointment mechanism, for judges and other officers, as likely to select "fit characters." THE FEDERALIST NO. 76, *supra* note 6, at 513 (Alexander Hamilton). Madison's discussion of debtor relief legislation rings with moral disapproval:

The loss which America has sustained since the peace, from the pestilent effects of paper money . . . constitutes an enormous debt against the States chargeable with this unadvised measure, which must long remain unsatisfied; or rather an accumulation of guilt, which can be expiated no otherwise than by a voluntary sacrifice on the altar of justice, of the power which has been the instrument of it.

THE FEDERALIST NO. 44, at 300 (James Madison) (Jacob E. Cooke ed., 1961). It is hard to imagine that they thought that fit characters would hesitate to enforce the limits on debtor relief found in Article I, Section 10 of the Constitution.

<sup>21</sup> The classic statement of the argument that the Constitution was so designed is CHARLES A. BEARD, AN ECONOMIC INTERPRETATION OF THE CONSTITUTION OF THE UNITED STATES 301 (Dover 2004) (1913).

<sup>22</sup> Richard Stewart coined the evocative phrase "Madison's Nightmare" to describe a national government under the control of well-organized interest groups that puts the central power Madison favored to the very opposite of the use he hoped it would serve of limiting faction. Richard B. Stewart, *Madison's Nightmare*, 57 U. CHI. L. REV. 335, 342 (1990).

constitutional designer since the framing, the Sly Fox of Kinderhook, Martin Van Buren. He believed that the monied interest, be it called Federalist or National Republican or something else, could much too easily take control of the national government.<sup>23</sup> The result would be activist programs like protective tariffs, the national bank, and internal improvements benefiting the rich at the expense of the ordinary farmers who made up the majority.<sup>24</sup> Judicial review, far from checking federal excess, would approve and empower it (Van Buren had seen the Marshall Court in its National Republican heyday).<sup>25</sup>

Van Buren's solution was to create an institution more powerful than Congress, the President, and the federal courts put together: the Democratic Party. Organized around constitutional principles of strict construction and states' rights, the party would control every part of the national government, including the judiciary.<sup>26</sup> In today's terminology, Van Buren sought to prevent capture of the federal government by minority interest groups. His solution was what one might call capture of the federal government by a broad coalition. The Democratic Party was designed to represent the majority, and Van Buren believed that if properly constructed and maintained, that party would always prevail, precisely because it was the party of the

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<sup>23</sup> See *id.*

<sup>24</sup> In Van Buren's view, party competition was not between competing groups that accept the premises of democracy, but "between democrats and aristocrats." Gerald Leonard, *Party as a "Political Safeguard of Federalism": Martin Van Buren and the Constitutional Theory of Party Politics*, 54 RUTGERS L. REV. 221, 247 (2001). In Van Buren's view, the small farmers who dominated America were intrinsically democrats, and intrinsically committed "to minimal government, since unnecessary government could only mean redistribution of society's benefits from the people at large to special interests." *Id.* at 251. The first manifestation of the tendency of aristocratic interests to seek to use the federal government came right at the Constitution's inception, with Hamilton's program of funding the national debt, assuming the state debt, establishing a national bank, and aiding manufacturing. *Id.* at 253. Not only would that program "sustain Hamilton's monied aristocracy," but even worse, its obvious unconstitutionality would "establish the central government's general power to do whatever it conceived to be in the national interest, regardless of constitutional restrictions." *Id.* Although Hamilton himself did not succeed, in Van Buren's view, "the anti-constitutional party of the monied proved itself a fixed feature of American public life." *Id.* at 254.

<sup>25</sup> In the 1820s, as Van Buren saw it, "[l]oose-constructionism was . . . the dogma of the United States Supreme Court," as well as being the guiding principle of the later Monroe and Adams Administrations. *Id.* at 262; see also *id.* at 259-61 (discussing the Monroe and John Quincy Adams Administrations).

<sup>26</sup> "Van Buren believed that preservation of the democratic character of the Constitution required a permanently and highly organized party of the democracy, by which every aspect of government would be made directly responsible to the majority of the people." *Id.* at 245. The Constitution itself, with power dispersed among the branches of the national government and between the national government and the states, was incomplete without an institution "to provide the people with direct capacity to settle disputes" among the dispersed centers of power. *Id.* "This final institution was the democratic political party." *Id.*

many.<sup>27</sup> In effect, the people's party would permanently disenfranchise the few, in that the monied interest would never exercise power at the national level. Hence Van Buren's proposal was to put control of the federal government in the hands of a coalition that was by design both a majority and only a majority. Through party discipline, the majority would always stick together, and so would have the power of all the people, even though it included only most of the people.

Martin Van Buren himself was explicitly opposed to judicial supremacy.<sup>28</sup> The party, not the courts, would articulate and enforce constitutional principles—for him, principles of strict construction and state power.<sup>29</sup> That party, however, soon came to see the advantages of control of the judiciary, as have American political parties since then. In 1837, at the end of Jackson's presidency, Congress expanded the Supreme Court and restructured the circuits in a way favorable to slave-holding interests.<sup>30</sup> The result was a Court that very likely was prepared to reject *McCulloch*.<sup>31</sup> That would prove unnecessary because, consistently with Van Buren's design, Congress and the President kept that from happening.<sup>32</sup> Much to Van Buren's personal disgust, other members of his coalition were only too happy to use the judicial power later, infamously in *Dred Scott*.<sup>33</sup>

The federal courts, and in particular the Supreme Court, thus became one way in which dominant national coalitions cemented their constitutional principles. The next coalition to be able to do that probably qualifies as

<sup>27</sup> As the party of the people against the aristocrats, the democratic party was the only legitimate party, entitled to an "exclusive and towering supremacy" over the monied factions." *Id.* at 244. If this sounds Leninist to modern ears, that is because it is. Van Buren set out, not to create a system of competing parties, but to secure the permanent dominance of the only legitimate party, that of the people. *Id.* at 246.

<sup>28</sup> *Id.* at 262-63.

<sup>29</sup> For Van Buren, no institution, "least of all the unelected and irresponsible federal judiciary, could claim final authority" on any question of constitutional interpretation. *Id.* at 263. "[O]nly the sovereign people—the one constitutional body superior to and not coordinate with any other constitutional body—could claim that power." *Id.*

<sup>30</sup> The Judiciary Act of 1837, which created a Supreme Court of nine, redrew circuit boundaries so that a majority of the circuits would be composed entirely of slave-holding states. See Act of Mar. 3, 1837, ch. 34, 5 Stat. 176, 176-77 (1837). Because at the time Presidents generally appointed one Justice from each circuit, the result was very likely to be a Court that would favor slave-holding interests. MARK A. GRABER, *DRED SCOTT AND THE PROBLEM OF CONSTITUTIONAL EVIL* 149 (2006).

<sup>31</sup> See GRABER, *supra* note 30, at 71-72.

<sup>32</sup> "*McCulloch* survived the Taney Court only because Jacksonian presidents vetoed on constitutional grounds every measure that might have given the justices an opportunity to overrule or narrow Marshall's broad conception of national power. In 1858, Lincoln considered *McCulloch* to be overturned by this political practice." *Id.* (footnotes omitted).

<sup>33</sup> In the 1850s, Van Buren thought, the party system degenerated into regional factions, with "neither party now resting on the democracy as a whole but only on the partisans of its substantive policy preferences." Leonard, *supra* note 24, at 278. That "left the Constitution without its legitimate interpreter—the embodied people. It therefore ceded control of the Constitution to the worst possible institution—the federal judiciary, unelected, life-tenured, and irresponsible." *Id.*



Van Buren's nightmare. The Republicans in the nineteenth century were a political party devoted to using federal power to promote economic development and were not shy about having the federal courts help.<sup>34</sup> They stood for open interstate markets (mainly through the dormant commerce principle), strong protection for vested rights of property, and very tight limits on redistribution through regulation, especially through regulation of the rates charged by capital-intensive businesses that, they thought, were subject to ex post expropriation after they had been created.<sup>35</sup>

The Jacksonian–Van Burenite Democrats and the Republicans had, as central components of their coalitions, a set of constitutional principles that were constructions in Keith Whittington's sense.<sup>36</sup> Those principles resolved contested issues of constitutional meaning—is a national bank permissible, is there a dormant aspect of the Commerce Clause, does confiscatory rate regulation constitute a deprivation of property without due process—in ways that, together, reflected an integrated theory of what the document was about. Of course, the participants did not present their answers as constructions, but as true constitutional principles.<sup>37</sup>

The Republican coalition was replaced by the New Deal coalition. Whether there has been such a dominant coalition since the latter's breakup is a difficult question. The existence of such governing coalitions, and their use of the courts, is a fact of American constitutional politics, a fact as important as the Constitution itself. So just as I asked what role judicial virtue might play in enforcing the Constitution, I will ask what role judicial virtue actually plays in the governing practice of those coalitions. In particular, I will seek to identify the form of judicial virtue that can be of use to them, and hence the form that they are likely to select in judges.

Governing coalitions are about constitutional law. They staff the courts with judges who carry out the coalition's constitutional principles. The federal courts can perform important functions in that respect, for ex-

<sup>34</sup> “As economics became the most salient feature of the Republican constitutional regime [after Reconstruction], the Court was in the vanguard of enforcing its requirements.” KEITH E. WHITTINGTON, *POLITICAL FOUNDATIONS OF JUDICIAL SUPREMACY* 115 (2007) [hereinafter WHITTINGTON, *POLITICAL FOUNDATIONS*].

<sup>35</sup> *Id.* at 115-17.

<sup>36</sup> “Constitutional construction is the method of elaborating constitutional meaning in [the] political realm.” KEITH E. WHITTINGTON, *CONSTITUTIONAL CONSTRUCTION: DIVIDED POWERS AND CONSTITUTIONAL MEANING* 1 (1999). An example of a substantive principle (a construction) that emerged from the interpretive process of construction is the norm, which was forged in and has endured since the impeachment of Justice Samuel Chase, that federal judges may be impeached and removed not just for “narrowly criminal conduct,” but also “for abuse of public office in accord with an essentially political standard,” but not “for mere technical errors in the conduct of their office, for private political sentiments, or simply for the purpose of creating vacancies.” *Id.* at 65. That norm is an elaboration of the “high crimes and misdemeanors” language of Article II, Section 4 of the Constitution.

<sup>37</sup> Van Buren, for example, did not maintain that he and the plutocrats agreed on the Constitution's meaning but disagreed about what to do when its meaning ran out; he thought that Hamilton's plan was blatantly unconstitutional and designedly so. Leonard, *supra* note 24, at 253-54.

ample, by overcoming the barriers of federalism; Republican dormant commerce doctrine limited southern and western states' ability to regulate national businesses.<sup>38</sup> Given that role of the judiciary on behalf of the political grouping that creates it, one might conclude that parties have no use for judicial virtue. Politics is about agendas, whether they are called constitutional or not, and perhaps courts are politics carried on by other means. What value can someone add who has an attachment to a legal principle, without regard to the particular consequences of the principle's application?

But judges can, within this scheme, perform the judicial function of a commitment device for actual constitutional principles, in a qualified sense. The qualification is that those principles will include, and perhaps will be limited to, the constructions of the party that appoints the judges. Commitments are important. Members of a coalition may fear that they will give their support and then not get what they were promised. In a Van Buren-style political party, support means accepting party discipline, and thus going along with a majority of the majority.<sup>39</sup> That bargain makes sense only if the majority of the party keeps its promises to the minority, the promises that are the price of the minority's acceptance of party discipline.

Confidence that promises will be kept holds coalitions together just as it holds countries together through their constitutions. One way to make promises credible is to appoint judges and Justices who are sincerely committed to the constitutional principles on which the coalition rests, and are prepared to enforce those principles against opportunistic defection. The attachment of a nominee to the coalition's constructions and the nominee's attachment to the rule of law can usually be known reasonably well in advance.<sup>40</sup> Judicial appointments, especially Supreme Court appointments, require broad support within a coalition that controls the Presidency and the Senate; the coalition's margin in the Senate may not be that wide, and the President will not want to anger his own allies. So he will tend to appoint judges and Justices who are known to be reliable in that they sincerely endorse the coalition's constitutional constructions and are more attached to those constructions than to particular policies on which defection is possible.

Because of life tenure, Presidents cannot take appointments back, so one path of possible defection is blocked. Agreeing on a judge or Justice is thus a way of locking in the agreement, provided the judge or Justice has judicial virtue: ideological commitments to constitutional principles that go

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<sup>38</sup> See WHITTINGTON, *POLITICAL FOUNDATIONS*, *supra* note 34, at 115-16.

<sup>39</sup> Van Buren's system of party decision through party conventions "could only work, however, as long as a strict ethic of party loyalty was in place." Leonard, *supra* note 24, at 257.

<sup>40</sup> "The northern justices appointed to the Supreme Court after 1837 were on record as supporting the Fugitive Slave Act, the Compromise of 1850, and, after 1857, *Dred Scott*." GRABER, *supra* note 30, at 149.

beyond policy issues that are controversial within the coalition.<sup>41</sup> Presidents who lead broad coalitions thus will have an eye on the usefulness of judges and Justices as enforcers of the coalition's shared principles. Senators who are members of the coalition will similarly have that function in mind. The result will be selection for a relative form of judicial virtue: sincere and principled commitment to the coalition's constructions of the Constitution.

In saying that this relative form of judicial virtue will be selected for in the appointment process, of course I do not mean to say that it is the only characteristic selected for, and hence I do not mean to say that judges and Justices will always manifest it. Some of them, especially those who are appointed for narrower reasons of patronage, whether by faction, region, or demographic group, will just be hacks—including ideological hacks. Even relative virtue is in short supply. But there is good reason to think that we will see this kind of relative virtue.

Having spoken in general and with some theoretical support, I will suggest that Judge Bork's nomination to the Supreme Court illustrates my claim. On two important issues, the issues that in my view ultimately led to the rejection of his nomination, Bork embodied positions of constitutional principle to which the Reagan coalition was committed, but as to which there was substantial danger of ex post defection by politicians and elements of the coalition, so that a Justice was a good commitment device for the coalition as a whole.

First is abortion. That Bork would have voted to overrule *Roe* is virtually beyond doubt. He had said that the right of privacy on which *Roe* relied was the imposition of the Justices' own value choices, and not found in the Constitution.<sup>42</sup> Where the Constitution is silent, he said, the majority rules.<sup>43</sup> In light of today's politics, it is important to remember that Bork's position was a constitutional construction that, when he was nominated, could unite elements of a party that had diverging views. The coalition that elected Reagan and the Republican Party that nominated him was not the coalition that elected George W. Bush or the party that nominated him. The earlier party had a very substantial pro-choice wing.<sup>44</sup>

For pro-life Republicans, eliminating *Roe* was a necessary condition for substantial progress, barring an unlikely constitutional amendment. For

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<sup>41</sup> "Bolstering the authority of judges to hear and resolve disputes over constitutional meaning may insure affiliated political leaders against a failure of will when faced with particular controversial decisions." WHITTINGTON, POLITICAL FOUNDATIONS, *supra* note 34, at 86. An affiliated leader in Whittington's terms is one who shares the basic constitutional principles, or constructions, of a regime created by a dominant coalition.

<sup>42</sup> Bork, *Neutral Principles*, *supra* note 4, at 7-10.

<sup>43</sup> *Id.* at 3-4.

<sup>44</sup> For example, at the 1980 Republican National Convention, which nominated Reagan, newly powerful pro-life forces clashed with still-significant pro-choice Republicans, especially over the platform. ANDREW E. BUSCH, REAGAN'S VICTORY: THE PRESIDENTIAL ELECTION OF 1980 AND THE RISE OF THE RIGHT 81 (Illustrated ed., 2005).

pro-choice Republicans, opposing *Roe* could be, and was for some, a position of principle. Like Bork, some believed that the Constitution did not address the issue and that judges should leave such grave moral questions to the ordinary political process.<sup>45</sup>

But there was plenty of incentive for defection. A Republican politician who was personally pro-choice but had to be officially pro-life might well favor *Roe*.<sup>46</sup> Perhaps more interesting is the fact that some pro-life Republicans could more easily win elections if abortion were not directly an issue, having been transferred to strictly Supreme Court appointment politics.<sup>47</sup> Appointing anti-*Roe* Justices would make it unnecessary for pro-life Republicans to rely further on the adherence of such reluctant allies.

The other issue is racial preferences, which may well have been the crucial reason Bork's nomination was rejected.<sup>48</sup> Bork endorsed the color-blind reading of the Constitution and the civil rights statutes.<sup>49</sup> The color-blind-Constitution view was another constitutional principle that resolved a dispute about constitutional meaning and could help hold together a Republican coalition with a variety of views on the merits. That view was a construction, a resolution derived from constitutional values but not explicitly required by the text.<sup>50</sup> It was also a principle on which the party of Lincoln and Reagan could hope to converge because it rejected both discrimination

<sup>45</sup> Bork himself was, at one point in his life, in that group. When his Constitutional Law class discussed *Roe* in the fall of 1977, he said that if he were a state legislator he would have no trouble supporting an abortion statute that would satisfy that case's constraints. He also took the position that the question was to be decided by legislators, not judges.

<sup>46</sup> Seven Justices joined the majority opinion in *Roe*: Chief Justice Burger and Justices Douglas, Brennan, Stewart, Marshall, Blackmun and Powell. *Roe v. Wade*, 410 U.S. 113, 116 (1973). Four of those seven—Burger, Stewart, Blackmun, and Powell—were appointed by Republican Presidents.

<sup>47</sup> For example, someone who would be a single-issue pro-choice voter if abortion were decided by elections might otherwise prefer a pro-life Republican's policies.

<sup>48</sup> As the political situation then stood, the balance of power on his nomination was held by a number of relatively conservative southern Democratic Senators who depended electorally on high turnout by black voters. "The opposition of Southern senators to Judge Robert H. Bork reflects a crucial political reality in the region: the electoral fortunes of many Southern Democrats depend on overwhelming support from blacks." Robin Toner, *Saying No to Bork, Southern Democrats Echo Black Voters*, N.Y. TIMES, Oct. 8, 1987, at A1. "As a result, a powerful lever was pulled when Judge Bork's opponents campaigned on the charge that he would 'turn back the clock' on civil rights." *Id.* The Senate, then controlled by Republicans, confirmed then-Judge Scalia to the Supreme Court in 1986. In the election of that year, the Democrats regained control of the Senate, in part through victories in the South driven by very strong support among black voters. "The [anti-Bork] message was particularly effective with the class of '86, those Southerners who won election to the Senate a year ago because of huge black majorities." *Id.*

<sup>49</sup> "Most Americans, though thoroughly in favor of civil rights, are opposed to quotas. And they are right on policy as well as legal grounds." ROBERT H. BORK, *THE TEMPTING OF AMERICA: THE POLITICAL SEDUCTION OF AMERICA* 109 (1990) [hereinafter BORK, TEMPTING].

<sup>50</sup> Except in the 15th Amendment, the Constitution does not mention race. Determining how Section 1 of the 14th Amendment affects race-based laws and other government decisions thus requires more than just the identification of a ban on race discrimination in so many words.

against black Americans and government use of race to choose winners and losers among citizens who should be equal.<sup>51</sup>

Despite the color-blind principle's appeal to Republican ideology, incentives to defect from it in day-to-day politics were substantial. The Reagan Administration and the Republican coalition more generally were wracked with internal division about changing executive policies that encouraged affirmative action.<sup>52</sup> Appointing a Justice who took the color-blind view thus was a way for the majority of the coalition to enforce the agreed-upon principle and prevent opportunistic variations by politicians.<sup>53</sup> It could ensure those who signed on with that condition in mind that they would get what they had been promised.

From the standpoint of the Reagan coalition, Bork thus had judicial virtue: he had an ideological commitment, which here means a belief about the Constitution that he would carry out on the bench without regard to his own views on policy. On the two issues I discussed, one involved a departure for him from his policy views, one an adoption of those views. Fifty-fifty is pretty good as far as virtue goes.

But Bork, of course, believed that he had absolute, and not just relative, judicial virtue. He believed that he saw a difference between the Constitution and his views of policy, and was prepared to act on that difference. His central claim was that courts must follow *neutral* principles. And he practiced what he preached. For example, Bork was a friend of neither the regulatory welfare state nor a general constitutional principle in favor of economic liberty.<sup>54</sup> As he saw it, his function as a judge was to uphold the

<sup>51</sup> In her opinion for a plurality of the Court in *Croson*, Justice O'Connor stressed the importance of fact-based justification for race-conscious government decisions, in order to assure all citizens that the deviation from the norm of equal treatment of all racial and ethnic groups is a temporary matter, a measure taken in the service of the goal of equality itself. Absent such findings, there is a danger that a racial classification is merely the product of unthinking stereotypes or a form of racial politics.

*City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 510 (1989).

<sup>52</sup> For example, during the second Reagan Administration, Attorney General Edwin Meese and Secretary of Labor William Brock clashed over Meese's proposal to reform existing executive orders concerning government contractors in a way that would substantially weaken the encouragement they offered to race-conscious employment decisions. NICHOLAS LAHAM, *THE REAGAN PRESIDENCY AND THE POLITICS OF RACE: IN PURSUIT OF COLORBLIND JUSTICE AND LIMITED GOVERNMENT* 29-30 (1998). Secretary Brock was not the only Republican who supported race-conscious measures that were unacceptable to conservatives like Meese. Another reason militating against executive action was that Congress would respond with legislation that would restore support for race-conscious decisions, with the support of many Republicans in the Senate and House. *Id.* at 124.

<sup>53</sup> "Given his strident opposition to racial and gender preferences and quotas, and his commitment to colorblind law, Reagan was philosophically dedicated to reforming affirmative action." *Id.* at 121. Moreover, "support for reforming affirmative action came from conservatives, who served as Reagan's natural political base." *Id.* Judicial appointments are an important means by which a majority of a majority coalition can further the coalition's principles despite the hesitation of groups within it.

<sup>54</sup> Bork explained his views in *The Constitution, Original Intent, and Economic Rights*:

rule of law, not to carry to the bench the mere constructions of the coalition that put him there.<sup>55</sup>

Bork's role in American constitutional history thus provokes the question whether the realities of judicial politics mean that the courts will in fact be ill suited to the role of enforcing the Constitution itself, in large measure because they are selected in order to enforce a powerful coalition's views about the Constitution.

As Judge Edwards's categorization of D.C. Circuit cases suggests, there is an optimistic account according to which courts can perform both functions. For the 85% to 95% of cases as to which expert lawyers agree, they will demand compliance with the actual Constitution. As to the cases that remain, the courts will neutrally enforce the constitutional constructions of the coalition that appointed them. Constructions operate within the zone of uncertainty, in which standard tools of interpretation do not lead legal experts to converge. As to issues within that zone of uncertainty, resolution through constitutional politics has real advantages. It means that interpretation will be responsive to the views of a great many voters, and not just those of a narrow elite or, perhaps even worse, the effectively randomly chosen views of particular judges. A country could do much worse.

Less welcome possibilities must be considered, however. Perhaps Judge Edwards's estimates are wrong with respect to constitutional disputes. Perhaps 95% of constitutional issues will be resolved in line with the interpreter's own politics. Or perhaps courts that are chosen to enforce the constructions of a governing coalition will have no concern with the other aspects of the Constitution at all.

Two factors seem to me especially important in resolving this issue. The first is the interest of the people at large in constitutional enforcement, especially enforcement of the relatively clear provisions. Those provisions include many that are especially important in ensuring that government officials retain their dependence on the people. Possibly most important are the terms of office, which require that positions be refilled by election. Even in the darkest days of the Civil War, elections were held. Without them, the people might have ceased to support the government.

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My concern is with the contention that a more general spirit of libertarianism pervades the original intention underlying the fourteenth amendment so that courts may review all regulations of human behavior under the due process clause of that amendment. . . . Judicial review would extend, therefore, to all economic regulations. The burden of justification would be placed on the government so that all such regulations would start with a presumption of unconstitutionality. Viewed from the standpoint of economic philosophy, and individual freedom, the idea has many attractions. But viewed from the standpoint of constitutional structures, the idea works a massive shift away from democracy and toward judicial rule.

Robert H. Bork, *The Constitution, Original Intent, and Economic Rights*, 23 *SAN DIEGO L. REV.* 823, 829 (1986).

<sup>55</sup> The subtitle of *The Tempting of America* makes the point: the political seduction of the law. BORK, *TEMPTING*, *supra* note 49, at 109.

Judges too might help ensure compliance with those aspects of the Constitution, and thereby help with the hardest task of constitutionalism: maintaining social cooperation without allowing rule to degenerate into tyranny. The interest of the people at large—the interest in retaining ultimate control over the elites who make up the government and lead political coalitions—is widely shared. It is the interest on which the almost-unanimous coalition is organized, an interest that transcends the constructions of any party. If the people at large demand that their party leaders select judges who will, if necessary, demand compliance with the clear and structural features of the Constitution, they likely will get what they want.

In pursuing that goal, the people at large might have some help from frail human nature, which is the second factor. It is at least possible that people who are prepared neutrally to enforce coalitional constructions, because they believe them to be the best answer to constitutional puzzles, will also tend to be people who are prepared neutrally to enforce the aspects of the Constitution that need no construction. That may seem like too much to ask, but as Publius said, just as some features of human nature call for skepticism, others merit some confidence.<sup>56</sup> A judge who is prepared to demand compliance with a rule like color-blindness, because he thinks it the right rule, might well be the sort of person who would never think to countenance canceling an election. Virtue is in short supply, but we can hope that it is to some extent indivisible.

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<sup>56</sup> “The supposition of universal venality in human nature is little less an error in political reasoning than the supposition of universal rectitude. The institution of delegated power implies that there is a portion of virtue and honor among mankind, which may be a reasonable foundation of confidence.” THE FEDERALIST NO. 76, *supra* note 6, at 513-14.

# JAMES BUCHANAN'S CONTRIBUTIONS TO CONSTITUTIONAL POLITICAL ECONOMY, INSTITUTIONAL ANALYSIS, AND SELF- GOVERNANCE

*Peter Boettke\* & Liya Palagashvili\*\**

## I. BUCHANAN AND THE REBIRTH OF POLITICAL ECONOMY

Throughout most of the twentieth century, the term political economy was used to designate the population of radical heterodox critics of modern economics. Modern neoclassical economics and the development of the formal analysis of marginal conditions had demonstrated the theoretical shortcomings of the Marxist analysis of capitalism. The consequences were that in the first half of the twentieth century, Marxism as a framework for analysis of the economic system was pushed to the sides of the economics profession, and mainly staked a claim in the disciplinary homes of sociology and history. Ironically, the development of neoclassical economics during this period transformed a discipline from a study of political economy and the institutions that govern the market economy as advanced by Adam Smith and other classical economists, into a study of allocation and utility maximization in a static world that was void of any institutional analysis. Thus, not only were radical political economists pushed to the sidelines of the economics profession, but so were classical liberal political economists.

The second half of the twentieth century saw classical liberal political economy make a major comeback, largely due to the work of James Buchanan. In this paper, we outline the work of James Buchanan and his influence and contributions to political economy, institutional analysis, and self-governance. Although James Buchanan passed away on January 9, 2013, his legacy remains and continues to penetrate not only through research in political economy, but also to teachers of economics and their significant role in communicating the basic principles of economics.

James McGill Buchanan was born in Murfreesboro, Tennessee on October 2, 1919.<sup>1</sup> He attended a local public school and then was admitted to

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Middle Tennessee State Teachers College, where he earned a B.A. in 1940, and soon after earned an M.S. in economics from the University of Tennessee in 1941.<sup>2</sup> Buchanan was admitted into the PhD program in economics at the University of Chicago and graduated in 1948.<sup>3</sup> It was at Chicago where Buchanan came across his two main influences that jumpstarted his intellectual journey and lifelong work in political economy. The first was during Frank Knight's price theory course, where Buchanan was taught the basic principles of economics, including the idea of scarcity and choice, the role of the price system and relative prices in guiding adjustments to changing circumstances, and the significance of competition in the market. In describing the impact of Knight's course, Buchanan said, "I was converted by the power of ideas, by an understanding of the model of the market. This experience shaped my attitude toward the use and purpose of economic instruction; if I could be converted so could others."<sup>4</sup> Also at Chicago, Buchanan discovered Knut Wicksell's dissertation in the Harper Library and applied many of Wicksell's insights into his own work—which include Wicksellian themes on the principle of just taxation, politics as exchange, and the general application of economic principles into politics. Buchanan attributed much of his own success to this influence, stating, "[m]any of my contributions, and especially those in political economy and fiscal theory, might be described as varied reiterations, elaborations, and extensions of Wicksellian themes."<sup>5</sup>

After graduating from Chicago, Buchanan went on to hold academic positions at the University of Tennessee, Florida State University, and UCLA—but most important were his positions in the Virginia schools that led to the development of the Virginia school of political economy. Buchanan began working at the University of Virginia in 1956, and there he established the Thomas Jefferson Center for Studies in Political Economy in order to jumpstart the tradition in political economy; he explained that "[t]he Center represents the institutional embodiment of an effort deliberately made to bring about a rebirth of Political Economy."<sup>6</sup> Though Buchanan left the University of Virginia in 1968, the Center was critical for the emergence of Virginia political economy. His next main step in this

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<sup>1</sup> Robert D. McFadden, *James M. Buchanan, Economic Scholar and Nobel Laureate, Dies at 93*, N.Y. TIMES (Jan. 9, 2013), [http://www.nytimes.com/2013/01/10/business/economy/james-m-buchanan-economic-scholar-dies-at-93.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2013/01/10/business/economy/james-m-buchanan-economic-scholar-dies-at-93.html?pagewanted=all&_r=0).

<sup>2</sup> James M. Buchanan, *Better than Plowing*, BANCA NAZIONALE DE LAVORO Q. REV. (1986), reprinted in 1 THE COLLECTED WORKS OF JAMES M. BUCHANAN 11-16 (Liberty Fund 1999).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 15.

<sup>5</sup> James M. Buchanan, *The Constitution of Economic Policy*, LES PRIX NOBEL (1986), reprinted in 1 THE COLLECTED WORKS OF JAMES M. BUCHANAN 455 (Liberty Fund 1999) [hereinafter Buchanan, *Constitution of Economic Policy*].

<sup>6</sup> James M. Buchanan, *The Thomas Jefferson Center*, UNIV. VA. NEWSLETTER (Univ. of Va., Charlottesville, Va.), Oct. 15, 1958, at 6.

development was establishing the Center for Study of Public Choice while at Virginia Polytechnic Institute (from 1969 to 1983), and this functioned as the institutional home for political economists and public choice theorists around the world. Then in 1983, Buchanan, along with several colleagues, relocated the Public Choice center to George Mason University, where Buchanan received the Nobel Prize in Economic Science in 1986 and where he would stay for the remainder of his career.

Before James Buchanan and the public choice movement, it was commonplace in economics to explain how the market economy failed to live up to the ideals of equilibrium models and then declare that government action could engage in costless correction of the failures. This idea was that when markets failed to deliver the expected results, the automatic correction mechanism was public provision of the good or service. There were scholars during this time that fought this romantic and idealistic vision of the political sector—in contrast to the less romantic vision of the market—but it was Buchanan and his colleague Gordon Tullock's extensive investigation of political markets that fundamentally shifted scholarly focus and changed the intellectual examination of politics. Their work has triggered an array of fruitful research areas and is credited for a number of major insights of modern political economy. These include the application of concentrated benefits and dispersed costs and the logic of special interest groups, the vote motive, term limits and the shortsightedness bias in policy, and the constitutional economic perspective in policy, among many others. Buchanan's work changed the paradigm to viewing politics as endogenous in the models of economic policy making and to understanding political processes without rose-tinted glasses. In doing so, his work also cultivated greater appreciation for the need for constitutional constraint—precisely because we faced nonromanticized politics. Buchanan's work sparked this method and field of research analysis, and economics became introduced to the study of law and political science. This particular intersection between economics and law became especially prevalent at the George Mason University School of Law.<sup>7</sup>

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<sup>7</sup> Henry Manne, Dean of the GMU Law School from 1986 to 1996, discusses the important applicability of the *Calculus of Consent* to a great variety of issues in law and addresses in particular how it was influential in discussions of partnership and corporate voting arrangements.

For instance, the analysis of the concept of unanimity begins to give us the theoretical foundations for analyzing such phenomena as non-voting shares, voting trusts and other control devices. . . .

. . . .  
Since Buchanan and Tullock's is the first scale analysis available of the whole questions of vote buying and selling, it is of tremendous importance for understanding analytically much of what goes on in connection with corporate voting.

Henry G. Manne, *James Buchanan and Gordon Tullock's The Calculus of Consent*, 31 GEO. WASH. L. REV. 1065, 1070-71 (1962-1963) (reviewing JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* (1962)).

In addition to pioneering the public choice movement, we contend that Buchanan's great contribution to political economy was initiating the constitutional level of analysis in economics and its significant impact on institutional analysis. Buchanan did this by introducing the distinction between preconstitutional and postconstitutional levels of analysis. The basis of preconstitutional analysis is the rules of the game, while postconstitutional analysis refers to the strategies that players use within those rules. As Boettke explains it, Buchanan's contribution was to "reconcile the emphasis on economic processes and the strategic behavior of individuals within the economic game, and the choice over the rules of the game, the enforcement of those rules and in general the constitutional level of analysis."<sup>8</sup> Constitutional political economy teaches us that the rules of the game (preconstitutional-making choices) are more important for reaching socially desirable outcomes than are the strategies that players may use within a given set of rules. Therefore, sustainable reforms come from changes to the rules of governance as opposed to policy changes within the existing rules of governance. Buchanan's analysis at the constitutional level ties directly to his contributions in conceptualizing government in a nonromanticized vision: Because government officials are revenue maximizing, constitutional design is important since it can convert revenue-maximizing behavior into wealth-maximizing behavior. This idea resonates throughout the work in modern political economy and is seen as a "revival" from when questions of institutions and political economy were first discussed by classical economists—but lost in mid-twentieth century economics. Finally, we argue that Buchanan's contribution to constitutional political economy also extends to the understanding and importance of self-governing communities by emphasizing the significance of appropriate constitutional constraints on government, describing the constitutional design-making process, and designating the role of the political economist as one who respects the consent of citizens in constructing the rules of the game.

In Section II of the paper, we describe Buchanan's emphasis on the elementary principles of economics, how these principles were the foundation for his work, and how they fit into the broader agenda of the economist as teacher and enabler of improving the democratic process. Section III of the paper discusses the role of economists as studying exchange, and in Section IV we discuss how Buchanan reconciled the economists' zeal for reform with positive economic theory and how this notion advances the importance of constitutional-making from the bottom up. Section V dives into Buchanan's main puzzle in political economy and constitutional design, and Section VI concludes on the continuing relevance of Buchanan's work in contemporary political economy, with an emphasis on research in development economics and self-governing communities.

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<sup>8</sup> Peter Boettke, *Teaching Economics, Appreciating Spontaneous Order, and Economics as a Public Science*, 80 J. ECON. BEHAV. & ORG. 265, 273 (2011).

## II. BUCHANAN ON ELEMENTARY PRINCIPLES OF ECONOMICS

One of Buchanan's main themes is that economists should consistently apply the principles of economics to our work, but also, he emphasized the role of economists as teachers in explaining the basic principles of economics to students and to the "everyman." If the general public is able to understand these principles, they can then develop an appreciation of the market process and the spontaneous order of everyday market activity—and this, Buchanan argued, will improve the democratic process by creating informed participants who are themselves in the process of selecting the rules of governance in which economic exchange takes place. He explained that "teaching must involve a transmission of the basic principles of the science itself with the objective of placing the student in a potential role as a participant in the ongoing 'public choice' process in which the parametric constraints for economic interaction are selected."<sup>9</sup> In making this argument about the basic principles of economics and the role of the economist in society, Buchanan was advancing the importance of self-governance and enabling citizen voice in the democratic process. That is, the economist's role is not to impose controls on society, but to cultivate an appreciation for the market process such that individuals themselves will become informed about market mechanisms and engage in designing the rules within which market exchanges take place. These basic elements of economics that Buchanan stressed are rational choice and *homo economicus*, opportunity-cost reasoning, and spontaneous order processes.

### A. *Homo Economicus*

In some sense, Buchanan's work in public choice was simply the introduction of motivational symmetry for individual decision makers in both their private and public lives. When individuals enter the political arena, they are still the same self-interested individuals, but now they may be either holding office or voting for politicians. This is the nature of *homo economicus*—individual rational behavior is similarly applied to individuals in politics; Buchanan referred to this as "politics without romance."<sup>10</sup> The motives of the individuals do not switch when they move from setting to setting—from market to political interactions—so the differences that we may see in outcomes are from the differences in institutional structures, and

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<sup>9</sup> James M. Buchanan, *Economics as a Public Science*, in FOUNDATIONS OF RESEARCH IN ECONOMICS: HOW DO ECONOMISTS DO ECONOMICS? (Steven G. Medema & Warren J. Samuels eds., 1996), reprinted in 12 THE COLLECTED WORKS OF JAMES M. BUCHANAN 48 (Liberty Fund 2000).

<sup>10</sup> James M. Buchanan, *Politics without Romance*, IHS-JOURNAL, ZEITSCHRIFT DES INSTITUTS FÜR HÖHERE STUDIEN, WIEN 3 (1979), reprinted in 1 THE COLLECTED WORKS OF JAMES M. BUCHANAN 45 (Liberty Fund 1999).

this is why the study of institutional analysis is paramount for understanding societal outcomes such as economic growth or the growth of government.

*Homo economicus* is standard in economic theory, and it gives us the ability to draw predictions about an individual choosing to consume more of good X relative to good Y when the price of good X falls relative to good Y. This is the same tool of analysis for predictions that are markedly “political in nature”—such as holding office and voting. Buchanan illustrated some examples of applying this tool to predictions in the political arena:

[I]f income is a positively valued “good,” and, then, if the marginal rate of tax on income source A increases relative to that on income source B, more effort at earning income will be shifted to source B; if charitable giving is a positively valued “good,” then, if charitable gifts are made tax deductible, more giving will be predicted to occur; if pecuniary rents are positively valued, then, if a political agent’s discretionary power to distribute rents increases, individuals hoping to secure these rents will invest more resources in attempts to influence the agent’s decisions.<sup>11</sup>

Applying the elementary principle of this behavioral postulate in economics to politics became foundational in the advancement of public choice and political economy in general, and has opened up an entire research arena for the use of economic tools in analyzing political topics.

One important distinction to bring out here is that Buchanan embraced methodological individualism and saw it as perfectly legitimate that an individual is engaged in self-interested rational choice, but distinguished it from analyzing society as behaving collectively along these lines.<sup>12</sup> This is precisely why Buchanan objected to treating the economic problem that society faces as the allocation of scarce resources among competing ends.

The starting point of analysis for the economist is to focus on human action and individual choice, and this is normally the case when economists focus on their applications as private sector interactions. But the problem arises when we move to public sector analysis, as the dominant view in political theory has been to interpret “the economy” and the “polity” as the units of analysis. The source of evaluation is always the individual, and the study of economics is to explain the process through which individual choices and actions create complex institutions. This directly contrasts with

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<sup>11</sup> Buchanan, *Constitution of Economic Policy*, *supra* note 5, at 459.

<sup>12</sup> This emphasis on teaching basic principles of economics and especially on methodological individualism is closely connected with the Austrian School. It is important to stress that Buchanan, especially earlier in his career, did not treat the Austrian school contributions of Mises and Hayek (and Kirzner) as anything exotic and unique, but instead treated those ideas and arguments as part of the common knowledge of economists circa 1940s, 1950s and 1960s. As we move from the intellectual context of 1950 to 1970 with the increasing emphasis on mathematical formalism, the ideas that formed the common knowledge of economics in Chicago in the 1940s and 1950s become more and more exotic to the larger profession.

a teleological view that evaluates the market as having its own purpose or end. It is the failure to understand that

[t]he market economy, *as an aggregation*, neither maximizes nor minimizes anything. It simply allows participants to pursue that which they value, subject to the preferences and endowments of others, and within the constraints of general “rules of the game” that allow, and provide incentives for, individuals to try out new ways of doing things. There simply is no “external,” independently defined objective against which the results of market process can be evaluated.<sup>13</sup>

## B. *Opportunity-Cost Reasoning*

Buchanan most clearly and comprehensively tackled the issue of opportunity-cost reasoning in *Cost and Choice*.<sup>14</sup> He defined the basic notion of opportunity costs, but lamented that the logic of this concept is often not applied to economic theory, even though all economists seem to understand the general concept of opportunity costs. Buchanan stated:

My aim is to utilize the theory of opportunity cost to demonstrate basic methodological distinctions that are often overlooked and to show that a consistent usage of this theory clarifies important areas of disagreement on policy issues. In public finance alone, debates over tax incidence, tax capitalization, public-debt burden, and the role of cost-benefit analysis can be partially resolved when protagonists accept common concepts of cost.<sup>15</sup>

One of the best examples of how the thorough analysis of opportunity cost led to stark differences in policy understanding is the issue over the burden of debt. This became one of Buchanan's popular battles against the Keynesians and one that is addressed expansively in his *Public Principles of Public Debt*.<sup>16</sup> One of the challenges Buchanan raised to the Keynesians was that their level of aggregation in fiscal theory hid the true nature of the debt burden because their theories overlooked the problem of who will pay for the creation of public goods. In discussing opportunity-cost reasoning, Buchanan stressed that it measures *real* costs in terms of *real* resources. Consequently, questions of debt financing mean that economists must look

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<sup>13</sup> James M. Buchanan & Viktor J. Vanberg, *The Market as a Creative Process*, 7 *ECON. & PHIL.* 167, 181 (1991), *reprinted in* THE PHILOSOPHY OF ECONOMICS, AN ANTHOLOGY 378, 389 (Daniel M. Hausman ed., 3d. ed. 2008).

<sup>14</sup> *See generally* JAMES M. BUCHANAN, *COST AND CHOICE* (1969), *reprinted in* 6 THE COLLECTED WORKS OF JAMES M. BUCHANAN (Liberty Fund 1999) (discussing the theory of opportunity cost and its applications).

<sup>15</sup> *Id.* at xiv. Again, here we see Buchanan's emphasis on basic principles of economics and connection to the Austrian School. For example, he says, “much of what seems to me to be orthodox cost theory can be traced directly to its Austrian sources.” *Id.* at xv.

<sup>16</sup> *See generally* JAMES M. BUCHANAN, *PUBLIC PRINCIPLES OF PUBLIC DEBT* (1958), *reprinted in* 2 THE COLLECTED WORKS OF JAMES M. BUCHANAN (Liberty Fund 1999) (providing an economic analysis of public debt).

at questions of *who* gives up the control over the resources that are used for debt financing and *when* are individuals paying for it. Buchanan concluded that it is not bondholders who are burdened with financing the expenditures since they will be repaid in the future and they voluntarily choose to lend the money, indicating that they are better off. Instead, the future taxpayer bears the burden of today's debt-financed expenditure.<sup>17</sup> Though this may seem straightforward today, at the time Buchanan was writing, this simple fact was overlooked and the consensus was that the burden was borne by present rather than future generations.<sup>18</sup>

Continuing to apply basic opportunity-cost reasoning to debt issues, Buchanan also discussed the unnoticed economic costs of borrowing, since the borrower will have to pay interest. If the borrowing today is for future consumption rather than investment, then this has a negative effect on net wealth. Unlike in standard intertemporal models, where agents borrow for financing an investment, government expenditures are often not for investment or capital-formation uses, but rather to finance future consumption. Buchanan explained that the

public debt incurred by the U.S. government during the regime of ever-increasing, and apparently permanent, budget deficits has financed public or government *consumption* rather than public or government investment. The classical rules for fiscal prudence have been doubly violated. Not only has government failed to "pay as it goes"; government has also failed to utilize productively the funds that have been borrowed.<sup>19</sup>

### C. *Spontaneous Order*

The market economy, through the role of incentives and information in property, prices, and profit/loss, is the main example of a spontaneous order, and one that Buchanan believed should be emphasized in all teachings of economics. Buchanan's understanding of the fundamental nature of the market order is also shared in the Austrian view of the market process, as emphasized by F.A. Hayek and Ludwig von Mises. The order of the market is generated by the market process—the decisions to buy or sell or refrain from buying or selling. The market process consists of voluntary de-

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<sup>17</sup> In addition to pointing out that it is future taxpayers who face the burden of debt financing, Buchanan and Wagner argue that because present taxpayers are not burdened by debt-financing expenditures and because present taxpayers are the ones voting for politicians, politicians have an incentive to keep tax rates low (so as to not burden the present generation) and pay for public expenditures with debt. See JAMES M. BUCHANAN & RICHARD E. WAGNER, *DEMOCRACY IN DEFICIT* (1977), reprinted in 8 THE COLLECTED WORKS OF JAMES M. BUCHANAN 79-80 (Liberty Fund 1999).

<sup>18</sup> See generally Jerry H. Tempelman, *James M. Buchanan on Public Debt Finance*, 11 THE INDEP. REV. 435 (2007) (providing an overview of Buchanan's arguments on public debt finance).

<sup>19</sup> James M. Buchanan, *Public Debt and Capital Formation*, in *TAXATION AND THE DEFICIT ECONOMY: FISCAL POLICY AND CAPITAL FORMATION IN THE UNITED STATES* (Dwight Lee ed., 1986), reprinted in 14 THE COLLECTED WORKS OF JAMES M. BUCHANAN 369 (Liberty Fund 2000).

cisions made by market participants that lead to a “market order.” We cannot obtain economic order without the very process of exchange that takes place in the marketplace. The importance of this fact is that economists often invoke the concept of a social engineer who could know all the information of all participants and hence be able to mimic the outcome of the market order which results from the process of market adjustment. Implicit in this conception is that individuals have static and fully determined utility functions known to the social engineer. But this analysis is void of choice and presumes that the information that the social planner needs is available without the process. It assumes that the end results we seek—the allocation of resources to their most highly valued uses—can be obtained by the social planner who may have all the relevant information needed in order to achieve that end result. The point that Buchanan and the Austrians emphasized is that the information ceases to exist without the institutional setting of the marketplace, and it is only through the process of the market that the information is brought into existence and becomes embodied in the price system. It is the price system that allows for the emergence of the order of the market economy. The market order is “defined as the outcome of the *process* that generates it. The ‘it,’ the allocation–distribution result, does not, and cannot, exist independently of the trading process. Absent this process, there is and can be no ‘order.’”<sup>20</sup>

The process occurs within an institutional setting of the marketplace, where market participants face relative prices that provide information about relative scarcities that market participants use to infer the alternative uses of resources and methods of production. The profit-and-loss mechanism provides market participants with a judgment of their decision making and

the very discrepancy between the *ex ante* expectations, and the *ex post* realization in the market, motivates the *discovery* or *learning* by economic actors of better ways to match their production plans with consumption demands. If this process of production and exchange does not take place, the knowledge and incentives required to produce the complex coordination of the market would not exist.<sup>21</sup>

Thus, it would be impossible to have the outcome of the market order without the process that generates this order. Furthermore, and more importantly, as raised by Buchanan and Vanberg,<sup>22</sup> any notion of the market as an instrument predicted to move toward some end goal is misleading, since it misses this entire nature of the market as an open-ended process driven by

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<sup>20</sup> James M. Buchanan, *Order Defined in the Progress of Its Emergence*, LITERATURE OF LIBERTY, Winter 1982, at 5, *reprinted in* 1 THE COLLECTED WORKS OF JAMES M. BUCHANAN 244 (Liberty Fund 1999).

<sup>21</sup> Boettke, *supra* note 8, at 268.

<sup>22</sup> See generally Buchanan & Vanberg, *supra* note 13 (suggesting that the market is an open-ended creative process, instead of one with a purpose or goal).



human action. The importance of comprehending the above mechanisms is critical to understanding the market as a spontaneous order where social cooperation under the division of labor emerges as individuals strive to realize the gains from trade—and it is this understanding that marks Buchanan’s emphasis on the study of economics as exchange.

### III. WHAT SHOULD ECONOMISTS DO?

In Buchanan’s classic paper *What Should Economists Do?*, he stressed the idea that economics is a theory of exchange and not a theory of resource allocation.<sup>23</sup> A theory of resource allocation is one that involves studying how a particular society solves its economic problem of having unlimited wants and competing means necessitated by scarcity. But once we have established the format in allocation terms, Buchanan argued, “some solution is more or less automatically suggested. Our whole study becomes one of applied maximization of a relatively simple computational sort.”<sup>24</sup> If we, as economists, continue to take on the allocation-problem approach, we will continue to be misled to believe that the economic problem is merely a mathematical problem that can be solved by a social designer. If, however, we take on the approach of economics as the study of exchange, then we can bring institutional analysis to the forefront of our focus and address the questions regarding the development of institutional arrangements within which exchange takes place.

Buchanan pushed back against teaching elementary economics as the problem of allocating scarce resources among competing ends because it is undoubtedly not the actual problem that society faces and because it leads the discipline more into mathematical computation than into the understanding of the nature of human action, choice, and the institutions within which human interaction and exchange take place. If we know the ends to be maximized (as provided by the social welfare function), then “everything becomes computational. . . . If there is really nothing more to economics than this, we had as well turn it all over to the applied mathematicians.”<sup>25</sup> And if economics continues to be taught as the problem of resource allocation, then students of economics are led to believe that *someone* is able to manage the economic system and that the system must answer the questions of what, how, and for whom goods are to be produced, and then we can merely observe the machine-like efficiency achieved in the market system. In this static world, all gains from exchange have been ex-

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<sup>23</sup> See generally James M. Buchanan, *What Should Economists Do?*, S. ECON. J. 30 (1964), reprinted in 1 THE COLLECTED WORKS OF JAMES M. BUCHANAN 28 (Liberty Fund 1999) [hereinafter Buchanan, *What Should Economists Do?*].

<sup>24</sup> *Id.* at 33.

<sup>25</sup> *Id.*

hausted, prices reflect the full opportunity cost of production, and all production results in utilizing the least cost technologies. Again *if* markets are perfect, *then* we are in this situation. But this opens up the question that has become quintessential in modern economic theory: What happens if there are market imperfections? In this case, markets are said to fail to produce the expected results, and these imperfections may come about because of supposed monopolies, externalities, and imperfect information. This type of reasoning then opens the ground for students to be taught that, because the market failed to reach the expected results due to its own imperfections, then there must be reform of the market from the outside—mainly the role of government is said to correct the problems of the market.

Buchanan pushed this understanding that the market is not a mechanism toward the realization of anything, and the notion that the market process allocates resources to their most highly valued uses means

nothing more than to say that all recognized gains from exchange have been exhausted, or that all potential trades that promise mutual advantage have been implemented. . . . To say that all gains from exchange are exhausted, within the constraints that participants confront in their dealings one with another, tells us little or nothing about the constraint structure itself. Whether tightly or loosely constrained, the exchange process will facilitate the enhancement of individual values in the sense defined above. The normative focus necessarily shifts to the constraints, as such, and prompts the question concerning the possibility of mutuality (generality) of gain from modification of some constraints, some rules, some elements of the effective constitution.<sup>26</sup>

Discussion of the market's ability to efficiently allocate scarce resources among competing ends necessarily cuts out institutional analysis and presumes that the exchange order is functioning within an already determined set of laws.<sup>27</sup> That is, the political and institutional constraints within which exchange takes place are taken as given or exogenous. But the market is

the institutional embodiment of the voluntary exchange processes that are entered into by individuals in their several capacities. This is all that there is to it. Individuals are observed to cooperate with one another, to reach agreements, to trade. The network of relationships that emerges or evolves out of this trading process, the institutional framework, is called "the market."<sup>28</sup>

If economics is the study of exchange, then we can discuss how a market economy can function or fail to function on the basis of the rules within

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<sup>26</sup> JAMES M. BUCHANAN, *HAS ECONOMICS LOST ITS WAY?: REFLECTIONS ON THE ECONOMISTS' ENTERPRISE AT CENTURY'S END 4* (1997).

<sup>27</sup> See generally James Buchanan, *Rights, Efficiency, and Exchange: The Irrelevance of Transaction Costs*, *ANSPRÜCHE EIGENTUM UND VERFÜGUNGSRICHTE* (1984), reprinted in 1 *THE COLLECTED WORKS OF JAMES M. BUCHANAN* (Liberty Fund 1999) [hereinafter Buchanan, *Rights, Efficiency, and Exchange*].

<sup>28</sup> Buchanan, *What Should Economists Do?*, *supra* note 23, at 38.

which it operates instead of merely emphasizing the efficiency of markets under perfect assumptions. The exchange that goes on in the marketplace and the outcome and end results we observe are a function of the rules of the game. Independent of the rules that cultivate exchange, economics just becomes a study of a system that, under perfect conditions, can automatically produce some end results.

Buchanan's understanding of the task of the economist as the study of exchange and the institutions that allow for exchange, and how those relationships advance within the market process, fits neatly into his conception of the role of the political economist as proposing changes in the rules of governance that may foster greater gains from trade.

#### IV. BUCHANAN ON POSITIVE ECONOMICS, WELFARE ECONOMICS, AND POLITICAL ECONOMY

Individuals decide to enter markets in order to exchange with one another, and as such markets are institutions of exchange that do not have their own purpose or end of aggregate allocation to be achieved.<sup>29</sup> The conceptualization of the exchange paradigm extends to Buchanan's understanding of politics as exchange as well. If economics is the study of exchange, then economists cannot act as social engineers, offering advice to a social planner on the ways to allocate scarce resources among competing ends. Potential policy proposals for improvements cannot be about inching closer or reaching some ideal that is defined externally. Instead, Buchanan argued, the role of the political economist is to suggest what rules of governance can be changed in order to achieve greater gains from trade that are acceptable to all the individuals or participants in society.

In Buchanan's conceptualization of exchange relationships, the "accepting" of the new rule is equivalent to the voluntary trading in the market place among participants. In both market and political settings, individuals who voluntarily trade are engaging in an agreement, and thus voluntary exchange or freedom to exchange in the marketplace is akin to unanimous agreement for such things as collective rules in the political realm. Buchanan argued that, unlike the standard notion of efficiency advanced by mainstream economists, the agreement among individuals who participate is paramount for the assessment of whether the rule is "efficient." In this sense, the rules are efficient precisely because they are chosen:

Agreement on a change in the rules within which exchanges are allowed to take place would be a signal that patterns of outcomes reached or predicted under the previously-existing set of rules are less preferred or valued than the patterns expected to be generated under the rule-as-

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<sup>29</sup> See generally Buchanan & Vanberg, *supra* note 13 (describing markets as institutions of exchange).

changed. Hence, the new rule is deemed more efficient than the old. The discussion and agreement on the change in the rules here is analogous to the trade that takes place between ordinary traders in the simple exchanges made under postulated rules.<sup>30</sup>

Buchanan believed that by moving to the rules level of analysis, he was able to reconcile this reformer zeal within economists, yet still abide to the scientific demands of the discipline in terms of offering positive analysis. Buchanan noted that framing the logic of choice in terms of “utility maximization” is still a violation of the notions of value–freedom strictures of positive economics because utility is only calculable to the individual decision maker. That is, the economist may be able to observe facts and make assumptions about utility, but he must “remain fundamentally ignorant concerning the actual ranking of alternatives.”<sup>31</sup>

Buchanan’s reconciliation rejected the value-filled-omniscience assumption and relied on consensus of the adoption of the rule as a test for the political economist’s hypothesis. In this sense, the political economist still proposes reforms that may improve societies, but they are testable by observing the behavior of individuals in their roles as collective decision makers to adopt the proposed rules. Buchanan explained this difference in the role of the political economist:

He does not recommend policy A over policy B. He presents policy A as a hypothesis subject to testing. The hypothesis is that policy A will, in fact, prove to be Pareto-optimal. The conceptual test is *consensus* among members of the choosing group, not objective improvement in some measurable social aggregate.<sup>32</sup>

and “[t]he measure of ‘wellness’ for the political economist is not improvement in an independently observable characteristic but rather agreement.”<sup>33</sup>

In this case, there is no objective criterion for evaluating a particular policy independent of the political process. Instead of evaluating the end results that the policy may deliver, the focus of evaluation is on the process itself, and a successful reform may be understood as one that provides a set of outcomes that are preferred by those who were involved in its formation. Buchanan provided this analysis by moving the actual level of policy evaluation to that of rule formation, since it is about the constitution of the policy instead of the policy itself. This is Buchanan’s preconstitutional and postconstitutional movement distinction; the preconstitutional moment is about the discourse over the rules of the game, while postconstitutional

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<sup>30</sup> Buchanan, *Rights, Efficiency, and Exchange*, *supra* note 27, at 265.

<sup>31</sup> James M. Buchanan, *Positive Economics, Welfare Economics, and Political Economy*, 2 J.L. & ECON. 124, 126 (1959), *reprinted in* 1 THE COLLECTED WORKS OF JAMES M. BUCHANAN 194 (Liberty Fund 1999).

<sup>32</sup> *Id.* at 195.

<sup>33</sup> *Id.* at 196.

analysis refers to the strategies that players use within those rules. Thus, the role of the political economist is to work at the level of rules instead of at the level of active and strategic play within the rules.

Beyond his contributions in reconciling value-free economics with value-laden political economy, Buchanan's analysis here extended to the art and science of the association and the ideas of constitution making from the bottom up. The political economists' proposals must meet the consent of the people who partake in conversations of democratic deliberation and who are able to exercise power in creating their own rules to govern themselves. It is no surprise that Buchanan highlighted that the economist's role in society is to be a teacher of the basic principles of economics and that the economist cannot be a social engineer engaged in moving society to some ideal. What his research in constitutional political economy suggested is the ability of individuals to consciously design the rules that govern themselves by engaging in constitutional decision making. This contribution was picked up and extended further by Elinor Ostrom, who studied how individuals and communities were able to engage in rule formation and constitution making from the bottom up. Ostrom attributed this to Buchanan, saying that his work had been "an important stimulus for our extensive studies of how many diverse peoples around the world have been able to organize their own rules."<sup>34</sup> By moving his level of analysis to rules and discussing how to retain positive economics in political economy, Buchanan's contributions here fit in the broader theme of the importance of self-governance and providing citizen power and voice.

## V. CONSTITUTIONAL POLITICAL ECONOMY AND SOCIAL PHILOSOPHY

The study of constitutional political economy revolves around the question of how constitutions can constrain government in their quests to expand their powers beyond what is necessary for providing the conditions that allow for exchange to take place and the gains from exchange to be realized. This was ultimately Buchanan's puzzle—how can we design institutions that allow government to provide the functions of property-rights protection and public-goods provision without overstepping its limits into public predation or wealth redistribution? That is, how do we empower the protective state (providing secure property rights and enforcing contracts) and productive state (providing essential public goods) but constrain the redistributive state (providing special privileges to groups)? Constitutional political economy is about institutional design and constitutions that *can* constrain government behavior in its chase to overstep its boundaries.

The first part of Buchanan's constitutional political economy is looking at how different rules produce different results. It is important to ana-

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<sup>34</sup> Elinor Ostrom, *Honoring James Buchanan*, 80 J. ECON. BEHAV. & ORG. 370, 372 (2011).

lyze and compare different constitutional structures and how the structures affect performance. Take the Soviet Union as an example. The economy of the Soviet Union is contrasted with economies that protect private property and avoid political intrusions on freedom. The poor economic performance of socialist economies can be attributed to these differing structures in the rules. The importance of constitutional political economy is that it teaches us that the rules of the game matter more for getting better outcomes than the strategy that people within those rules adopt. If the set of rules is such that wealth is best achieved through lobbying and not engaging in productive activities, then the players operating within that set of rules will find a higher payoff in engaging in lobbying efforts. When lobbying efforts are rewarded more than productive efforts of innovation and entrepreneurship in the market place, the "outcome" is greater poverty and overall bad economic performance.

The constitutional structure of federalism is often cited for its effectiveness in hindering the ability of the state to confiscate wealth from its citizens. The lower units of government are induced under an effectively established federalist structure to compete and ensure that no one unit of government has a monopoly power over economic regulation.<sup>35</sup> The exit power that citizens have checks the local units of government when they attempt to regulate economic activity because citizens can locate elsewhere, and thus lower units of government will compete for residents by providing better policy packages. Through the structure of federalism, citizens can realize the generalized benefits of a market economy and reduce the prevalence of rent-seeking and regulatory burdens, therefore enhancing the level of competition for productivity and growth overall. Furthermore, rules such as term limits for politicians more often lead to a systematic growth in government spending and size than those that allow either greater time in office or have unlimited term limits.<sup>36</sup> Longer or unlimited term limits incentivize politicians to work on building their reputations over a long period of time and focus on long-term outcomes of their policies, while shorter term limits produce incentives for politicians to be shortsighted in their actions because they cannot run for reelection anyway. From an economic point of view, we would expect that in their last terms politicians would reduce efforts to serve their constituents, since they have little incentive to do so without a reelection option. In fact, Besley and Case find that taxes are lower for governors during their first terms than during their second terms.<sup>37</sup> Thus,

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<sup>35</sup> See Barry R. Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 J.L. ECON. & ORG. 1, 5 (1995).

<sup>36</sup> See generally Timothy Besley & Anne Case, *Does Electoral Accountability Affect Economic Policy Choices? Evidence from Gubernatorial Term Limits*, 110 Q.J. ECON. 769 (1995). See also Joseph M. Johnson & W. Mark Crain, *Effects of Term Limits on Fiscal Performance: Evidence from Democratic Nations*, 119 PUB. CHOICE 73, 86 (2004).

<sup>37</sup> Besley & Case, *supra* note 36, at 785.

with respect to fiscal policy, lengthening term limits (or creating unlimited term limits) induces politicians to be more fiscally responsible or to act in the interest of their constituents.

It is no surprise to find that Buchanan's constitutional political economy goes hand in hand with work in development and transitional economies where questions of constitutional design are in the foreground of analysis. In order to actually achieve lasting reform in developing or transitional economies, we need to have changes in the rules of governance and not policy changes within the existing rules. Policy changes that remove price ceilings from particular industries are fundamentally different from changes of constitutional design, such as the separation of power in government, or credible rules, such as protection of property rights. Furthermore, Buchanan emphasized the need to look at the "here and now" with regard to questions of reform. Reform is always constrained by where we start, and that includes understanding constraints such as a particular culture and its impact on difficulties in reform. The importance of these rules is also that they need to be legitimized in the belief structures of the people. We cannot get constitutions with teeth without legitimate rules of governance.

Buchanan's work raises these important questions regarding how rules affect performance—how we can get lasting reforms of rule changes that are legitimized by the belief structures of that culture, and how we can make sure that rules that are meant to constrain the power of the government are effective. Buchanan's puzzle of empowering the protective and productive state without unleashing the redistributive state raises important questions in overcoming this problem by limiting the scope of government. This also blends into research of self-governing societies and the importance of the individuals within those societies in understanding the mechanisms of spontaneous order and the market economy. This issue regarding scope is about citizens not *demanding* government intervention, and deliberately checking governmental power when it moves beyond its limits. Buchanan's emphasis on the role of the economist as a teacher, and in particular a teacher who focuses on the spontaneous order of the market, fills an important role in the solution to his puzzle—that a general understanding by the public of the market economy is foundational for the sustainability of democratic and liberal institutions of limited government. If the economist does not fulfill his role and the general public blindly accepts the romantic vision of politics and lacks an understanding of the market process, then this introduces a gaping hole in the path to growth.

## VI. THE CONTINUING RELEVANCE OF BUCHANAN'S WORK

Buchanan's work is mainly appreciated in the field of public economics and public choice, but perhaps it is in the broader field of development economics that his ideas concerning the "rules level of analysis" can have

their deepest impact. What are the rules that enable populations to live better together? How can groups establish those rules that will result in peaceful social cooperation and productive specialization among free individuals? Growth and wealth come from the institutions that allow for voluntary exchange to take place—the key institution that has been identified is the protection of property rights, which includes protection from both private and public predation. Interestingly, the critical questions in development economics are the questions that Buchanan has raised in works such as *The Calculus of Consent*,<sup>38</sup> *The Limits of Liberty*,<sup>39</sup> and *Freedom in Constitutional Contract*<sup>40</sup>—in particular, how to create institutions or rules that can empower the protective function of the government to ensure against predation of private property and the productive function of the government that can provide for necessary public goods, without having that same government succumb to special interest groups and become a redistributive government associated with the “churning state.”

A fruitful research topic in this area is how to reduce the incentives of the government to cater to special interest groups and align their interests with the overall interests of society<sup>41</sup> and create endogenous mechanisms of private property rights protection. As briefly discussed above, the structure of federalism and function of competition has been identified as one mechanism. Contemporary research in development economics has also looked at the function of foreign aid, and how it exacerbates the problem of attempting to align incentives of the rules with that of the overall well-being of the nation.<sup>42</sup> With millions of dollars going to autocrats and dictators because of the poverty-stricken state of their countries, autocrats find that it pays to not provide public goods for their citizens and dissociate the “invisible hand mechanisms” that may have existed with dictators who had an incentive to provide the conditions to enrich their tax base in order to get more from their subjects.<sup>43</sup>

One of the key implications from recent research in development economics is the importance of self-governance for development. Allowing individuals to find the best mechanisms to foster social cooperation has led to better outcomes than an imposition of rules. It is in this respect as well

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<sup>38</sup> JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* (1962).

<sup>39</sup> JAMES M. BUCHANAN, *THE LIMITS OF LIBERTY* (1975).

<sup>40</sup> JAMES M. BUCHANAN, *FREEDOM IN CONSTITUTIONAL CONTRACT: PERSPECTIVES OF A POLITICAL ECONOMIST* (1977).

<sup>41</sup> Examples are reducing the incentives of political decision makers to cater to lobbying groups by establishing election by random lottery or bicameral legislation, etc.

<sup>42</sup> See generally ANGUS DEATON, *THE GREAT ESCAPE: HEALTH, WEALTH, AND THE ORIGINS OF INEQUALITY* (2013).

<sup>43</sup> See generally Martin C. McGuire & Mancur Olson, Jr., *The Economics of Autocracy and Majority Rule: The Invisible Hand and the Use of Force*, 34 J. ECON. LIT. 72 (1996) (providing a more detailed analysis of the invisible mechanisms in autocracies and democracies).



that constitutional political economy is key, because it puts to the forefront the importance of understanding and implementing constitutional constraints that allow individuals to self-govern, and that allow them to build these institutions from the bottom up. The development in early America has often been cited as an example of how a limited government that allowed individuals to self-govern led to economic growth. Tocqueville identified that it was during this time that there was a proliferation of civil societies and a thriving and functioning independent sector that took up most of what we would think of as the responsibilities of the state today.<sup>44</sup> This again goes back to the question of limiting not only the scale, but also the scope of government, and turns to questions of “starving the beast of responsibility.” Buchanan pushed the role of the economist as teacher and diffuser of the knowledge of the market economy, and this is significant to Buchanan’s puzzle because it instills an appreciation of the market economy within the citizens such that they will be less likely to demand a government that will intervene in the market economy and in their private lives. Buchanan said “a generalized willingness to leave things alone, to let the economy work in its way and outside of politicized inference” is key to sustaining liberal institutions.<sup>45</sup> This means also that a greater insistence of the role of civil societies and the independent sector is important to making sure the government does not overstep its boundaries. Buchanan explained:

There is . . . an ever present danger that these [liberal] institutions, which are vital to the preservation of individual liberty, may be undermined and eroded . . . . Twentieth century American democracy can well commit the irrevocable sin of “social carelessness” . . . . Individual liberty or freedom remains the fundamental organizing principle of the free society, and the temporary pursuit of will-of-the-wisp current objectives at the expense of individual freedoms must be examined much more carefully and thoroughly than scholars and policy-makers now seem willing to attempt.<sup>46</sup>

One of the most important insights from contemporary political economy is that democracies are prone to democratic despotism where citizens lose their self-governing capacities and become dependent on the state.<sup>47</sup> Buchanan stressed citizens “must attend to the rules that constrain our rulers” and that a vision of the liberal tradition must embody “an understanding of the principles of constitutional order and recognition that the individual, as a citizen, must accept the ethical responsibility of full and informed partici-

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<sup>44</sup> See generally ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* (1835) (analyzing the individual’s relationship to the market and the state in Western culture).

<sup>45</sup> JAMES M. BUCHANAN, *THE ECONOMICS AND THE ETHICS OF CONSTITUTIONAL ORDER*, 248 (1991) (previously published as *The Potential and the Limits of Socially Organized Humankind*, in *Nobel Laureates Forum in Japan* (1988)).

<sup>46</sup> Buchanan, *supra* note 6, at 6.

<sup>47</sup> See generally VINCENT OSTROM, *THE MEANING OF DEMOCRACY AND THE VULNERABILITIES OF DEMOCRACIES: A RESPONSE TO TOCQUEVILLE’S CHALLENGE* (1997).

pation in a continuing constitutional convention.”<sup>48</sup> It is through Buchanan’s work in constitutional political economy that an important appreciation and understanding of bottom-up constitutional rules and the importance of individual choice over the rules of the game can be cultivated. In a letter lamenting how the field of public choice had abandoned the ideas of individuals initiating action, Buchanan stressed that “at the level of philosophical discussion . . . which we sometimes call constitutional economics, [we] recognize the severe limits of any deterministic public choice” in which there is “very little room for the genuine entrepreneur, to use the term broadly to include those who might initiate ideas.”<sup>49</sup>

Buchanan’s work on focusing the attention on the level of the rules has gained traction and has led to the rebirth of political economy. This continues to be a fruitful area of research and much work is being done in studying what is referred to as *constitution-making from the bottom up*.<sup>50</sup> This was especially prevalent in Elinor Ostrom’s work; she found that individuals in their local communities are better able and suited to understand the right rules and actions to take in order to overcome many of the community’s problems and create the rules to govern their communities.<sup>51</sup> In this regard, the importance of Buchanan’s work can be especially seen within the context of transitional economies and failed and weak states, where we must focus our attention on the emergence of the rules of the game and how those rules can lead to better economic performance.

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<sup>48</sup> James M. Buchanan, *The Economics and the Ethics of Constitutional Order*, ESSAYS ON THE POLITICAL ECONOMY (1989), reprinted in 1 THE COLLECTED WORKS OF JAMES M. BUCHANAN 368, 372-73 (Liberty Fund 1999).

<sup>49</sup> Letter from James Buchanan, Former Professor at George Mason University, to Paul D’Andrea, (June 9, 1986) (on file at the Buchanan House archives of James Buchanan, George Mason University).

<sup>50</sup> See Peter Boettke, *Entrepreneurship, and the Entrepreneurial Market Process: Israel M. Kirzner and the Two Levels of Analysis in Spontaneous Order Studies*, 27 REV. AUSTRIAN ECON. 233, 244 (2014), available at <http://link.springer.com/article/10.1007/s11138-014-0252-1>.

<sup>51</sup> ELINOR OSTROM, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION (1990).



## PUBLIC CHOICE ORIGINALISM: BORK, BUCHANAN, AND THE ESCAPE FROM THE PROGRESSIVE PARADIGM

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### INTRODUCTION

The most important development in constitutional theory in the last fifty years was the revival of originalism as a substantial theory of constitutional interpretation. The most important development in political theory was the rise of public choice. The two are related. The public-choice view provided support for a Constitution with features that constrain ordinary politics, protecting key social institutions like rights, federalism and the separation of powers. Originalism provided a theory of interpretation that supports these constraints on democratic politics, preventing them from being eroded by the forces that would favor their erosion, according to the predictions of public choice itself.

In this essay I explore the connections between these two important movements. Public choice is crucial to development of originalism both in its diffuse popular and more academic forms. As Robert Bork's famous article, *Neutral Principles and Some First Amendment Problems*, illustrates, originalism begins as a reaction to the Warren Court, but it is a reaction that largely accepts the primacy of democratic majoritarianism that had begun in the Progressive Era.<sup>1</sup> It is public choice more than any other theory of politics that loosens the straightjacket that majoritarianism has placed on constitutional theory. In its more diffuse form, public choice with its emphasis on the self-interested nature of politicians, the power of interest groups, and the pathologies of collective choice made majoritarianism less attractive. James Buchanan's contribution with Gordon Tullock in *The Calculus of Consent* has particular relevance to originalism, because it decisively breaks from the idea that majority rule should be the presumptive norm in constitutional republics.<sup>2</sup> If constitutions are best made by supermajority rules, as Buchanan and Tullock imply, originalism can be justified as a way of protecting the results of supermajoritarian constitution making from change by either majorities or the peculiar submajorities that are comprised by the justices of the Supreme Court.

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<sup>1</sup> See generally Robert H. Bork, *Neutral Principles and Some First Amendment Problems*, 47 IND. L.J. 1 (1971) (discussing the origin of originalism).

<sup>2</sup> See generally JAMES M. BUCHANAN AND GORDON TULLOCK, *THE CALCULUS OF CONSENT* (Charles K. Rowley ed., Liberty Fund 2004) (1962).

The displacement of majoritarianism from the center of political theory has other important implications for constitutional theory in general and originalism in particular, which are still being worked out today. Most importantly, the public choice understanding of constitutionalism suggests that countermajoritarian difficulty, which dominated constitutional law for decades, should not be the lodestar of constitutional theory. If majority rule is not a privileged norm, enforcing countermajoritarian aspects of the constitution are not only unproblematic but in fact an essential aspect of constitutionalism. And thus many of the moves in constitutional theory that have been devised to meet or temper the countermajoritarian difficulty are solutions in search of a problem.

Most histories of originalism have focused on the shifts in interpretive methods that have marked its recent arc.<sup>3</sup> Originalism's revival began as a theory of finding meaning in the original intent of the Framers or ratifiers. After many critics noted difficulties with original intent, originalists predominantly embraced public meaning as the touchstone of originalism.<sup>4</sup> Still later some originalists argued for original-methods originalism where the original meaning is derived by the enactors' own interpretive methods.<sup>5</sup> The so-called New Originalists argued that originalism was controlling in matters of interpretation where the Constitution was sufficiently clear, but not in matters of construction where the Constitution was irreducibly ambiguous or vague—claims that have themselves been sharply contested.<sup>6</sup>

As important as these modifications and disputes are within the application of originalism, public choice's inflection point is more important because it moves originalism from a theory that was concerned primarily with protecting democratic majorities to a theory that was concerned with preserving a republican regime that was in its formation and essence non-majoritarian. That shift in turn empowered originalism to be a much more aggressive theory of judicial review of legislation, creating more potential conflict between the judiciary and legislative majorities. It also tended to make originalist theorists less respectful of precedents, particularly the many that empowered national majorities, because these precedents are seen to have more costs: they prevent the constitutional framework from being fully realized.

Part I of this essay begins by outlining the replacement of the original republican ideas of the Constitution with the transformative politics of the

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<sup>3</sup> See, e.g., Lawrence B. Solum, *District of Columbia v. Heller and Originalism*, 103 NW. U. L. REV. 923, 928-37 (2009) (recounting the history of originalism in the modern era).

<sup>4</sup> *Id.*

<sup>5</sup> See JOHN O. MCGINNIS & MICHAEL B. RAPPAPORT, *ORIGINALISM AND THE GOOD CONSTITUTION* 116-39 (2013).

<sup>6</sup> See, e.g., Lawrence B. Solum, *Originalism and Constitutional Construction*, 82 FORDHAM L. REV. 453 (2013).

Progressive Era—ideals that tended to devolve into majoritarianism. Part II of this essay argues that Bork’s revival of originalism took place within the Progressive Paradigm when the Warren Court caused a crisis in that paradigm by its blithe willingness to invalidate the products of the democratic process. Part III describes the rise of public choice, both in the general form of applying economic analysis to politics and in the particular contribution of Buchanan and Tullock to voting rules. Part IV argues that the fundamental change of originalism since Bork’s important contribution has occurred in no small measure because ideas of public choice gained purchase both in the academy and in the general public. Part V shows that self-consciously progressive or left-liberal theorists, being as a general matter much less sympathetic to public choice, are still largely concerned with solving the countermajoritarian difficulty. As a result, many nonoriginalist theories continue to take this problem very seriously, even if the new solutions offered are not very compelling. Part VI recognizes that no theory is ever completely triumphant. The essay ends by describing a few challenges, unlike the countermajoritarian difficulty, which an originalism inspired by public-choice republicanism does still need to solve.

My point in this essay is *not* to defend originalism, but to show how by replacing the Progressive Paradigm, public choice has substantially changed originalism. This transformation creates opportunities for new justifications of originalism, but also generates new challenges—challenges that originalism has yet fully to address.

## I. THE PROGRESSIVE PARADIGM

To understand the importance of Buchanan and public choice to political theory, one must go back to the Progressive Era. It was then that political theory took a decisive turn toward favoring living-constitution theory as well as political majoritarianism.<sup>7</sup> The need for this living constitution was rooted in the claims of Progressive reformers that Constitution’s enumerated powers had to be adapted to exigencies of new circumstances. Ultimately, such theorists wanted the Court to ratify the expansion of these powers agreed to by mere majorities of the national legislature.

It is fitting that it was the second political theorist to become President, Woodrow Wilson, who overturned the work of the first, James Madison. Wilson believed that the national government could not be narrowly confined to original understanding of the enumerated powers. As Wilson put it: “The explicitly granted powers of the Constitution are what they always

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<sup>7</sup> See Howard Gilman, *The Collapse of Constitutional Originalism and the Rise of the Notion of the “Living Constitution” in the Course of American State-Building*, 11 *STUD. AM. POL. DEV.* 191, 205-09 (1997) (showing that originalism was the overwhelmingly dominant theory of constitutional interpretation until the Progressive Era).

were; but the powers drawn from it by implication have grown and multiplied beyond all expectation, and each generation of statesmen looks to the Supreme Court to supply the interpretation which will serve the needs of the day.”<sup>8</sup> For Wilson, the needs of the day were found in a kind of Hegelian spirit of the time.<sup>9</sup> Thus, he was not explicitly majoritarian. But as time went on, it became clear that the spirit of the time did not speak in the same way to everyone and disagreements on the proper response to social change persisted. As a result, there was no mechanism for the content of the spirit of the age but majority will, which the Court would then ratify.

Thus, there is a connection between Wilson’s Progressive notions and the strong presumption of constitutionality for legislation which was created by the New Deal Court in *Carolene Products*.<sup>10</sup> Even two of the exceptions to that presumption, defined in its famous footnote 4, explicitly concern strengthening the political process and thus are wholly consistent with primacy of a purified majoritarianism at the heart of the Progressive Paradigm. One focuses on eliminating roadblocks to voting.<sup>11</sup> Another focuses on the danger that prejudice against minorities will frustrate the political process.<sup>12</sup> The first two exceptions refine majoritarianism, but are still consistent with its essence. The third exception is truly an exception to majoritarianism, but a limited one: the Court says that the presumption disappears when “legislation appears on its face to be within a specific prohibition of the Constitution, such as those of the first ten amendments.”<sup>13</sup>

Note that what is left out of *Carolene Products* footnote 4 is any notion that the Court is to enforce federalism or the separation of powers. These social institutions are contained within the structure of the enumerated powers and the distribution of powers among the branches rather than the specific prohibitions, like the Bill of Rights. Thus, New Deal constitutional settlement, as articulated in *Carolene Products*, is conducive both to a national government of essentially plenary power not substantially constrained by federalism, and a powerful administrative state not substantially constrained by the separation of powers.<sup>14</sup>

Even the Court’s statement in *Carolene Products* about prohibitions should be qualified by consideration of the fuller context of Progressive

<sup>8</sup> WOODROW WILSON, CONSTITUTIONAL GOVERNMENT IN THE UNITED STATES 158 (Columbia Univ. Press 1911) (1908).

<sup>9</sup> Ronald Pestritto, *Roosevelt, Wilson and Democratic Theory of National Progressivism*, in NATURAL RIGHTS INDIVIDUALISM AND PROGRESSIVISM IN AMERICAN POLITICAL PHILOSOPHY 318, 328 (Ellen Frankel Paul et. al. eds., 2012).

<sup>10</sup> See generally *United States v. Carolene Prod.*, 304 U.S. 144 (1938).

<sup>11</sup> *Id.* at 152 n.4.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> The Progressive Paradigm includes substantial delegation to the executive, because of the view that the modern world is too complicated for Congress to write the detailed rules necessary to regulate economic activity.

jurisprudence. In *Home Building & Loan Association v. Blaisdell*,<sup>15</sup> the Court had made clear that there would in effect be no such presumption against the key provisions of the Constitution that concerned individual economic rights, like the Contract Clause. This view is also a working out of Wilson's theory. If the Hegelian spirit of the age could expand the enumerated powers of Congress, it followed that this spirit could shrink them as well when that abridgement accorded with the felt necessities of the time.

The combination of living constitutionalism and an enthusiasm for a suitably refined majority rule shows that the constitutional vision largely gives up on the Constitution's braking function and the amendment process. The ordinary legislative process will address social change, even if its plans are substantially different from those in the Constitution itself. This theory of constitutionalism is optimistic about the possibility of relatively unchecked social planning and is relatively indifferent to any concern about any inherent pathologies of collective action—underlying assumptions that are in substantial tension with those of public choice.

## II. BORK AND THE REVIVAL OF ORIGINALISM

The intellectual revival of originalism dates from Robert Bork's justly famous article, *Neutral Principles and Some First Amendment Problems*.<sup>16</sup> A careful reading of the article shows that it was largely written in the majoritarian tradition of political theory. The concern of the article was how to give legitimacy to the Court in order to invalidate the results of legislative action, thus solving the countermajoritarian difficulty. While Bork acknowledged the rights of the minority, majority rule is treated as the more powerful norm.<sup>17</sup> Two elements of the article underscore this premise. First, while Bork criticizes many cases as wrongly decided, all are cases where the Court invalidates constitutional legislation and none where the Court fails to invalidate unconstitutional legislation.<sup>18</sup> Second, Bork's interpretation of the First Amendment—the payoff of the interpretive theory he propose—owes much to making the right an instrument of the ordinary political process, confirming its essential primacy.<sup>19</sup>

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<sup>15</sup> See generally *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934).

<sup>16</sup> Bork, *supra* note 1. Bork never uses the term originalism in this essay, but it is nevertheless clear that his is a version of originalism. Constitutional interpretation has to be rooted in the text as a way of capturing the values the Framers chose.

<sup>17</sup> For a discussion of the tension between originalism and democracy in Bork's article, see generally Ilya Somin, *The Borkian Dilemma: Robert Bork and the Tension between Originalism and Democracy*, 80 U. CHI. L. REV. DIALOGUE 243 (2013).

<sup>18</sup> See generally Bork, *supra* note 1.

<sup>19</sup> *Id.*



It is not surprising that the impetus of the article was a Supreme Court that overrode democratic legislative choices. It was written in the aftermath of the Warren Court, which had struck down many legislative acts in areas as diverse as criminal procedure and the regulation of sexual morality, without articulating a clear basis in the specific prohibitions of the Bill of Rights. As a result, the Warren Court seemed to reject the presumption of constitutionality that was at the heart of the constitutional settlement between majoritarianism and individual rights reflected in *Carolene Products*.<sup>20</sup> Through its willingness to invalidate the work of democratic majorities, the Warren Court caused a crisis in the constitutional theory wrought by Progressivism.

Moreover, it was not only the macroclimate of the nation, but the microclimate at Yale that put democratic majorities front and center. Alexander Bickel, Bork's closest friend on the Yale faculty, saw "the countermajoritarian difficulty" raised by invalidating the work of the democratic branches as the central difficulty in constitutional law.<sup>21</sup> The most famous political scientist at Yale, Robert Dahl, cited in Bork's piece, was a strong advocate of majoritarianism.<sup>22</sup>

Bork began his essay by acknowledging that the Constitution had two principles—one that protected minority rights and one that protected the rights of the majority. His solution was to derive rights from something extrinsic to the will of either the minority or majority—the text of the Constitution could generate the proper guideposts.<sup>23</sup>

His formulation was consistent with another overriding concern of legal theory at the time—neutral principles. Neutral principles were key to the dominant legal process school.<sup>24</sup> For the legal process school, what distinguished the judicial from the political process was the judiciary's obligation to follow neutral principles, rendering consistent decisions from one case to the next. Bork's insight was that neutral principles by themselves are not sufficient to constrain judicial discretion because judges would still have discretion to decide which principles to follow. The neutral principles had to be neutrally derived and that requirement also pointed

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<sup>20</sup> See Michael C. Dorf, *Legal Indeterminacy and Institutional Design*, 78 N.Y.U. L. REV. 875, 880-81 (2003) ("[W]ith each new decision of the Warren Court, . . . the New Deal settlement" seemed like an "increasingly inadequate" explanation of constitutional law.).

<sup>21</sup> ALEXANDER M. BICKEL, *THE LEAST DANGEROUS BRANCH: THE SUPREME COURT AT THE BAR OF POLITICS* 16-23 (1962).

<sup>22</sup> He later assailed the Constitution itself as being insufficiently democratic. See generally ROBERT DAHL, *HOW DEMOCRATIC IS THE AMERICAN CONSTITUTION?* (2002) (arguing that the Constitution incorporates significant antidemocratic elements).

<sup>23</sup> Bork, *supra* note 1, at 3.

<sup>24</sup> Steven Graines & Justin Wyatt, *The Rehnquist Court, Legal Process Theory, and McCleskey v. Kemp*, 28 AM. J. CRIM. L. 1, 6 (2000) (stating that neutral principles are a premise of the legal process school).

to deriving the principles from the text of the Constitution.<sup>25</sup> Thus a great virtue of Bork's article was to use the legal tools of the time to begin the revival of originalism.

Bork did state that the legitimacy of the Court action was raised "when any court either exercises or declines to exercise the power to invalidate any act of another branch of government."<sup>26</sup> But all the cases his article calls wrongly decided are ones where the court overturned legislative majorities.<sup>27</sup> In contrast, he never labels a case as wrongly decided because the Court failed to invalidate a law that it should have invalidated. And he singles out *Griswold v. Connecticut*<sup>28</sup> for special and extended criticism.<sup>29</sup> That was the case more than any other that signaled the end of the *Carolene Products* era as matter of theory. Justice Douglas famously struck down the Connecticut law not on the basis of any "specific prohibitions" but rather on "penumbras" emanating from almost every one of the first ten amendments of the Constitution.<sup>30</sup> This methodology stood *Carolene Products* on its head, threatening to create a presumption of unconstitutionality for much legislation.<sup>31</sup>

But perhaps the most striking proof of the centrality of the democratic process to Bork is his derivation of his own First Amendment principles. While this article is correctly seen as the beginning of the originalist revival, his analysis of the First Amendment is not originalist by modern standards. He does no historical analysis himself. While he cites Leonard Levy on a restrictive understanding of the First Amendment,<sup>32</sup> Levy's work does not become the basis of his analysis either. Instead he argues that the way to derive First Amendment law from neutral principles is to invoke the overarching principle of democracy embedded in the Constitution.<sup>33</sup> The concern of the Constitution for democratic self-government is what provides the neutral principle to decide what speech should be protected—political speech that facilitates that democratic exercise and not, for in-

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<sup>25</sup> Bork, *supra* note 1, at 7-8.

<sup>26</sup> *Id.* at 2.

<sup>27</sup> *See id.* at 11 (listing wrongly decided cases). He criticizes other cases as inconsistent but that is not the same as calling out any case in particular as wrongly decided.

<sup>28</sup> *See generally* *Griswold v. Connecticut*, 381 U.S. 479 (1965).

<sup>29</sup> Bork, *supra* note 1, at 8.

<sup>30</sup> *Griswold*, 381 U.S. at 483-85.

<sup>31</sup> *See* Nelson Lund & John O. McGinnis, *Lawrence v. Texas and Judicial Hubris*, 102 MICH. L. REV. 1555, 1569-70 (2004).

<sup>32</sup> Bork, *supra* note 1, at 22 (citing LEONARD LEVY, *LEGACY OF SUPPRESSION* (1960)).

<sup>33</sup> *Id.* at 23 ("The first amendment indicates that there is something special about speech. We would know that much even without a first amendment, for the entire structure of the Constitution creates a representative democracy, a form of government that would be meaningless without freedom to discuss government and its policies.").

stance, artistic speech or speech by those dedicated to overthrowing the ordinary democratic order.<sup>34</sup>

It is interesting to note that Bork's interpretive approach in this article has some substantial kinship with John Hart Ely's *Democracy and Distrust*.<sup>35</sup> Both focus not so much on the historical meaning of the particular textual provision of the Constitution but on how the text is best interpreted in light of the overarching democratic process that the Constitution creates for ordinary governance. It is a testament to the power of the Progressive Paradigm that the most famous reviver of originalism (in his most signal contribution) and the greatest of twentieth century nonoriginalists are not so distant in outlook.<sup>36</sup> Once public choice cracks the Progressive Paradigm, originalism and nonoriginalism diverge more radically.

### III. THE RISE OF PUBLIC CHOICE AND BUCHANAN'S AND TULLOCK'S *CALCULUS OF CONSENT*

Public choice—the application of economic analysis to political action—is itself a challenge to the dominant political theory that grew out of Progressivism. Because individuals are self-interested, there can be little assurance that collective action will redound to the public interest because majorities may use their power to impose costs on minorities. Moreover, interest groups systematically distort public policy, leading to legislation that benefits such concentrated groups at the expense of the diffuse citizenry, even when it is a majority.<sup>37</sup> Finally, the rational ignorance of citizens means that they are often not present in politics.<sup>38</sup> The people cannot be relied on either to constrain special interests or enforce the fundamental constitutional order.

All of these considerations undermine enthusiasm for the primacy of majority rule. They also cast doubt on the notion that the Constitution is necessarily an impediment to social progress. Instead, assuming that the Constitution is a sound framework, allowing ordinary politics to expand its powers and change its structures may be harmful. Indeed, public choice suggests that an economically successful society under a good Constitution is likely to accumulate more and more special-interest organizations over time—interest groups that want to live through gaining resources and exac-

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<sup>34</sup> *Id.* at 28-35.

<sup>35</sup> JOHN HART ELY, *DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW* (1980).

<sup>36</sup> *Cf.* Louis Michael Seidman, *Acontextual Judicial Review*, 32 *CARDOZO L. REV.* 1143, 1161 n.79 (2011) (stating that both Bork's and Ely's theories attempt to permit the political system to mediate between "different conceptions of the good").

<sup>37</sup> For a general discussion of interest group power in public choice theory, see MAXWELL L. STEARNS & TODD J. ZYWICKI, *PUBLIC CHOICE CONCEPTS AND APPLICATIONS IN LAW* 42-93 (2009).

<sup>38</sup> Rational ignorance occurs because acquiring information about politics is both costly and unproductive. *See* DENNIS C. MUELLER, *PUBLIC CHOICE II* 205-06 (1989).

tions from the diffuse majority.<sup>39</sup> The Progressive Paradigm makes it easier for interest groups to break down the constraints that sustain economic flourishing.

While public choice is an academic theory, it had political resonance beyond the academic world. The political movement, located largely in the Republican Party, but also among moderate Democrats for deregulation and smaller government beginning in the late 1970s, was broadly consonant with public choice. Moreover public sentiment also turned suspicious of government. Thus, like most important political theories, public choice influenced constitutional law both through the academy and through more diffuse political effects.

The importance of *The Calculus of Consent* was that it used public choice theory to show systematically why majority rule should not be the presumptive rule of a constitutional republic.<sup>40</sup> Buchanan and Tullock begin with the familiar public choice assumption that political actors, legislators, and citizens alike, are self-interested and therefore vote to maximize their preferences.<sup>41</sup> Buchanan and Tullock then analyze different voting rules in terms of two kinds of costs—external costs and decision-making costs. External costs are the first kind of costs legislation imposes on individuals in society, such as the cost of complying with regulations.<sup>42</sup> Under a voting rule that requires unanimous consent, there are no external costs, because individuals can veto the legislation unless they are compensated for the costs.<sup>43</sup> Less inclusive voting rules, like majority rule, however, permit external costs, because a coalition of individuals can impose measures that benefit the coalition at the expense of others. As a voting rule becomes less inclusive, the external costs are likely to rise.<sup>44</sup>

The second kind of costs consists of decision-making costs.<sup>45</sup> Decision-making costs include the costs of the time spent by legislators on reaching legislative decisions.<sup>46</sup> More subtly, decision-making costs would appear to include the costs of laws foregone, because the benefits of legislation that a voting rule blocks must also be counted as a cost of that voting rule. As a voting rule becomes more inclusive and approaches unanimity, it becomes harder to reach decisions under the rule. It thus increases the time

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<sup>39</sup> See generally MANCUR OLSON, *THE RISE AND DECLINE OF NATIONS: ECONOMIC GROWTH, STAGFLATION, AND SOCIAL RIGIDITIES* (1982) (showing that the accumulation of interest groups slow down economic growth in a prosperous society).

<sup>40</sup> See John O. McGinnis & Michael Rappaport, *Majority and Supermajority Rules: Three Views of the Capitol*, 85 TEX. L. REV. 1115, 1122-28 (2004). This section summarizes our joint analysis of analytic contribution of *THE CALCULUS OF CONSENT*.

<sup>41</sup> BUCHANAN & TULLOCK, *supra* note 2, at 17-30.

<sup>42</sup> *Id.* at 63-68.

<sup>43</sup> *Id.* at 64.

<sup>44</sup> *Id.* at 65.

<sup>45</sup> *Id.* at 68-69.

<sup>46</sup> *Id.* at 68.

legislators must take to reach agreement and the likelihood that desirable laws will not be passed.<sup>47</sup>

Buchanan and Tullock thus see voting rules in terms of a trade-off between external and decision-making costs. External costs start high at less inclusive voting rules and slope downward until zero at unanimity rule. By contrast, decision-making costs start low at less inclusive voting rules and slope upward to their highest point at unanimity rule. Buchanan and Tullock recommend choosing the voting rule that would minimize the sum of these two kinds of costs.<sup>48</sup>

Buchanan and Tullock argue that representative democracy is justified because it reduces the very high decision-making costs of direct democracy in a large society. The trade-off is that representative democracy raises external costs—in the form of agency costs—because it permits legislators to impose external costs on ordinary citizens to benefit themselves. As a legislative voting rule becomes more inclusive it reduces external costs because legislators tend to represent varying interests. On the other hand, as a legislative voting rule becomes more inclusive it increases decision-making costs because it is harder to get the requisite number of legislators to reach agreement.

*The Calculus of Consent* contains many great insights, but the most important is that majority rule may often be worse than some other form of supermajoritarian decision-making rule. Moreover, because the optimal voting rule turns on a trade-off, it must be selected depending on the circumstances, including the subject matter of the legislation under consideration.

*The Calculus of Consent* has implications for constitutions and thus for their interpretation. Constitutions that can be amended, like ours, are a series of judgments about the appropriate voting rule. For instance, Congress can enact legislation within its enumerated powers under a relatively majoritarian rule. I say relatively majoritarian because Buchanan and Tullock themselves demonstrate that bicameralism is a mild supermajority rule.<sup>49</sup>

But Congress cannot pass legislation that violates rights protected in the Constitution—rights can be changed only by a constitutional amendment. The amendment process is of course strongly supermajoritarian, and thus rights are not absolute, but protected by another voting rule—albeit one that is far more inclusive than that for ordinary legislation. Similarly, Congress can pass legislation only within its enumerated powers, reserving

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<sup>47</sup> *Id.* at 68-69.

<sup>48</sup> *Id.* at 69-72.

<sup>49</sup> *Id.* at 233-49. Given the President's veto power the United States national legislature is actually a tricameral system requiring a greater than majoritarian consensus for legislation to pass. See John O. McGinnis & Michael Rappaport, *Our Supermajoritarian Constitution*, 80 TEX. L. REV 703, 769-80 (2002). There are also specific, more inclusive rules for some subjects in the constitution, such as ratifying a treaty with a foreign power. *Id.* at 760-69.

some areas of legislation for the states. Such state autonomy is also protected by the supermajority voting rule of the amendment process. The structure of the separation of powers is similarly protected by that voting rule.

Federalism and the separation of powers have themselves been justified by modern public choice analysis. Federalism creates competition among the states and, at least in areas where there are few interstate externalities, such competition is likely to lead to better government—both because the individuals can choose among states and because different states policies will generate more information about governance.<sup>50</sup> The separation of powers creates specialization among institutions and also provides its own checking function on the federal government, itself preserving federalism.<sup>51</sup>

Thus, Buchanan and Tullock provide a fine description, as well as justification, for both the provisions of our Constitution and the rules for changing them. One way of understanding their contribution to constitutional theory is that they provide an intellectual framework to reverse Progressive theories of Constitution. It roots the supermajoritarian constitution of the Framers in a modern framework of optimizing social welfare.

#### IV. PUBLIC CHOICE'S DIFFUSE AND DIRECT INFLUENCE ON ORIGINALISM

While Bork made the first steps toward modern originalism, it is the move toward public choice in political theory that explains most of the rest of the journey. Those who label themselves originalists espouse a variety of substantive views but none, except Jack Balkin, labor under the assumptions of the Progressive Paradigm. In my view, the best diffuse explanation for this is generational. Younger theorists of today grew up under a politics where the ideas of public choice moved to the center of social life, justifying deregulation, federalism and limited government. Of course, not everyone agreed with this movement, but it became encompassing enough not to be simply the preserve of conservatives and libertarians, but more moderate scholars and those without the strong left-liberal political commitments that often resist public choice. Consistent with this story is the continuing concern with the countermajoritarian difficulty of many left-liberal scholars who look askance at much of political development in the latter quarter of the last century.

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<sup>50</sup> The public choice literature defending federalism is vast. See, e.g., Barry Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 J.L. ECON. & ORG. 1, 1-31 (1995).

<sup>51</sup> Bradford R. Clark, *Separation of Powers as a Safeguard of Federalism*, 79 TEX. L. REV. 1321, 1458 (2001).

It is true that modern originalists come to originalism through a variety of routes. Perhaps the closest to public choice are those that seek to ground originalism in a theory of the appropriate voting rules for a constitution.<sup>52</sup> Others rely on classical liberalism's concern with limiting government for the protection of liberty<sup>53</sup>—a concern that has some kinship with Buchanan's stance on public choice.<sup>54</sup> Still others begin with the commitments to a philosophy of language that do not seem politically motivated at all.<sup>55</sup> But nevertheless, even these theorists reflect diffuse public choice influence. Because public choice diffusely felt pushed majoritarianism from the center of politics, it was much easier to move the countermajoritarian difficulty from the center of constitutional theory. In other words, the public choice movement broadly understood cleared out the previously progressive concerns and permitted a variety of new starting points for constitutional theory.

Moreover, all of these theories are not simply theories of adjudication, which is another contrast with originalism in Bork's article. Bork's first heading in his article is "The Supreme Court and the Demand for Principle."<sup>56</sup> His article pivots on his view that "[t]he Supreme Court is major power center, and we must ask when its power should be used and when it should be withheld."<sup>57</sup> But an originalism in the aftermath of public choice, freed from the countermajoritarian difficulty, is more expressly focused on protecting the constitutional norms formed by the constitution-making process from the erosion by any actor, whether judicial or not.

As a result of public choice, the originalism of the new generation also became an originalism that was more aggressive and less constrained by concerns to use the democratic political process as a principle of interpretation as did Bork's original article. If the majoritarian political process was not the default rule there was no need to tie one's interpretation of the First Amendment, or, for that matter, any other provision, to the political process. The First Amendment could be interpreted to protect nonpolitical

<sup>52</sup> See, e.g., MCGINNIS & RAPPAPORT, *supra* note 5 (explaining originalism's relationship to supermajoritarian government). Keith Whittington locates the justification for following the Constitution in popular sovereignty. KEITH E. WHITTINGTON, *CONSTITUTIONAL INTERPRETATION: TEXTUAL MEANING, ORIGINAL INTENT, & JUDICIAL REVIEW* 142 (1999). It is not clear exactly what popular sovereignty entails, but it is clear that it is not constituted by a mere majority, because it is important that it be respectful of minorities.

<sup>53</sup> See RANDY BARNETT, *THE LOST CONSTITUTION: THE PRESUMPTION OF LIBERTY* 89-117 (2004).

<sup>54</sup> See Daniel Klein, *Ideological Migration of the Economics Laureates: Introduction and Overview*, 10 *ECON. J. WATCH*, Sept. 2013, at 235 (describing Buchanan as a kind of classical liberal).

<sup>55</sup> See Larry Solum's contribution in LAWRENCE B. SOLUM & ROBERT W. BENNETT, *CONSTITUTIONAL ORIGINALISM: A DEBATE* 1-77, 143-64 (2011).

<sup>56</sup> Bork, *supra* note 1, at 1. It becomes clear that Bork becomes interested in more than courts in subsequent work, like ROBERT BORK, *THE TEMPTING OF AMERICA* (1997).

<sup>57</sup> Bork, *supra* note 1, at 2.

speech if that were the best interpretation of its words, taken independently of concern about the political process. If democratic majorities were often problematic, then they needed to be restrained as much as judges, and thus judicial restraint would no longer be at the center of constitutional theory. Originalists would be as concerned with judicial decisions that failed to enforce provisions in the Constitution as with decisions that fabricated norms to enforce.

This change is reflected in the Court's jurisprudence. Originalism has now been used to support not-insubstantial limitations on the Commerce Power, from *United States v. Lopez*<sup>58</sup> to *NFIB v. Sebelius*,<sup>59</sup> although the notion the government has plenary power over commerce was at the heart of the Progressive paradigm. In the area of separation of powers, the Court has slightly cut back on the insulation of independent agencies.<sup>60</sup> The originalist impulse was at the heart of *Heller v. District of Columbia*<sup>61</sup> despite the fact the Court deployed an individual-rights interpretation that it had never used to invalidate a law.

This change is also reflected in the generational shift of the two originalists on the Court—Antonin Scalia and Clarence Thomas. Scalia's major argument for originalism is that it is likely to yield clear rules that provide more objective constraints on the discretion of judiciary.<sup>62</sup> Concern with discretion is connected to a desire to preserve the discretion of ordinary political processes—which is at the heart of the Progressive paradigm. Moreover, just as Bork's overarching commitment to the democratic process influenced his interpretation of particular clauses, so does Scalia's commitment to clear rules. *Employment Division v. Smith*,<sup>63</sup> which states that laws that burden religious exercise do not violate the Free Exercise Clause so long as they are neutral laws of general applicability has been heavily criticized as favoring a construction of the clause that provides a clear rule rather than being faithful to the original meaning.<sup>64</sup>

To be sure, Scalia has been willing to enforce the original meaning against legislatures. The Confrontation Clause, which he, more than any other justice, is responsible for reviving is a case in point.<sup>65</sup> He also wrote the opinion in *District of Columbia v. Heller*, breathing life into the Second Amendment. But in the crucial areas of the enumerated powers of the fed-

<sup>58</sup> *United States v. Lopez*, 514 U.S. 549 (1995).

<sup>59</sup> *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012).

<sup>60</sup> *Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 561 U.S. 477 (2010).

<sup>61</sup> *District of Columbia v. Heller*, 554 U.S. 570 (2008).

<sup>62</sup> See Antonin Scalia, *Originalism: The Lesser Evil*, 57 U. CIN. L. REV. 849, 863-64 (1999).

<sup>63</sup> *Emp't Div., Dep't of Human Res. of Or. v. Smith*, 494 U.S. 872, 879-80 (1990).

<sup>64</sup> See generally Michael W. McConnell, *Free Exercise Revisionism and the Smith Decision*, 57 U. CHI. L. REV. 1109 (1990) (arguing that *Employment Division v. Smith* changed the landscape of the interpretation of the Free Exercise Clause).

<sup>65</sup> *Crawford v. Washington*, 541 U.S. 36 (2004) (relying on the Sixth Amendment's Confrontation Clause to strike down a lower court opinion).



eral government, he has often been by his own lights a “faint-hearted originalist,” refusing, for instance, to cut back on precedents that are hard to square with the original meaning.<sup>66</sup> This practice does give space to national majorities on the subject that is now of greatest importance to Congress—economic legislation.

The contrast with the younger originalist on the Court is not insubstantial. Thomas is perfectly willing and eager to overturn the precedent that expands Congress’ enumerated powers. He not only joined the majority in *Lopez* but also wrote an opinion that would have sharply cut back on the administrative state.<sup>67</sup> Unlike Justice Scalia, he was in dissent in *Gonzales v. Raich*—the case that permitted Congress to regulate marijuana grown at home for medicinal purposes.<sup>68</sup> He has never suggested that his originalism is justified largely by the need to control judicial discretion rather than to follow the historical meaning of the Constitution. Of the two justices, it is not surprising that Justice Thomas’s are generally the opinions with the greater historical exegesis. Thomas’s more stout-hearted originalism and greater willingness to invalidate national legislation reflect the generational shift. His career arc coincided with rise of diffuse public choice and was propelled by the Reagan presidency—the administration that most reflected concern with limiting government in the last eight decades.

## V. NONORIGINALISM’S CONTINUING COUNTERMAJORITARIAN DIFFICULTY

It is not surprising the nonoriginalists do not generally accept the public choice critique of majoritarianism. Most nonoriginalists are still operating within the Progressive Paradigm that has confidence in social movements and national state power to remake society for the better. They are also, as a rule, less sympathetic to market and other spontaneous forms of ordering that structure society in the absence of government action—forms of ordering that can be protected by supermajoritarian voting rules. As a result, unlike originalists, most nonoriginalists are still focused on solving the countermajoritarian difficulty. Jack Balkin is the exception that proves the rule.<sup>69</sup> His theory of constitutional interpretation radically downplays the constraints of the Constitution, understanding it as an elastic framework through which social movements can work for fundamental social change. As a result, Balkin stands apart from other originalists, even those original-

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<sup>66</sup> Justice Scalia was in the majority in *Gonzales v. Raich*, 545 U.S. 1, 33 (2008) (Scalia, J., concurring). He there accepted *Wickard v. Filburn*, 317 U.S. 111 (1942).

<sup>67</sup> *United States v. Lopez*, 514 U.S. 549, 584 (1995) (Thomas, J., concurring).

<sup>68</sup> *Gonzales*, 545 U.S. at 58 (Thomas, J., dissenting).

<sup>69</sup> For discussion of Balkin, see *infra* notes 78-82 and accompanying text.

ists who, like him, acknowledge a role for constitutional construction as opposed to interpretation.

Perhaps the easiest way to see how nonoriginalists remain in the Progressive Paradigm is to recount three ways that nonoriginalists have addressed the countermajoritarian difficulty.

#### A. *John Hart Ely and Democracy and Distrust*

In my view, the strongest way of reconciling nonoriginalism and the countermajoritarian difficulty is John Hart Ely's *Democracy and Distrust*. Ely dismisses clause-bound originalism but sees judicial review as justified when it reinforces and refines democratic outputs. Thus, anti-discrimination principles are to be enforced, because they prevent the political process from being distorted by racial and gender stereotypes. Similarly, free speech permits people to deliberate and thus reinforces democracy.

*Democracy and Distrust* can be seen as providing an interpretive theory for *Carolene Products*.<sup>70</sup> It also provides expansive reading of its protection for minorities and shows how that reading is democracy-reinforcing—thus justifying the Warren Court's racial discrimination decisions. *Democracy and Distrust* famously does not justify *Griswold* or *Roe v. Wade*,<sup>71</sup> because it is difficult to see these decisions as reinforcing the democratic process rather than providing substantive rights.<sup>72</sup> Thus progressives who want to preserve a jurisprudence that expands what they consider to be core human rights have needed other theories to address the countermajoritarian difficulty.

#### B. *Barry Friedman and Majority Will*

Barry Friedman, in his book *The Will of the People: How Public Opinion Has Influenced the Supreme Court and Shaped the Meaning of the Constitution*, provides another possible route to justifying substantive progressive decision.<sup>73</sup> He argues that, in the long run, for the most part, the Supreme Court follows popular opinion. If the Court largely follows majority will, there should be little concern with the countermajoritarian difficulty.

While an interesting effort, Friedman's claim is belied by the facts. That the Court is an institution constrained by other institutions should not

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<sup>70</sup> ELY, *supra* note 35, at 75-76.

<sup>71</sup> *Griswold v. Connecticut*, 381 U.S. 479 (1965); *Roe v. Wade*, 410 U.S. 113 (1973).

<sup>72</sup> ELY, *supra* note 35, at 18 (disagreeing with substantive due process).

<sup>73</sup> See generally BARRY FRIEDMAN, *THE WILL OF THE PEOPLE: HOW PUBLIC OPINION HAS INFLUENCED THE SUPREME COURT AND SHAPED THE MEANING OF THE CONSTITUTION* (2010) (arguing the court is held accountable to the American public).

be confused with the claim that it follows popular will. First, as matter of structure, the judiciary is substantially insulated from popular opinion.<sup>74</sup> Moreover, political scientists have suggested that there is no convincing proof of the majoritarianism of the Supreme Court.<sup>75</sup> Others have suggested, correctly in my view, that the Court is more likely to follow elite opinion.<sup>76</sup> That is the group that will determine their reputation. As a result, the Court tends to be particularly out of step with the will of the people when elite opinion sharply diverges from popular opinion on such issues as prayer in schools.

### C. *Reva Siegel and Social Movements*

Reva Siegel has argued that lasting Supreme Court decisions are a product of social movements.<sup>77</sup> This theory has the advantage of not relying on the erroneous claim that Supreme Court decisions tend to link up with majoritarian opinion. One may understand Siegel's theory as a throwback to the original Progressive theory, which justified Supreme Court decisions that departed from originalism as following the spirit of the age. The difficulty is also similar to that which beset Progressivism's attempt to ground change in a kind of Hegelian dialectic. Each age does not provide everyone with the same political revelations, just as it does not provide the same religious revelations. The Tea Party is a social movement that disagrees with Occupy Wall Street. Judges would be left in the position of deciding among social movements.

### D. *Jack Balkin and Living Originalism*

Jack Balkin, a leading scholar of the left, has declared himself an originalist.<sup>78</sup> Balkin's originalism is an originalism framed to be consistent with Progressivism. He argues in favor of "framework originalism," where much of the Constitution's content, from the Equal Protection Clause to the Commerce Clause, is written in such broad terms as to be a delegation to future generations.<sup>79</sup> Because of this delegation, much of the work of con-

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<sup>74</sup> See JESSE H. CHOPER, *JUDICIAL REVIEW AND THE NATIONAL POLITICAL PROCESS: A FUNCTIONAL RECONSIDERATION OF THE ROLE OF THE SUPREME COURT* 3-7 (1980).

<sup>75</sup> See JEFFREY A. SEGAL & HAROLD J. SPAETH, *THE SUPREME COURT AND THE ATTITUDINAL MODEL* 331-32 (1993).

<sup>76</sup> See, e.g., Lawrence Baum & Neal Devins, *Why the Supreme Court Cares About Elites, Not the American People*, 98 GEO. L.J. 1515 (2011).

<sup>77</sup> See, e.g., Reva B. Siegel, *Constitutional Culture, Social Movement Conflict and Constitutional Change: The Case of the De Facto ERA*, 94 CALIF. L. REV. 1323, 1334 (2006).

<sup>78</sup> JACK M. BALKIN, *LIVING ORIGINALISM* 3 (2011).

<sup>79</sup> *Id.* at 21.

stitutional adjudication occurs not through interpreting the original meaning of the provisions, but in construing which of many possible meanings the Constitution should be given. This construction in turn is guided by the social movements of the day.

In my view, this theory of interpretation has fatal flaws, because it presumes without warrant that key provisions of the Constitution are abstract delegations to the future.<sup>80</sup> Here I do not want to emphasize such normative criticism, but merely note that Balkin's interpretive theory is emphatically not influenced by public choice. This is a theory that puts the most important mechanisms of constitutional change outside the supermajoritarian amendment process. It translates in modern interpretive terms Wilson's view that construction of the enumerated powers can reflect the spirit of each succeeding age, because they are broad and elastic. Social movements working through the ordinary political process can be counted on to bring on the necessary constitutional change.

Too great an emphasis on the twists and turns of interpretative theory may suggest that Balkin's version of originalism is akin to Larry Solum's and Randy Barnett's, because they both accept a role for construction.<sup>81</sup> But Solum's and Barnett's "Construction zone" is much more limited because they do not begin with Balkin's presumption that key constitutional provisions are abstract delegations to the future, full of vagueness that is waiting to be spun by the social movements of the day.<sup>82</sup> A history of originalism that understands the importance of the public choice inflection point shows why Balkin stands radically apart from others who fly the originalism banner.

## VI. FUTURE CHALLENGES FOR PUBLIC CHOICE ORIGINALISM

No theory, however successful, is without its challenges, and public choice originalism is no exception. Here are four challenges that must be addressed.

### A. *How is Originalism Self-Sustaining?*

Public choice originalism shows why one needs to enforce constitutional provisions according to their original meaning to prevent legislative

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<sup>80</sup> John O. McGinnis & Michael B. Rappaport, *The Abstract Meaning Fallacy*, 2012 U. Ill. L. Rev. 737 (2012).

<sup>81</sup> For description of the construction zone, see SOLUM & BENNETT, *supra* note 55, at 22-23.

<sup>82</sup> It is thus not surprising that Barnett sharply disagrees with Balkin's very elastic construction of the Commerce Clause. For Barnett, the Commerce Clause has a definite and quite confining meaning. See also Randy E. Barnett, *The Original Meaning of the Commerce Clause*, 68 U. CHI. L. REV. 101 (2001).

or even popular majorities from undermining the supermajoritarian framework. But why will judges follow originalism, when public choice suggests that judges themselves will act in their own interests and the supermajoritarian framework of the Constitution makes it very difficult for people to overrule their decisions through a constitutional amendment? Recent work by rational-choice political scientists has focused on the general question of how a constitution can be self-enforcing.<sup>83</sup> Because interpretive theory is part of the enforcement process, their analysis naturally leads to a focus on the question of what will constrain judges to employ originalism.

One possible answer is that justices will be disciplined by a culture of originalism. As Richard Posner notes, an important part of judicial satisfaction comes from feeling that they have played the game by the rules.<sup>84</sup> If the rules are understood to be originalist, that understanding provides substantial discipline. But how is a culture of originalism created and what are the conditions of its creation and sustenance? These questions have not been sufficiently explored. One observation about this solution is that it makes the success of originalism ultimately dependent on cultural capital. That fact is not necessarily surprising. Many other important social institutions, like the market economy itself, have been thought dependent on culture.

#### B. *How Do We Know That the Constitution Strikes the Right Balance for Amendments?*

Recall that Buchanan and Tullock believe that identifying the right voting rule depends on a trade-off between information and external costs. How can we be sure that the amendment process makes that trade-off? Historically, the stringency of the amendment process seems reasonable.<sup>85</sup> For the most part, amendments that have come close to passing but have not passed can now be seen as unimportant, obviously bad, or stopped by the Court's anticipation of some of their most important effects through non-originalist interpretations of the Constitution. And Article V permitted one amendment—the one that created Prohibition—that was quickly admitted to be a costly failure and repealed.

But as the investment saw states, past performance is no guarantee of future results. In our world of accelerating technological change, which is

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<sup>83</sup> Sonia Mittal & Barry Weingast, *Self-Enforcing Constitutions: With an Application to Democratic Stability in America's First Century*, 29 J.L. Econ. & Org. 278, 278 (2011).

<sup>84</sup> See Richard A. Posner, *What Do Judges and Justices Maximize? (The Same Thing Everybody Else Does)*, 3 Sup. Ct. Econ. Rev. 1, 28-29 (1993).

<sup>85</sup> MCGINNIS & RAPPAPORT, *supra* note 5, at 64-67.

necessarily also accelerating social change,<sup>86</sup> is there an argument that the amendment process is too strict? How can we evaluate such a claim? If it is too strict, are there forces that will allow Article V to responsibly amend the amendment process, despite the fact that making amendment easier will reduce the power of those who today must ratify an amendment. Of course, the Nineteenth Amendment providing the franchise to women was passed principally by men whose votes it would dilute. Should such history give us confidence that states and members of Congress would be willing to give up power by making the amendment process easier?

C. *Is the Constitution an Incomplete Contract?*

Public Choice has often analyzed legislation as a kind of contract between various interests groups. If this is a correct analogy for the Constitution, is not such a contract fundamentally incomplete?<sup>87</sup> If so, how are methods based on originalism going to fill in the gaps? Perhaps deference to legislatures can serve where the Constitution does not provide enough information to displace their judgment. Such deference, as in Thayer's famous formulation,<sup>88</sup> brings back an element of majoritarianism to originalism. If such methods cannot address incompleteness, what are the other legitimate sources to fill in the constitutional interstices?

D. *Does Rational Ignorance Undermine Reliance on the Original Public Meaning?*

Another possible critique of public choice is that citizens are so rationally ignorant of politics that it difficult to attribute to the public any understanding of many of the Constitution's terms.<sup>89</sup> If so, then it might be argued that the terms are less definite than originalism supposes. Is this claim true? At least in the amendment process, the supermajority rule so restricts the number of amendments that get serious consideration, that citizens are likely to know much more about them than they know about ordinary legislation. Does it matter? If citizens agree that the Constitution is a legal document, are not they agreeing to the explication of its terms by the legal

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<sup>86</sup> See JOHN O. MCGINNIS, *ACCELERATING DEMOCRACY: TRANSFORMING GOVERNANCE THROUGH TECHNOLOGY* 1-8 (2013).

<sup>87</sup> Daniel Sutter, *Enforcing Constitutional Constraints*, 8 CONST. POL. ECON. 139, 139 (1997) (describing constitutions as "necessarily incomplete contracts" that can neither anticipate all contingencies that might "arise after the constitutional founding" nor preclude disagreement over "the application of the rules in a specific case").

<sup>88</sup> See James Bradley Thayer, *The Origin and Scope of the American Doctrine of Constitutional Law*, 7 HARV. L. REV. 129, 144 (1893).

<sup>89</sup> Ilya Somin, *Originalism and Political Ignorance*, 97 MINN. L. REV. 625 (2012).

methods that apply to such a document, even if they do not fully understand every term?

## CONCLUSION

The rise of public choice was important, perhaps crucial, to the rise of originalism. This connection helps us better understand the trajectory of originalism—from a theory that was designed to solve a crisis in the Progressive Paradigm to a theory that rejects that paradigm and is willing to take on constitutional errors that have spanned many generations. Understanding originalism from the perspective of public choice also helps highlight some future challenges.

THE RELEVANT THEORY OF IRRELEVANT EXTERNALITIES:  
BUCHANAN, COASE, AND PIGOU

*David D. Haddock\**

Over the course of 691 days between June 12, 2012 and May 3, 2014, the discipline of law and economics lost six great avatars. As a lawyer, Robert Bork was an unlikely candidate for the Nobel Prize in economics, but many who are familiar with Armen Alchian's work remain incredulous that the Nobel Committee never acknowledged his scholarship, either individually or jointly with other members of the "UCLA School" such as Harold Demsetz and Jack Hirshleifer. Appropriately, the remaining four, Gary Becker, James Buchanan, Ronald Coase, and Elinor Ostrom, did receive Nobel recognition.

This essay deals with an important intersection within the capacious thickets of work of two Nobel laureates, James Buchanan and Ronald Coase, and of necessity with their precursor, Arthur Cecil Pigou. That intersection concerns proper governmental approach to external costs and benefits. The intersection is not merely of ideas, but also of geography, for the careers of Buchanan and Coase overlapped at the University of Virginia between 1958 and 1964, when they published some of their most cited investigations relevant to an understanding of externalities.<sup>1</sup>

Many readers who hold Buchanan and Coase in as high esteem as I do may be surprised by my high regard for the seminal, though preliminary and incomplete, inquiry of Pigou.<sup>2</sup> It is well to recall that Pigou was exposing his externality recommendations during the same era as Coase pub-

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<sup>1</sup> See generally JAMES M. BUCHANAN, GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* (1962); James M. Buchanan & Wm. Craig Stubblebine, *Externality*, 21 *ECONOMICA* 371 (1962); Ronald Coase, *The Problem of Social Cost*, 3 *J.L. ECON.* 1 (1960) [hereinafter Coase, *The Problem of Social Cost*]; Ronald Coase, *The Federal Communications Commission*, 2 *J.L. ECON.* 1 (1959) [hereinafter Coase, *The FCC*].

<sup>2</sup> Many of Pigou's antagonists appear to rely on secondary sources rather than a careful reading of Pigou's own work, and as a result attack a somewhat cartoonish model to which Pigou himself did not subscribe. For more evenhanded reviews of the Pigouvian view, see A. H. Barnett & Bruce Yandle, *The End of the Externality Revolution*, 26 *SOC. PHIL. & POL'Y* 130 (2009); Bruce Yandle, *Much Ado about Pigou*, *REG.* 2 (2010).



lished his seemingly unrelated *The Nature of the Firm*,<sup>3</sup> where our modern understanding of transaction cost was born. It would be several decades before scholars began to realize that transaction-cost analysis would have to be made an indispensable component of sound externality theory. The article then examines Buchanan and Stubblebine's crucial but neglected extension of Coase's work, the distinction between relevant and irrelevant externalities.<sup>4</sup> It turns out that worrying about an awful lot of the world's externalities is a waste of time. The majority of externalities are irrelevant while, surprisingly, private individuals can internalize the majority of the rest that cost less to correct than the damage entailed by leaving them uncorrected.

## I. THICK MARKETS, THIN MARKETS

Buchanan and Coase were sensitive to a great but often-neglected distinction between the tasks commonly faced by economic scholars versus those regularly faced in court, the distinction between objectively measurable variables versus difficult to measure subjective variables. The focus of economic scholarship ordinarily—though certainly not exclusively—is on thick markets, those possessing a liquidity that readily yields data such as price quotations, quantities, hours spent working, and the like. An example would be the wheat market. Traders exchange entitlements to tons of wheat continuously, and quantities and prices of a comprehensive variety of grades in a plethora of cities can easily be ascertained, not just for past transactions but online and virtually in real time. When investigating thick markets, economists quite reasonably begin analysis by seeing what we can learn by modeling variables of interest as attaining equality at some margin. Because people can increase or decrease quantities incrementally, trading continues until marginal utility and marginal cost both equal price. Thus, in thick markets the value to the buyer of having another unit equals the value to the seller of having to supply it. Thus, if one can discover price, one can infer marginal utility and marginal cost without directly observing them. If a unit is taken wrongfully, a court would seem to have little difficulty ascertaining what the plaintiff has lost.

At the same time, one longs for more deference to Alchian's admonition that marginal analysis is a model of the real world rather than the real world itself.<sup>5</sup> That model is useful due to the Darwinian pressures that

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<sup>3</sup> Ronald Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937) [hereinafter Coase, *The Nature of the Firm*].

<sup>4</sup> Buchanan & Stubblebine, *supra* note 1, at 375-76.

<sup>5</sup> Armen Alchian, *Uncertainty, Evolution and Economic Theory*, 58 *J. POL. ECON.* 211, 221 (1950).

firms face.<sup>6</sup> While observed firms likely accord with the economic model more closely than their extinct competitors, it would be a mistake to imagine that many firms consciously seek to satisfy the model's marginal dictates. That is analogous to the observation that ants (for instance) do not think about how to optimize—probably do not even “think” at all according to our conception of thinking—but observers see none that fail to behave more or less optimally because ants that do not approach that standard do not survive and reproduce. Thus, the ants we observe seem to behave more or less optimally, and according to Alchian, so for a similar reason do surviving firms.

Alchian had brought an evolved and sharpened Darwinian biology back into economics, just as Darwin had brought an earlier version of economics into biology.

In October 1838, that is, fifteen months after I had begun my systematic enquiry, I happened to read for amusement “Malthus on Population,” and being well prepared to appreciate the struggle for existence which everywhere goes on from long-continued observation of the habits of animals and plants, it at once struck me that under these circumstances favourable variations would tend to be preserved, and unfavourable ones to be destroyed. The result of this would be the formation of a new species. Here then I had at last got a theory by which to work; but I was so anxious to avoid prejudice, that I determined not for some time to write even the briefest sketch of it.<sup>7</sup>

In contrast to economic scholars, very often the judicial system cannot ignore the subjective variables that characterize thin markets which, being illiquid, fail to issue objective measures on a continuous basis, if ever. Consider for instance the condemnation of a person's longtime home to make way for a land-intensive public project. That someone else's somewhat similar home may have sold a few months ago for an observable price in a neighborhood somewhere in the vicinity in no way implies that such a price represents the reservation value of the homeowner who could have sold, chose not to do so, but now will lose the home in the condemnation proceeding.

Thin market exchanges rarely occur marginally but come in lumps—what (non-Soviet) family sells the southern third of their living room while retaining the rest of the home? Even if there has been a recent transaction of precisely the taken entitlement, the buyer and seller each will have realized a surplus, and their reservation values, being distinct from price, are unobservable by third parties. Equality of the buyer's and the seller's res-

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<sup>6</sup> Twenty-five years earlier, Alfred Marshall had hinted somewhat mysteriously at the link between biology and economics: “[t]he Mecca of the economist lies in economic biology rather than in economic dynamics.” ALFRED MARSHALL, *PRINCIPLES OF ECONOMICS* xxv (Macmillan ed. 1925). Marshall's remark appears to have fallen by the wayside until Alchian revived and elaborated the notion. See, e.g., Alchian, *supra* note 5.

<sup>7</sup> CHARLES DARWIN, *THE AUTOBIOGRAPHY OF CHARLES DARWIN* 120 (Collins, 1958) (1887).

ervation values would be an astonishing coincidence and in any event would sap away all benefit of an exchange. Nor in litigation need reservation values even have been in the order that would have motivated a voluntary transaction—a lower reservation value for the potential buyer than for the owner precludes a voluntary transaction, but a defendant may well have destroyed an entitlement that an unwilling plaintiff valued more highly.<sup>8</sup>

If what the defendant was after (e.g., the thrill of driving fast) was conceptually distinct from what the plaintiff lost (e.g., life itself) modeling the matter as analogous to an exchange, useful indeed as a preliminary step, nevertheless misses a lot of context to say the least. Failure to recognize that distinguishing between objective and subjective value is crucial for analysis has left much modern law and economics scholarship devoid of meaningful content—more evocative of parlor games than useful science.

The issue addressed in the present article is the proper governmental approach to external costs, such as those imposed on neighbors by a smoky factory, and external benefits, such as the amenity afforded passersby after brush removal reveals a pristine view of the ocean. That is an issue thoroughly infused with subjective value.

## II. BUCHANAN, COASE, AND PIGOU

It is impossible to understand the externality arguments of Buchanan and Coase without referring to the prior work of Arthur Cecil Pigou. Over-enthusiastic disciples of Buchanan and Coase excoriate Pigou with an unwarranted vigor that, I dare say, goes well beyond anything Buchanan or Coase themselves would have sanctioned. As Coase himself said,

Economists, following Pigou whose work has dominated thought in this area, have consequently been engaged in an attempt to explain why there were divergences between private and social costs and what should be done about it, using a theory in which private and social costs were necessarily always equal. It is therefore hardly surprising that the conclusions reached were *often* incorrect.<sup>9</sup>

In the quotation, Coase did not subscribe to the disciples' erroneous belief that Pigouvian conclusions are *inevitably* or even *usually* incorrect.

Unfairly, the disciples seem to criticize Pigou for failing to comprehend the lessons of Coase's *The Problem of Social Cost*<sup>10</sup> and Buchanan

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<sup>8</sup> If the plaintiff's entitlement has not been seriously damaged by the taking, an injunction can and appropriately will undo the transfer, though a punitive augmentation will be appropriate if the defendant acted intentionally. David D. Haddock, Fred S. McChesney & Menahem Spiegel, *An Ordinary Economic Rationale for Extraordinary Legal Sanctions*, 78 CALIF. L. REV. 1, 27 (1990).

<sup>9</sup> R.H. COASE, *THE FIRM, THE MARKET, AND THE LAW* 175 (1988) (emphasis added) [hereinafter COASE, *THE FIRM, THE MARKET, AND THE LAW*].

<sup>10</sup> See generally Coase, *The Problem of Social Cost*, *supra* note 1.

and Stubblebine's *Externality*,<sup>11</sup> despite the ailing eighty-one-year-old Pigou having died in 1959, the year before the first of those articles was published.<sup>12</sup> Consider as well that for a time several future Nobel laureates at the University of Chicago tried patiently to explain to Coase the failings of his analysis in comparison with Pigou's. Eventually Coase won them over (after which Chicago hired him away from Virginia). It seems rather apparent that for a number of very intelligent and well-educated economists, understanding Coase's insight presented a nontrivial task even after he had articulated it for them. Moreover, even today a great many well-known professional economists fail to understand the lessons of Buchanan and Coase—there are a few at each of the world's leading universities. Against the charge of failure to comprehend, any reasonable court of law would hold Pigou non-negligent.

Not only are the disciples' criticisms unfair, they are uninformed. Many disciples consider Pigouvian taxes and subsidies paragons of big-government command-and-control regulation, whereas in truth Pigou aimed them in precisely the opposite direction. No careful reader could deny that his "polluter pays" analysis indubitably attempted to infuse quasi-market pricing (albeit one-sided) into government policy in place of rigid command-and-control mandates that epitomized government policy of his day (and regrettably epitomizes most policy even now).<sup>13</sup> Far from advocating strengthened command-and-control regulation, Pigou aimed to provoke moderation of concurrent government intrusions—whether a proposal is pro-market or anti-market depends on the baseline from which one begins. After his death, with Buchanan and Coase's aid we began to understand that Pigou's work had been preliminary and incomplete, but considering the understanding of other economists of his generation, Pigou's attempt to improve public policy regarding externalities was brilliant. Just as Ricketts says of Coase, Pigou "did not argue that regulation was totally unnecessary. He was discussing a starting position in which there was no scope for private agreements."<sup>14</sup> Pigou was attempting to establish a baseline from which to coherently criticize public policy, though he was not sanguine in his expectations that his recommendations would bear fruit.

Critics have frequently misunderstood Coase, too. One way to enhance the well-being of society is through production. One may dig a use-

<sup>11</sup> See generally Buchanan & Stubblebine, *supra* note 1.

<sup>12</sup> Pigou developed serious heart trouble in the mid-1930s, but continued to write thought-provoking articles at least into the war years, epitomized most emphatically by *The Classical Stationary State*, 53 *ECON. J.* 343 (1943), published seventeen years prior to Coase's unrelated *Problem of Social Cost*, *supra* note 10.

<sup>13</sup> "The 'polluter pays principle' states that whoever is responsible for damage to the environment should bear the costs associated with it." UNITED NATIONS ENV'T PROGRAMME, TAKING ACTION: AN ENVIRONMENTAL GUIDE FOR YOU AND YOUR COMMUNITY 13 (1995).

<sup>14</sup> Martin Ricketts, *The Contribution and Intellectual Legacy of Ronald Coase (1910–2013)*, 34 *ECON. AFF.* 46, 51 (2014).

less material such as iron ore from the earth and by using a production process convert it into highly useful steel that can then become part of an automobile or a kitchen range. A more subtle way to enhance the well-being of society is through exchange. Imagine a person who has just purchased a replacement for his old automobile but who has no kitchen range, and another who has just purchased a replacement for her nearly new but too small kitchen range but has no automobile. Quite possibly each of them would find advantage in an exchange of the old automobile for the too small kitchen range. What exists physically in the world is unchanged and thus the improvement easily goes unnoticed by third parties, but the exchange enhances the well-being of the traders just as production of the steel did.

At least since Adam Smith published *The Wealth of Nations*,<sup>15</sup> and probably before, economists have paid attention to both production and exchange, but the relative emphasis on the two has fluctuated over the years. During the late eighteenth century and early nineteenth, the predominant emphasis was on exchange, but the relative weights began to shift in the late nineteenth century as economists adopted mathematical tools, which even now offer more powerful insights into the production side of the economy than the exchange side.<sup>16</sup> By the time Pigou published *The Economics of Welfare*, the attention of economists was concentrated very strongly on production, and that emphasis comprised the foundation of Pigou's work.

As early as his *The Nature of the Firm*,<sup>17</sup> Coase had endeavored to create a more balanced attention between production and exchange, but he realized extremely modest success until he published *The Problem of Social Cost*<sup>18</sup> twenty-three years later. Both Pigou and Coase intended to help better optimize the level of externalities. Pigou, however, had focused entirely on its production with no attention to exchange, whereas Coase focused little attention on the externality's production and much on the exchange rights to impose or be free of it. In consequence, Coase showed (a year after Pigou had died) that Pigou should have asked that rules and policy endeavor to influence both sides of an externality to examine their options, not just the one.

Remarkably, as both Buchanan and Coase pointed out repeatedly,<sup>19</sup> what often is required to induce parties on both sides of an externality to

<sup>15</sup> See generally ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (1776).

<sup>16</sup> Ricketts, *supra* note 14, at 46-47.

<sup>17</sup> See generally Coase, *The Nature of the Firm*, *supra* note 3.

<sup>18</sup> See generally Coase, *The Problem of Social Cost*, *supra* note 1.

<sup>19</sup> COASE, THE FIRM, THE MARKET, AND THE LAW *supra* note 9; James M. Buchanan, *An Economic Theory of Clubs*, 32 *ECONOMICA* 1 (1965) [hereinafter Buchanan, *An Economic Theory of Clubs*]; James M. Buchanan, *Politics, Property, and the Law: An Alternative Interpretation of Miller Et Al. v. Schoene*, 15 *J.L. & ECON.* 439 (1972) [hereinafter Buchanan, *Politics, Property, and the Law*]; James M.

evaluate their options is simply for regulators to get completely out of the way. Then courts can adjudicate grey areas to define entitlement margins more precisely and markets can sort the entitlements into their best configuration.

Certainly, we should now recognize that application of a one-sided Pigouvian tax in an inappropriate situation could induce people to come to the nuisance and make an externality worse. To see this, understand that one does not appropriately measure an external cost,  $E$ , directly by weighing some technological magnitude (tons of smoke or whatnot), but from the aggregated cost experienced by people. Consequently, the proper measure is external cost per person,  $E/p$ , multiplied by the affected population,  $p$ ,

$$(E/p) \cdot p \equiv E.$$

If the tax causes a smaller percentage reduction in externality per person than the percentage increase in population that the improvement of the neighborhood induces, the external cost would actually increase. Each individual feels a decreased level of discomfort, but there are more individuals feeling that discomfort, and the latter effect could dominate.

Perhaps the argument is more transparent if illustrated by a numeric example. Let the initial cost per person,  $(E/p)_0$ , be 4 and the affected population,  $p_0$ , be 2,000. Multiplying,

$$(E/p)_0 \cdot p_0 \equiv E_0$$

$$4 \cdot 2,000 = 8,000.$$

Now suppose the cost per person falls by 25% to 3 while the resulting improvement of the neighborhood causes population to rise by 50% to 3,000. Let the difference in cost per person be  $\Delta E/p$  and the difference in population be  $\Delta p$ . The proper measure of external cost,  $E_1$ , increases to 9,000, because

$$[(E/p)_0 + \Delta E/p] \cdot [p_0 + \Delta p] \equiv E_1$$

$$3 \cdot 3,000 = 9,000.$$

Taking the idea to an extreme, emit no smoke and there would be no external cost, but neither would there be an external cost if there were no people

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Buchanan, *The Coase Theorem and the Theory of the State*, 13 NAT. RESOURCES J. 579 (1973) [hereinafter Buchanan, *The Coase Theorem and the Theory of the State*]; Buchanan & Stubblebine, *supra* note 1; Coase, *The FCC*, *supra* note 1; Coase, *The Problem of Social Cost*, *supra* note 1; Ronald Coase, *The Economics of Broadcasting and Government Policy*, 56 AM. ECON. REV. 440 (1966) [hereinafter Coase, *The Economics of Broadcasting and Government Policy*].

in the affected neighborhood. Perfect policy would induce each side to see the consequences of their decisions, whether it is a decision to emit more or less smoke or a decision to move toward or away from a smoke emitter. The correctable flaw in Pigou's formulation was that he had looked in only one direction—the decision to emit more or less smoke—not that his insight was nonsense.

Conversely, a Pigouvian tax can lead to over mitigation if transaction cost is modest. A perfect Pigouvian tax would cause firms to see the costs they impose on neighbors in the same light as the costs the firm incurs when purchasing inputs in the market. Since the purchase of marketed inputs does not prevent efficient firms from producing, ordinary imposition of a Pigouvian tax will permit the firm to remain in operation. In effect, the neighbors are providing a necessary input into the production process, but the firm had been getting that input for free. With a Pigouvian tax being imposed, the firm now has to pay. But the firm is still not paying the neighbors, those who are supplying the input! Rather than closing the firm down, an optimal level of the tax would reduce the externality but would not eradicate it as the firm reduces output until it has restored marginal (not total) profit to zero. The government receives the tax however, so the neighbors receive no compensation for the (reduced) external cost that they continue to bear.

Because marginal profit is zero at equilibrium, the firm is indifferent to the production of marginal units while the neighbors are not. Therefore, with modest transaction cost, the neighbors can contract with the firm to reduce output and thus pollution even further. The firm avoids some tax and receives some compensation from the neighbors in exchange for the firm's additional reduction of output and thus pollution, and the neighbors pay to reduce the externality they suffer. By analogy, an environmental organization might purchase part of a new housing development, then leave the purchased plots undeveloped as parkland or wilderness. In the example at hand, the neighbors of the polluter are doing something similar, in effect purchasing some marginal units of output but directing the firm not to bother producing what has been bought.

Since by hypothesis the Pigouvian tax had reduced pollution initially to the optimum, any additional negotiated reduction amounts to over-mitigation. That may strike one as odd—how could one over-mitigate a bad thing like pollution? The answer is that the bad thing is locked together with a good thing—polluters do not pollute because they enjoy injuring their neighbors, but because the pollution is jointly produced with the item the firm sells, typically to people other than the neighbors. Over-mitigation causes units of output to go unproduced despite their value to potential buyers exceeding the value of the alternative outputs the freed resources produce instead, including of course that special output of value, freedom from marginal pollutants.

In effect, the neighbors and the firm are negotiating with each other to reduce other parties' benefits. One hopes that the Pigouvian tax receipts would finance useful public projects enjoyed by citizens throughout the jurisdiction, recipients of pollution and non-recipients alike.<sup>20</sup> Consequently, a reduction of the tax receipts would deprive people at some distance of benefits. The argument is not normative—those who see their tax-financed projects curtailed may or may not deserve such benefits. The point is the positive one that because the firm and its neighbors have an incentive and ability to deprive non-recipients of benefits, deserved or not, a Pigouvian tax in a low-transaction-cost setting leads to too much mitigation and too little output. Product buyers are deprived of units that are worth more to them than the full cost of production, including the subjective cost to the plant's neighbors of bearing marginal pollution.

Of course, transaction cost need not be modest. Coase noted that with substantial transaction costs it is well for the legal structure to pay heed to initial entitlement assignment, but he provided, at best, a very tentative road map showing how to proceed.<sup>21</sup> Neither Buchanan nor Coase ever claimed to demonstrate that the Pigouvian approach would never achieve the *best attainable* result in a situation in which transaction cost is extreme, collective action problems are daunting, and the elasticity of adjustment by the untaxed side of the externality is low. Even with extreme transaction cost and daunting collective action problems, however, the situation deteriorates if the elasticity of adjustment by the untaxed side is high. In other words, the best assignments might involve one side's right to benefit from a Pigouvian tax and the other side's obligations to bear it but the correct side of the interaction must bear the tax, and the correct side will sometimes be the neighbors, not the plant.<sup>22</sup>

To note that a Pigouvian tax or subsidy would miss the perfect result hardly means it would miss a Demsetz-optimal result<sup>23</sup>—ordinarily any

<sup>20</sup> If efficient tax-financed projects benefitted only the neighbors, they would have no incentive to negotiate with the firm for additional mitigation.

<sup>21</sup> John Prather Brown, *Toward an Economic Theory of Liability*, 2 J. LEGAL STUD. 323 (1973), provides an insightful beginning toward filling that gap. He apparently did not follow up on his insight but did motivate more subsequent work than is convenient to enumerate here. Steven Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1 (1980), merits mention, however, and since I was a coauthor, so does David Haddock & Christopher Curran, *An Economic Theory of Comparative Negligence*, 14 J. LEGAL STUD. 49 (1985).

<sup>22</sup> Residential neighborhoods that formed on the verge of newly constructed airports, such as Washington's Dulles or Chicago's O'Hare, would seem to be the incorrect side to benefit from a Pigouvian tax on the airports' noise pollution.

<sup>23</sup> Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 1 (1969) [hereinafter Demsetz, *Information and Efficiency*]. Perhaps Pigou could be said to have offered a partial, if cumbersome, statement of Demsetz's Nirvana Fallacy:

It is not sufficient to contrast the imperfect adjustment of unfettered private enterprise with the best adjustment that economists in their studies can imagine. For we cannot expect that any public authority will attain, or will even whole-heartedly seek, that ideal. Such authori-



workable response to an externality will deviate from perfection. To dismiss the best real option in favor of the perfect option is to commit the nirvana fallacy except in the rare instances, if they exist, where the perfect result is attainable.

The view that now pervades much public policy economics implicitly presents the relevant choice as between an ideal norm and an existing “imperfect” institutional arrangement. This *nirvana* approach differs considerably from a *comparative institution* approach in which the relevant choice is between alternative real institutional arrangements. In practice, those who adopt the nirvana viewpoint seek to discover discrepancies between the ideal and the real and if discrepancies are found, they deduce that the real is inefficient. Users of the comparative institution approach attempt to assess which alternative real institutional arrangement seems best able to cope with the economic problem . . . .<sup>24</sup>

Compare the range of possible, though imperfect, alternatives to try to discern the least imperfect, then adopt it. As Demsetz implies, perfection is ideal, but contrary to common but naïve parlance it is not optimal in any useful sense; the least imperfect attainable alternative is optimal.<sup>25</sup>

Even the most fervent of Buchanan’s and Coase’s disciples must surely admit that Pigou’s work was seminal. Pigou motivated virtually all subsequent economic theory regarding externalities. Would it have occurred to Coase to write *The Problem of Social Cost*<sup>26</sup> or Buchanan and Stubblebine to write *Externality*<sup>27</sup> if Pigou had not published *The Economics of Welfare*?<sup>28</sup>

Venturing outside the realm of externalities, the injustice of accusing Pigou of big governmentalism becomes more apparent still. His concept of the real balance effect—sometimes known as the Pigou effect—as elucidat-

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ties are liable alike to ignorance, to sectional pressure and to personal corruption by private interest.

ARTHUR CECIL PIGOU, *THE ECONOMICS OF WELFARE* 332 (Nahid Aslanbeigui ed., 2002) (1920) [hereinafter PIGOU, *THE ECONOMICS OF WELFARE*].

<sup>24</sup> Demsetz, *Information and Efficiency*, *supra* note 23, at 1.

<sup>25</sup> *Id.* at 1-2. Many economists might say something like “the equilibrium is suboptimal” though that tells one nothing regarding whether the equilibrium is so objectionable that good public policy demands an improvement. In any event, all possible real-world equilibria are apt to be suboptimal if what one means is merely they are imperfect in some way, as revealed for example by things being done better a decade later following ensuing technological advances. If, on the other hand, one follows Demsetz to mean by suboptimal that something both preferable and operational is possible, then suboptimal is indeed objectionable.

<sup>26</sup> See generally Coase, *The Problem of Social Cost*, *supra* note 1 (arguing that in a world without transaction costs, individuals would bargain to produce the most efficient distribution of resources regardless of the initial allocation).

<sup>27</sup> See generally Buchanan & Stubblebine, *supra* note 1 (examining marginal and inframarginal, relevant and irrelevant, and Pareto-relevant and Pareto-irrelevant externalities).

<sup>28</sup> See generally PIGOU, *THE ECONOMICS OF WELFARE*, *supra* note 23 (asserting that individuals are the best judges of their own welfare, that people prefer greater welfare to less, and that welfare may be measured in monetary terms or as a relative preference).

ed in *The Classical Stationary State* attacked the ascendant theory of Pigou's close friend and colleague, John Maynard Keynes.<sup>29</sup>

### III. THE LONG AND WINDING ROAD TO THE COASE THEOREM (SO CALLED)

As many people, including Coase himself, have noted, Coase never claimed to articulate a theorem. Nor for that matter is what others have articulated for him actually a theorem. A theorem is a deductive mathematical construct that takes a set of defined axioms and proves that something less obvious—the theorem—must inexorably follow. *If* the axioms represent some interesting aspect of reality, then the theorem does too, the *if* implying an empirical question.

What Coase articulated was not a theorem but a set of scientific hypotheses, analytical statements that make empirical predictions that are potentially false. Notice that I say that Coase articulated a set of hypotheses rather than saying he articulated the Coase Hypothesis. As Pagano<sup>30</sup> noticed, roots of the two most cited Coase hypotheses—what I will call the “Minor Coasean Hypothesis” relating to a world of zero transaction cost and the “Major Coasean Hypothesis” relating to a world of substantial transaction cost—can be traced all the way back to *The Nature of the Firm*.<sup>31</sup> I doubt that in 1937 even Coase realized that his work had any substantial bearing on that of Pigou, however, and it is unjust to condemn Pigou for failing to realize it either.

The Minor Hypothesis intended to show that if *counterfactually* it were possible to deal without incurring a transaction cost, economics would have little useful to say about externalities. Aside from rationalizing the use of money due to its ability to bypass barter's double coincidence of wants, until 1960 few economists other than Coase seem even to have noticed the existence of transaction cost as a general feature of the economy.<sup>32</sup> Through private negotiation, Coase argued, any affected parties who face no transaction cost would mitigate to the proper degree those externalities that are worth mitigating, unless legal restrictions intrude. That transaction cost influenced relatively few economists before 1960 reflects neglect of *The Nature of the Firm* before *The Problem of Social Cost* spurred people

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<sup>29</sup> See A. C. Pigou, *The Classical Stationary State*, 53 *Econ. J.* 343 (1943); see also JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY* (First Harvest/Harcourt 1964) (1953).

<sup>30</sup> See generally Ugo Pagano, *No Institution is a Free Lunch: A Reconstruction of Ronald Coase*, 59 *INT'L REV. ECON.* 189 (2012) (examining Coase's theories over time).

<sup>31</sup> See generally Coase, *The Nature of the Firm*, *supra* note 3 (offering an explanation as to why individuals form partnerships and other business entities rather than relying on market contracts).

<sup>32</sup> Ricketts, *supra* note 14, at 54.

to ask what the then fifty-year-old Coase had been doing all these years (quite a lot, it turned out).

Among the more serious attacks on Coase are those concerning his Minor Hypothesis. A well-known attack hypothesized empty core cycling within multiparty externalities.<sup>33</sup> When cycling occurs in a stable world, however, the marginal temptation to withdraw from one unconsummated negotiation in order to initiate a new one diminishes with each revolution of the cycle.<sup>34</sup> Unless the negotiators' time has absolutely no value, one might expect them eventually to find it pointless to continue renegotiating and settle. If they have past experience with cycling, they may go directly to some focal point rather than pointlessly waste valuable time getting there.<sup>35</sup>

Society has evolved institutions that mitigate the danger of cycling. Contract law's allowance of earnest payments held in escrow is a useful device, but property law also helps in a world with transaction costs.

In the zero transaction cost world, each actor could have rights to control the narrowest use of the smallest chunks of resources, and then these ultra-thin entitlements could easily be assembled in the hands of whoever would most value them. In our world of positive transaction costs, however, this procedure is a non-starter, because the costs of transactions do not neatly scale with the value of the individual entitlements that are the subject of those transactions. . . . As a result, in a world of entitlements that are ultra-thin . . . transaction costs quickly become a prohibitive barrier to entitlement transfers. . . . To avoid this inefficiency, property law initially creates packages of rights that are chunkier in terms of the resources covered and the domain of control they provide their holders, thereby providing a massive shortcut over this theoretical baseline of myriad ultra-thin entitlements and innumerable transactions.<sup>36</sup>

Certainly cycling is observable in some instances, especially in the political sphere where the aggrieved cannot litigate breached promises and unending flux characterizes the roster of negotiators.

Dixit and Olson attack the Minor Hypothesis from a different angle with an analysis in which the cost of discussion among multiple parties is zero—the Coasean counterfactual—but the parties cannot conclude a mutually beneficial agreement without some sort of exogenous structure to de-

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<sup>33</sup> See generally Varouj Aivazian & Jeffrey L. Callen, *The Coase Theorem and the Empty Core*, 24 J.L. & ECON. 175 (1981) (analyzing the role played by transactions cost in the "Empty Core" problem). Below I discuss the invariance fallacy that is manifest in many discussions of either multiparty externalities such as agriculturist–railroad, e.g., *Vaughan v. Taff Vale Ry. Co.*, 5 H. & N. 679, 688 (1860), or pairwise externalities such as doctor–factory, e.g., *Sturges v. Bridgman*, LR 11 ChD 852, 852 (1879).

<sup>34</sup> See R. H. Coase, *The Coase Theorem and the Empty Core: A Comment*, 24 J.L. & ECON. 183, 183-87 (1981) [hereinafter Coase, *The Coase Theorem and the Empty Core*].

<sup>35</sup> THOMAS C. SHELLING, *THE STRATEGY OF CONFLICTS* 3-4 (reprt. ed. 1981).

<sup>36</sup> Brian Angelo Lee & Henry E. Smith, *The Nature of Coasean Property*, 59 INT'L REV. ECON. 145, 147-48 (2012).

fuse attempts to free ride.<sup>37</sup> Some Coaseans might assert that Dixit and Olson merely sharpened our understanding of transaction cost. Others might follow Clark<sup>38</sup> in viewing free riding as one aspect of the collective action problem, conjoined with rational ignorance and rational apathy.

In any event, Coase's principal interest lies with his Major Hypothesis, which subsumes any barrier to voluntary exchange.

[W]hile consideration of what would happen in a world of zero transaction costs can give us valuable insights, these insights are . . . without value except as steps on the way to the analysis of the real world of positive transaction costs. We do not do well to devote ourselves to a detailed study of the world of zero transaction costs, like augurs divining the future by the minute inspection of the entrails of a goose.<sup>39</sup>

Though generally a most congenial man, it is evident that Coase could become testy when commentators insisted on missing his point. He had spent the decades since 1937 trying to compel economists to take account of transaction cost, but an endless line of critics seemed intent on leaving them out, and doing it explicitly no less.

What Coase undertook in 1937 was to explain why firms exist in the face of agency cost, information cost, cost of hierarchical supervisory structures, and so on, when economists of the time understood atomistic market exchange to make each participant sensitive to every cost and every benefit of each action. Coase concluded that there must be costs of market exchange that successful firms equated at the margin with the aforementioned frictions the firm would encounter if producing the item or service within the firm. That subsidiary insight that solved one problem—the boundary between firm and market—planted the seed of transaction-cost analysis, which by today has grown into a distinct subfield, transaction-cost economics. An often frustrating and uncompleted attempt to infuse transaction-cost thinking throughout mainstream economics was on Coase's mind from that day forward.

At some point Coase began to develop a serious interest in the regulation of broadcast, publishing at least seven noteworthy articles<sup>40</sup> and one

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<sup>37</sup> Avinash Dixit & Mancur Olson, *Does Voluntary Participation Undermine the Coase Theorem?*, 76 J. PUB. ECON. 309, 310 (2000).

<sup>38</sup> See ROBERT C. CLARK, CORPORATE LAW 389-93 (1986) (as explicated in a different context).

<sup>39</sup> Coase, *The Coase Theorem and the Empty Core*, *supra* note 34, at 187.

<sup>40</sup> See generally R. H. Coase, *Payola in Television and Broadcasting*, 22 J.L. & ECON. 269 (1979) (examining the role of undisclosed payments in broadcasting, their effects, and the results of the government's intervention in stopping them); Coase, *The Economics of Broadcasting and Government Policy*, *supra* note 19; R.H. Coase, *The Interdepartment Radio Advisory Committee*, 5 J.L. & ECON. 17 (1962); Coase, *The FCC*, *supra* note 1; Ronald H. Coase, *The Development of the British Television Service*, 30 LAND ECON. 207 (1954) (examining how and why British television was created and the scheme in which it is regulated); R. H. Coase, *Wire Broadcasting in Great Britain*, 15 ECONOMICA 194 (1948) (considering the effects of monopoly in Great Britain's public broadcast system); R. H. Coase,

book<sup>41</sup> during the ensuing decades.<sup>42</sup> I imagine that it was there that he turned his attention to externalities. To my knowledge, *The Federal Communications Commission* provides the first published statement of the Minor Coasean Hypothesis.<sup>43</sup> That Coase published the article about a year after he and Buchanan became colleagues at Virginia is intriguing.

Ostensibly, Congress established the Federal Communications Commission (FCC) and its precursor, the Federal Radio Commission to control interference between neighboring users of the electromagnetic spectrum. Two stations operating on overlapping frequency bands create interference for listeners and viewers who attempt to receive the signals. In other words, each station produces a negative externality for the other.

Reducing broadcast power or antenna height above ground, increasing the distance between transmitters, time sharing, geographically alternating polarization, or shaping propagation patterns (the laws of physics permit engineers to devise noncircular ones) can reduce the mutual interference. In fact, those are the very tools the FCC uses (or rather overuses) to deal with the problem.<sup>44</sup>

Coase argued that the stations themselves possess better information and incentives than the FCC. Consequently, stations could better optimize the externalities if they possessed alienable entitlements to be free of interference above some threshold. They could sue neighboring stations to enforce their entitlements, as they cannot under FCC governance. They could buy or sell if the defined rights were suboptimal, transacting either complete entitlements or using the mitigation tools discussed above to fine-tune interference along the geographical margins between stations. Trades would occur when desirable because the transaction cost between neighboring stations is modest relative to the potential increase in entitlement value. Each one could easily ascertain the identity of the troublesome neighbor, and the difficulty of transacting would be no more onerous than when one

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*The Origin of the Monopoly of Broadcasting in Great Britain*, 14 *ECONOMICA* 189 (1947) (examining the start of regulation and monopolization of the broadcasting industry in Great Britain).

<sup>41</sup> See generally RONALD COASE, *BRITISH BROADCASTING: A STUDY IN MONOPOLY* (Routledge 2013) (1950) (analyzing the BBC's monopoly status in Great Britain).

<sup>42</sup> To discuss all of Coase's important insights regarding regulation of the electromagnetic spectrum would take us far afield. See generally Björn Ljungberg & Emma Rydgren, R. H. Coase on the Media, (presented at the 15th Nordic Conference on Media and Communication Research) (Aug. 10–13, 2001), available at <http://predoc.org/docs/index-38989.html>, for a review of that topic.

<sup>43</sup> Coase, *The FCC*, *supra* note 1, at 27.

<sup>44</sup> The vast majority of people who might have had more signals available had the FCC exercised less caution are unaware of the shortfall and lodge no complaints. People along geographical margins who suffer increased interference, however, would complain to members of the House and Senate if the controls were relaxed somewhat in order to permit additional signals. No personal benefit would accrue to the FCC bureaucrats making the decision to relax the controls to offset the new pressure they received from Capitol Hill. The FCC thus has an incentive to be overly cautious, and that means (among other things) that they overuse their interference mitigation tools.

station purchases other stations, (unfortunately with the invariant interference entitlements the FCC imposes) in order to put together a network of greater or lesser scope, transactions that occur many times every year.

Certainly, the act of transacting interference entitlements would consume resources—just as the purchase of your present home and sale of your former one consumed resources. The empirical claim is that turgid and often arbitrary restrictions emanating from the FCC constrain the ability of stations to optimize propagation patterns, wasting resources in a different and more substantial way.

Coase's focus on broadcast was important for a more subtle reason. Broadcast stations impose mutual externalities, making it plain that reducing the cost to one of them inevitably imposes a cost on the other. Endow one station with a right to bear less interference cost and you saddle the other with an obligation to bear more mitigation cost. The problem is symmetrical—each station is interfering with the other, so one has no prior by which to decide which is the perpetrator and which the victim.

There was an insight lurking there, and Coase found it. The problem is not that a perpetrator is injuring a victim but that treating economically scarce electromagnetic spectrum as an open access resource had induced stations to make mutually incompatible uses of it. For instance, the stations spent too much money purchasing electricity but degraded the quality of the product as a result. More cost, less value; what's not to like? But that does not mean the nation needed a new regulatory agency. Treat scarce grassland as an open access resource and ranchers will make mutually incompatible uses of that resource too, buying more cattle and denuding the range. We handle that problem by defining alienable rights to use the range and to exclude from the range. Treat the high seas as an open access resource, then larger and faster boats will bear increased cost but deplete the fish stock while selling more of the catch frozen and less fresh. We handle that problem by . . . well, we have not really handled it.

There is a reason the "fishing problem" on the high seas is so vexing. Defining entitlements can deal with such problems, but definition and enforcement are themselves costly, so one would be surprised to find an entitlement established when the benefit of curtailing imperfect exploitation is less than the cost.<sup>45</sup> One sees again that perfection is ordinarily non-optimal. Recognizing the proper variables is the only means of approaching a proper resolution. "All institutions have to be analyzed and assessed in a comparative perspective. . . . Even the least costly institutional mix is still costly and the advantages of the mix have to be compared with its costs."<sup>46</sup>

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<sup>45</sup> See Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 351-53 (1967) [hereinafter Demsetz, *Toward a Theory of Property Rights*].

<sup>46</sup> Pagano, *supra* note 30, at 198-99.

The year after publication of *The Federal Communications Commission*, Coase generalized and extended his analysis in *The Problem of Social Cost*.<sup>47</sup> The new article did not restrict itself to a particular industry, and in its latter two-thirds articulated the Major Coasean Hypothesis, which dealt with situations of significant transaction cost. If transaction cost is substantial, either a misplaced entitlement will remain misplaced or relocating it will consume a worrisome amount of resources. It is worth thinking carefully about how to proceed when one finds oneself facing a high transaction cost environment. As Demsetz explains, in some instances the least costly, and thus efficient, option will simply be to bear the external cost.<sup>48</sup> In other instances, however, applying a Pigouvian tax or subsidy to the correct side of the interaction might be the best option. “[A] Coasean world is always a second-best world . . . .”<sup>49</sup>

#### IV. BUCHANAN’S EXTENSIONS OF THE COASEAN HYPOTHESES

A retrospective examination of James Buchanan’s work leaves one astounded at the breadth and depth of his interests. Major among those many interests of course was the working of government—public choice—as epitomized by his work with Gordon Tullock. For Buchanan, an important intertwined collateral interest lay with the proper understanding of nonrivalrous goods, including subtle means by which private parties might control externalities and the constraints institutions impose when they try. In view of Buchanan’s careful analysis, the degree of hand wringing that accompanies a great many discussions of what should now be viewed as nonissues leaves one quite perplexed. Alone and with colleagues such as Stubblebine<sup>50</sup> and Tullock,<sup>51</sup> Buchanan demonstrated that many externalities simply do not impede the efficient functioning of markets.

As shown above, clumsy policies aimed at mitigating an externality can easily have a deleterious impact by encouraging individuals to come to the nuisance, and in a low transaction cost setting may well encourage parties to over-mitigate the effect as they incompletely internalize it. More troubling still as Buchanan showed, those policies can open an avenue for rent-seeking dissipation.

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<sup>47</sup> See generally Coase, *The Problem of Social Cost*, *supra* note 1.

<sup>48</sup> See generally Demsetz, *Information and Efficiency*, *supra* note 23.

<sup>49</sup> A. Nicita et al., *Exploring Coase’s World: An Introduction*, 59 INT’L REV. ECON. 111, 117 (2012).

<sup>50</sup> See generally Buchanan & Stubblebine, *supra* note 1.

<sup>51</sup> JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF A CONSTITUTIONAL DEMOCRACY* (Univ. of Michigan Press, 1962).

As one example, Buchanan<sup>52</sup> criticized an article by Warren Samuels<sup>53</sup> that acquiesced in what Samuels believed to be judicial or legislative reordering of entitlements as a way to deal with externalities that emerge on a regular basis in a changing world. Red cedars are indigenous to the Shenandoah Valley, appearing in several different guises. One guise is as an ornamental planting around a home, a cemetery, or the like as a substitute for other varieties of tree, shrub, or flower. In a second guise red cedars have some minor commercial value as posts, wood for constructing chests that deter moths from stored woolens, or (at the time) as cladding for the graphite in pencils. But red cedars do not require human aid to germinate prolifically, and many are essentially weeds, both costly to remove and capable of degrading pastures and cropland.

Unfortunately, cedars are also an alternate year host for a rust that damaged some varieties of apple tree (though today modern fungicides have ameliorated that problem). After the nonindigenous apple became a major crop in the Shenandoah, the Virginia legislature acted to compel cedar owners to remove or permit removal of their trees if within a few miles of an apple orchard. The immediate focus of each article—that of Samuels and that of Buchanan—was the 1928 U.S. Supreme Court decision in *Miller v. Schoene*,<sup>54</sup> but the intention of both Buchanan and Samuels was to derive general understandings from that case.

As was true with Coase's consideration of the mutuality of interference by neighboring broadcast stations,<sup>55</sup> Samuels noted that *Miller v. Schoene* "is not a case with which one can get readily emotionally or ideologically involved, thereby adversely affecting one's powers of perception and analysis."<sup>56</sup> Unlike the broadcast setting, however, the level of transaction cost between apple growers and cedar owners was nonobvious.

Following an exhaustive institutional investigation, Fischel ascertained that their owners readily permitted removal of most of the offending cedars when approached by neighboring orchardists, with the orchard owner(s) doing the cutting and then leaving the sawn posts for use by the cedar owner.<sup>57</sup> Score one for manageable transaction cost. In several instances however, cedar owners resisted, resulting in a few cases that reached the courts, one being *Miller v. Schoene*.

Writing for the Court, Justice Stone remarked that

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<sup>52</sup> Buchanan, *Politics, Property, and the Law*, *supra* note 19, at 441-43.

<sup>53</sup> Warren J. Samuels, *Interrelations Between Legal and Economic Processes*, 14 J.L. & ECON. 435, 441-42 (1971).

<sup>54</sup> *Miller v. Schoene*, 276 U.S. 272 (1928).

<sup>55</sup> Coase, *The FCC*, *supra* note 1.

<sup>56</sup> Samuels, *supra* note 53, at 435-36.

<sup>57</sup> See generally William A. Fischel, *The Law and Economics of Cedar-Apple Rust: State Action and Just Compensation in Miller v. Schoene*, 3 REV. L. & ECON. 133 (2007) (presenting evidence that *Miller* did not mark the demise of the public-private distinction in constitutional law and that moral hazard explains why in some instances cedar owners were denied compensation).



[T]he state was under the necessity of making a choice between the preservation of one class of property and that of the other wherever both existed in dangerous proximity. It would have been none the less a choice if, instead of enacting the present statute, the state, by doing nothing, had permitted serious injury to the apple orchards within its borders to go on unchecked.<sup>58</sup>

That says nothing more nor less than that clear entitlements facilitate mutually beneficial transactions, but offers little rationale for why the entitlements that existed before apple cultivation was introduced into the Shenandoah should be overturned. Buchanan noted that the policy the Virginia legislature selected weakens private incentives to discover which sort of land use is more valuable, which may be different in different locations. But more troubling still, leaving entitlements constantly at risk of legislative or judicial redefinition simultaneously encourages diversion of resources from production to efforts to persuade one or another branch of government to transfer another person's property to oneself, i.e., to engage in rent seeking.

Cedars had originally posed no problem for anyone, and the cedar owners had done nothing to change that while the introduction of apple cultivation into the Shenandoah had. Consequently, Buchanan would have preferred a rebuttable presumption that the entitlement to cedars should have remained intact, and the orchardists would need to purchase those cedars they desired to destroy. In other words, if possible, the best option is to leave established entitlements where they lie. Like Coase, Buchanan then introduced a possibility that daunting transaction cost might preclude a beneficial transfer, but only then ought one begin to search for the best alternative. Buchanan identified several private alternatives that might have sufficed, the choice depending on institutional features. To do otherwise encourages never-ending races up the Capitol steps, and we really do not have time for that.

Fischel shows that the "facts on the ground" in *Miller v. Schoene* were quite different than had been understood by the Court, if one is to believe the Court's brief and unanimous opinion.<sup>59</sup> In consequence, the facts were different from those that Samuels and Buchanan distilled from the opinion. Contrary to the Court's understanding, initially orchardists paid taxes specifically to finance compensation for nearby landowners whose cedars were cut, though admittedly that was liability-rule protection rather than the stronger property-rule protection.<sup>60</sup>

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<sup>58</sup> 276 U.S. at 279.

<sup>59</sup> Fischel, *supra* note 57.

<sup>60</sup> Property-rule protection amounts to a bilateral veto—one entitlement owner can veto a transaction unless the would-be acquirer can be persuaded to offer a different entitlement in exchange, but the acquirer can veto the demanded compensation. Liability-rule protection is a unilateral veto—the acquirer can veto by choosing not to take the entitlement in the first place, but if the entitlement is taken, the owner can only seek compensation through a legal proceeding. Guido Calabresi & A. Douglas Mela-

However, owners of “weed” cedars occasionally contended opportunistically that their trees were ornamental or of commercial value in an effort to obtain compensation. Removal by the orchardists actually benefitted those cedar owners, who were attempting to double dip. That curtailed the willingness of orchardists to finance compensation, and that in turn resulted in some litigation.

Though the factual backdrop relied upon in the Samuels–Buchanan dispute is precarious, Buchanan’s urging for great circumspection before entitlement anchors are withdrawn is sound. If entitlement anchors are insecure, rent seeking will thrive and productivity will suffer, as Zimbabwe recently has been busy demonstrating to the world.<sup>61</sup>

Buchanan’s work on externalities was consistent with the contemporaneous work of his colleague Coase, while filling niches that Coase’s work left unaddressed. If Coase theorem must be a term of art, there is considerable justice in having it bear Coase’s name, but the degree of neglect of Buchanan’s parallel work is a gross injustice. As the recently deceased Pigou and all of his followers living at that moment had done, Buchanan and Coase often employed an initial simplifying assumption of putting transaction cost aside, in effect treating it as zero.<sup>62</sup> But the latter two did so knowingly in order to discern a baseline against which real world alternatives could be gauged.

In *The Coase Theorem and the Theory of the State*, Buchanan provided an interesting, if neglected, example.<sup>63</sup> Applying the Minor Coasean Hypothesis to government, Buchanan asserted that in a zero-transaction-cost world, private individuals would influence government agents as easily as Coase had argued they would influence each other. Buchanan, it seems, responded to Dixit and Olson<sup>64</sup> seventeen years in advance. If that counterfactual world’s public could not properly obtain public goods via individual negotiation, they would do so via a government that they could perfectly influence due to Dixit and Olson’s assumed zero transaction cost. That

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med, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1092-93 (1972). In Calabresi and Melamed’s concise treatment, liability compensation is inevitably available to the plaintiff, though (as they certainly understood) under some liability rules compensation will not be forthcoming. Consider the rule of negligence, for example, where the court finds the defendant to have been non-negligent.

<sup>61</sup> Zimbabwe, called “the breadbasket of Africa,” exported substantial quantities of grain. Following implementation of a massive, poorly conceived, corrupt, and uncompensated redistribution of prime agricultural land beginning in 2000, the country quickly lost the ability to provision even domestic consumption and is now a grain importer.

<sup>62</sup> Cf. PIGOU, *THE ECONOMICS OF WELFARE*, *supra* note 23; Buchanan, *Politics, Property and the Law*, *supra* note 19, at 445-48; Coase, *The Problem of Social Cost*, *supra* note 1; COASE, *THE FIRM, THE MARKET, AND THE LAW* *supra* note 19 (reviewing Coase’s work on transaction costs and the effects they have on social and legal worlds).

<sup>63</sup> Buchanan, *The Coase Theorem and the Theory of the State*, *supra* note 19, at 583.

<sup>64</sup> Dixit & Olson, *supra* note 37, at 310-12.

public would persuade bureaucrats to create the exogenous structures that Dixit and Olson require in order to defuse free riding and thus enable private negotiations to reach fruition.

Turning to the Major Coase Hypothesis, Buchanan noted that transaction cost involved in influencing government is far from minor. Bureaucrats, Buchanan asserted, can be treated as being endowed with entitlements to act according to their judgment of the public interest. Unfortunately extreme transaction cost makes the entitlement difficult to transact, so results are apt to fall far afield of Nirvana.

[C]onceive "the State" merely as the instrumental means or device through which individuals attempt to carry out activities aimed at securing jointly-desired objectives. . . . [E]ven if it is recognized that the exchange process is significantly more complex than that which makes up the central subject matter of orthodox economic theory. There is at least no conceptual or logical necessity to think of "the State" as an entity that exists separate from and apart from citizens.

...

. . . For the most part, those who propose "corrections" to the outcomes of voluntary exchange processes, like those who oppose them, are content to treat governmental decisions as exogenous to the valuations of the persons in the economy itself.<sup>65</sup>

The passage readily turns this reader's mind to condominiums that individuals voluntarily join, fully recognizing that a quasi-governmental regulatory structure will henceforth generate a stream of decisions that are not perfect, though perhaps optimal given transaction cost. Individuals are motivated to join on the expectation that each perceived alternative to the condominium falls even further from Nirvana.

## V. IRRELEVANT EXTERNALITIES

By introducing a distinction between relevant and irrelevant externalities, Buchanan and Stubblebine<sup>66</sup> fill many gaps in the work of both Pigou and Coase.<sup>67</sup> That distinction enabled them *inter alia* to cover the middle range of transaction cost to which Coase and his critics had given too little

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<sup>65</sup> Buchanan, *The Coase Theorem and the Theory of the State*, *supra* note 19, at 583, 587.

<sup>66</sup> Buchanan & Stubblebine, *supra* note 1, at 381-84.

<sup>67</sup> *Id.* Buchanan and Stubblebine define a rather more articulated taxonomy than merely relevant versus irrelevant, but I fear that explains a degree of the neglect suffered by their important article. Mastering all their taxonomic alternatives requires patience, but people such as those who cannot spare the time even to notice the final two-thirds of *The Problem of Social Cost* are, to coin a term, patience-deprived.

attention, the range where transaction cost is neither negligible nor prohibitive.

Stated simply, something that would remain an externality even if transaction cost were zero is irrelevant. Ten people in the room might hate looking at my shirt and be willing to pay up to a dollar apiece, hence a maximum of ten dollars in aggregate to induce me to change into something else. However, I may like the bad-boy image I present by wearing that shirt, which is why I bought it. I might be unwilling to change for anything less than twelve dollars. In that event, there would be a cost that results from the inevitable failure to eliminate the discomfort felt by the ten people, but the cost to me of relieving the discomfort would be greater still.

My imposition of that cost is optimal. Failure to eliminate it is irrelevant as to issues of efficiency. It does not matter if we all speak the same language and can easily negotiate or each of us speaks a language incomprehensible to the others.<sup>68</sup> The latter situation would certainly increase transaction cost among us and might well make it prohibitive, but it does not matter because we would not transact even if transaction cost were zero. Only relevant externalities can conceivably lead to inefficiency.

When discussing public goods such as national defense, it is obvious that provision provides benefits but also entails costs. Many people (if not all members of Congress) can appreciate the need to compare the costs with the benefits. When the public good in question is the control of some externality, however, consideration or even recognition of cost is often absent so that nearly the entire focus turns to the benefit. If the sole focus is on benefit, I would be forced to change my shirt despite the value of the lost opportunity to wear it exceeding the value to the others of no longer having to see it.

Correcting even a relevant externality might be a mistake, however. Correction imposes resource costs of its own; compare those with the cost of failing to put right the externality.<sup>69</sup> A cost is a cost is a cost; saving one unit of external cost by incurring two units of a different form of cost is a loser. It does not matter whether the alternative cost is a transaction cost, a cost of operating a regulatory bureau, a cost incurred in court, or any other cost that one might imagine. That a non-internalized cost be relevant is necessary to rationalize an extra-market correction *but it is not sufficient*. A person should regard locating a potentially relevant externality as the first step in the empirical process, not, as it often is, as the final step. A great many externalities should go “uncorrected” in other words, or to put it more

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<sup>68</sup> If we can negotiate, an economist would say the negotiation internalizes the externality, because I would at least take into account the other people's discomfort due to the opportunity cost of the offer that I refuse.

<sup>69</sup> Buchanan & Stubblebine, *supra* note 1, at 373-74 (Buchanan and Stubblebine differentiate *relevant* from *potentially relevant*).

accurately, it would be incorrect to “correct” externalities that impose a correction cost exceeding the cost of the uncontrolled externality.<sup>70</sup>

## VI. A FISH STORY

The Welland Canal provides a link between Lakes Ontario and Erie, permitting oceangoing vessels to reach ports upstream of Niagara Falls. The canal inadvertently allowed a small Atlantic fish—the alewife—useful mainly as lobster-trap bait to enter inland waterways and expand the species range as far inland as Chicago. Following a brief annual breeding frenzy, the mature alewives die, and their rotting, stinking bodies began to wash up on beaches in large numbers. Alewife bodies, though welcomed by gulls, coyotes, and feral cats, created a human health hazard around Lakes Huron and Michigan.

Suppose one individual, call him Supporter, advocates introducing Pacific salmon as a commercially useful predator of alewives. Another individual, call her Opponent, opposes the introduction because salmon will also prey upon native fish such as perch.<sup>71</sup>

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<sup>70</sup> Harold Demsetz, *The Problem of Social Cost: What Problem?*, 7 REV. L. & ECON. 1, 9 (2011).

<sup>71</sup> The example is not apocryphal. Coho and Chinook salmon were introduced to control the alewives, succeeding at that task so admirably that today one rarely sees a dead alewife upon the shore. Lake salmon now support a modest commercial and sport fishery, but they do prey on native fish in addition to alewives, and some collateral prey are themselves commercially and recreationally important.

**Figure 1**

		A	B	C			D	E
		Entity Valuing Entitlement Most Highly	Initial Entitlement Owner	Magnitude of Transaction Cost				
				Negligible E.g., Negotiating Pair Who Are Eager to Capture Gains from Trade	Significant E.g., Several Parties on Each Side Behaving Strategically	Prohibitive E.g., Many Interested Parties & Insuperable Public Action Problem		
I	Supporter of Alien Species Introduction	Supporter	No Transaction Necessary to Achieve Efficiency					
			Supporter Purchases from Opponent	Supporter Purchases from Opponent	No Market Transaction Will Occur			
II	Opponent	Distributinal Rather Than Efficiency Consequences		Evaluate Notable Transaction Cost Versus Intervention Cost	Evaluate Cost of Missing Nirvana Versus Intervention Cost			
		Opponent Purchases from Supporter	Opponent Purchases from Supporter					
III	Opponent of Alien Species Introduction	Supporter						
IV	Opponent	No Transaction Necessary to Achieve Efficiency						

Figure 1 illustrates degrees of efficiency in such a situation. Most attention to *The Problem of Social Cost*<sup>72</sup> focuses on the extreme transaction cost cases of negligible and prohibitive, shown by columns C and E respectively. To show the important intermediate case of transaction cost that, though insufficient to defeat market exchange, would consume too many resources in transacting for the cost to be brushed aside, Figure 1 includes column D as well. Rows I and IV show Buchanan and Stubblebine’s irrelevant externalities. There, the initial owner values the entitlement more than the counterparty so no exchange will occur regardless of the magnitude of transaction cost, whether it be negligible, prohibitive, or anything in between—zero to infinity pretty much covers every alternative.

Without real world investigation of a particular externality, it might initially seem that any one of Figure 1’s four rows are equally likely, though one would hesitate to say the same for the columns. That observation is rather remarkable. Even at that level of analysis, the diagram illustrates at least a rebuttable presumption that about half of all externalities are irrelevant and thus have no implications for efficient resource use.

Moreover, the area at the intersection of column C with rows II and III shows where the market will typically internalize externalities because transaction cost is negligible, so concern over efficiency loss there will be muted. In brief, though the illustration clearly exhibits an externality and

<sup>72</sup> Coase, *The Problem of Social Cost*, *supra* note 1, at 15-18.

thus a potential public good in mitigating it, only the intersections of rows II and III with columns D and E show situations where there *might* be inefficiency.

Notice that column D's intersection with rows II and III shows market transactions that can reallocate the entitlement to its higher value, but reallocation will consume a notable amount of resources in transacting. If a bureaucrat or court were able to accomplish the reallocation at no cost with all due compensation being paid, the world would be a better place. Such a supposition commits the nirvana fallacy.<sup>73</sup> Bureaucrats and courts cannot operate without directly consuming resources like personnel, office space, office machinery, Internet connection, and so on.

Moreover, bureaucratic and court-imposed transactions suffer from three less obvious disadvantages in comparison with market transactions.<sup>74</sup> First, bureaucrats and courts cannot gauge the values affected people place on experiencing and eliminating externalities nearly as well as can the affected people themselves, especially true for subjective values with no direct market standard to which the bureaucrat, judge, or jury can refer. Second, there is no guarantee that bureaucrats and courts will not substitute their own values for those of the governed due to mistaken suppositions regarding the values of the governed, indifference toward the values of the governed, paternalism, or the temptations of corruption. Finally, because governments are legal monopolies spanning a geographical territory it is more difficult for affected parties to escape bureaucratic and judicial mistakes than it is to escape mistakes made by the market. It is also difficult to escape a decision that is actually appropriate in aggregate if you happen to be a member of a minority whose preferences deviate from those of the larger community.<sup>75</sup>

Certainly bureaucrats and courts should deal with some externalities that fall within column D's intersection with rows II and III. However, such an act will be inefficient for those externalities for which bureaucratic or legal costs exceed the non-negligible transaction cost of market internalization. Again, costs are costs are costs, so finding the situation to be in that section of Figure 1 ought to imply merely that further empirical investigation is called for, not that one is free to pack up and go home. Bearing even a substantial transaction cost is desirable if the cost of the best alternative is even greater.

It does not take long to extend the discussion to Figure 1's intersection of rows II and III with column E. If transaction cost is prohibitive—which is to say it exceeds the cost to individuals of simply bearing the externali-

<sup>73</sup> Demsetz, *Toward a Theory of Property Rights*, *supra* note 45, at 347.

<sup>74</sup> David D. Haddock, *Must Hydrological Regulation Be Centralized?*, in *WATER MARKETING—THE NEXT GENERATION* 43 (Terry L. Anderson & Peter J. Hill eds., 1997).

<sup>75</sup> *Cf.*, Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 *J. POL. ECON.* 416, 416-24 (1956).

ty—a market transaction will never lead to internalization.<sup>76</sup> That externality certainly imposes a cost. But bearing even a substantial cost that results from a nirvana-inefficient externality is preferable to bearing an even greater sum via some other route such as a bureaucracy or judicial proceeding, whose costs, both obvious and elusive, were discussed above. Once more, that does not preclude bureaucrats and courts from dealing with externalities that fall in the intersection, but desirable policy would compare the cost of the alternatives. To restate, many nirvana-inefficient externalities are real-world efficient.<sup>77</sup> The task is to determine which nirvana-inefficient externalities are real-world efficient, and that difficult task requires more than writing down a few Greek letters.

So was the introduction of salmon into the Great Lakes efficient? Transaction cost certainly would seem to have been prohibitive in that the alewives and introduction of their predators affected millions of people to a greater or lesser extent. Knowing that we were in column E, however, does not tell us which half. I appreciate the absence of alewives along the shore, but I am not an angler who is especially interested in the missing collateral prey. Nobody bothered carefully to compare the cost of the alternatives.

## VII. DISTRIBUTIONAL ISSUES

A common, albeit erroneous, objection to such analysis holds that even if transaction cost is negligible—in effect within column C of Figure 1—the outcome cannot be demonstrating efficiency because there are distributional consequences, as shown by the relevant parts of Figure 1 reproduced as Figure 2. Suppose, for instance, that “Supporter” places the higher value on the entitlement so that we are in either row I or II. If the initial state of the world is as shown in row I, Supporter owns the entitlement and nothing happens. If the initial state of the world is as shown in row II, however, Supporter will indeed obtain the entitlement but only by paying Opponent to relinquish it. Thus the outcome varies according to the starting point and that, it is argued, means if one outcome is efficient the other must be inefficient.

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<sup>76</sup> Notice that a transaction cost of \$3 is prohibitive if the cost of the externality is \$2, but a transaction cost of \$3,000 seems negligible if the cost of the externality is \$2,000,000. One ascertains whether a transaction cost is negligible, significant, or prohibitive in comparison with the benefit of bearing it.

<sup>77</sup> Demsetz, *Information and Efficiency*, *supra* note 23, at 4.



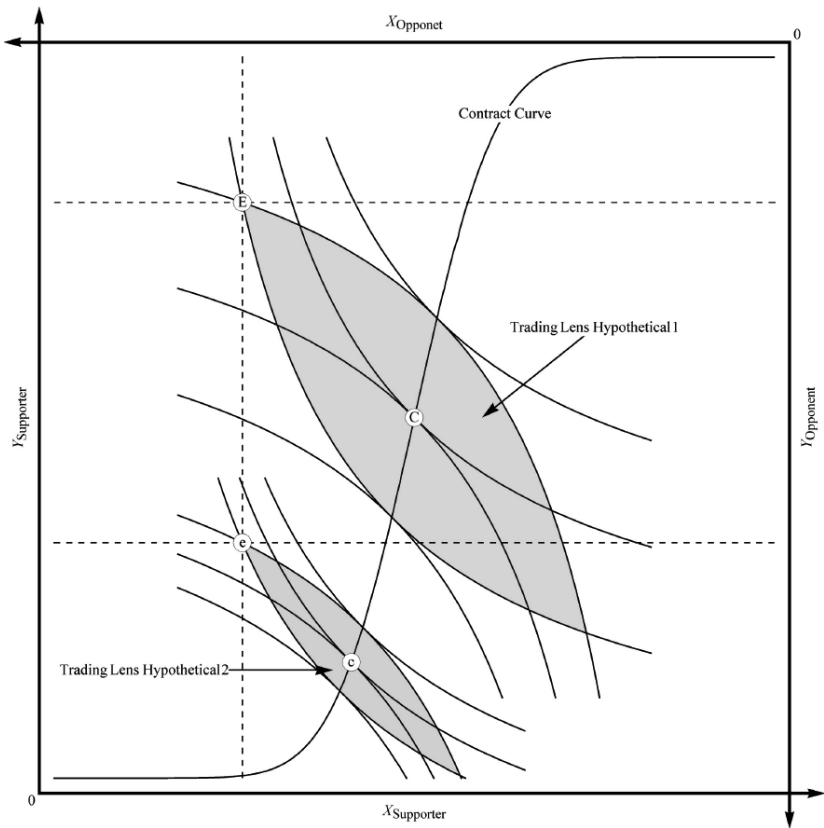
**Figure 2**

		A	B	C
		Entity Valuing Entitlement Most Highly	Initial Entitlement Owner	Transaction Cost
		Negligible E.g., Negotiating Pair Who Are Eager to Capture Gains from Trade		
I	Supporter of Alien Species Introduction	Supporter		No Transaction Necessary to Achieve Efficiency
		Opponent		Supporter Purchases from Opponent
II	Opponent of Alien Species Introduction	Supporter		Distributional Rather Than Efficiency Consequences
		Opponent		Opponent Purchases from Supporter
III	Supporter of Alien Species Introduction	Supporter		No Transaction Necessary to Achieve Efficiency
		Opponent		No Transaction Necessary to Achieve Efficiency
IV	Opponent of Alien Species Introduction	Supporter		No Transaction Necessary to Achieve Efficiency
		Opponent		No Transaction Necessary to Achieve Efficiency

The error in that line of reasoning comes from assuming that there is a single efficient outcome. Pareto efficiency occurs whenever the distribution of entitlements is such that making one party better off requires making another worse off. There are an infinite number of efficient points—known to economists as the contract curve—best shown by an Edgeworth box as illustrated by Figure 3.

Let  $X$  represent money and  $Y$  an entitlement of a certain sort, for instance the right to introduce or exclude the predatory salmon across an area of variable dimensions. Under hypothetical 1 the parties' entitlements are shown at point  $E$ , where Supporter possesses only a small initial right to determine the extent of salmon introduction and Opponent possesses a large right. Under hypothetical 2 the parties' entitlements are shown at point  $e$ , and now Supporter possesses the large initial right to determine the extent of salmon introduction whereas Opponent possesses the small right.

Figure 3



With negligible transaction cost, one of the parties will accept money from the other in exchange for a portion of the other's entitlement to determine the range of the salmon. Assuming a thin market without a well-defined price, one can say only that the parties will bargain to some point on the contract curve within the trading lens, which is defined by each party's indifference curve passing through the initial entitlements.<sup>78</sup> But, as drawn, the trading lens for point *E* nowhere overlaps the trading lens for point *e*. The outcomes have to be different, though if the alternative negotiated entitlements lie on the contract curve then each is efficient.

That illustrates the wealth effect, and says only that more is better than less, which is obvious to any child. If you have more and I have

<sup>78</sup> See David D. Haddock, Fred S. McChesney & Menahem Spiegel, *An Ordinary Economic Rationale for Extraordinary Legal Sanctions*, 78 CALIF. L. REV. 1, 15-17 (1990), for elucidation of the Edgeworth box and several applications to legal issues. The concept named "trading lens" is apparent from the shapes on the diagram.

correspondingly less, you are better off and I am worse off, but that does not make the consequence inefficient. Other policies can deal with an unwanted wealth distribution if there is one, and some of the alternatives would lead to less aggregate, and potentially individual, cost than manipulating entitlements in ways that are disagreeable to both parties.

### VIII. IRRELEVANT EXTERNALITY ANGST

Two people are rivals if each wants to wear the same pair of shoes, so economists call items such as shoes “rivalrous goods.” Economists often analyze externalities that affect rivalrous goods, as when a cigarette thrown from an automobile sets a farmer’s wheat field afire—wheat being a rivalrous good. In contrast, an economist calls something a public good if consumption is nonrivalrous and nonexcludable.<sup>79</sup> By definition, one person’s consumption of a public good is completely consistent with its simultaneous consumption by another person. For example, you can either look at a beautiful vista or not as you prefer, but typically you neither know nor care whether I am looking. The view is a public good because it is available simultaneously to every interested member of the public. Improving a view confers a positive externality if bystanders appreciate the change but play no role in obtaining it.

Public goods are perplexing because insuperable transaction costs emerge when optimization requires comprehensive negotiation among large populations of beneficiaries. Though scrutiny certainly is warranted, private internalization of public-good externalities is common. That internalization occurs even when many parties benefit from the good if most experience an externality that is real but marginally irrelevant. Private interactions among the few for whom the impacts remain marginally relevant can suitably balance marginal costs and benefits across entire populations. It is impossible to ascertain the desirability or form of government intervention if observers neglect empirical tasks solely due to inconclusive and naïve theoretical conjectures relating to mere population counts.<sup>80</sup>

Those who appreciate beautiful vistas or abhor smog seem to face a potentially crippling obstacle; optimization may require widespread participation to finance a movement away from the status quo. If benefits cannot be denied to nonpayers, however, many potential beneficiaries will refuse

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<sup>79</sup> Buchanan, *An Economic Theory of Clubs*, *supra* note 19, at 1-2 investigated crucial but previously neglected differences between public goods and those that though nonrivalrous are excludable. Buchanan called them club goods because clubs often provide such things to members; in many instances that provision is the primary reason the club formed.

<sup>80</sup> See David D. Haddock, *Irrelevant Externality Angst*, 19 J. INTERDISC. ECON. 3, 5 (2007). There I offer more detailed discussion of the theoretical basis of this section.

to participate—the dilemma of free riding. In consequence, a desirable public good may not materialize, or the amount may be deficient.

Using Buchanan and Stubblebine<sup>81</sup> this section develops a graphical model to show why an individual who acts self-interestedly and unilaterally may provide an efficient amount of a public good even in a high-population setting. The model then moves to related situations where an individual whose private incentives did not initially result in optimization will negotiate to a suitable outcome. Only when both unilateral and negotiated provisions fail do the article's discussion of the locus and nature of (costly) government involvement become germane.

People are not identical, a fact that is as facially obvious as it is neglected in scholarly work. Even if everyone else could somehow overcome their free-rider problem and obtain the proper amount of a public good for their own purposes, anyone with an abnormally strong preference for it would remain dissatisfied. A person cannot satisfy a supernormal preference without arranging privately for the excess. When the free-rider dilemma foils contribution from others, that person may even shoulder the entire burden, or share it with one or a few others with similarly strong demands. Once created, of course, everyone who wishes can enjoy the public good, provider and free rider alike. And that will sometimes be the best outcome!

Consider all coalitions possible among the members of a large population, and all possible negotiating pairs that might potentially form from those coalitions. Whenever any one of those coalitions would fail to complete a transaction with another randomly selected coalition, regardless of transaction cost, then it does not matter if the transaction cost between that particular pair of coalitions is prohibitive, as it very often will be. Slightly modifying the terminology of Buchanan and Stubblebine,<sup>82</sup> one could say that in such an instance we are dealing with an irrelevant coalition pair, irrelevant, that is, from the standpoint of achieving an efficient outcome. The crux is not whether the number of *imaginable* coalition pairs is large, but whether the number of *relevant* coalition pairs is large—or even positive—and whether the members of relevant pairs can identify each other.

If every imaginable pairing of coalitions is irrelevant, the level of transaction cost is also irrelevant. If, in contrast, the subset of relevant pairs is small and the members can readily identify each other, transaction cost is merely an inconvenience, even if irrelevant coalitions include a multitude of free riders. That militates against public-sector involvement in such situations even when millions of others benefit from the efforts of the few. Many costs and benefits that befall bystanders are subjective and thus knowable only to them. Consequently, private individuals can often deal with problems that should properly—if sometimes counterintuitively—be

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<sup>81</sup> Buchanan & Stubblebine, *supra* note 1, at 380-81 (1962).

<sup>82</sup> *Id.*

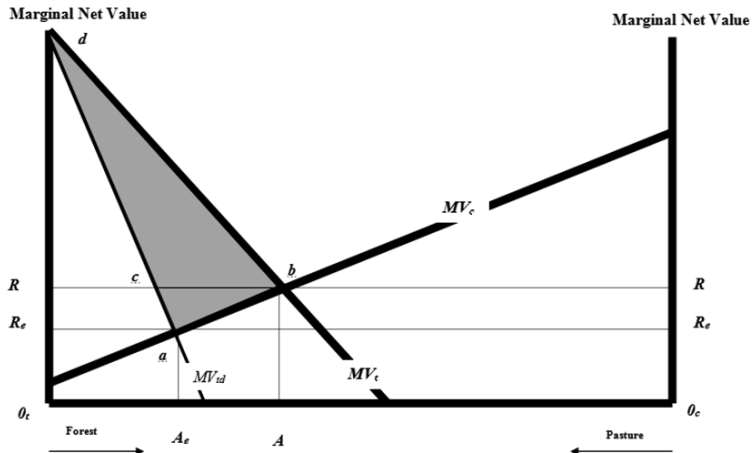
understood to involve low transaction costs, and deal with them better than any diligent, honest bureaucracy could even be imagined doing. The task, then, is to show the plausibility of situations where the set of relevant coalitions is small or empty, despite a substantial population who use the public good.

To understand a crucial contrast between rivalrous and nonrivalrous goods, begin by noting that nearly every individual's demand bears a significant relationship to the ideal quantity of a rivalrous good. If the market ignores some demanders, there ordinarily will be a welfare loss. To see why, envision the only region capable of producing some nation's timber and cattle. For simplicity, assume each of the region's land units is worth exploiting for one or the other of those two products, but other products can be produced profitably only in other regions. All markets are competitive. Assume fixed proportions in production so a demand curve's horizontal axis represents both land area and the product quantity that amount of land can produce. Figure 4 illustrates.

The horizontal axis between the alternative origins  $0_t$  and  $0_c$  shows the region's total area. Distance from the left-hand origin measures timber production, which with fixed proportions is proportional to forested area, while distance from the right-hand origin measures cattle production, or equivalently pastureland. The price of a land unit's output is measured vertically, net of the cost of all other required inputs.<sup>83</sup> The respective marginal net value curves for timber and cattle are shown as  $MV_t$  and  $MV_c$ . An unfettered market will equilibrate where the marginal net value of forest equals the marginal net value of pasture, dividing the region into areas  $0_tA$  of forest and  $0_cA$  of pasture. The area under the curves consists of a rectangle below  $R$  that represents the economic rent of land and two triangles above  $R$  that represent consumer surplus.

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<sup>83</sup> To avoid inessential clutter the latter costs are not shown. All flows should be interpreted as discounted to present value.

**Figure 4: Welfare Loss from Excluding a Demand for a Private Good**

If  $MV_{td}$  shows the marginal net value curve of domestically consumed timber, an embargo on timber exports alters the regions devoted to the two products to areas  $0_t A_e$  and  $0_c A_e$  respectively, lowering land rent to  $R_e$ . The reduction from  $R$  to  $R_e$  is predominantly a transfer from landowners to domestic consumers, with some deadweight loss of surplus, as shown by the triangle  $abc$ . With the curves shown, however, the major welfare loss is the consumer surplus of foreign timber buyers, shown by triangle  $bcd$ . Only if the foreign demand were so weak that it intersected the vertical axis below  $R_e$  would the welfare loss evaporate, though the embargo would then be pointless since foreigners would have been purchasing no domestic timber to begin with. That illustrates the relevance of whether individual rivalrous good demands intersect the *vertical* axis above the market price. The market can only ignore those individuals who would consume nothing at the market price or a welfare loss will result.

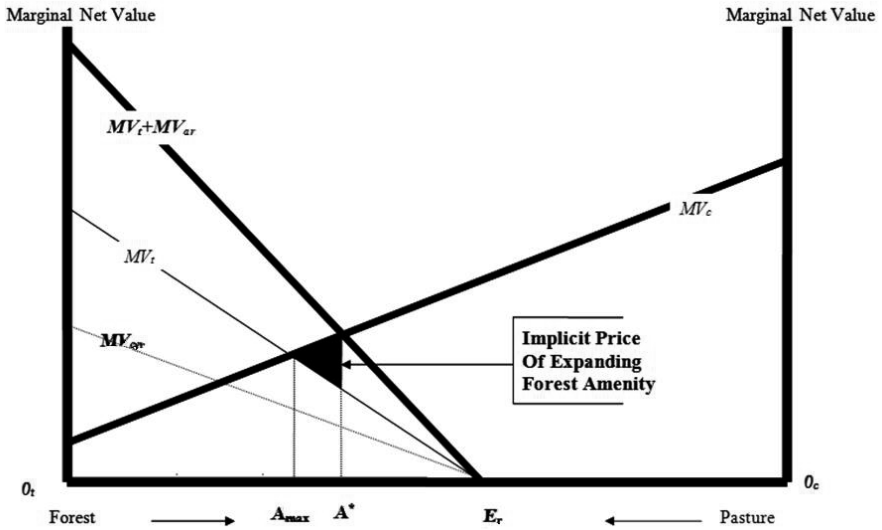
The analysis changes radically if a good is nonrivalrous in consumption, whether an excludable club good or nonexcludable public good. In stark contrast to rivalrous goods, many individual demands for a nonrivalrous good bear absolutely no relationship to its ideal quantity and are irrelevant to ascertaining the optimal amount.

Assume a woman single-handedly owns and operates an island ranch in the region discussed above, regarding it solely as a tool for maximizing pecuniary profit. No one else visits or cares about the island, so the production of timber and beef result solely in rivalrous goods. Government policy is neutral. The island produces too little to affect prices and might plausibly be specialized to produce only timber or only cattle. But suppose that the factor requirements for the alternatives have distinct time profiles so that cattle are most demanding when the forest is least so, which counters economies of specialization. Due to the seasonal disjunction between cattle and

timber employment, the net value of marginal land units is a decreasing function of the area devoted to either output.

Analogously to Figure 4, Figure 5 shows the island's forest measured from an origin  $0_t$  and its pasture measured from  $0_c$ . As before, the distance between  $0_t$  and  $0_c$  indicates the island's total area. The marginal net value of timber ( $MV_t$ ) begins high along the left axis—the opportunity cost of the non-land inputs such as the rancher's time are low for the first units devoted to forest since most work can be done while cattle compete for little attention. Expanding the forest, however, causes diversion of non-land inputs such as the rancher's time from increasingly weighty cattle-tending duties, as reflected in the downward slope along the  $MV_t$  curve for movements to the right. Analogous considerations apply to the marginal net value of cattle ( $MV_c$ ). Maximizing the island's pecuniary value yields a boundary at  $A_{max}$  separating the plots devoted to the alternative products.

Imagine now that the isolated rancher notices that she feels less forlorn when she relaxes in her forest. Timber and cattle receipts remain objectively comparable, but an objective measure contrasting the newfound forest amenity's marginal benefit with any pecuniary magnitude is missing—because the rancher is both its producer and its consumer, the market does not price the amenity. For someone other than the rancher to discover all the relevant objective information would be a daunting task, but for that person to ascertain relevant subjective valuations would be impossible. Though unfortunately quite common in the economic literature, models that merely imagine that some third party can ascertain objective quantitative measures for other people's subjective values, though potentially useful as a point of theoretical embarkation, are vacuous when treated as its terminus. Only the rancher can determine the island's optimal use pattern.

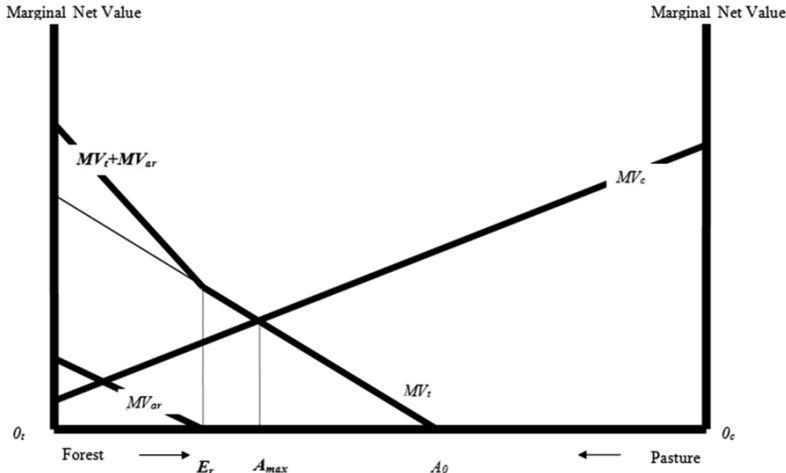
**Figure 5: Private Environmental Amenity**

The boundary will move if added forest creates additional amenity value for the rancher for areas larger than  $A_{max}$ . Because  $MV_t = MV_c$  at  $A_{max}$ , the marginal cost of expanding the forest amenity is locally zero, whereas the marginal amenity value  $MV_{ar}$ , which the rancher alone can calibrate, has become positive. The rancher will move the boundary to  $A^*$  where  $MV_c - MV_t = MV_{ar}$ , in other words, where the marginal (objective) cost of the amenity equals its marginal (subjective) benefit. Buchanan and Stubblebine<sup>84</sup> discuss relevance solely in the context of externalities, but the concept is more broadly useful—because there is only the decision-making rancher on the island, there are no externalities in Figure 5. Nonetheless, the amenity is relevant to the rancher's choice of boundary between the outputs. For brevity, call the amenity “boundary-relevant,” meaning the rancher's demand curve for the amenity extends beyond the initial boundary at  $A_{max}$ . Define “extensiveness” as the quantity where marginal amenity value reaches zero, at  $E_r$  for the rancher.<sup>85</sup>

<sup>84</sup> See Buchanan & Stubblebine, *supra* note 1, at 374-76.

<sup>85</sup> As the figure is drawn, marginal amenity value and marginal timber value reach zero at the same place, but that is merely drafting convenience. The amenity could provide utility even after marginal timber value fell to zero, inducing the rancher to maintain so much forest that her accountant would scold her about the marginal pecuniary profit being lost. Ted Turner appears to feel that way—about bison rather than forest—considering the several cattle ranches he has purchased and converted into a sort of operation that his neighbors find unprofitable. Or as will be discussed next, satiation with the amenity could occur where the marginal timber value remains positive.



**Figure 6: Boundry-Irrelevant Environmental Amenity**

It might come as a surprise that this public good, the forest amenity, may have no relevance to the optimal boundary between forest and pasture. The rancher may see only part of the island at any moment, and then her demand for the amenity could be inframarginal with no influence on the division, as in Figure 6. The intersection of the marginal value of cattle-producing land with the pecuniary marginal value of timberland at  $A_{max}$  occurs to the right of  $E_r$ . The amenity is real, but has no impact on optimal production of cattle or timber—it is “boundary-irrelevant.”

Like oxygen, an amenity can be important in aggregate but irrelevant at the margin. Perhaps the lonesome rancher cherishes few things more than her beloved woodland, but is satiated before marginal amenity value has any impact on production decisions. The rancher enjoys as much of the treasured amenity as she wants while sacrificing nary a cent of market income. Those best things in life that actually are free (impose no opportunity cost) pose no economic problem that government needs to resolve.

Vessels begin passing, and sailors admire the forested view. The public trust doctrine prevents the rancher from barring offshore viewers, so the forest amenity is nonexcludable. The amenity is nonrivalrous in consumption—the rancher’s act of viewing left the vista unaltered for anyone else wanting to take a peek. For economists to call the amenity a public good seems a bit odd—a view of the island forest was already a public good according to that nonrivalrous and nonexcludable definition, even when the rancher was the sole member of the public. According to the definition, bird songs that Robinson Crusoe could hear were public goods.

If no sailor would anticipate sufficient benefit to justify bearing the transaction cost necessary to induce the rancher to expand the forest, an appropriate tax-expenditure scheme might offer a Kaldor–Hicks improve-

ment, just as the common intuition would have it. Being offshore however, the sailors would see less of the island than the rancher and see it less often. Thus the rancher might value a more extensive amenity than do the sailors and value the amenity more highly than would any one of them—indeed, perhaps more highly even than the entire aggregation of sailors. The sailors might be satiated with less investment in the island forest than the rancher has selected solely to maximize her own utility.

Any additional units cultivated to satisfy the rancher beyond what satiated the sailors would create a public good in the economist's nonrivalrous and nonexcludable sense, but would imply nothing regarding the public interest. The sailors' free riding would not interfere with obtaining the efficient size of forest if only the rancher values the amenity *at the margin*. Nor does transaction cost lead to a market failure if there is no marginally relevant demander with whom the rancher could transact. Though the rancher cannot keep the sailors from free riding, the size of the forest is optimal nonetheless.

A tax-expenditure scheme will be unnecessary to achieve the optimal forest amenity if the rancher selects it of her own volition. A positive externality certainly exists since the sailors can and do enjoy a view of the forest while bearing none of its cost, but it is an irrelevant externality in the terminology of Buchanan and Stubblebine.<sup>86</sup> In fact, if the rancher *could* exclude but could not perfectly price discriminate among the sailors because their idiosyncratic interests are unascertainable by her, her profit-maximizing choice of an asking price would likely leave some sailors unwilling to pay despite the utility they could receive from viewing the forest-amenity/public-good. In other words, if the rancher were able to transform this public good into a club good, she might not solve a problem that was reducing the amenity's value but create one. But because the rancher can bar none of the viewers, there will be both free riders and an efficient amount of amenity.

The intuition that more users inevitably require more of a good betrays careless thinking. Given willingness to pay at least marginal production cost, it is indeed efficient that nearly all rivalrous-good demands have an impact on output, as was illustrated above by Figure 4. But relatively weak demands have no impact on the optimal amount of a public good. Those with the most extensive demands may finance so much of the good that the marginal interest of the rest evaporates.

The point is not that appropriate policy would discriminate against some beneficiaries of public goods, but that some interests become irrelevant once the beneficiaries have been satiated. In brief, the beneficiary and not the policy determines whether a demand is relevant or irrelevant. Those with inframarginal demands value the good, but they are satiated before

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<sup>86</sup> Buchanan & Stubblebine, *supra* note 1, at 375-76.

their preferences have any impact on optimal provision. We use up a rivalrous good as we utilize it, but nobody uses up a public good by enjoying it. Consequently those with less extensive demands can enjoy as much as they want. They use it until marginal value *to them* has fallen to zero, with no expenditure beyond what has been expended by marginal demanders. Blessed are they whose demands for public goods are irrelevant, for they shall be satiated while bearing none of the cost.

The arrival of boats carrying forest-loving sailors may or may not alter the optimal pasture–forest division. If not, the amenity remains important to the sailors but their demand is boundary irrelevant. To alter the optimal amenity it is necessary and sufficient that the most extensive of the sailors' demands exceed  $A_{max}$  if the rancher's amenity demand is boundary irrelevant or  $A^*$  if the rancher's demand is boundary relevant. If the rancher's demand is boundary irrelevant, Figures 5 and 6 suffice as illustration by substituting  $MV_{as}$ , the marginal amenity value to the most extensively interested sailor, for  $MV_{ar}$ , the marginal amenity value to the rancher.

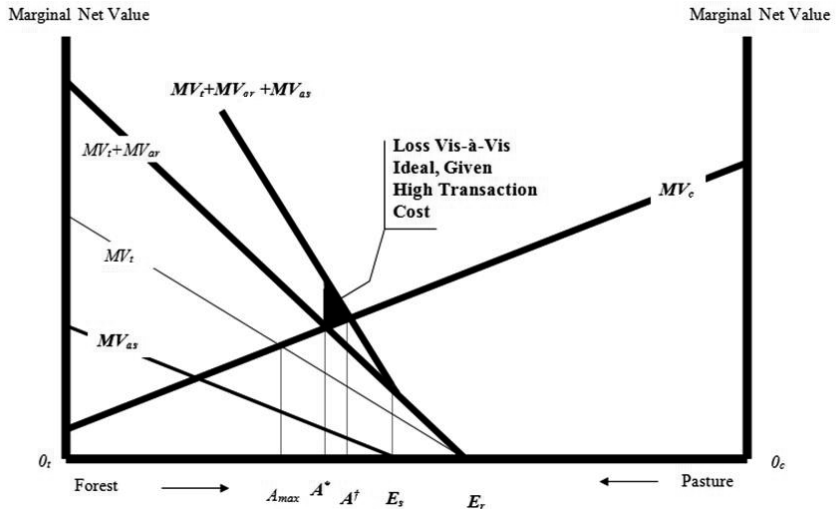
But if the rancher's demand is boundary relevant, even less extensive demands by one or more sailors may alter the ideal amount, as Figure 7 illustrates.  $E_r$  shows the extensiveness of the boundary-relevant rancher demand that led to forest area  $A^*$  in Figure 5. Though the most extensive sailor's demand intersects the horizontal axis at  $E_s < E_r$  the ideal boundary moves from  $A^*$  to  $A^\dagger$ . If the rancher does not make that adjustment there will be a loss, as shown by the shaded area. Focus frequently falls on the shortfall of the product that yields the amenity, in other words on the area under the summed marginal values of timber and amenity between  $A^*$  and  $A^\dagger$ . That clearly overstates the loss (perhaps grossly) because it ignores the value of the additional cattle permitted by the larger pasture. Still, a policy that expanded the forest might recoup part of the shaded area, though no policy could recoup it all because, as discussed above, administering the resulting bureaucracy would entail cost, whether modest or disproportionate, and that must be netted out.

If transaction costs were modest, the rancher would of her own volition move the boundary to  $A^\dagger$  because she would be paid to do so by those sailors who enjoy the marginally enhanced amenity. But with a potentially large group of sailors offshore enjoying the amenity, how likely is transaction cost to be low?

The amenity being a public good, low transaction cost is substantially more likely than one's intuition might suggest. With a rivalrous good, the number of necessary consumer–producer interactions depends on where individual demand curves intersect the *vertical* axis, and for the vast majority of viable products there will be a lot of intersections above the market *price*. But for a public good, the intersection of less extensive demands with the *horizontal* axis matters in comparison with the *quantity* secured by those with more extensive demands. With rivalrous goods, everyone pays the same price for different quantities (possibly zero) unless there is price

discrimination, whereas with public goods everyone enjoys the identical quantity for different prices (possibly zero). Sailors will have varying demands, and sometimes the second most extensive of those will not reach  $A^\dagger$  and will therefore be boundary irrelevant.

**Figure 7: Public Environmental Amenity**



Then it hardly matters how many sailors are offshore, two or two million; only the most extensive demand is boundary relevant, and the rancher must negotiate only with that single especially interested sailor. To be sure, the rancher would find it difficult to determine if there are any boundary-relevant sailors. In the present example, however, any boundary-relevant sailors would have little difficulty identifying the rancher and should realize that she might be a worthwhile negotiating counterparty. A boundary-relevant sailor would have to self-identify if his demand were to have any influence.

A different public policy issue arises if, though there are only a few of them, boundary-relevant parties cannot easily identify each other. Suppose there are two million sailors, one or a few of whom might be willing to pay enough individually or in combination to obtain an expanded forest, and two thousand ranchers, one or a few of whom might be willing to expand their forest for that payment. The parties might quite plausibly find it prohibitively costly to solve the identification problem. In such an instance, however, proper public policy would not determine the forest's size by fiat, but less intrusively, help boundary-relevant parties identify each other so negotiations between them can commence. The amenity value is subjective, and bureaucrats will never be able to estimate it with anything approaching the precision of the parties themselves.

As the common intuition has it, for the rancher to negotiate with two million sailors would indeed be prohibitively costly, but as Figure 7 shows, it may be pointless. Imagine new technology reduced transaction cost to zero. After the rancher has satisfied herself and one or a few sailors, nobody else would pay one iota to expand the forest amenity further. The level of many-party transaction cost is irrelevant if only a few sailors (or none) have boundary-relevant demands. The island will continue to provide the appropriate amounts of cattle, timber, employment, amenity, and, of course, existence value even for those of us who never expect to visit the region.

The rancher already understands the local cattle and timber markets, local transport, the markets for hay and all the other inputs she uses, and thus can cheaply judge the opportunity cost of forest expansion. Bureaucrats can find objective information for some of that, but collecting it is costly. Moreover, the few boundary-relevant sailors are the only reliable judges of the marginal subjective value to them of the amenity, just as the rancher is the only reliable judge of marginal amenity value to her.

That actually understates the bureaucrat's problem. Suppose that the bureaucracy manages to hit  $A^*$  on the nose. None of the curves are likely to be static, but will shift constantly with changing market prices of cattle, timber, hay, transport, and the like, as well as technical advances that will alter the way cattle and timber are produced. And that leaves aside potential changes in the subjective preferences of the boundary-relevant amenity demanders. Even an unlikely perfect division of the island between forest and pasture is unlikely to remain perfect.

Of course, a tolerable bureaucratic estimate yesterday implies that a tolerable one is plausible tomorrow. However, that will require canvassing those affected in one way or another, once again obtaining costly information that the rancher and sailors come to possess as a byproduct of their activities. Due in part to that greater information cost, bureaucratic policy making tends toward inflexibility followed by occasional large, disruptive, and often inappropriate adjustments.

Transaction costs for public goods—even if enjoyed by millions—are chronically overestimated. Only one or a few strong demands often determine both actual and ideal provision. Even two million demands are irrelevant if they are inframarginal.

The analysis here disputes the notion that one can infer the optimal amounts of public goods by applying a theory appropriate for analyzing rivalrous goods. Because a public good is not used up as individuals enjoy it, the appropriate amount cannot be determined from the population of users, but instead depends on the relatively strong preferences of the most avid user(s). Surveys that attempt to aggregate amenity value over the entire population miss the mark entirely. That would be true even were the surveys capable of eliciting accurate responses from interviewees who realize that they will not be asked to pay anything in response to their claimed

valuation—if I like it even a little, claim that I like it a lot because any increase will be free to me. To be trustworthy, surveys have to find a way to impose the relevant opportunity cost on respondents. Because many of those demands will be marginally irrelevant the respondent would prove unwilling to bear any opportunity cost. Surveys generally ask questions better designed to elicit information regarding average valuations across the entire amenity stock and population when what is needed would be valuations of marginal increases or decreases for boundary-relevant demanders.

Free-rider problems do not inevitably become more severe as the number of users consuming a public good grows; free riding becomes worrisome only when boundary-relevant users become numerous. Consequently, private parties are able to arrange for an efficient amount of many public goods—including the mitigation of public bads—because so many externalities are irrelevant. Given enough interpersonal variance among preferences, the other parties with relevantly strong interests will sometimes consist of only one or a few people, so relative to transaction cost in the political sphere little cost would be incurred through negotiation. How then is one to choose between government and private provision of a public good? Theory can tell us what screwdrivers and saws can do, but one can never know whether to employ a saw or a screwdriver without first determining whether the task requires cutting wood or fastening it together. Theory often exists on a pedestal to the exclusion of serious institutional analysis. Theory is a tool, to assume that it can preempt careful observation is mistaken. Buchanan and Coase pressed that point on us repeatedly during their long and productive lives, but the point remains shamefully neglected by far too many commentators.

Much mischief arises from a misapprehension that a large pool of public-good beneficiaries inevitably creates prohibitive transaction costs. That will be true only if comprehensive negotiation among them is necessary, but comprehensive negotiation will be unnecessary when there is a large variance across beneficiaries in the strength of interest in the good. For public goods, there can be such a thing as a free lunch.

## IX. THE LEGACY OF BUCHANAN, COASE, AND PIGOU

It has been nearly a century since Pigou published the first edition of *The Economics of Welfare*.<sup>87</sup> It has been more than half a century since the first appearance of the Minor Coasean Hypothesis<sup>88</sup> and Buchanan and Stubblebine's distinction between relevant and irrelevant externalities.<sup>89</sup>

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<sup>87</sup> PIGOU, *supra* note 23.

<sup>88</sup> Coase, *The FCC*, *supra* note 1, at 26-28.

<sup>89</sup> Buchanan and Stubblebine, *Externality*, *supra* note 1.

Now Harold Demsetz<sup>90</sup> argues that none of that analysis went far enough, which is to say that even the best models are, after all, models rather than the world they model, and thus unendingly subject to improvement. Buchanan, Coase, and Pigou have all left the trenches, but the intellectual and political battles over externalities rage on. Too few scholars properly apprehend the fulcrum of transaction cost, not merely with respect to externalities as were addressed here, but also business organization, and undoubtedly many other areas. Too few bother to distinguish the occasional problematic relevant externality from its vastly more common and innocuous irrelevant cousin. We need to keep those tools as handy as our supply and demand scissors.

What I have undertaken is a chronological history of thought leavened with a few extensions and examples, beginning with an attempt to restore some warranted respect for the seminal but preliminary and (even now) incomplete inquiry that Pigou stimulated into externality policy. From that beginning, I traced the trajectory of externality theory sideways, as it were, to what at the time must have seemed the unrelated *The Nature of the Firm*,<sup>91</sup> where our modern understanding of transaction cost was born. Coase articulated the Minor Coasean Hypothesis from his clearly on-point *The Federal Communications Commission*<sup>92</sup> to formulate the Major Coasean Hypothesis,<sup>93</sup> where externality theory was finally integrated with transaction cost analysis. The article attempts to put an end to the invariance fallacy regarding the Minor Hypothesis. Though distributional effects have no inevitable efficiency consequences, efficiency has no constituency but wealth distribution has many.

At some length, the essay examined and extended Buchanan and Stubblebine's crucial but neglected distinction between relevant and irrelevant externalities.<sup>94</sup> One must hope that the discussion there made it apparent that worrying about an awful lot of the world's externalities is at best a waste of time, even worse when it motivates inappropriate policy. Many other arguments of Buchanan and Coase that I had to leave untouched could have bolstered my claim that economists and legal scholars worry entirely too much about externalities. The majority of externalities are irrelevant, and the majority of the rest are either internalized or would cost more to correct than the damage entailed by leaving them uncorrected.

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<sup>90</sup> Demsetz, *supra* note 70. According to Demsetz, the costs of defining rights and transacting them should be treated in economic analysis like any other costs, and that the missing crux of the argument is actually deceit. That deceit is the unwillingness of utility-maximizing individuals to provide accurate statements of the value they place on indivisible goods, which I take to mean goods that are nonrivalrous and nonexcludable.

<sup>91</sup> Coase, *The Nature of the Firm*, *supra* note 3.

<sup>92</sup> See Coase, *The FCC*, *supra* note 1, at 26-28.

<sup>93</sup> *Id.*

<sup>94</sup> Buchanan & Stubblebine, *supra* note 1, at 375-76.

I close now by paraphrasing an elegant requiem composed for an unrelated person in an unrelated discipline:

The truth is that every genre produces its share of marvels and masterpieces, works that endure from one generation to the next, inviting attempts at explication and defeating them in short order: the work of Buchanan, Coase, and Pigou has manifested far more staying power than that of countless critics who may have been more hailed at the time, and one suspects that work is here for the ages.<sup>95</sup>

We will miss the focused analysis of those three.

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<sup>95</sup> Deborah Solomon, *American Enigma*, SMITHSONIAN, Oct. 2013, at 76, 88.