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**Lala Hansraj Puthela College of Law Sirsa**

**Economic history - economic law**

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**Abstract:** The roots of law & economics lie in late 19<sup>th</sup> century continental Europe. However, this early movement did not persist, having been cut off in the 1930s. After World War II, modern law & economics was (re-)invented in the United States and subsequently grew into a major field of research at U.S. law schools. In continental Europe, law & economics was re-imported as a discipline within economics, driven by economists interested in legal issues rather than by legal scholars. Hence, the European discourse was more strongly influenced by formal analysis, using mathematical models. Today, research in the U.S., Europe, and in other countries around the world, including Latin America and Asia, uses formal, empirical, and intuitive methods. New subfields, such as behavioral law & economics and experimental law & economics, have grown in the U.S. and in Europe during the past two decades.

**Keywords:** law & economics, mathematical models, U.S. and in Europe, economists interested

**Historical antecedents:** Precursors to modern law and economics can be identified as early as the 19<sup>th</sup> century, particularly in German-speaking Europe (Gelter/Grechenig 2007, Grechenig/Gelter 2008 referring to work by Kleinwächter, Mataja, Menger, and Steinitzer). Perhaps the defining piece for this period was the monograph on tort law by Victor Mataja (1888) “*Das Recht des Schadensersatzes vom Standpunkte der Nationalökonomie*” (*The law of civil liability from the point of view of political economy*), in which Mataja anticipated central ideas of the American law and economics movement, developed almost a century later. Prefiguring modern law and economics, Mataja focused on the incentive effects of tort law. While the book did not go unnoticed among legal scholars and influenced policy debates, including the drafting of the German Civil Code, it had no lasting influence on legal analysis (Englard 1990; Winkler 2004). While the University of Vienna, where Mataja held a position, integrated law and economics into one faculty, and economists in academia were typically trained in law, no law and economics movement developed (Grechenig/Gelter 2008, Litschka/Grechenig 2010).

Generally, one explanation for why the early law and economics movement left no lasting impression is the increasing specialization of the social sciences (Pearson 1997: 43, 131). In the German-speaking countries in particular, legal scholarship remained strongly under the influence of a tradition that had grown out of the 19<sup>th</sup> century “Historical School”. While conceptual jurisprudence gave way to the more functional jurisprudence of interests, legal scholarship continued to be seen as a hermeneutic discipline focused on a coherent interpretation of the law based on an internal consistency of the system in terms of language and value judgments (e.g., Grimm 1982: 489; Wieacker 1967: 443). Policy arguments remained outside of the purview of legal scholarship. Moreover, nascent alternative views that may have led to more openness toward interdisciplinary work, such as the sociological jurisprudence pioneered by Eugen Ehrlich and Hermann Kantorowicz’ “Free Law School”, petered out in the 1930s and were finally cut short by the Nazi regime and World War II. Post-war jurists had no interest in portraying the law as an objective system in order to maintain the legitimacy of the legal profession (Grechenig/Gelter 2008; see also Curran 2001).

By contrast, when the modern economic analysis of law developed in the United States in the second half of the 20<sup>th</sup> century, legal theory was far more conducive to integrating interdisciplinary and specifically economic approaches. The Langdellian orthodoxy of the late 19<sup>th</sup> century and the conceptual jurisprudence of the Lochner period up to the 1930s were thoroughly discredited by the legal realist movement. With “the great dissenter” Oliver Wendell Holmes on the Supreme Court as their role model, the legal realists criticized the formalism of the majoritarian jurisprudence, arguing that the law itself was to a large extent indeterminate. As for the rejection of its analogues in Germany, there is also a strong political component to the historical development in the US: The Lochnerian judges on the Supreme Court defended the previous legal order against interventionist “New Deal” policies of the Roosevelt administration which they declared were unconstitutional. Only when Roosevelt threatened to “pack the court” with more compliant justices, this jurisprudence changed, and the realists, who were generally New Deal progressives, won. Even if there was no agreement on the extent of indeterminacy, the insight that judges enjoyed great discretion in interpreting and shaping the law with policy took a strong foothold. The void left by the abandonment of formalism was filled with innovative jurisprudential movements in the second half of the 20<sup>th</sup> century, including the legal process school, critical legal studies, and not least law and economics. After 1980, with the older generation of scholars having left the scene, legal scholars could finally say that they were “all realists” now (Singer 1988: 467; Reimann 2014: 15). Another important issue was the prevalent role of utilitarian philosophy, on which welfare economics is based, in the

U.S. legal discourse compared to other countries (Grechenig/Gelter 2008: 319-325). Finally, the maturation of economics as a discipline meant that it was better equipped for addressing legal issues than it was in the late 19<sup>th</sup> century (Litschka/Grechenig 2010).

**The Development of Modern Law and Economics:** The contemporary law and economics school is typically traced back to around 1960, specifically to the work of Ronald Coase and Guido Calabresi (e.g., Schanze 1988: 2-3). However, from an institutional perspective, the basis was laid at the University of Chicago in the 1940s and 1950s,



when economists first taught at the law school. Most prominently, Aaron Director began to teach at Chicago in 1946 and initiated interdisciplinary discussions both inside and outside of the classroom, most significantly in antitrust law (Duxbury 1995: 342-345). He was the first editor of the *Journal of Law and Economics*.

A “law and economics movement” can probably be traced to the publication of Ronald Coase’s “Problem of Social Cost” in this particular journal in 1960. The article’s core insight about the reciprocity of the relationship between the tortfeasor and the victim, and hence the significance of transaction cost, helped the economic method to expand into fields where the application of economic principles did not seem immediately obvious, such as contract or tort law. In this intellectual climate, other economists developed economic theories pertinent immediately to legal questions. Gary Becker of the Chicago economics department can be credited for applying economic principles to crime (Becker: 1968), racial discrimination (Becker: 1957) and family life (Becker: 1981).

The prominence of the economic analysis of law in the U.S. today, however, probably must be attributed to its adoption by *legal* scholars, for whom the law is – other than for most economists – the primary field of research. Among these, Guido Calabresi, Henry Manne, and Richard Posner stand out as some of the pioneering law & economics scholars.

Yale professor (later federal judge) Calabresi, in 1960, apparently independently from Coase, began a research program that led him to publish a series of articles on tort law, in which he explained its structure on the basis of simple economic principles (Calabresi 1961, 1965, 1970, 1975, 1975a; Calabresi/Melamad 1972; Calabresi/Hirschhoff 1972).

Henry Manne, who worked in corporate and securities law, critiqued the wisdom prevailing in these areas from the 1960s onwards (Manne 1962, 1965, 1967), attracting particular attention for his view that insider trading should be legal (Manne 1966, 1966a). He succeeded in transforming the George Mason University’s fledgling law school into a law and economics powerhouse (see Manne 2005). He established intensive courses on microeconomics for judges and for law professors. The fact that about 40% of federal judges had taken such a course by 1990 helped the acceptance of law and economics in the courts (Butler 1999).

Richard Posner, as a young professor at the University of Chicago Law School, not only established the *Journal of Legal Studies* in 1972, but became a trailblazer within legal academia by publishing the first edition of his monograph “Economic Analysis of Law” (Posner 1973). This standard text was the first to subject almost the entire legal system in its full breadth to a systematic analysis from an economic perspective. Posner’s publication output, both before and after joining the federal bench, is unparalleled, as he continued to influence the development of both the law and legal scholarship with his articles, books, and opinions. One of the most noted ideas was the theory, originally proposed in his textbook, that efficiency (largely defined as wealth maximization) could explain the structure of the common law across the legal system. Given that an inefficient precedent was likely to be questioned and subsequently overruled, in this view the common law tends to develop efficient solutions in the long run (Posner 1979, 1980). Obviously, the thesis has remained controversial, both as a descriptive account of the common law and as to whether wealth maximization should, normatively, be the objective of policy analysis in law (see Parisi 2005: 44-48 for a summary of the debate).

Continental Europe has been described as lagging behind the U.S. by at least fifteen years in terms of the development of law & economics (Mattei/Pardolesi 1991). While law & economics is steadily growing in continental Europe since the publication of Schäfer & Ott’s textbook in 1986 (Schäfer/Ott 1986), important differences remain in both the methodological mainstream approach as well as in the quantity of law & economics scholarship published in domestic law reviews. Scholars have attempted to explain the divergence by institutional factors at university level, such as publication incentives, hiring policies, and the legal curriculum (Gazal-Ayal 2007, Garoupa/Ulen 2008, Parisi 2008), on the one hand, and the institutional environment on a state level, including the separation of the legislature and the judiciary & legal positivism (Kirchner 1991, Weigel 1991, Dau-Schmidt/Brun 2006), on the other. Others have extended these approaches and focused on the legal discourse that was connected to the institutional setup. Since the continental European concept of a separation of powers implies that a judge may only “interpret” the law, policy arguments such as those provided by law & economics were outside the scope of the legal discipline. To the extent that the legal discourse allowed for policy arguments, European legal doctrine was more strongly based on deontological philosophy than scholarship at U.S. law schools (Grechenig/Gelter 2008).

**Maturation into an established discipline:** In the United States, economic analysis became one of the main methods of legal scholarship both descriptive and normative – in legal academia. Other than in the early 20<sup>th</sup> century, and in sharp contrast to continental Europe, law is not recognized as an autonomous discipline, but a field to be studied from various social science perspectives (Posner 1987). Leading law schools often hired economists to teach and research in the area of economic analysis of law, and in the course of the 1980s and 1990s, the number of faculty with an interdisciplinary background, e.g., with a J.D. and a Ph.D. in Economics, increased (e.g., Ellickson 1989). While some legal academics publish in economics journals or in specialized law and economics journals where formal modeling or econometric analysis is typically required, a lot of economic analysis of law takes the intuitive, non-



formal/non-mathematical form that is accepted in law reviews, and one does not necessarily need to be a trained economist to be able to follow the law and economics approach.

In contrast, European law & economics scholarship was more formal (both theoretical and empirical) and was primarily driven more by economists – a characterization that remains true today (Depoorter/Demot 2011), even though non-formal law & economics scholarship at law faculties continues to grow. Several universities (primarily in the Netherlands, Germany, and Italy) have established research centers for law & economics; there are also a number of public research institutes with a strong focus on law & economics, such as the Max Planck Institute for Research on Collective Goods in Bonn, which emphasizes experimental research, and private initiatives, e.g., the Center for European Law and Economics (CELEC). Several professorships in law & economics have been established, including, for example, at the Universities of Amsterdam, Bonn, Frankfurt, Hamburg, Lausanne, and St. Gallen, as well as at the EBS. International programs for the study of law & economics (EMLE, EDLE), both at undergraduate and at graduate level, allow students to specialize at the intersection of the two fields. An increasing number of national programs complement the options students have today. From a historical perspective, the European Association of Law and Economics (EALE), founded in 1984, seven years before the formation of the American Association (ALEA), has played an important role in the emergence of law & economics. A significant number of national and international associations for law & economics have been established since, including in Latin America (ALACDE), Asia (AsLEA), Israel (ILEA), and other non-European countries, as well as in several European countries. These associations typically hold annual conferences, facilitating the cooperation between law and economics scholars. Today's conferences and meetings are typically more formal in terms of research methods than they used to be, although some meetings, for example in Latin America, focus on non-formal methodology (a verbal, law-review style). An increasing number of law & economics journals, textbooks, and treatises have become available as publication outlets. Since the beginning of law & economics scholarship, research has risen to a countless number of associations, conferences, articles, etc. As a consequence, some scholars have claimed that the divergence between European and American law & economics has become much smaller than often perceived (Depoorter/Demot 2011). However, it is certainly fair to say that the influence of law & economics on the mainstream legal discourse is still much larger in the U.S than in Europe. Scholars continuously argue that courts outside the U.S. rarely take economic consequentialist arguments and empirical evidence into account (Grechenig/Gelter 2008, Petersen 2011).

**New Developments in Law & Economics:** Current law & economics incorporates much of the critique that has been brought forth throughout the past decades, for example regarding the notion of efficiency. While the traditional rational-choice approach still plays an important role, there is a growing literature on behavioral and experimental law & economics (Jolls/Sunstein/Thaler 1998, Sunstein 2000, Gigerenzer/Engel 2006, Engel 2010, 2013, Towfigh/Petersen 2014). One of the most notable movements includes empirical legal studies. With the formation of a Society of Empirical Legal Studies (SELS), the launch of the *Journal of Empirical Legal Studies* (JELS) and an annual Conference on Empirical Legal Studies (CELS) (all between 2004 and 2006), empirical legal studies became an important discipline closely connected to Law & Economics. Behavioral economics as well as empirical legal studies have helped the economic analysis of law broaden its scope by including studies with field data and experimental data, for example experiments with judges (e.g. Guthrie/Rachlinski/Wistrich 2000) and laboratory experiments that demonstrate how humans behave under legally relevant circumstances (McAdams 2000, Arlen/Talley 2008, Engel 2010). Recently, a Professorship for Experimental Law & Economics, held by Christoph Engel, was established at Erasmus University in Rotterdam. The coming decades will show the way to a closer connection between the two disciplines and an enhanced use of economics in legal research, making use of whole spectrum of economic methods and possibly extending to new fields such as Law & Neuroeconomics.

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