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## Exploring the Complicationist Gambit: An Austrian Approach to the Economic Analysis of Law

Gregory S. Crespi  
*Southern Methodist University, Dedman School of Law*

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EXPLORING THE COMPLICATIONIST GAMBIT: AN  
AUSTRIAN APPROACH TO THE ECONOMIC  
ANALYSIS OF LAW

*Gregory Scott Crespi\**

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\* Associate Professor of Law, Southern Methodist University. J.D. 1985, Yale Law School; Ph.D. 1978, University of Iowa.

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*The real danger . . . is the opposite of reductionism: call it complicationism.*

—Richard Posner<sup>1</sup>

*[T]he more [one] accepts as relevant, the less [one] can say at all. . . .  
[T]unnel vision is the price we pay for avoiding total blindness.*

—Arthur Allen Leff<sup>2</sup>

*We must at all costs avoid over-simplification . . . .*

—J.L. Austin<sup>3</sup>

*[T]he social sciences . . . have to deal with structures of essential complexity . . . whose characteristic properties can be exhibited only by models made up of relatively large numbers of variables. . . . I prefer true but imperfect knowledge . . . to a pretence of exact knowledge that is likely to be false. . . . [S]eemingly simple but false theories may . . . have grave consequences.*

—Friedrich Hayek<sup>4</sup>

## INTRODUCTION

Over the past several decades the methods of inquiry developed in the social sciences have been broadly incorporated into legal scholarship and law school curricula. In particular, economic principles are now widely utilized to illuminate relationships that are often obscured by conventional legal categorizations.<sup>5</sup> The incorporation of economic theory into legal scholarship and education is arguably one

1 RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 17 (4th ed. 1992).

2 Arthur Allen Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV. 451, 477 (1974).

3 EDWARD HUNDERT, *LESSONS FROM AN OPTICAL ILLUSION: ON NATURE AND NURTURE, KNOWLEDGE AND VALUES* (1995), at Part One frontispiece (quoting J.L. Austin).

4 Friedrich Hayek, *The Pretence of Knowledge*, in *THE ESSENCE OF HAYEK*, 266, 269, 272 (Chiaki Nishiyama & Kurt Leube eds., 1984).

5 One recent study concluded that for the past several decades law-and-economics reasoning "appears to have pervaded about one quarter of scholarship in elite law reviews." Robert C. Ellickson, *Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics*, 65 CHI.-KENT L. REV. 23, 28 (1989). To reach this conclusion Ellickson surveyed annual volumes of the *Harvard Law Review*, the *Stanford Law Review*, the *University of Chicago Law Review*, and the *Yale Law Journal* at five-year intervals, ending with the 1985-86 issues. *Id.* at 26-29.

of the two most significant jurisprudential developments over that period.<sup>6</sup>

There now exists a wide-ranging and technically sophisticated body of legal scholarship that utilizes economic models to explain and predict the consequences of legal rules, and that applies normative economic criteria to evaluate alternative legal and institutional regimes. In addition, most major American law schools now regularly offer at least one upper-level elective course, generally titled either "Economic Analysis of Law" or "Law and Economics," that reviews the concepts of basic and intermediate-level microeconomic theory<sup>7</sup> and applies those concepts to examine and evaluate the core doctrines of property, contract, tort, and criminal law.<sup>8</sup> Such courses are usually taught by a law professor who has both academic credentials in law and a substantial graduate school background in economics, generally a Ph.D. degree.<sup>9</sup> This economics-oriented legal scholarship and the

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6 The other highly significant jurisprudential development, in this author's opinion, is the incorporation into legal thinking of the various branches of "critical theory," including critical legal studies, critical race theory, and feminism.

7 The more basic concepts usually covered are those relevant to the standard supply-and-demand models of price and output determination. The somewhat more advanced concepts presented generally include the concepts of producer and consumer surplus, the Pareto and Kaldor-Hicks efficiency criteria and their normative premises, the Coase Theorem, externalities and public goods, certain basic statistical measures, the implications of risk-aversion, cost/benefit analysis, and basic game-theoretic concepts. For a detailed discussion of one professor's attempt to structure such a course along neoclassical lines, but with due regard given to criticisms of that framework, see Gregory Crespi, *Teaching the New Law and Economics*, 25 U. Tol. L. Rev. 713 (1994).

8 The *AALS Directory of Law Teachers* lists 153 law professors who teach law and economics courses and notes that 78 of these professors are currently teaching the subject. ASSOCIATION OF AM. LAW SCHS., *AALS DIRECTORY OF LAW TEACHERS* 1153-54 (1995-96). This information understates the number of law professors qualified to teach the subject, and probably the number of courses offered as well, because it omits many noted law and economics scholars. It also does not reflect the significant extent to which economic concepts have been incorporated into the teaching of substantive courses at many law schools.

9 There are professors teaching these courses, as well as leading scholars in the area, who have graduate degrees only in one of the two fields and have through informal study developed the necessary level of expertise in the other field. However, it is difficult to teach economic concepts effectively if one has not had the opportunity for the advanced study and teaching of the subject provided by graduate economics programs. It is, of course, a rare person who can effectively teach law courses without having formal legal training. The standard credentials required today for obtaining a position at a major American law school that would involve teaching law and economics courses, particularly for a person seeking to obtain an entry-level position, are both a J.D. degree in law and a Ph.D. in economics.

economic analysis of law courses each serve to facilitate understanding of economic concepts and their applications to legal questions within the legal community, and together have had a significant influence on the development of legal doctrines.

This scholarship and instruction has been very broad in terms of the range of legal questions it has addressed. It has, however, been relatively narrow in terms of the limited range of economic models and normative criteria that have been utilized. Almost all of this work has been based upon highly reductionist neoclassical economic models of human behavior and social coordination that have their roots in the works of Adam Smith,<sup>10</sup> David Ricardo,<sup>11</sup> Alfred Marshall,<sup>12</sup> and other 18th and 19th century economic theorists. Despite the persistent criticisms made concerning the unrealistic assumptions and problematic normative standards inherent in the neoclassical approach, almost all efforts by legal scholars to utilize economic principles still take place within its confines, and this conventional framework continues to be imparted to law student neophytes in a relatively uncritical fashion.

There exists, however, another approach to economic analysis that also has its roots in *The Wealth of Nations*,<sup>13</sup> but which is far less reductionist than the neoclassical approach, and which is the product of over a century of sustained intellectual development that has proceeded largely independently of neoclassical thought. This is the "Austrian" approach, which traces its origins as an independent line of inquiry to the 19th century work of Carl Menger,<sup>14</sup> one of the recognized instigators of the "marginal revolution" in neoclassical economic theory,<sup>15</sup> and has subsequently been refined and articulated by

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10 See, e.g., ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* (R.H. Campbell et al. eds., 1976) (1776) [hereinafter SMITH, *THE WEALTH OF NATIONS*]; ADAM SMITH, *THE THEORY OF MORAL SENTIMENTS* (R.H. Campbell et al. eds., 1976) (1759).

11 DAVID RICARDO, *PRINCIPLES OF POLITICAL ECONOMY AND TAXATION* (J.M. Dent & Sons Ltd. 1973) (1817).

12 ALFRED MARSHALL, *PRINCIPLES OF ECONOMICS* (9th ed. 1961) (1890).

13 SMITH, *THE WEALTH OF NATIONS*, *supra* note 10.

14 See, e.g., CARL MENGER, *INVESTIGATIONS INTO THE METHOD OF THE SOCIAL SCIENCES WITH SPECIAL REFERENCE TO ECONOMICS* (Louis Schneider, ed. & Francis J. Nock, trans., N.Y. Univ. Press 1985) (1883); CARL MENGER, *PRINCIPLES OF ECONOMICS* (Bert F. Hoselitz, ed. & James Dingwald, trans., The Free Press 1950) (1871); KAREN I. VAUGHN, *AUSTRIAN ECONOMICS IN AMERICA: THE MIGRATION OF A TRADITION* 12 (1994) ("Modern Austrians of all stripes uniformly trace their beginnings back to the writings of Carl Menger . . . , and especially to his *Principles of Economics*.").

15 See VAUGHN, *supra* note 14, at 13.

such significant intellectual figures as Eugen von Bohm-Bawerk,<sup>16</sup> Friedrich von Weiser,<sup>17</sup> Ludwig von Mises,<sup>18</sup> Friedrich Hayek,<sup>19</sup> Murray Rothbard,<sup>20</sup> Israel Kirzner,<sup>21</sup> Ludwig Lachmann,<sup>22</sup> and numerous

16 EUGEN VON BOHM-BAWERK, *THE POSITIVE THEORY OF CAPITAL* (William Smart trans., G.E. Steichert & Co. photo. reprint 1930) (1891).

17 FRIEDRICH VON WEISER, *NATURAL VALUE* (William Smart ed. & Christian A. Malloch trans., Macmillan & Co. 1893).

18 LUDWIG VON MISES, *HUMAN ACTION: A TREATISE ON ECONOMICS* (3rd ed. 1966).

19 Friedrich Hayek's contributions to the development of Austrian economic theory are extensive. See, e.g., F.A. HAYEK, *COLLECTIVIST ECONOMIC PLANNING* (1935); F.A. HAYEK, *THE CONSTITUTION OF LIBERTY* (1960); F.A. HAYEK, *THE COUNTER-REVOLUTION OF SCIENCE* (1952); F.A. HAYEK, *THE DENATIONALISATION OF MONEY: AN ANALYSIS OF THE THEORY AND PRACTICE OF CONCURRENT CURRENCIES* (1976) [hereinafter HAYEK, *THE DENATIONALISATION OF MONEY*]; F.A. HAYEK, *THE FATAL CONCEIT: THE ERRORS OF SOCIALISM* (1988); F.A. HAYEK, *INDIVIDUALISM AND ECONOMIC ORDER* (1st Gateway ed. 1972) (1945); F.A. HAYEK, *LAW, LEGISLATION AND LIBERTY: THE MIRAGE OF SOCIAL JUSTICE* (1976) [hereinafter HAYEK, *THE MIRAGE OF SOCIAL JUSTICE*]; F.A. HAYEK, *LAW, LEGISLATION AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE* (1979) [hereinafter HAYEK, *THE POLITICAL ORDER OF A FREE PEOPLE*]; F.A. HAYEK, *LAW, LEGISLATION AND LIBERTY: RULES AND ORDER* (1973) [hereinafter HAYEK, *RULES AND ORDER*]; F.A. HAYEK, *MONETARY THEORY AND THE TRADE CYCLE* (N. Kaldor & H.M. Croome trans., 1933); F.A. HAYEK, *NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS, AND THE HISTORY OF IDEAS* (1978) [hereinafter HAYEK, *NEW STUDIES*]; F.A. HAYEK, *PRICES AND PRODUCTION* (2d ed. 1935); F.A. HAYEK, *PROFITS, INTEREST AND INVESTMENT* (1939); F.A. HAYEK, *THE PURE THEORY OF CAPITAL* (1941); F.A. HAYEK, *THE ROAD TO SERFDOM* (1946); F.A. HAYEK, *THE SENSORY ORDER: AN INQUIRY INTO THE FOUNDATIONS OF THEORETICAL PSYCHOLOGY* (1952); F.A. HAYEK, *STUDIES IN PHILOSOPHY, POLITICS AND ECONOMICS* (1967); F.A. Hayek, *The Use of Knowledge in Society*, 35 *AM. ECON. REV.* 519 (1945).

Hayek was awarded a Nobel Prize in Economics in 1974. While his most widely read work is probably his anti-socialist tract *The Road to Serfdom*, his most extensive discussions of his economic theories and their applications to legal questions are probably presented in *The Constitution of Liberty*, and in *Law, Legislation and Liberty: Rules and Order*.

20 Murray Rothbard has written extensively on Austrian economics and its political implications. His best known work is his two-volume treatise, *Man, Economy and State*, written in 1970. MURRAY NEWTON ROTHBARD, *MAN, ECONOMY AND STATE: A TREATISE ON ECONOMIC PRINCIPLES* (1970).

21 Israel Kirzner has written extensively on questions of Austrian economics. See, e.g., ISRAEL M. KIRZNER, *COMPETITION AND ENTREPRENEURSHIP* (1973) [hereinafter, KIRZNER, *COMPETITION*]; ISRAEL M. KIRZNER, *DISCOVERY AND THE CAPITALIST PROCESS* (1985); ISRAEL M. KIRZNER, *MARKET THEORY AND THE PRICE SYSTEM* (1963) [hereinafter, KIRZNER, *MARKET THEORY*]; ISRAEL M. KIRZNER, *THE MEANING OF THE MARKET PROCESS: ESSAYS IN THE DEVELOPMENT OF MODERN AUSTRIAN ECONOMICS* (1992); Israel M. Kirzner, *The Economics of Time and Ignorance: Review Essay*, 3 *MARKET PROCESS* 1-4, 17-18 (1985) [hereinafter Kirzner, *Review*].

22 Ludwig M. Lachmann has written a number of works important in the development of Austrian economic thinking. See, e.g., L.M. LACHMANN, *CAPITAL AND ITS STRUCTURE* (1956); L.M. LACHMANN, *CAPITAL, EXPECTATIONS AND THE MARKET PRO-*

other contributors.<sup>23</sup> While the Austrian approach has not been articulated and applied to the extent that it constitutes a fully developed alternative to the neoclassical paradigm,<sup>24</sup> it nevertheless presents a coherent and comprehensive alternative framework which incorporates a number of important insights largely overlooked in most neoclassical theorizing, and which does not rely upon some of the more unrealistic neoclassical premises.

The Austrian approach has much to offer anyone frustrated with the limitations of the neoclassical paradigm. While it is perhaps possible to criticize the Austrian approach for tending towards the opposite vice of "complicationism,"<sup>25</sup> a better attitude is to regard that approach as reflecting an inclusive, "Yin" mode of thinking which complements the more precise but narrower "Yang" mode of neoclassical thought.<sup>26</sup> There is of course some heterogeneity of views among Austrian economists (hereinafter "Austrians"), but the extent of their agreement on core principles overshadows their differences. The Austrians all demonstrate a much greater willingness than do neoclassical economists (hereinafter "neoclassicists") to confront directly the difficult theoretical problems presented by the passage of time, the malleability of preferences, and the pervasiveness of limited knowl-

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CESS: ESSAYS ON THE THEORY OF THE MARKET ECONOMY (1977); LM. LACHMANN, THE LEGACY OF MAX WEBER (1971); L.M. LACHMANN, THE MARKET AS AN ECONOMIC PROCESS (1986) [hereinafter LACHMANN, ECONOMIC PROCESS]; Ludwig M. Lachmann, *An Austrian Stocktaking: Unsettled Questions and Tentative Answers*, in NEW DIRECTIONS IN AUSTRIAN ECONOMICS 1-18 (L. Spadaro ed., 1978); Ludwig M. Lachmann, *Carl Menger and the Incomplete Revolution of Subjectivism*, 6 ATL. ECON. J. 57 (1978); Ludwig M. Lachmann, *From Mises to Shackle: An Essay on Austrian Economics and the Kaleidic Society*, 14 J. ECON. LIT. 54 (1976); Ludwig M. Lachmann, *On Austrian Capital Theory*, in THE FOUNDATIONS OF MODERN AUSTRIAN ECONOMICS 145-51 (E. Dolan ed., 1976); Ludwig M. Lachmann, *On the Central Concept of Austrian Economics: The Market Process*, in THE FOUNDATIONS OF MODERN AUSTRIAN ECONOMICS 126-32 (E. Dolan ed., 1976); Ludwig M. Lachmann, *Review Essay of The Economics of Time and Ignorance by Gerald O'Driscoll and Mario Rizzo*, 3 MARKET PROCESS 1-4, 17-18 (1985) (book review) [hereinafter Lachmann, *Review*].

23 See, e.g., ROY E. CORDATO, WELFARE ECONOMICS AND EXTERNALITIES IN AN OPEN ENDED UNIVERSE: A MODERN AUSTRIAN PERSPECTIVE (1992); THE ECONOMICS OF LUDWIG VON MISES: TOWARDS A CRITICAL REAPPRAISAL (Laurence Moss ed., 1976); GERALD O'DRISCOLL & MARIO RIZZO, THE ECONOMICS OF TIME AND IGNORANCE (1985); VAUGHN, *supra* note 14.

24 See VAUGHN, *supra* note 14, at x. But see THOMAS SOWELL, KNOWLEDGE AND DECISIONS (1980), (including text in which the central Austrian concepts are developed in some detail and applied to a broad range of social policy issues).

25 See POSNER, *supra* note 1, and accompanying text.

26 See generally LAO-TZU, TAO, A NEW WAY OF THINKING: A TRANSLATION OF THE TAO TE CHING (1975), for the definitive explanation of the principle of complementarity.

edge and uncertainty. They evidence a greater recognition of the centrality of market processes, the importance of tacit social institutions in structuring market orders, and the power of habits and traditions in shaping behavior. Their analytical methods require little if any facility with mathematical or statistical techniques. Their approach consequently has significant advantages over the neoclassical framework as a tool for legal scholars to use for aid in understanding, predicting, and evaluating the operation of legal regimes, although, as will be discussed below, the Austrian approach has certain disadvantages as well. It also has advantages as a pedagogical framework that can effectively focus law students' attention upon certain processes and constraints highly relevant to the operation of the legal system that tend to be obscured by the neoclassical paradigm.

Interest in Austrian economic theory has grown dramatically in recent decades,<sup>27</sup> and the level of acceptance of Austrian ideas has taken another quantum advance with the general collapse of the Eastern European socialist economies, an event that Austrians had long predicted.<sup>28</sup> There are now well-regarded Austrian economics graduate programs at two American universities,<sup>29</sup> a Ludwig von Mises Institute has been established at Auburn University,<sup>30</sup> and "innumerable" undergraduate courses in Austrian economics are now offered at American colleges and universities.<sup>31</sup> A comprehensive analysis of decision-making and the American social order that was based largely on Austrian concepts was published in 1980<sup>32</sup> and was greeted with critical acclaim.<sup>33</sup> The widespread interest that this book has stimulated

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27 See VAUGHN, *supra* note 14, at 1 ("Certainly, the number of books and articles that take an Austrian view of some issue or another or that make reference to the views of some well-known Austrian economist have grown dramatically since the early 1970s.").

28 See *id.* There remains, however, considerable hostility to Austrian economics among neoclassicists. See also *infra* notes 58–64 and accompanying text.

29 See VAUGHN, *supra* note 14, at 1 (stating that these Ph.D. programs, located at New York University and George Mason University, are long the leading center of Austrian thought in the United States).

30 See *id.*

31 See *id.*

32 See SOWELL, *supra* note 24.

33 Milton Friedman was quoted on the back cover of THOMAS SOWELL, *KNOWLEDGE AND DECISIONS* (2d ed. 1996) ("This is a brilliant book."). See also Peter Brimelow, *A Man Alone*, *FORBES*, Aug. 24, 1987, at 41. ("[*Knowledge and Decisions* is] regarded by [Milton] Friedman and other economists as his [Sowell's] single most important theoretical contribution to their discipline . . ."); Phillip F. Lawler, *Dismal Yes, Science No*, *POLICY REVIEW*, Spring 1980, at 164 ("[*Knowledge and Decisions* is] a brilliantly original book . . .").



has resulted in its recent re-publication in a paperback edition.<sup>34</sup> We may be on the verge of a Kuhnian<sup>35</sup> revolution in economic theory where the Austrian approach will henceforth share equal billing with the neoclassical paradigm as complementary frameworks through which economic analyses may be conducted. If this occurs, it seems likely that there will be a corresponding expansion in the range of theoretical perspectives utilized in the economic analysis of law.

Most readers of this Article will probably have at most only a limited familiarity with the Austrian tradition. Therefore, in Part I of this Article I will describe the main assumptions underlying the Austrian approach, and contrast those assumptions with the corresponding premises of the conventional neoclassical framework generally used for the economic analysis of law. I will then briefly discuss the prospects for convergence of the two approaches. In Part II, I will discuss and summarize the earlier efforts undertaken by Austrians to apply their framework to understand and assess the evolution of legal rules and institutions. In Part III, I will draw upon this prior work in an attempt to outline the contours of an Austrian approach to understanding the legal system and the process of legal change. In Part IV, I will discuss the advantages and disadvantages of the Austrian approach as compared to the neoclassical framework as a basis for legal scholarship and instruction. In Part V I will present a few concluding observations.

## I. THE AUSTRIAN APPROACH COMPARED TO THE NEOCLASSICAL APPROACH

Austrian economic theory rests upon a number of fundamental premises that also underlie the neoclassical paradigm. This is not surprising because both approaches are based upon the work of Adam Smith and other 18th and 19th century classical economists, and because the Austrian approach did not separate from the classical mainstream until the 1870s.<sup>36</sup> There are, however, some significant differences between the two approaches. Most importantly, the two frameworks differ sharply in their treatment of time and uncertainty. The neoclassical framework, as will be discussed below, largely abstracts from such considerations to preserve analytical tractability and the ability to generate precise, quantitative predictions and determi-

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34 SOWELL, *supra* note 33.

35 See generally THOMAS KUHN, *THE STRUCTURE OF SCIENTIFIC REVOLUTION* (3d ed. 1970).

36 All Austrians trace the roots of their approach to the work of Carl Menger, particularly his *Principles of Economics*. See VAUGHN, *supra* note 14.

nate normative assessments. Austrians, in contrast, attempt to incorporate directly into their analyses the consequences of the passage of time for the preferences, expectations, and extent of knowledge of economic actors. This difference has significant implications not only for explanatory and predictive efforts, but also for normative assessment as well.

#### A. *Shared Premises of the Two Approaches*

First of all, Austrian economics shares with its neoclassical competitor the characteristic of being a "theoretical" approach to understanding phenomena. By this I mean simply that both approaches are based upon the use of simplified logical models of individual human behavior and social interaction that selectively abstract from much of the richness and complexity of actual events.

Austrians and neoclassicists differ, of course, in their views as to which aspects of the world can be abstracted from without vitiating the relevance of the models for explanatory or predictive purposes. They also differ in a more subtle way in their views of the purposes their theoretical models are to serve. Neoclassicists primarily regard their theories and models as tools for predicting future events. To them, a good "theory is merely a convenient fiction . . . which is capable of generating predictions that are more often correct than are [those] generated by other convenient fictions."<sup>37</sup> Predictive accuracy is the ultimate value; the degree of realism of those assumptions is a secondary consideration.<sup>38</sup> Austrians, in contrast, regard efforts to attempt to predict more than the most general features of future events as rather dubious, and consequently design their theories primarily to provide intellectually satisfying explanations of phenomena, rather than accurate predictions.<sup>39</sup> They therefore are inclined to favor the use of much more realistic and complex assumptions in their theories than are the neoclassicists.

A second central premise shared by Austrians and neoclassicists is the commitment to "methodological individualism" as the primary explanatory and evaluative principle. Both approaches regard individual human actors as the fundamental loci of choice and action in the social world, and the welfare of those actors as the appropriate basis for any normative assessments. In either framework, supra-individual collective entities such as "markets," "governments," "societies," and

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37 Richard B. McKenzie, *The Neoclassicalists vs. the Austrians: A Partial Reconciliation of Competing Worldviews*, 47 S. ECON. J. 1, 7 (1980).

38 See MILTON FRIEDMAN, *ESSAYS IN POSITIVE ECONOMICS* 3-43 (1953).

39 See *id.* at 9.

the like are regarded as being merely abstract intellectual concepts that, while often useful for organizing data for particular analytical purposes, do not possess a "real" ontological status. These supra-individual entities are viewed as derivative social creations that are unable to act independently of the individual human actors whose thoughts and behavior create and sustain them, and the consequences of policies for those entities are not accorded any normative significance apart from their consequences for those individuals.

A third feature shared by Austrian and neoclassical economics is the assumption of rational individual behavior. Both approaches posit that people will behave rationally, though not necessarily self-consciously so, in utilizing their knowledge and available economic means to best satisfy their preferences.<sup>40</sup> Austrians and neoclassicists are each confident in the "power and fruitfulness of the rationality postulate," and both groups generally reject attempts to empirically test the "assumption of rationality in any experimental setting."<sup>41</sup> The neoclassicists, however, tend to emphasize somewhat more the consciously rational aspects of human behavior, while the Austrians stress the importance of tacit knowledge and habitual conformity with institutional routines as a key component of rational action.

Both approaches presuppose scarcity as the fundamental economic problem. Individuals are regarded as faced with the constraint that their available means are insufficient to achieve all of their desired ends, and thus are forced to "economize" in their deployment of those means to achieve the greatest total satisfaction possible under the circumstances. Both approaches, therefore, recognize that trade-offs are pervasive and unavoidable.

Finally, both the Austrian approach and the neoclassical paradigm give pride of place to the "invisible hand" principle. Central to both approaches is the insight that a spontaneous order can emerge in human affairs that was not planned or intended by any person or group of persons, and that has desirable properties beyond the capability of any group of persons to consciously orchestrate. Both Austrians and neoclassicists see this phenomena manifested most visibly by a system of free markets, where the structure of relative prices in the different markets serves to efficiently coordinate the economic activity

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40 There is a difference between the two approaches in the justification offered for use of the rationality assumption. The Austrians regard it as an axiom necessarily implicit in the concept of human action, where the neoclassicists tend to regard it more as an instrumental assumption selected for its ability to generate useful predictions. See Gary Lawson, *Efficiency and Individualism*, 42 DUKE L.J. 53, 54 (1992).

41 Karl-Heinz Paqué, *How Far Is Vienna from Chicago?: An Essay on the Methodology of Two Schools of Dogmatic Liberalism*, 38 KYKLOS 412, 420 (1985).

of many millions of persons in a fashion that would be difficult or impossible to replicate through central governmental coordination. Austrians, however, typically are willing to rely upon such spontaneous orders to achieve more social objectives than are neoclassicists, as will be discussed below, perhaps because their approach has given them a greater appreciation of the nature and power of market processes.

### *B. Differences Between the Two Approaches*

Where the two approaches diverge most dramatically is in their respective treatments of time and uncertainty. The passage of time must be addressed in some fashion in any theoretical model of economic behavior, because the sought-for results of human actions generally do not occur instantaneously with those actions. There is usually a period of time that must elapse between when a person chooses how to deploy his economic means to achieve the greatest possible satisfaction of his wants, and when this objective is achieved. The existence of such a time period creates the possibility that the person's preferences, or his access to economic means, or the extent of his knowledge as to how such means can be wielded to achieve maximal satisfaction, will change before his objective is achieved. If so, that person may, on the basis of this new information or perspective, regard his earlier choices as inferior to those that might have been made and seek to revise his plans to the extent possible. This is particularly likely if the person's initial choices were made on the basis of relatively incomplete information as to the possible uses of his economic means, because under those circumstances the passage of time is more likely to reveal new and better ways, the available means can be utilized to achieve satisfactions.

The neoclassical framework abstracts from these difficulties posed by time and uncertainty in its efforts to predict behavior. This simplification permits neoclassicists to preserve a level of analytical tractability that allows for the use of sophisticated mathematical and quantitative techniques. The conventional foundational assumptions made in a neoclassical analysis are that persons have stable, exogenously determined preferences that do not change during the period of time under scrutiny, and that they also have access to perfect information as to available possibilities and constraints when making their optimizing decisions. Because the problems created by the passage of time, pervasive ignorance, and uncertainty have been assumed away in this fashion, the neoclassical models have a simple, determinate structure that allows them to be used to generate "equilibriums"—steady-state results uniquely determined by the original preference and con-

straint conditions—which can then be compared across different initial preference or constraint sets.

Consider, as the best known example of a neoclassical economic model, the basic market model of price and output determination under perfect competition that is at the heart of most neoclassical analyses. Persons are regarded as coming to such a market with an exogenously determined wealth endowment and set of preferences that do not change during the period in which they make their buying or selling decisions. Furthermore, they come with perfect information as to the (unchanging) set of production possibilities and the availability and prices of complementary and substitute goods and factors of production. In such a timeless market comprised of all-knowing persons, there is deemed to occur an instantaneous equilibration.<sup>42</sup> Any shortages or surpluses lead to rapid price adjustments which mesh the competing interests of all these persons into a supply and demand equilibrium at a single price and quantity, where the marginal costs equal marginal benefits, and which thereby leaves no further possibilities for mutually beneficial transactions among the participants.

The results obtained from such a model are completely determined by its initial conditions, in a fashion quite similar to the results obtained from the Newtonian models of classical physics.<sup>43</sup> Such models of the market process of this nature are obviously well-suited for application of the sophisticated mathematical techniques of constrained optimization. Any set of initial preferences, wealth endowments, and resource and technology constraints can be input into a simultaneous equation framework to derive the resulting equilibrium outcome for each actor and for the market as a whole.

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42 DANIEL B. SUITS, *PRINCIPLES OF ECONOMICS* 320–43 (2d ed. 1973).

43 This congruence is to be expected, because the visible success of the Newtonian models is what led economic theorists to design their explanatory schemes along similarly deterministic lines.

The dominant [sic] school of economic theory in the West, which we shall call “neoclassical economics,” has in the past often been praised and damned by being held up to the standards of physics . . . [O]ne rapidly discovers that the resemblances of the theories are uncanny, and one reason they are uncanny is because the progenitors of neoclassical economic theory boldly copied the reigning physical theories in the 1870’s. The further one digs, the greater the realization that those neoclassicals did not imitate physics in a desultory and superficial manner; no, they copied their models mostly term for term and symbol for symbol, and said so.

PHILLIP MIROWSKI, *MORE HEAT THAN LIGHT: ECONOMICS AS A SOCIAL PHYSICS: PHYSICS AS NATURE’S ECONOMICS* 3 (1989).

Here is where the Austrians part company from the neoclassicists. From their perspective, it makes as little sense to abstract from such central and ubiquitous features of life as time and uncertainty as it would to assume away the existence of scarcity.<sup>44</sup> While they concede that such drastic simplifications make analysis much more straightforward and create possibilities for displaying mathematical virtuosity, Austrians contend that these simplifications defeat the main purpose of the whole theoretical enterprise, which is to aid in understanding real world events.<sup>45</sup>

Austrians instead start from what they regard as more realistic assumptions. They posit that individuals are malleable in terms of their preference structures, continually changing their wants as they undergo the experiences of life.<sup>46</sup> They further assume that individuals have access at any given point in time to only radically incomplete

44 See VAUGHN, *supra* note 14, at 4.

45 Ludwig Mises, for example, rejected mathematical and quantitative methods as unsuitable methodologies for economic analysis:

The impracticability of measurement [in economics] is not due to the lack of technical methods for the establishment of measure. It is due to the absence of constant relations. If it were only caused by technical inefficiency, at least an approximate estimation would be possible in some cases. But the main fact is that there are no constant relations. [Austrian] Economics is not, as ignorant positivists repeat again and again, backward because it is not "quantitative." It is not quantitative and does not measure because there are no constants.

LUDWIG VON MISES, *HUMAN ACTION: A TREATISE ON ECONOMICS* 56 (1949). In his 1974 Nobel Memorial Lecture, Friedrich Hayek offered a similarly critical assessment of the use of mathematical methods in economics:

It seems to me that this failure of the economists to guide policy more successfully is closely connected with their propensity to imitate as closely as possible the procedures of the brilliantly successful physical sciences—an attempt which in our field may lead to outright error. It is an approach which has come to be described as the "scientistic" attitude—an attitude which, as I defined it some thirty years ago, "is decidedly unscientific in the true sense of the word, since it involves a mechanical and uncritical application of habits of thought to fields different from those in which they have been formed."

HAYEK, *NEW STUDIES*, *supra* note 19, at 23, see also Walter Block, *On Robert Nozick's 'On Austrian Methodology'*, 23 *INQUIRY* 397, 398 (1980).

The explanation . . . of why people act is *teleological*; they act because they have *purposes* which they think can be accomplished if they act. But such a mode is completely at variance with that which prevails in the natural sciences. There, causality or correlation is all, and teleology is dismissed as a suspect and illegitimate kind of anthropomorphism.

*Id.*

46 See VAUGHN, *supra* note 14, at 80.

knowledge as to existing circumstances, and moreover are highly uncertain in their expectations as to the future course of events. They believe that to assume away this malleability, pervasive ignorance, and inherent uncertainty—and also to assume that market outcomes occur instantaneously rather than over a period of time during which individual preferences as well as opportunities and constraints may change—serves to obscure the key insight Austrians wish to specially emphasize. This key insight is that market behavior is best viewed as a “discovery process,” continually generating entrepreneurial opportunities to be seized by alert individuals. It is a process involving trial and error, engaged in by creative persons having fluid attitudes and expectations and quite limited knowledge. It is a process taking place within an evolving institutional framework, rather than a process that is completely determined by exogenous conditions and that rapidly converges to a stable equilibrium state. Through their market and non-market activities, persons obtain feedback concerning their available opportunities and the constraints they must respect. As a result of this feedback, they may alter their preferences and expectations as they become aware of new potential satisfactions and new ways to deploy their means to satisfy their preferences. These changes alert individuals to new entrepreneurial possibilities, which will lead some of them to make behavioral changes to take advantage of these opportunities, and which will in turn impact and influence other market participants and the overall institutional order in a continual evolutionary process.

This ongoing social “learning” process, and the continual revealing and pursuit of entrepreneurial opportunities, is regarded by Austrians as the central dynamic force underlying the evolution not only of markets, but also of all other social institutions. They therefore choose to highlight this evolutionary process in their explanatory models, rather than to obscure it through the use of restrictive, deterministic models that rely heavily upon concepts of stable equilibria and instantaneous adjustment.

The two approaches also diverge in terms of their assumptions as to the nature of factors other than preferences, expectations, and the extent of knowledge of prices and production possibilities. Most significantly, Austrians and neoclassicists regard differently the overarching structure of laws and other social institutions that condition market behavior and other forms of social interaction. Neoclassicists generally posit a stable framework of customary practices and legal rules—particularly the rules governing property ownership and contractual rights—that remains unchanged during the (assumed instantaneous) period during which actors make their choices and obtain

the results of those choices. From the Austrian perspective, however, the framework of legal and social institutions is as endogenous with regard to the social learning process as are individuals' expectations and the extent of their knowledge. That institutional framework is viewed as simply another form of spontaneous order that emerges as individuals attempt to avoid the consequences of their ignorance and uncertainty. It necessarily undergoes continuous change, as it is simply the result of the behavior of individuals who play various conscious or habitual roles in its articulation.<sup>47</sup> The outcomes of the market processes that take place within the confines of the overarching institutional structure change over time as those persons participating in those processes continually adjust their behavior in light of new information as to the relative prices of goods, services, and factors of production, as well as in response to changes in their preferences and understanding of production possibilities. The institutional structure itself similarly undergoes alterations, as those persons whose private and public behavior constitutes those institutions undergo comparable alterations in their attitudes and knowledge.

From this Austrian perspective, the emphasis neoclassicists place on the econometric estimation of the various structural parameters of the economy seems to be a misdirection of effort. Trying to estimate the parameters of an economy that is in a constant, all-encompassing, evolutionary disequilibrium is a futile exercise because, in such an economy, there can be no such parameters; "no static, time invariant relations."<sup>48</sup> Such econometric estimates may be of some assistance for historical work done in an attempt to establish the connections that existed among prior events, but they cannot be of meaningful predictive assistance.

This dramatic difference in the approaches taken with regard to dealing with the effects of time and limited knowledge in explanatory models also has major implications for the choice of normative criteria. The neoclassical approach, with its assumptions of exogenous preferences and stable institutional structures, and its consequent ability to derive partial and general equilibrium results for various initial conditions, obviously lends itself well to evaluation of policy alter-

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47 There are not two kinds of things—individual actions and institutions. Rather, they are one and the same, looked at, perhaps, from two different perspectives. Human history is the story of the unfolding of actions which lead to other actions which lead to further ones, in a, so far, unending chain. The fact that some commentators have called some of these complex patterns of individual actions "institutions" should not confuse the issue, and lead us to believe that there is anything apart from such separate human actions.

Block, *supra* note 45, at 405.

48 Paqué, *supra* note 41, at 429.



natives by comparing their different equilibrium outcomes with regard to the degree of preference satisfaction obtained by the affected individuals under the differing constraint sets imposed by those alternatives. The Pareto improvement<sup>49</sup> and Kaldor-Hicks improvement<sup>50</sup> efficiency criteria naturally emerge as reasonable normative standards within such a framework, although a complete justification for the use of either efficiency criterion requires a resort to additional value judgments beyond those inherent in the neoclassical explanatory framework. The plausibility of the Pareto improvement unanimity criterion, for example, rests upon the anti-paternalistic premise that each person is properly regarded as the best judge of his own welfare.<sup>51</sup> The Kaldor-Hicks criterion, however, is an aggregate measure rather than a unanimity criterion, and consequently also rests upon some additional and more problematic premises concerning the proper method of valuing of impacts and the appropriateness of imposing uncompensated losses on some persons.<sup>52</sup> Despite its shortcomings, however, the latter criterion is widely used to assign normative significance to the conclusions reached through a neoclassical analysis.

In the Austrian framework, however, there is no assumption made that either individual preferences or the legal and other social institutions shaping social interactions will remain unaffected by a policy measure. It is instead assumed that any significant policy alternative will, over time, result in market process-generated learning by many individuals which will influence their preferences, expectations, knowledge, and behavior, including those persons whose behavior provides the overall institutional framework. It is meaningless, from this perspective, to attempt to assess the consequences of a policy alternative with any yardsticks of "efficiency" that are based upon the

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49 A change in the allocation of resources is defined as a Pareto improvement if at least one person prefers the new allocation over the original allocation, and no person regards himself as worse off as a result of the new allocation. For a discussion of the properties and problems of the Pareto improvement criterion, see Gregory Scott Crespi, *The Midlife Crisis of the Law and Economics Movement: Confronting the Problems of Nonfalsifiability and Normative Bias*, 67 NOTRE DAME L. REV. 231, 234-37 (1991).

50 A change in a resource allocation is defined as a Kaldor-Hicks improvement if the benefits of the change, as measured by the willingness to pay of the persons benefited, exceeds the costs of the change, as measured by the willingness to pay of the persons injured. For a discussion of the properties and problems of the Kaldor-Hicks improvement criterion, see *id.*

51 *See id.* at 235.

52 *See id.* at 236-37

original structure of preferences and institutional framework that no longer exist once that policy has been implemented.

When Austrian economists offer a normative assessment of a policy, their judgment is not based upon the "efficiency" characteristics of the resource allocation resulting from that policy, as measured at any point in time against any particular set of preferences and constraints.<sup>53</sup> Their assessments focus instead on the impact of the policy measure at issue upon the *processes* through which individual learning and behavioral changes take place over time, and upon the institutional structure which shapes and guides those processes.<sup>54</sup> In other words, their normative assessments are grounded in their conclusions as to the relative impacts of policy alternatives on the degree of freedom accorded to persons to utilize markets and other social institutions as means of identifying and seizing entrepreneurial opportunities, broadly defined, and for correcting their prior mistakes and reducing their ignorance, rather than with regard to the relative level of preference satisfaction obtainable at any point in time under those alternatives.

Why do the Austrians so favor market processes? Obviously such processes are not endorsed for their own sake, but for their perceived desirable effects upon individual persons. Value judgments external to their explanatory models concerning what effects upon persons are desirable are therefore necessarily implicit in the Austrian normative criteria, just as in the case of neoclassical normative assessment through the use of efficiency criteria. The central value premise embraced by Austrians is individual freedom from domination,<sup>55</sup> which they regard as best furthered by pervasive and clearly demarcated private property rights and reliance upon consensual market processes for social organization. A related and subsidiary evaluative criterion is whether a proposed policy will ultimately work to facilitate the free

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53 *But see infra* notes 121–50, 207–12 and accompanying text (discussing the efforts of Roy Cordato and Linda Schwartzstein to develop an efficiency criterion grounded in Austrian premises).

54 *See infra* text accompanying notes 285–88.

55 Mises "defines freedom as that state of affairs in which the individual is free in the sense of being free to choose between various actions within a market economy. The government is to be confined to the protection of people against the violence or aggression of other individuals." ALEXANDER H. SHAND, *FREE MARKET MORALITY: THE POLITICAL ECONOMY OF THE AUSTRIAN SCHOOL* 94–95 (1990). "Freedom is the predominant [sic] value in Hayek's social and economic philosophy . . ." *Id.* at 97. "[Rothbard contends] that freedom is meaningfully definable only as absence of interpersonal restrictions . . . . [Rothbard states that] 'it is the free market in a free society that furnishes the only instrument to reduce or eliminate poverty and provide abundance.'" *Id.* at 109.

market discovery process by which price data and other crucial economic information is disseminated and entrepreneurial opportunities are perceived and taken advantage of.<sup>56</sup> This second criterion rests upon the implicit premise that the ultimate consequences of the entrepreneurial dynamism unleashed by free markets will necessarily be of general benefit to humanity in terms of increasing levels of satisfaction of wants. Some Austrians have argued, however, that this premise is potentially open to refutation.<sup>57</sup>

### C. *The Prospects for Convergence of the Two Approaches*

One of the major current debates among Austrians is whether the prospects for eventual incorporation of Austrian principles into the mainstream neoclassical framework in a fashion that does proper justice to the central Austrian insights are promising enough for that reconciliation to be actively pursued.<sup>58</sup> Israel Kirzner, one of the leading active Austrians, has attempted to develop a model of the entrepreneurial process that captures the emphasis Austrians place upon market discovery processes and individual uncertainty, yet is sufficiently formalized to be incorporated into neoclassical market models of optimization under exogenous constraints.<sup>59</sup> Other prominent

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56 See Cordato, *supra* note 23, at 62–63.

57 See, e.g., VAUGHN, *supra* note 14, at 147.

If entrepreneurs can be wrong, not in the simple sense of missing opportunities but in the far more important sense of using resources in ways that lead to losses, how can they be seen as the unequivocal driving force bringing the system toward equilibrium? If they can be wrong, perhaps they can be a destabilizing influence on the market and perhaps that instability can persist for long periods of time.

*Id.*

In other words, rather than entrepreneurs having only the effect of arbitrageurs who reduce price differentials and thus smooth fluctuations and imbalances, they may at times act in a disorganized group fashion to push markets further out of balance, at least temporarily, until their collective error becomes apparent. For example, the Austrian view of the monetary disturbance-generated business cycle assumes that entrepreneurs in the capital goods industries will collectively overreact to the fall in interest rates caused by an expansion in the money supply, which will lead to a subsequent discoordination between the production of investment and consumption goods. See Edwin Dolan, *Introduction to THE FOUNDATIONS OF MODERN AUSTRIAN ECONOMICS* (Edwin Dolan ed., 1976). There is therefore both a “boom” and a “bust” period generated by entrepreneurial behavior during such a business cycle, rather than a simple move towards equilibrium.

58 See, e.g., VAUGHN, *supra* note 14, at 1–9, 162–78; Kirzner, *Review*, *supra* note 21, at 1–4, 17–18; Lachmann, *Review*, *supra* note 22, at 1–4, 17–18 (1985).

59 KIRZNER, *COMPETITION*, *supra* note 21.

Austrians such as Ludwig Lachmann, Mario Rizzo, and Karen Vaughn, however, have criticized such efforts to “domesticate” Austrian concepts for neoclassical absorption as resulting in essentially deterministic models that inadequately embody the central Austrian notion of an economic and institutional world in continual flux, and that consequently are unable to explain certain important and pervasive real-world phenomena.<sup>60</sup> While certain recent developments in neoclassical theory could be viewed as attempts from the “other side” to incorporate to some extent the central Austrian insights,<sup>61</sup> the general

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60 See LACHMANN, *ECONOMIC PROCESS*, *supra* note 22; ]; VAUGHN, *supra* note 14, at 162–78; Mario Rizzo, *Afterward to AUSTRIAN ECONOMICS: TENSIONS AND NEW DIRECTIONS* 245, 246–47 (Bruce J. Caldwell & Stephan Boehm eds., 1992) [hereinafter Rizzo, *Afterward*].

61 For example, neoclassicists in recent years have made increasing use of game-theoretic models in an attempt to capture some of the dynamic aspects of market processes and their relation to law. See, e.g., DOUGLAS G. BAIRD ET. AL., *GAME THEORY AND THE LAW* (1994); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 *YALE L.J.* 615 (1990).

In addition, there has developed an economics of information literature that examines some of the implications of relaxing the neoclassical perfect information assumption. See, e.g., 2 HERBERT ALEXANDER SIMON, *MODELS OF BOUNDED RATIONALITY* (1982); George A. Akerlof, *The Market for Lemons: Quality Uncertainty and the Market Mechanism*, 84 *Q.J. ECON.* 488 (1970); Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 *AM. ECON. REV.* 777 (1972); Kenneth J. Arrow, *Limited Knowledge and Economic Analysis*, 64 *AM. ECON. REV.* 1 (1974); Michael Spence, *Job Market Signaling*, 87 *Q.J. ECON.* 355 (1973); George Stigler, *The Economics of Information*, 69 *J. POL. ECON.* 213 (1961).

Some of the work associated with various strands of neoclassical thought commonly labeled “Transaction Cost Economics,” “Institutional Economics,” “Socio-Economics,” or “Evolutionary Economics” also shows an attempt to grapple with the difficulties of introducing dynamic considerations into the essentially static equilibrium framework. See, e.g., *SOCIO-ECONOMICS: TOWARD A NEW SYNTHESIS* (Amitai Etzioni & Paul R. Lawrence eds., 1991); George Barker, *A Comparative Institutional Approach to Law and Economics*, 26 *VICTORIAN U. OF WELLINGTON L. REV.* 109 (1996); RICHARD R. NELSON & SIDNEY G. WINTER, *AN EVOLUTIONARY THEORY OF ECONOMIC CHANGE* (1982).

Finally, some of the work done by the prominent public choice theorist and Nobel Laureate James Buchanan reveals the major influence of Austrian thought upon his work. See, e.g., JAMES BUCHANAN, *COST AND CHOICE: AN INQUIRY INTO ECONOMIC THEORY* (1969) (endorsing Hayek’s methodology and the Austrian position taken in the socialist calculation debate); JAMES M. BUCHANAN, *WHAT SHOULD ECONOMISTS DO?* (1979) (containing the 1963 Presidential address to the Southern Economic Association and arguing that economics should be regarded as the study of exchange in a catallaxy). In addition, until shortly after he received the Nobel Prize in 1986, Buchanan taught virtually all of the graduate students who studied Austrian economics at George Mason University, one of the leading American centers of Austrian thought. His influence over those students was described as “immense.” VAUGHN, *supra* note 14, at 119 n.10.

intellectual climate among mainstream economists has always been relatively hostile to Austrians, and perhaps has become increasingly so in recent years.<sup>62</sup> This hostility stems largely from a widespread perception that Austrian economics is “unscientific” because of its refusal to adopt the mathematically-oriented stable preferences/constrained maximization/equilibrium methodology favored by neoclassicists,<sup>63</sup> which is even regarded by some neoclassicists as more determinative of economics as a discipline than is its ostensible subject matter.<sup>64</sup> Neoclassicists are likely to continue to reject any aspects of Austrian theory that require them to discard the equilibrium concept and thus lose the ability to utilize mathematical techniques to generate determinate results.

It thus appears that Austrians are fated to remain outside of the neoclassical mainstream, and consequently their efforts would probably be better spent in further refinement and articulation of their own explanatory models. In the spirit of this enterprise, I will outline in Part III below the general contours of an Austrian explanatory framework that could aid in understanding the legal process. In setting forth these principles, I will attempt to remain faithful to the Austrian conception of a social world driven by individual actions taking place over time, under circumstances of malleable preferences, extreme ignorance, pervasive uncertainty, and institutional flux. Before engaging in this theoretical effort, however, in Part II below let me first discuss and summarize some of the prior work that has been done by Austrians that most directly applies Austrian concepts to questions of legal design and evolution.

## II. PRIOR EFFORTS TO APPLY AUSTRIAN CONCEPTS TO LEGAL QUESTIONS

From the Austrian perspective, a society’s “legal system” has no existence independent of the subjective perceptions and conduct of the individuals that constitute that society. Austrians define such social institutions functionally and tentatively, remaining cognizant of the fact that they are simply abstract categories used as organizing concepts for thinking about certain of the more regular and predictable aspects of individual behavior. In other words, the fundamental

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62 “The intellectual climate in the mainstream of the [economics] profession has become increasingly hostile to Austrian economics.” Rizzo, *Afterward*, supra note 60, at 246.

63 *See id.*

64 *See id.* at 247 (citing GARY S. BECKER, *THE ECONOMIC APPROACH TO HUMAN BEHAVIOR* (1976)).

reality is that the overall social process through which persons interact over time, with certain aspects of their behavior having sufficient persistence and regularity to create and sustain enduring “institutions” rather than being merely transient and unique episodic phenomena. Further, regularized behavior that relates directly to the actual or potential use of coercion, and that takes place in a particular context where most individuals generally acquiesce to such coercion as a legitimate exercise of authority, can be collectively described as a “legal institution,” and the set of all such legal institutions might be collectively labeled the society’s “legal system.”

Given their holistic view of the social process, it is not surprising that Austrians have tended to address legal questions only tangentially in the context of broader analyses of social and political processes and institutions, rather than as separate issues. However, some Austrians, particularly some of the more recent writers who have legal backgrounds and who target their work primarily at an audience of legal scholars, have written articles that while grounded in the holistic Austrian perspective focus primarily upon legal issues of a more narrowly defined character.

Let me first outline in relatively broad terms in Section A below the general position traditionally taken by Austrians with regard to legal questions. I will then turn in Section B to some more recent Austrian work that has been published largely in mainstream legal journals, and which focuses more closely upon the kinds of questions of primary interest to legal scholars. Finally, in Section C, I will discuss an influential and widely-read book by Thomas Sowell which broadly applies Austrian themes. After summarizing and critiquing these more recent efforts from an “internal” Austrian perspective, I will then attempt to set forth the general contours of a framework for addressing legal issues that rests upon Austrian principles, which can also serve as an introductory pedagogical vehicle for teaching law students how to engage in the economic analysis of law.

#### A. *The Traditional Austrian Stance on Legal Questions*

To the extent that the major Austrian writers such as Mises, Hayek, Rothbard, and others have addressed legal questions, they have done so primarily from a normative rather than a descriptive or explanatory perspective. The dearth of attempts to utilize the Austrian framework to explain how legal and political institutions come into being and evolve is one of the major deficiencies of Austrian literature.

As noted earlier, the primary normative commitment shared by Austrians is their embrace of individual freedom from domination as the ultimate value. It is generally taken as a second article of faith that the greater the degree of freedom of contract accorded market participants, and the more stable and predictable the regime of property rights, the more dynamic will be the entrepreneurial market process, the more rapid will be economic growth, and the more individual welfare will ultimately be enhanced.<sup>65</sup> The Austrian writers taking normative positions have therefore consistently endorsed those kinds of legal and political regimes that they view as both enhancing individual freedom and furthering the market process. Such regimes include: 1) stable and comprehensive regimes of property rights that internalize as many of the consequences of behavior as reasonably possible, given the costs and inherent limitations of governmental action,<sup>66</sup> 2) freedom of contract, and 3) governmental intervention into private affairs, other than the definition and protection of property rights and enforcement of contracts, being limited to at most arranging for the availability of those public goods not suitable for provision through private market mechanisms.<sup>67</sup> The ideal state that those writers envision is one that is profoundly neutral and is not linked to the purposes of any one social group, but simply provides a stable framework of rules and arrangements under which people can pursue their own individual aims without coming into conflict with one another.

However, there have been very few attempts to explain the contours and evolution of the legal framework over time through the use of the same explanatory framework used by Austrians to explain the dynamics of the market process. Much of the Austrian normative writing suggests, at least implicitly, that a structure of legal rules can be formulated by persons of good intentions, and then imposed upon the market process from "the outside," so to speak, and subsequently operate as a purely exogenous constraint on that process.<sup>68</sup> This view

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65 *But see* VAUGHN, *supra* note 14, at 143, 146-47.

66 Some recent Austrian writers, however, are quite skeptical regarding the ability of the government to assemble the information necessary to accurately "internalize" the impacts of behavior that are not priced through markets. *See, e.g.*, CORDATO, *supra* note 23, at 15-27.

67 *But see id.* (arguing that Austrian premises do not support government intervention to facilitate the provision of public goods).

68 Friedrich Hayek took the following position concerning the proper role of the judge in a legal dispute:

In this [judging] it will often be impossible to distinguish between the mere articulation of rules which have so far existed only as practices and the statement of rules which have never been acted upon before but which, once stated, will be accepted as reasonable by most. But in neither case will the

of the legal and political system, however, is radically inconsistent with the basic Austrian position as to how the evolution of social institutions in fact occurs.

In the general Austrian explanatory framework, all legal rules and institutions, as well as all other social institutions, are treated as endogenously determined as part of the ongoing social process. Persons come to the markets and their other social interactions with malleable preferences, limited information, and pervasive uncertainty. In response to the circumstances they encounter, they act in rational fashion to maximize their satisfactions. One form of action is to attempt to utilize coercion to achieve one's ends. As persons interact with one another their exercise of actual or threatened coercion tends to become regularized over time—through the processes of victory, defeat, and mutually advantageous accommodation and compromise—into various institutional forms that might collectively be labeled the “legal system.” Some persons gravitate towards social roles where their behavior is often significant for the operation of this legal system, such as the roles of judges, legislators, attorneys, and police. Others may play more indirect roles where they generally attempt merely to accommodate to the patterns of coercion imposed by the legal system as they perceive them, rather than seek to actively maintain or influence those patterns. As any individual alters his coercion-related behavior in entrepreneurial fashion in response to changes in his preferences or to new information or constraints, these alterations in a small way influence the operation of this legal system, which then has feedback effects upon that person and other individuals.

The contours of a legal system thus evolve endogenously over time in the same fashion as do markets and other social institutions. Given this fact, any efforts to influence the development of a legal system can only have their impacts through their contribution to this same dynamic process. From this Austrian perspective as to how social change occurs, normative declarations by an individual as to the nature of an “ideal” legal system will have no impact upon events except insofar as those declarations alter some individual's behavior. Moreover, the behavioral changes they motivate will then interact with a myriad of other behaviors in a very complex fashion where even the

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judge be free to pronounce any rule he likes. The rules which he pronounces will have to fill a definite gap in the body of already recognized rules in a manner that will serve to maintain and improve that order of actions which the already existing rules make possible.



general direction of change, let alone the ultimate result at any subsequent point in time, is difficult or impossible to predict.<sup>69</sup>

In light of its core commitment to dynamic explanations of events that they believe better reflect the true circumstances facing individuals than do static neoclassical explanations, and their emphasis of the unpredictability of future events, the Austrian normative literature has a strangely disembodied, *ex cathedra* quality to it that does not mesh well with those principles.<sup>70</sup> Beyond offering a few unsubstantiated claims that governmental efforts to intervene into the workings of free markets will tend to “snowball” into more extensive interventions until full socialism is established,<sup>71</sup> Austrians traditionally have not made serious efforts to identify the crucial points of leverage in the network of social institutions where attempts to reshape the legal and political order are likely to have significant and beneficial consequences, nor have they attempted to bring their energies to bear at these points in furtherance of their normative agenda.<sup>72</sup> However, some of the more recent Austrian writers whose work will be discussed below have shown

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69 It could well be that theorizing as to the optimal contours of legal regimes, such as the major Austrian writers have done extensively, might not be a particularly effective way to bring about such regimes. Moreover, the ultimate consequences of such theorizing could be to move the legal institutions in the wrong direction, given the particular dynamic of counter-responses and adjustments that might be triggered by the behavior inspired by those theories.

70 This problem has been noted by other observers. See, e.g., McKenzie, *supra* note 37, at 11.

Austrians are primarily interested in discussing the broad outlines of a Lockian-style social contract that will maximize individual freedom. . . . However, much of the discussion of social contracts appears to be conducted on the assumption that the contract, once devised, will be fully operative. Any dispute which may arise subsequently to the adoption of the contract can be settled with reference to rules laid down within the contract. There is a presumption, in other words, that rules for maximizing individual freedom and minimizing collective action can be constructed and can form an effective barrier against subsequent efforts by special interest groups to distort the substance and meaning of the adopted rules. Austrians seem . . . to presume that the economic forces which make a social contract necessary in the first place are held in check by the social contract that is developed.

*Id.*

71 See e.g., Mises, *supra* note 18, at 855–61.

72 Other observers have also noted and been critical of the dearth of Austrian attempts to operationalize their explanatory models through empirical research. See, e.g., Paqué, *supra* note 41, at 426.

The central question for [Austrian] economics, then is whether, how, and how quickly individuals become successful entrepreneurs by discerning past errors and inefficiencies and correcting their resource allocation accordingly.

a greater interest in formulating explanatory schema that could link the more abstract and general Austrian normative commitments to recommendations for specific action.

### B. *More Recent Austrian Writings on Legal Questions*

Over the past two decades a significant number of scholars have produced some interesting work in the Austrian tradition which bears more directly upon legal questions than did the more general, economics-oriented writings of their predecessors, and which is addressed primarily to legal scholars rather than professional economists. I would like to briefly discuss the work of nine Austrian writers in particular: Mario Rizzo, Gerald O'Driscoll, Christopher Wonnell, Roy Cordato, Michael Debow, Thomas Arthur, Linda Schwartzstein, Michael Spicer, and Thomas Sowell. I will discuss the first eight of these authors' works in that order, since it roughly corresponds to the chronological order of their major contributions. I will then turn in Section C to a more extended discussion of Thomas Sowell's work.

#### 1. Mario Rizzo

During the early 1980's Mario Rizzo carved out a niche for himself in the mainstream law journals in which he developed a recognizably Austrian approach to the economic assessment of tort law.<sup>73</sup> While those articles addressed a number of issues, his major Austrian

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Unfortunately, Austrian economics at its present stage of development looks very much like a programme without research. While the fundamental points of departure from mainstream economics have been repeatedly formulated, there has so far been no serious attempt to operationalize the ideas in a full-scale empirical research project. This is probably due to two facts: the traditional Austrian scepticism [sic] concerning empirical research, and the nature of the required research project itself which would have to fall in the no man's land between social psychology, sociology, and economics. Until the Austrians overcome their reluctance to start empirical research on the dissemination of information, their programme is stuck.

*Id.*

<sup>73</sup> See, e.g., Mario Rizzo, *A Theory of Economic Loss in the Law of Torts*, 11 J. LEGAL STUD. 281 (1982); Mario Rizzo, *Can There be a Principle of Explanation in Common Law Decisions? A Comment on Priest*, 9 J. LEGAL STUD. 423 (1980); Mario Rizzo, *Foreword: Fundamentals of Causation*, 63 CHI.-KENT L. REV. 397 (1987); Mario Rizzo, *Law Amid Flux: The Economics of Negligence and Strict Liability in Tort*, 9 J. LEGAL STUD. 291 (1980) [hereinafter Rizzo, *Law*]; Mario Rizzo, *The Imputation Theory of Proximate Cause: An Economic Framework*, 15 GA. L. REV. 1007 (1981); Mario Rizzo, *The Mirage of Efficiency*, 8 HOFSTRA L. REV. 641 (1980) [hereinafter Rizzo, *Mirage*]; see also TIME, UNCERTAINTY AND DISEQUILIBRIUM: EXPLORATION OF AUSTRIAN THEMES (Mario Rizzo ed., 1979); Rizzo, *Afterward*, *supra* note 60, at 245-53.

theme was that if judges were to attempt to follow the recommendations of many law and economics scholars to utilize economic efficiency as a criterion for deciding tort cases, they would first have to be able to calculate the appropriate efficient shadow prices—the prices that would be established in hypothetical zero transaction cost markets in a state of economy-wide general equilibrium—for the rights subject to litigation. However, to Austrians the inherent limitations of human knowledge and the continual and unpredictable dynamics of technological change make this an impossible task, and therefore an unwise pursuit.<sup>74</sup> On this basis Rizzo argued that strict liability was preferable to negligence as a general standard of liability, since it would provide greater certainty for individuals attempting to plan their conduct by saving courts and litigants the difficulties of having to grapple with issues of foreseeability, cost avoidance capability, and the like.<sup>75</sup>

As a leading Austrian theorist, Rizzo was certainly aware that from the Austrian perspective of a world in continual and total flux the concept of “economic efficiency” is meaningless, since it is predicated upon the neoclassical assumption of stable preferences and institutional structures that are unaffected by the decision being assessed. However, he apparently elected not to emphasize in his writings this more fundamental critique of attempts to utilize the efficiency criteria to shape tort law. Rizzo also co-authored with Gerald O’Driscoll the important Austrian treatise *The Economics of Time and Ignorance*.<sup>76</sup> That work will be discussed below in connection with the examination of O’Driscoll’s other writings.

## 2. Gerald O’Driscoll

In 1980 Gerald O’Driscoll contributed a review essay titled *Justice, Efficiency and the Economic Analysis of Law* to a symposium issue of the *Journal of Legal Studies*.<sup>77</sup> That essay was written in response to an arti-

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74 [T]he substantial information requirements that must be satisfied in order to identify efficient rules make efficiency impractical as a standard. Unless the efficiency theorists can show how courts can overcome the difficulties . . . they will continue to argue for a norm that has little operational content. It is all too easy to show that efficiency leads to desirable results within simplified constructs; it is quite another thing to show what this has to do with the world in which we live.

Rizzo, *Mirage*, *supra* note 73, at 658.

75 Rizzo, *Law*, *supra* note 73, at 317.

76 O’DRISCOLL & RIZZO, *supra* note 23.

77 Gerald O’Driscoll, Jr., *Justice, Efficiency, and the Economic Analysis of Law: A Comment on Fried*, 9 J. LEGAL STUD. 355 (1980).

cle by Charles Fried,<sup>78</sup> but went well beyond commenting on Fried's piece to offer an Austrian perspective on the controversy regarding the question of the efficiency of the common law.

In his essay, O'Driscoll emphasized the point made earlier by Mario Rizzo that even if judges were in fact attempting to promote economic efficiency in their rulings, they could not do so successfully since they as well as other individuals must act on the basis of very incomplete knowledge.<sup>79</sup> He drew a close parallel between the difficulties facing a judge who might try to mimic the "efficient" allocations that would result from a hypothetical market and the insoluble "socialist calculation" problem<sup>80</sup> extensively and convincingly discussed by Ludwig Mises in the early 1920s.<sup>81</sup> He also critiqued the position he attributed to both Charles Fried and Richard Posner that all rules of conduct can be "rationally reconstructed," and that this fact is their only claim to validity.<sup>82</sup> In his view, if one accepts this position concerning the ultimate rationality of rules one is encouraged to (wrongly) view all social institutions as deliberately designed.<sup>83</sup> O'Driscoll argued instead in true Austrian fashion that laws and morals are better regarded as spontaneously emerging social institutions, somewhat akin to language, rather than conscious human creations.<sup>84</sup> He therefore rejected the ideas implicit in much of the law and economics literature that the analysis of law should be regarded as a subset of the theory of rational choice, and that law can be explained as the pursuit of any single goal.<sup>85</sup>

O'Driscoll also co-authored with Mario Rizzo *The Economics of Time and Ignorance*,<sup>86</sup> which stimulated a well-publicized controversy among Austrians as to the merits of seeking closer reconciliation with neoclassical theory as opposed to developing an independent paradigm.<sup>87</sup> While that book was intended as a comprehensive restatement and clarification of Austrian economic theory, and dealt only

78 Charles Fried, *The Laws of Change: The Cunning of Reason in Moral and Legal History*, 9 J. LEGAL STUD. 335 (1980).

79 O'Driscoll, *supra* note 77, at 356-57.

80 *See id.* at 359.

81 *See, e.g.*, LUDWIG VON MISES, *SOCIALISM* (J. Kohane trans., MacMillan Co. 1936) (1922); Ludwig von Mises, *Economic Calculation in the Socialist Commonwealth*, in COLLECTIVIST ECONOMIC PLANNING 87 (F.A. Hayek ed., 1938).

82 O'Driscoll, *supra* note 77, at 364.

83 *Id.*

84 *Id.*

85 *Id.*

86 O'DRISCOLL & RIZZO, *supra* note 23.

87 *See, e.g.*, VAUGHN, *supra* note 14, at 133-38; Kirzner, *Review*, *supra* note 21, at 1-4, 17-18; Lachmann, *Review*, *supra* note 22, at 1-4, 17-18.

tangentially with legal issues, it nevertheless did provide some valuable insights concerning how Austrian concepts might be applied to examine questions of legal process. In particular, it suggested the use of a concept of "pattern equilibrium" that might facilitate Austrian analysis without abandoning its basic premises.

Both Austrians and neoclassicists refer to themselves as "subjectivists."<sup>88</sup> O'Driscoll and Rizzo in their book described the Austrian subjectivist position as a "dynamic subjectivism" that recognized the creativity and non-determinate nature of human choice, while claiming that the neoclassicists embraced a "static subjectivism" which recognized only the subjectivity of individual preferences, and which modeled choice as simply constrained maximization.<sup>89</sup> They also drew a distinction between the Austrian concept of "real time," in which learning continually takes place as a result of experience and leads to alterations in behavior, and the "Newtonian time" concept that characterizes neoclassical models in which the outcomes are completely determined by the initial conditions.<sup>90</sup>

The book emphasizes the importance of knowledge in economic behavior, and discusses the context, acquisition, role in market processes, and multi-faceted nature of knowledge.<sup>91</sup> In the authors' view it is not useful to conceive of the economic system as settling down to an equilibrium position.<sup>92</sup> The future is always uncertain, and the consequences of action are always speculative. Social institutions and rule-following behavior are evolved responses to the uncertainties people face and the pervasiveness of unintended consequences. Institutional regularities and entrepreneurial actions serve to reduce the discoordination that results from individuals each acting with incomplete knowledge and uncertainty, but this discoordination can never be completely eradicated.<sup>93</sup> The endogenous nature of preferences and knowledge in real time means that one cannot use end-state standards such as "efficiency" to judge market outcomes.<sup>94</sup>

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88 See O'DRISCOLL & RIZZO, *supra* note 23, at 1.

89 See *id.* at 17-33.

90 See *id.* at 52-70.

91 See *id.* at 35-51.

92 [M]arket activity . . . can be rendered intelligible as a *process of attempting* to correct errors and coordinate behavior. . . .

. . . [But] [t]here is no stable endpoint to which the process must lead, nor a single path that it must follow.

*Id.* at 5.

93 See *id.* at 77-78.

94 See *id.* at 90.

O'Driscoll and Rizzo made a major—and controversial<sup>95</sup>—concession to the neoclassicists by stating that it was necessary for the Austrian framework to incorporate some concept of equilibrium if it was to be successfully used as a tool of analysis.<sup>96</sup> In the most innovative portion of their book they attempted to develop a kind of equilibrium-like analytical notion that did not abstract from either real time or ignorance, and that did not impose the kind of end-state determinateness that Austrians objected to in neoclassical equilibrium concepts. They coined the terms “pattern coordination” and “pattern equilibrium” to describe an ongoing but essentially orderly state of affairs that still permitted the emergence of unexpected and undetermined behavior.<sup>97</sup> Once this state of pattern equilibrium is reached among a group of individuals, the regularized features of human conduct that are manifested in social institutions and other patterns of rule-following behavior would be relatively predictable and coordinated, while unpredictable actions could still occur within the bounds of these regularities.

The authors conceptually separate behavior into its “typical” and “unique” features.<sup>98</sup> The “typical” aspects of behavior are those that are relatively stable and time-independent, while the “unique” aspects of behavior are those that are highly time-dependent.<sup>99</sup> A pattern equilibrium is a situation where the plans of individuals are coordinated with regard to their typical features, even if their unique aspects fail to mesh.<sup>100</sup> This pattern equilibrium does not have the deterministic properties of the neoclassical equilibrium concept. Some of its features are relatively stable, while others may vary over time. In the short run, the typical institutional patterns of conduct are affected only by exogenous shocks to the system, while the unique aspects change endogenously within the system.<sup>101</sup> In the authors' view, this concept of a non-deterministic pattern equilibrium is useful because it

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95 See, e.g., Lachmann, *Review*, *supra* note 22, at 17.

96 The absence of *any* tendency to change is incompatible with real time. Yet . . . some idea of equilibrium is important. Indeed, it would be difficult to imagine a viable economics without one.

O'DRISCOLL & RIZZO, *supra* note 23, at 71.

In the broadest sense, equilibrium is inextricably linked to the causal mode of reasoning. . . . [W]e believe that *some* concept of equilibrium is an indispensable ingredient in all economic explanations.

*Id.* at 85.

97 See *id.* at 85–88.

98 See *id.* at 76–79.

99 See *id.*

100 See *id.* at 85.

101 See *id.* at 87.

allows analysts "to model adjustments in a way that does not foreordain their outcomes."<sup>102</sup> It thus may provide a workable means of setting some bounds upon the framework of Austrian analysis so as to avoid total indeterminacy of results.

### 3. Christopher Wonnell

As far as I am aware, Christopher Wonnell has only published one piece of scholarship that invokes Austrian themes.<sup>103</sup> That article is significant, however, for it represents the first time that a legal scholar has presented in a mainstream law journal a law and economics analysis of contract law based on Austrian principles.

Wonnell's article invokes the Austrian perspective to illuminate the issues raised by the long-standing tension between freedom of contract and the allowance of excuses from contractual obligations based upon impossibility, fraud by non-disclosure, or unconscionability.<sup>104</sup> The article demonstrates a solid grasp of the main precepts of Austrian theory, and an appreciation of the nature of the dynamic process of entrepreneurial discovery that Austrians regard as central to social progress. The piece does unfortunately evidence some confusion regarding the Austrian view of efficiency,<sup>105</sup> and consequently

102 See *id.* at 88.

103 Christopher T. Wonnell, *Contract Law and the Austrian School of Economics*, 54 *FORDHAM L. REV.* 507 (1986).

104 See *id.* at 508.

105 As has been discussed earlier in this article, Austrians assume that preferences are malleable and often change over time. Hence, they regard as rather meaningless neoclassical calculations as to the "efficiency" of rules, since those calculations are based upon an assumption of unchanged preferences over the period of analysis. Austrians in their normative assessments consequently emphasize the impacts of policies upon the entrepreneurial market process rather than comparative evaluations of end-states of the economy at different points in time. However, they do not generally utilize the term "efficiency" as a metric for assessing the impacts of proposed measures upon the market process. The following excerpts from Wonnell's article suggest that he has failed to fully appreciate this point:

The law-and-economics school can be criticized for . . . assuming the unspoken norm that economic efficiency is a desirable goal. The difference between neoclassical economics and the Austrian school, however, concerns positive analysis, not the desirability of particular ends. . . . [I]t is assumed without much argument [for this article] that efficiency is in fact a good thing.

. . . .

The Austrian critique of neoclassical economics, if accepted, tends to alter the *raison d'être* of the free market and freedom of contract. In general terms, freedom of contract is no longer defended because it produces perfect efficiency. Rather, freedom of contract produces more efficient out-

offers some inapt comparisons of the comparative efficiency of neo-classical and Austrian prescriptions.<sup>106</sup> Wonnell also fails, as unfortunately do most Austrian writers, to offer evidence establishing the necessary connection between measures that facilitate entrepreneurship and the resulting enhancement of overall social welfare. However, despite these minor deficiencies the paper presents an interesting and insightful examination of the normative positions generally taken by law and economics scholars with regard to the impossibility, fraud by non-disclosure, and unconscionability defenses in light of the Austrian emphasis on the significance of the entrepreneurial role.<sup>107</sup>

The conventional neoclassical analysis of the impossibility doctrine concludes that courts should apply this doctrine so as to allocate the risk of unforeseen supervening contingencies to the superior *ex ante* risk bearer.<sup>108</sup> Wonnell invokes Austrian themes to argue that this analysis fails to recognize adequately the nature and predicates of entrepreneurship.<sup>109</sup> He concludes that the impossibility doctrine should instead be applied in a fashion that takes pains to avoid discouraging acts of "entrepreneurial perceptiveness."<sup>110</sup>

He conducts a similar analysis to criticize the conventional law and economics framework first articulated by Anthony Kronman<sup>111</sup> for determining when a person should be excused from a contractual duty on the basis of a failure of the other party to disclose information. Wonnell argues that Kronman's well-known dichotomy between "deliberately acquired" and "casually acquired" information<sup>112</sup> fails to reward entrepreneurial skill in perceiving useful opportunities to acquire valuable information, even in seemingly "casual" settings, and that the impact upon entrepreneurial incentives as well as upon persons engaging in routine information-search cost calculations should be taken into account in determining liability.<sup>113</sup> Entrepreneurial ac-

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comes than does judicial or legislative intervention, and outcomes that are increasingly efficient over time.

*Id.* at 510, 524-25 (footnotes omitted).

106 "[T]he Austrians believe that freedom of contract leads to an *increasingly* efficient economy . . ." *Id.* at 542.

107 *Id.* at 525-42.

108 See Richard Posner & Andrew Rosenfeld, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977).

109 See Wonnell, *supra* note 103, at 525-26.

110 See *id.* at 526-27.

111 See Anthony Kronman, *Mistake, Disclosure, Information and the Law of Contracts*, 7 J. LEGAL STUD. 1 (1978).

112 See *id.* at 16.

113 See Wonnell, *supra* note 103, at 528-31.



quisition and subsequent non-disclosure of valuable information, even if seemingly casually acquired, should be regarded as the creation of value, rather than fraud.<sup>114</sup>

Wonnell then addresses the question of the proper scope of the unconscionability defense. He first considers the enforcement of the terms of standard form contracts.<sup>115</sup> He finds there to be much less divergence here than for the impossibility and fraud by non-disclosure doctrines between the conclusions reached through neoclassical and Austrian analyses. He concludes that the ability to conceal terms in inaccessible fine print is not vital to ensure adequate entrepreneurial incentives.<sup>116</sup> He does express concern, however, that an overly broad application of the unconscionability doctrine by the courts, so as to make large numbers of duties non-disclaimable, would be a serious mistake. From the Austrian perspective, the profit opportunities created by one-sided contracts will tend to encourage entrepreneurs to enter the relevant markets, and thereby reshape the prevailing contractual terms into a better balance, or at least depress prices obtained by the exploitative parties.<sup>117</sup> The Austrians generally see no advantages in enforcing hidden contract terms, according to Wonnell, but are primarily concerned that the remedial government intervention not be a cure that proves to be worse than the disease.<sup>118</sup>

Finally, Wonnell considers how the unconscionability doctrine should be applied in settings other than the form contract context, such as when the prices charged by one party are significantly higher than those generally prevailing in the market, or are set monopolistically, or when certain non-price terms are unfair.<sup>119</sup> His general conclusion is that from an Austrian perspective these other abuses are likely to be rapidly self-correcting—in a way that judicial errors usually are not on the same time scale—as consumers learn from their experience of these abuses and thus become better able to avoid them, and as new entrepreneurs avail themselves of opportunities to compete advantageously with the abusive firms.<sup>120</sup>

Wonnell's article is a valuable contribution to the law and economics literature. This is so not only because of its specific insights concerning the doctrines he considers, but also for demonstrating how a conventional law and economics analysis of legal issues can be

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114 *See id.* at 530.

115 *See id.* at 530–35.

116 *See id.* at 530.

117 *See id.* at 531–33.

118 *See id.* at 533.

119 *See id.* at 535.

120 *See id.* at 536.

greatly enriched by incorporating the Austrian insights concerning the market process and the important role of entrepreneurship.

#### 4. Roy Cordato

Roy Cordato in 1989 contributed a short article to a *Hamline Law Review* symposium that addressed questions of welfare economics and efficiency analysis from an Austrian perspective.<sup>121</sup> He first critiqued the standard neoclassical Pigouvian<sup>122</sup> and Coasian<sup>123</sup> approaches that are used for determining how to deal with the problem of externalities in a manner that will encourage efficient behavior.<sup>124</sup> The bases for his criticisms are the Austrian ideas that one cannot properly overlook the subjective nature of costs nor the passage of time in defining efficiency criteria, as do these two approaches.<sup>125</sup>

Cordato then attempted to develop an Austrian concept of “social efficiency” that properly incorporated the subjective nature of costs and the dynamics of the passage of time.<sup>126</sup> Building upon prior work in that area done by Israel Kirzner,<sup>127</sup> he concluded that “the efficiency of the economic system is judged [from the Austrian perspective] by the extent to which it encourages individuals to pursue their own goals efficiently.”<sup>128</sup> Such “social efficiency” is maximized by a set of “legal institutions that minimize conflicts in the use of resources and allow the economic system to maximize the dissemination and use of knowledge.”<sup>129</sup>

Cordato endorsed the conclusions previously reached by Kirzner concerning the institutional framework most conducive to achieving such “social efficiency”: a stable and comprehensive framework of property rights and free markets.<sup>130</sup> In his view, such a framework

<sup>121</sup> Roy Cordato, *Subjective Value, Time Passage, and the Economics of Harmful Effects*, 12 *HAMLIN L. REV.* 229 (1989).

<sup>122</sup> See generally A.C. PIGOU, *THE ECONOMICS OF WELFARE* (4th ed. 1932). The Pigouvian approach to externalities focuses upon the use of taxes or subsidies to align the marginal personal costs and benefits of an action to the actor with its marginal social costs.

<sup>123</sup> See generally Ronald Coase, *The Problem of Social Cost*, 3 *J.L. & ECON.* 1 (1960). The Coasian approach to externalities focuses upon achieving social wealth maximization. This approach assigns the property right to the party to a dispute concerning the use of the property who places the highest value on that property right.

<sup>124</sup> See Cordato, *supra* note 121, at 229–36.

<sup>125</sup> See *id.* at 235–36.

<sup>126</sup> See *id.* at 237.

<sup>127</sup> See *id.* at 239. See generally KIRZNER, *MARKET THEORY*, *supra* note 21.

<sup>128</sup> Cordato, *supra* note 121, at 239.

<sup>129</sup> *Id.*

<sup>130</sup> See *id.* at 239–40.

maximizes the extent to which the price system can disseminate relevant information among individuals, and yet still provides the necessary degree of "institutional certainty" to enable people to plan their future conduct.<sup>131</sup> He also joined Mario Rizzo<sup>132</sup> in concluding that from this perspective strict liability has advantages over a negligence standard because of the certainty it provides.<sup>133</sup>

In 1992, Cordato published a book in which he further developed these basic ideas.<sup>134</sup> He there renamed the concept that he had labeled "social efficiency" in his earlier article to "catallactic efficiency," thus embracing the idea first put forth by Friedrich Hayek that the social order is better conceived of as a "catallaxy" rather than as an economy.<sup>135</sup> The efficiency of a catallaxy, according to Cordato, "is to be judged by the extent to which the catallaxy encourages individuals existing in a social context, to pursue their own goals as consistently as possible."<sup>136</sup> Questions of catallactic efficiency must "focus upon the institutional setting in which individual actors operate."<sup>137</sup>

Cordato stated that there are "two overriding issues" relevant to determining the degree of catallactic efficiency that exists at any point in time.<sup>138</sup> The first issue has to do with the extent to which the institutional setting facilitates the use and discovery of information.<sup>139</sup> The second issue concerns the extent to which that institutional set-

131 See *id.* at 240-41.

132 See *supra* notes 73-75 and accompanying text.

133 See Cordato, *supra* note 121, at 241-42.

134 See CORDATO, *supra* note 23.

135 See *id.* at 58. A "catallaxy" is defined by Cordato as "a social order generated by the market activities of separate individuals and organizations, each pursuing their own purposes." *Id.* This term "catallaxy" is preferred to the term "economy" by a number of Austrian writers, including Friedrich Hayek, who originally coined the term:

The spontaneous order of the market resulting from the interaction of many . . . [smaller economic entities such as households or farms] is something so fundamentally different from an economy proper that it must be regarded as a great misfortune that it has ever been called by the same name. I have become convinced that this practice so constantly misleads people that it is necessary to invent a new technical term for it. I propose that we call this spontaneous order a *catallaxy* in analogy to the term "catallactics," which has often been proposed as a substitute for the term "economics."

Friedrich Hayek, *The Principles of a Liberal Social Order*, in *THE ESSENCE OF HAYEK* 363, 367 (C. Nishiyama & K. Leube eds., 1984).

136 CORDATO, *supra* note 23, at 62.

137 *Id.*

138 See *id.*

139 See *id.* at 62-63.

ting "will allow individuals to gather the necessary physical resources."<sup>140</sup> Cordato then argues that a catallaxy can only have desirable individual resource-gathering properties if conflicts over the uses of resources are minimized through a legal regime that upholds private property rights and allows freedom of exchange.<sup>141</sup> The catallaxy will similarly have desirable information use-and-discovery properties only to the extent that the price mechanism is allowed to work freely to signal information as to preferences, resource availability, and the like.<sup>142</sup> Entrepreneurs will respond to these price signals by discovering and exploiting opportunities for profitable arbitrage and in so doing increase the plan coordination of market participants.<sup>143</sup>

The key contrast between Cordato's "catallactic efficiency" and the concepts of Pareto efficiency or Kaldor-Hicks efficiency as defined under the neoclassical approach is thus that while the neoclassical efficiency criteria each focus upon the properties of an end-state equilibrium, catallactic efficiency "is construed in terms of an open-ended process of pursuing goals."<sup>144</sup> From the Austrian perspective outcomes cannot be preordained, but the degree to which the institutional setting best facilitates the process of individual goal-seeking can be evaluated against the benchmark of an ideal institutional setting.<sup>145</sup>

Cordato's concept of "catallactic efficiency" as a proposed Austrian measure of a society's dynamic ability to continually facilitate the coordination of individual behavior with minimal conflict is interesting, but raises a number of difficult questions that he fails to adequately address.<sup>146</sup> Consider, for example, if one were to attempt along these lines to determine whether a policy or practice would re-

140 *See id.* at 63.

141 *See id.*

142 *See id.* at 64.

143 *See id.* at 48; *see also* KIRZNER, *COMPETITION*, *supra* note 21, at 222:

Each entrepreneurial discovery represents alertness to a hitherto unperceived interpersonal opportunity—an opportunity that depends on the coordinated plans of two separate individuals. As this "general" equilibrating process proceeds by competitive-entrepreneurial alertness, it identifies more and more uncoordinated situations, at the same time spreading the information perceived by entrepreneurial alertness among wider and wider circles in the market.

*Id.* But see CORDATO, *supra* note 23, at 50–54 (recognizing that entrepreneurial activity can have discoordinating consequences for some third parties).

144 CORDATO, *supra* note 23, at 64.

145 *See id.* at 65.

146 *See* Gary Lawson, *Efficiency and Individualism*, 42 DUKE L.J. 53, 96–97 (1992) (discussing some of the difficulties raised by this concept).

sult in a “Pareto-catalactic efficiency improvement,” in the sense of increasing the ability of one or more individuals to coordinate their behavior with other persons, or allowing them to do so equally effectively but with less conflict, without creating any additional impediments for any other persons. To make such an assessment one would have to measure such changes in coordination abilities and in the level of conflict for each affected individual. This raises first of all a timing problem, because privileging any one particular point in time as the definitive benchmark for making the catalactic efficiency assessment of a policy that has continuing dynamic consequences seems to violate the spirit of the Austrian commitment to full incorporation of the consequences of the passage of time.

Perhaps more importantly, from the Austrian perspective one would have to concede that it would probably be impossible ever to assemble in one place the massive amounts of information that would be needed to make such an assessment for each of the numerous persons affected by any significant policy or practice. Finally, even if this information could be obtained, such a Paretian unanimity criterion is unlikely ever to be satisfied as a practical matter.<sup>147</sup>

Moreover, any attempt to determine an aggregate measure of the catalactic efficiency of a policy or practice that was analogous to the neoclassical Kaldor-Hicks criterion would pose not only the time of measurement problem and massive information gathering difficulties noted above, but also would raise the troubling issue of choosing an aggregation methodology. Suppose a policy or practice did improve the ability of some groups of persons to coordinate their behavior with minimal conflict, but made it more difficult for some other persons to achieve their objectives?<sup>148</sup> How are such diverging impacts to be valued and meshed into an aggregate assessment of catalactic efficiency consequences? The Austrian insistence on the dynamic evolution of individual preferences over time clearly rules out the use of a neoclassical-style “willingness to pay”-based aggregation formula that assumes as a predicate stable preferences. The Austrian commitment to a subjectivist perspective, for that matter, makes it particularly diffi-

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147 See Crespi, *supra* note 49, at 234–35.

148 It is easy to envision circumstances where a greater degree of coordination among some persons would impose greater difficulties upon others. For example, consider where a firm’s potential competitors are now excluded by the firm’s more coordinated relationships with its suppliers or customers, or where a greater degree of coordination among competitors through cartel arrangements or other collusive practices would impose added burdens upon customers.

cult to develop any acceptable aggregation formula.<sup>149</sup> However, without some aggregation methodology, it would be impossible to ever assess the relative “catallactic efficiency” of alternative legal or institutional regimes, rendering the concept rather useless.

In his 1992 book, Cordato also developed in more detail an Austrian approach to the question of externalities. He dealt separately with negative and positive externalities, and contrasted the positions taken by both Mises and Rothbard on these questions with those taken by Hayek, choosing to side with the former writers where they disagreed with Hayek.<sup>150</sup>

Cordato is in accord with all three of the above writers in asserting that the existence of negative externalities is a non-problem if property rights are well defined. Those persons adversely affected by an individual’s exercise of his property rights are free to contract with him in the market to have him cease or alter his behavior. If they choose not to do so, then they have simply foregone one of their market options. The fact that their failure to do so may be because of high transaction costs rather than costs of another sort is of no particular significance, and does not justify governmental intervention, even if the government had access to accurate information concerning the size and distribution of these transactions costs, which is most unlikely to be the case.<sup>151</sup>

Mises and Rothbard take a similar position with regard to positive externalities, arguing that their presence by definition can never be established. This is so because if contractual internalizing arrangements were made among the affected parties—the only actions that would evidence such external impacts—then the benefits of the action would no longer be external to the decision maker. Speculative arguments as to the existence of positive externalities that are not correctable by market transactions because of high transactions costs can

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149 But see Dominick T. Armentano, one of Roy Cordato’s mentors, who wrote the foreword to Cordato’s book, and who apparently endorses an aggregation methodology for a catallactic efficiency criterion that completely ignores the consequences of certain actions—specifically business collusion agreements—upon persons not party to those agreements, leading to a rather radical endorsement of collusive practices:

From a catallactic perspective the issue of social efficiency would be seen very differently. In the first place it would be impossible . . . to conclude that business collusion reduces social welfare . . . [A]ll business mergers and all joint ventures would be seen as socially efficient arrangements . . . Finally, the traditional antitrust concern with market share, concentration, and “entry barriers” would be seen as entirely misplaced.

Dominick T. Armentano, *Foreword* to CORDATO, *supra* note 23, at xii.

150 CORDATO, *supra* note 23, at 15–27.

151 *See id.* at 16–23.

never be a sufficient cause for governmental intervention, since that intervention imposes real, tangible costs.<sup>152</sup>

Hayek, however, took a position on this question much closer to the traditional neoclassical stance, arguing that the government would have to intervene where the market fails to provide certain services such as defense, education, roads, and flood protection because of the inability of providers to charge the beneficiaries; in other words, where the "free-rider" and "pure public goods" problems arise.<sup>153</sup>

Cordato sides with Mises and Rothbard and against Hayek on this issue. He believes that Hayek's position here is inconsistent with his analyses in other areas which emphasize the lack of governmental knowledge of individual preferences absent demonstrated market actions.<sup>154</sup> Cordato argues that from an Austrian perspective one simply cannot infer from a person's failure to participate in a market transaction the basis for that refusal. Since it can never be determined that a contractual arrangement that would have internalized external benefits would have occurred, but for transaction costs, Cordato concludes that it is improper for the government to act on that unfounded assumption.<sup>155</sup>

The Mises/Rothbard position embraced by Cordato, that governmental intervention to internalize benefits is per se illegitimate, is quite interesting, and obviously would have momentous implications if adopted. It would have been helpful to the reader of his book had Cordato gone further and discussed in somewhat more detail the Austrian view concerning the likely practical consequences of complete governmental withdrawal of financial support from national defense, education, public infrastructure, and the like, and in what ways and how quickly market processes would likely adjust to such changes.

Finally, Cordato succinctly summarizes the differences between the Austrian and the neoclassical Coasian positions concerning the resolution of disputes concerning property rights.<sup>156</sup> In his view, the focus of an Austrian inquiry into such a dispute is the issue of who had the rights in question prior to the dispute.<sup>157</sup> Once that is determined, the dispute is to be resolved by affirming that prior right. Stability of ownership is the paramount concern. It is irrelevant what the consequences of such a resolution are for social wealth, or whether

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152 *See id.* at 23.

153 *See id.* at 24.

154 *See id.* at 24-25.

155 *See id.* at 23-27.

156 *See id.* at 92-110.

157 *See id.* at 99.

the parties will be impeded by high transaction costs from contracting around a resolution of the dispute that fails to maximize social wealth.

A Coasian inquiry, according to Cordato, is based on very different premises. In sharp contrast to the Austrian approach, it essentially ignores existing property titles, and focuses solely upon prospective social wealth maximization considerations in determining which party should be allocated the rights at issue.<sup>158</sup> From an Austrian perspective, such an approach is morally dubious, requires information that is generally unavailable to the decision maker, and also sacrifices catalytic efficiency by creating uncertainty of title which impedes planning efforts.<sup>159</sup>

Cordato's work is quite helpful for one attempting to think through the normative implications of the Austrian approach. His discussions of Austrian recommendations concerning governmental responses to externalities and the contrast between the Austrian and Coasian perspectives on property disputes make clear some of the significant policy implications of the Austrian perspective. He has also made a valuable contribution by raising the important question of the possibility of formulating an Austrian normative criterion that would play a role in that framework analogous to the function served by the efficiency criteria in the neoclassical paradigm, and by identifying the sorts of information dissemination, plan coordination, and conflict minimization features of social life that an Austrian would wish such a criterion to incorporate.

Cordato has not, however, addressed a number of very significant difficulties that the development of a conceptually adequate and operationally feasible Austrian criterion of "catalytic efficiency" or "social efficiency" would entail. His proposed criterion is in full accord with the usual Austrian normative commitments to private property- and free market-oriented legal regimes, but it is not clear what such a vague criterion would contribute to policy analysis beyond generally reaffirming those normative commitments.<sup>160</sup>

## 5. Michael DeBow

In 1991 Michael DeBow wrote an article in which he utilized an Austrian approach to consider the merits of proposals to modify the

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158 *See id.* at 100.

159 *See id.* at 105-08.

160 But see Armentano, *supra* note 149, at xii, where he regards the catalytic efficiency criterion as going much further than earlier normative declarations and as excluding consideration of the impacts of collusive business arrangements upon third parties.



antitrust laws and merger guidelines to allow a government-implemented and coordinated national "industrial policy."<sup>161</sup> His conclusions, not surprisingly, were that such policies would almost certainly fail because of the inadequate knowledge and improper incentives of the government bureaucrats who would have to implement them.<sup>162</sup>

DeBow described the Austrian framework as a "disequilibrium" theory, and emphasized the nature of market competition as a discovery process whereby entrepreneurs have the incentives to discover and act upon valuable information.<sup>163</sup> He argued more generally that the use of the Austrian framework for policy analysis is particularly useful for helping people to avoid the "Nirvana fallacy" of contrasting real-world market imperfections with the hypothetical results of governmental interventions to correct those imperfections that are based on an assumption of perfect knowledge and disinterestedness on the part of governmental officials.<sup>164</sup> The emphasis Austrians place on the limits of knowledge and the importance of preserving entrepreneurial incentives to discover and act upon new information serves to highlight the weaknesses of governmental mechanisms that attempt to supersede markets.

To DeBow, use of the Austrian approach thus serves a function somewhat akin to that provided by the "public choice" perspective on governmental actions.<sup>165</sup> It actually contributes broader insights than that latter framework, however, because it directly addresses the information problems as well as the incentive problems inherent in government action. Moreover, while public choice analysis still utilizes the conventional neoclassical constrained optimization equilibrium model, albeit in the context of non-market behavior, the Austrian framework is not so limited and allows consideration of the structural ignorance that public officials must confront in dealing with non-market contexts.<sup>166</sup> In DeBow's view, therefore, the Austrian approach provides a uniquely valuable framework for policy analysis that is particularly helpful in identifying when a call for intervention is moti-

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161 Michael E. DeBow, *Markets, Government Intervention, and the Role of Information: An "Austrian School" Perspective, with an Application to Merger Regulation*, 14 GEO. MASON L. REV. 31 (1991).

162 *See id.* at 91-95.

163 *See id.* at 57.

164 *See id.* at 39-42.

165 *See, e.g.*, JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT* (1962); WILLIAM A. NISKANEN, JR., *BUREAUCRACY AND REPRESENTATIVE GOVERNMENT* (1971); MANCUR OLSON, JR., *THE LOGIC OF COLLECTIVE ACTION* (1965).

166 *See* Peter J. Boettke, *Hayek's The Road to Serfdom Revisited: Government Failure in the Argument Against Socialism*, 21 E. ECON. J. 7, 19 (1995).

vated primarily by redistributive motives rather than a desire to correct a market failure.<sup>167</sup>

Antitrust law and policy, perhaps more than any other field of law, rest upon an understanding of the nature of the competitive process and its economic consequences. Given this fact, one might expect antitrust scholars to be more receptive to the idea of de-emphasizing the neoclassical paradigm and making more use of the Austrian approach than any other group of legal academics. DeBow's article is a major step in this direction, and his discussion of Austrian methodology subsequently contributed to Thomas Arthur's reliance upon essentially Austrian notions of competition in a major article written in 1994 for the *New York University Law Review*.<sup>168</sup>

## 6. Thomas Arthur

Thomas Arthur's article sets forth a comprehensive and highly critical assessment of the United States Supreme Court opinion issued in *Eastman Kodak Co. v. Image Technical Services, Inc.*<sup>169</sup> Arthur evidences a clear awareness of the limitations of the neoclassical model of perfect competition as a framework for understanding real-world competitive circumstances.<sup>170</sup> Drawing extensively for support from the work of the Austrian writers Michael DeBow,<sup>171</sup> Friedrich Hayek,<sup>172</sup> and Israel Kirzner,<sup>173</sup> and upon related ideas found in the work of Frank Knight,<sup>174</sup> Joseph Schumpeter,<sup>175</sup> and Oliver William-

167 See DeBow, *supra* note 161, at 96.

168 Thomas C. Arthur, *The Costly Quest for Perfect Competition: Kodak and Nonstructural Market Power*, 69 N.Y.U. L. REV. 1 (1994).

169 504 U.S. 451 (1992).

170 "The all-out pursuit of perfect competition . . . cannot produce sensible results for antitrust law. Perfect competition is unattainable in the real world . . . Many practices challenged under the antitrust laws are in fact attempts to economize on the costs of coordinating interdependent economic actors in a complex economy." Arthur, *supra* note 168, at 3-4.

[T]he [perfectly competitive] model provides only a snapshot of an end-state. The only process it admits is pricing according to its assumptions. It cannot explain competition as we commonly think of it, as rivalry among business firms, nor can it explain innovation and entrepreneurship. It tells us nothing about the conditions necessary for economic progress.

*Id.* at 10 (footnote omitted).

171 *Id.* at 10 n.30, 11 n.33.

172 *Id.* at 11 n.33.

173 *Id.* at 11 n.33, 12 nn.38-39.

174 *Id.* at 11 n.31.

175 *Id.* at 11 nn.32, 34, 12 nn.40-43.

son,<sup>176</sup> he develops a rich concept of “rivalrous competition”<sup>177</sup> which embodies the major Austrian insights concerning the nature of the competitive process.<sup>178</sup> He then applies that concept to critique the reliance of the *Kodak* Court upon the perfect competition model as a normative framework for assessing the legitimacy of certain business practices and market structures.<sup>179</sup>

One could perhaps disagree with my characterization of Arthur as an “Austrian.” He never so describes himself in that article. Moreover, while he is forthright in arguing for the use of an Austrian-style model rather than a neoclassical model of the competitive process in the antitrust area, he does express some reservations concerning the wisdom of the larger Austrian project of more broadly displacing the neoclassical paradigm from its position of preeminence as a framework for general, theoretical inquiry.<sup>180</sup> However, Arthur clearly fa-

176 *Id.* at 11 n.35.

177 *Id.* at 11.

178 This concept of rivalrous competition has important virtues which perfect competition lacks. First, the concept accepts the ‘market imperfections’ which prevent the full achievement of perfect competition and admits the real world competitive activities absent in the artificial world of perfect competition and monopoly: advertising, marketing, product differentiation, price cutting, entrepreneurship, business associations, complex products, relational contracts, and, most importantly, innovation and change. It recognizes that rivals compete on far more than just price. In particular, it accepts the reality that in a world of imperfect information, consumers cannot afford the unbounded rationality of economic man, who considers every piece of relevant information before making an economic decision. Instead, real-world economic actions can only be boundedly rational; consumers acquire and use information only so far as the benefits from doing so outweigh the costs of acquiring and considering it.

Second, rivalrous competition does not suggest that rivalry itself is always desirable. In the real world not all rivalry is productive . . . .

Third, competition as rivalry recognizes that despite the epithet ‘market imperfections,’ product variety and asset specificity are in fact essential to economic progress . . . .

Fourth, rivalrous competition emphasizes that markets seldom are in the equilibrium states described by the perfect competition and monopoly models, in which the course of competition already has been run. Instead, there exists a dynamic process of rivalry in which entrepreneurs seek to discover new profit opportunities in a world of ignorance, risk and uncertainty.

*Id.* at 11–12 (footnotes omitted).

179 *See id.* at 13–14, 42–76.

180 “Despite its oft-criticized unworldliness, perfect competition remains the model of choice in mainstream economics, due to its superiority over its more ‘realistic’ rivals in providing useful generalizations and testable propositions.” *Id.* at 7.

Despite the greater descriptive accuracy of rivalrous competition, the perfect competition and monopoly models dominate mainstream microeconomics. Notwithstanding the limitations of its assumptions—indeed, because of them—perfect competition has served economic science well as a model. Rivalrous competition has not. In accepting the particularizing realities of the competitive world, it lacks the rigor and generality necessary to generate testable propositions and provide useful generalizations. Moreover, the de-

vors using the Austrian approach rather than the neoclassical paradigm to resolve the policy questions that he addresses in his article, so I feel justified in including his work with that of the more overtly Austrian writers discussed in this Section.<sup>181</sup>

## 7. Linda Schwartzstein

Linda Schwartzstein is one of the few active legal scholars who deals primarily with Austrian themes in her work. She has in recent years written two articles for mainstream legal journals that address the issues raised from an Austrian perspective.<sup>182</sup> In a 1992 article, Schwartzstein compared the premises of the Austrian framework of analysis with those that define the ideologies that underlie the competing Critical Legal Studies (CLS) and neoclassical law and economics approaches.<sup>183</sup> The main point of the article was that while the Austrians share with the CLS school the view that law is essentially indeterminate,<sup>184</sup> they do not see this indeterminacy as being unbounded<sup>185</sup> as is generally claimed by CLS adherents.<sup>186</sup>

Austrians view the law as a spontaneous and evolving order, and not primarily the result of the designs of judges or legislators.<sup>187</sup> Legal rules evolve both from customary practices and from actions taken by judges and legislators to fill perceived gaps.<sup>188</sup> While the legal order is therefore to some extent indeterminate, Austrians see "this indeterminacy as simply a part of the evolutionary process, and

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viations from perfect competition's assumptions are often insignificant. Its predictions hold true in a wide array of real world situations.

*Id.* at 12–13 (footnotes omitted).

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Despite its invaluable use as a scientific model, perfect competition is a treacherous normative guide for economic regulation . . . [I]t cannot be emphasized too strongly that perfect competition is an artificial, abstract model which can exist only in theory. It cannot be attained in the real world at *any* cost. It simply is not possible to eliminate the market "imperfections" that are abstracted out of the model.

*Id.* at 13–14.

182 See Linda A. Schwartzstein, *An Austrian Economic View of Legal Process*, 55 OHIO ST. L.J. 1049 (1994) [hereinafter Schwartzstein, *Legal Process*]; Linda A. Schwartzstein, *Austrian Economics and the Current Debate Between Critical Legal Studies and Law and Economics*, 20 HOFSTRA L. REV. 1105 (1992) [hereinafter Schwartzstein, *Current Debate*].

183 See Schwartzstein, *Current Debate*, *supra* note 182, at 1105.

184 See *id.* at 1127–28.

185 See *id.* at 1128.

186 See, e.g., MARK KELMAN, *A GUIDE TO CRITICAL LEGAL STUDIES* 66–67 (1987).

187 See Schwartzstein, *Current Debate*, *supra* note 182, at 1127–28.

188 See *id.* at 1128.

not a cause for despair."<sup>189</sup> She provides an apt quote to this effect from the Austrian economist Don Lavoie:

A spontaneous order is not designed and never really under our control, since it evolves according to a logic all its own. This does not mean, however, that we are utterly helpless to exert influence over the workings of such ordering processes. Its order may be intelligible in terms of general principles, and these principles may well show us that some environments are more conducive to its self-ordering process than others. Understanding a spontaneous order may enable us to tailor the general conditions for its flourishing.<sup>190</sup>

Schwartzstein also recognizes that Austrians do not view the economy as being in an equilibrium state, and that a number of Austrians go even further than this and totally reject the use of a concept of equilibrium in economic analysis.<sup>191</sup>

Schwartzstein further elaborated on these Austrian themes in a 1994 article that presented a comprehensive view of the legal process.<sup>192</sup> That later work represents the most ambitious attempt yet undertaken in a law journal article to apply the Austrian insights to understanding the contours and evolution of the legal system. The article first discusses the conventional law and economics view of the legal process, focusing on the common law efficiency hypothesis.<sup>193</sup> She concludes that this literature has yet to develop a consensus on the nature of the legal process, particularly with regard to whether the common law tends to promote efficiency,<sup>194</sup> but also with regard to the relevance of the public choice model of legal processes.<sup>195</sup> She

189 *Id.* at 1131.

190 Don Lavoie, *Economic Chaos or Spontaneous Order? Implications for Political Economy of the New View of Science*, 8 CATO J. 613, 621 (1989), quoted in Schwartzstein, *Current Debate*, *supra* note 182, at 1135.

191 Schwartzstein, *Current Debate*, *supra* note 182, at 1129; see also Murray N. Rothbard, *Comment: The Myth of Efficiency*, in TIME, UNCERTAINTY, AND DISEQUILIBRIUM 90 (Mario J. Rizzo ed., 1979), at 90.

[T]he individual's ends are not *really* given, for there is no reason to assume that they are set in concrete for all time. As the individual learns more about the world, about nature and about other people, his values and goals are bound to change. The individual's ends will change as he learns from other people; they may also change out of sheer caprice. But if ends change in the course of an action, the concept of efficiency—which can only be defined as the best combination of means in pursuit of given ends—again becomes meaningless.

*Id.*

192 See Schwartzstein, *Legal Process*, *supra* note 182.

193 *Id.* at 1051–57.

194 *Id.* at 1060.

195 *Id.* at 1061.

then argues that the Austrian framework can help to fill this “jurisprudential void” in the law and economics literature.<sup>196</sup>

Schwartzstein regards Fredrich Hayek as the Austrian economist who has devoted “by far” the most attention to legal issues,<sup>197</sup> and presents a succinct summary of his legal views.<sup>198</sup> She emphasizes the fact that Hayek argued for an evolutionary theory of social institutions, regarding them as developing as a result of human action, but not of human design,<sup>199</sup> and claiming that institutions that function well will survive and displace less successful competitors. She also emphasizes that Hayek called for social changes to be made only on an incremental, organic basis, and that he regarded it as an act of hubris to attempt to engage in large-scale institutional redesign.<sup>200</sup>

Hayek favored the spontaneous, unintended order of the common law over the conscious and detailed commands of legislatures.<sup>201</sup> His view of the ideal form of law was that it would consist of rules that were general and abstract and applied to all,<sup>202</sup> although he recognized that some laws by their nature will necessarily apply only to one group of persons. He endorsed laws of the latter category “if they are equally recognized as justified by those inside and those outside the group” affected.<sup>203</sup> Abstract rules, however, leave individuals a wide zone of discretion within which they can act creatively. These rules will thus often result in unforeseen consequences. Hayek therefore implicitly rejects the idea that the law will necessarily tend towards any particular result, including economic efficiency. Only experience can show the value and consequences of a law.<sup>204</sup>

196 *Id.* at 1062.

197 *Id.*

198 *Id.* at 1062–66.

199 See FRIEDRICH HAYEK, *THE CONSTITUTION OF LIBERTY* 35 (1960).

200 See Schwartzstein, *Legal Process*, *supra* note 182, at 1063; see also HAYEK, *supra* note 199, at 69–70.

What we must learn to understand is that human civilization has a life of its own, that all of our efforts to improve things must operate within a working whole which we cannot entirely control, and the operation of whose forces we can hope merely to facilitate and assist so far as we understand them. Our attitude ought to be similar to that of the physician towards a living organism: like him, we have to deal with a self-maintaining whole which is kept going by forces which we cannot replace and which we must therefore use in all we try to achieve.

*Id.*

201 See Schwartzstein, *Legal Process*, *supra* note 182, at 1063.

202 See HAYEK, *supra* note 199, at 155.

203 *Id.* at 154.

204 See Schwartzstein, *Legal Process*, *supra* note 182, at 1065.

Schwartzstein recognizes that while Hayek clearly viewed law as an evolutionary process, and was willing to offer normative criteria for assessing the legitimacy of particular rules, neither he nor his successors explain the precise process by which the evolution of law and legal institutions takes place.<sup>205</sup> As I have noted earlier, this is a persistent shortcoming of the Austrian literature.<sup>206</sup> In the latter part of her article Schwartzstein attempts to begin to fill this gap.

She commences this effort by first addressing the question of the appropriate normative standards to apply in assessing legal rules. She states that if one is to analyze “law as a process, similar to the Austrian market process” this requires one to focus “on law as a creative and cognitive discipline.”<sup>207</sup> She then asserts that a “major goal of the process is to reduce uncertainty while being able to accommodate change.”<sup>208</sup> Legal institutions are thus to be positively regarded for facilitating of the ability of individuals to achieve their goals “to the extent they clarify the terms under which people interact in the market.”<sup>209</sup> She states that the legal system “must reduce uncertainty and convey information to the people who need it,”<sup>210</sup> and that “Austrians believe that the purpose of the law is to foster certainty.”<sup>211</sup>

Schwartzstein thus clearly endorses using the criteria of certainty and flexibility as metrics to evaluate the rules that emerge from the legal process. She does not, however, explain how these criteria are to be reconciled into an aggregate measure in circumstances where achieving more of one quality appears to be possible only at the expense of trading-off some of the other quality, as may often be the case. Moreover, this description of the reduction of uncertainty as a “major goal of the [legal] process” and the assertion concerning what the legal system “must” accomplish to be judged adequate is an unusual way for an Austrian to speak. Such claims are inconsistent with the central Austrian premise that only individuals have goals and purposes, and that it is a category mistake to so personify an abstract social institution. It would have been more in the Austrian spirit for Schwartzstein to simply state that she favors the facilitation of market processes, and that she regards laws that provide certainty without unduly sacrificing flexibility as conducive to that end. This commitment to market processes, and her opinion as to their necessary legal predi-

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205 *See id.* at 1066–67.

206 *See supra* text accompanying note 65; *see also* Paqué, *supra* note 41.

207 Schwartzstein, *Legal Process*, *supra* note 182, at 1068.

208 *Id.*

209 *Id.*

210 *Id.* at 1070.

211 *Id.* at 1078.

cates, are beliefs that are certainly shared by most Austrians as well as by many other people. However, the assumption that those legal predicates are somehow “goals” of the “legal system” that it “must” accomplish does not mesh well with the methodological individualism that underlies the Austrian framework of analysis.

Schwartzstein then turns to the more difficult task of formulating an explanatory model of the legal process along Austrian lines. She first notes that since Austrian principles suggest that the evolution of social institutions is not wholly determined by exogenous constraints, one should not rely upon deterministic neoclassical theories of prediction or explanation to understand such institutions.<sup>212</sup> She then takes some preliminary steps towards developing an interesting model of the legal process that characterizes it as though it was constituted by a series of courthouse “markets,” with the lawyers engaged in litigation playing the crucial entrepreneurial roles and the judges acting as their “customers.”<sup>213</sup>

Drawing a parallel between the legal process and the market discovery process, she describes lawyers as acting in entrepreneurial fashion as they look for new opportunities to advance their clients’ interests by finding new winning arguments or interpretations of law.<sup>214</sup> By so doing, they place pressure on the judges to extend the law to cover new situations, and so provide the dynamic element of the legal process.<sup>215</sup> Judges, as well, play somewhat of an entrepreneurial role, as they are alert for opportunities to make new law in a fashion that wins approval from the legal community and thereby enhances their reputation. Their flexibility to play this entrepreneurial role, however, is more restricted than that of the lawyers because of the general expectation that judges will exercise caution in endorsing innovative arguments and interpretations, and will respect previously existing rules.<sup>216</sup>

An entrepreneurial lawyer who successfully advances a new legal theory, or who develops a new legal specialization, thereby gains a competitive advantage over his rivals. Those rivals will seek to replicate or overcome this advantage by also making use of the new arguments and developing expertise in the new specialty, or both. In so doing, they will extend the scope of the new law and the breadth of the new specialty, thus creating further opportunities for innovation.

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212 *See id.* at 1069–70.

213 *Id.* at 1071–72.

214 *See id.* at 1071.

215 *See id.*

216 *See id.*



The cycle of innovation, service differentiation, and competitor imitation that characterizes competitive markets thus also characterizes the judicial aspects of the legal process.

Just as customers in the marketplace discipline entrepreneurship by failing to reward unpopular innovations, therefore imposing losses on unsuccessful entrepreneurs, so too do the courts discipline entrepreneurial lawyers by rejecting many of their proposed theories and interpretations.<sup>217</sup> Thus, while lawyers are the dynamic element that drive the evolution of the judicial aspect of the legal process, the judges provide the conservative, institutional regularities that preserve certainty and continuity in the law, and thereby temper the entrepreneurial drive.<sup>218</sup>

While her depiction of the litigation process in Austrian market discovery process terms is very insightful, Schwartzstein goes too far with her subsequent claims that "the legal process tends to maximize certainty,"<sup>219</sup> and that the degree of certainty that will be provided by this process will depend "on the type of issue that needs resolution."<sup>220</sup> Her depiction of the tension between the entrepreneurial and conservative forces, as institutionalized through the different constraints placed upon lawyers and judges respectively, is illuminating. However, by merely describing that tension in general terms she neither demonstrates why this process will necessarily strike a balance that "maximizes certainty," rather than reaching a different balance more inclined to favor change and innovation, nor shows how the degree of certainty reached will be linked to the nature of the issues involved.

## 8. Michael Spicer

Michael Spicer has recently written two articles that apply Austrian concepts to assess governmental behavior.<sup>221</sup> In 1993, he published a piece that assessed the implications of Hayek's work for the conduct of public administration.<sup>222</sup> He first discussed Hayek's arguments concerning the significant problems government officials face in acquiring and using relevant information, and concluded that

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217 *See id.* at 1072.

218 *See id.*

219 *Id.*

220 *Id.* at 1078.

221 Michael Spicer, *On Friedrich Hayek and Public Administration: An Argument for Discretion Within Rules*, 25 ADMIN. & SOC'Y 46 (1993) [hereinafter Spicer, *Public Administration*]; Michael Spicer, *On Friedrich Hayek and Taxation: Rationality, Rules, and Majority Rule*, 48 NAT'L TAX J. 103 (1995) [hereinafter Spicer, *Taxation*].

222 Spicer, *Public Administration*, *supra* note 221.

these difficulties provided support for “the notion that public administrators should be able to exercise significant discretion in the conduct of their duties.”<sup>223</sup> A decentralized system of administration that allows lower-level personnel the latitude to exercise their best judgment would provide a means of utilizing their local knowledge, which higher political leaders could never acquire and apply even if they knew of its existence.<sup>224</sup>

Spicer recognizes, however, that such decentralization would raise a problem of coordination, and acknowledges that Hayek was quite sensitive to this problem.<sup>225</sup> The key to effective decentralization, in Hayek’s view, is that the behavior of the officials must be subject to rules of just conduct<sup>226</sup> that require equal treatment of all persons affected by their exercise of discretion.<sup>227</sup>

In a later 1995 article, Spicer set forth his views of the implications of Hayek’s principles for taxation policy.<sup>228</sup> He again emphasized Hayek’s Austrian arguments concerning the limitations of individual knowledge.<sup>229</sup> In Spicer’s opinion, these inherent limitations, coupled with the uncertainties of tax incidence, work-elasticity, savings-elasticity, and risk-taking-elasticity inherent in tax policy, and the further uncertainties associated with the macroeconomic effects of fiscal policies, together call for a conservative, minimalist stance with regard to tax reform.<sup>230</sup> These knowledge limitations pose very substantial difficulties for attempts to utilize tax policy to encourage particular forms of behavior or penalize particular groups of people. Spicer concludes that Austrian concerns lead to a preference for tax-neutrality, in the sense of favoring taxes that are uniform across different economic activities, and for achieving horizontal equity of tax burden across similarly situated individuals.<sup>231</sup> From the Austrian perspective, there is no practical way to apply the insights of so-called “optimal taxation theory.”<sup>232</sup> Given our radically limited knowledge as to the results of our tax policies, Spicer concludes that we should

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223 *Id.* at 50–51.

224 *See id.*

225 *Id.* at 51.

226 *See supra* notes 197–205 and accompanying text for more discussion of Hayek’s view as to the nature of such rules of just conduct.

227 *See Spicer, Public Administration, supra* note 221, at 51–54.

228 Spicer, *Taxation, supra* note 221.

229 *Id.* at 104–06.

230 *Id.* at 111.

231 *Id.* at 106.

232 *Id.*

strive for the modest, but achievable, goals of predictability and certainty.<sup>233</sup>

While Spicer's arguments are thoughtful and prudent, one could argue that even if one concedes that tax policy can have significant, unforeseen, and perhaps unforeseeable consequences, this does not necessarily counsel for a policy of neutral and horizontally equitable taxes. First, the unforeseen consequences of a tax measure may well be beneficial rather than adverse. Spicer may be unduly cautious: the unknown is merely the unknown, not necessarily the unfavorable. Second, a neutral and horizontally-equitable tax system will also have unforeseen consequences, and these consequences may also be adverse. Finally, it seems that there will likely be benefits resulting from individuals being able to rely upon a stable and predictable tax regime for planning purposes. However, from a Hayekian perspective, it is unknown and perhaps unknowable which of the many possible stable tax regimes will be most beneficial. There is nothing inherent in Austrian theory that necessarily identifies tax-neutrality and horizontal equity as the best "default options," so to speak. Spicer should perhaps be more candid in recognizing that he is imposing his own particular attitudes and preferences as to how to deal with unforeseeable possibilities upon the Austrian analytical framework.

### C. *Thomas Sowell's Knowledge and Decisions*

Thomas Sowell is well known for his provocative books<sup>234</sup> and controversial editorial writings on racial and political issues. In 1980 Sowell published a theoretical work titled *Knowledge and Decisions*<sup>235</sup> that received widespread critical acclaim.<sup>236</sup> While he made few explicit references to Austrian theory in that work, the book is essentially a translation of Austrian concepts into mainstream political discourse and an application of those concepts to a broad range of social issues. The Austrian genesis of Sowell's thinking is made clear by his candid recognition of the inspiration and guidance provided by Friedrich Hayek's work that is set forth in the "Acknowledgments" sections of both the original 1980 edition and the 1996 republication, and in the

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233 *Id.* at 108.

234 *See, e.g.*, THOMAS SOWELL, A CONFLICT OF VISIONS: IDEOLOGICAL ORIGINS OF POLITICAL STRUGGLE (1987); THOMAS SOWELL, RACE AND CULTURE: A WORLD VIEW (1994); THOMAS SOWELL, THE VISION OF THE ANNOINTED: SELF-CONGRATULATION AS A BASIS FOR SOCIAL POLICY (1995).

235 SOWELL, *supra* note 24.

236 *See, e.g.*, sources cited *supra* note 33.

"Preface" to the republication.<sup>237</sup> Given the stature that this book has achieved among economists, and its relatively large readership among members of the wider public, it is somewhat unfortunate for the reputation of the Austrian approach that Sowell did not acknowledge in more comprehensive and systematic terms its major influence upon his work.<sup>238</sup>

## 1. Sowell's General Themes

The central message of *Knowledge and Decisions* is that social organizations can be better understood if one focuses upon the specific decision making processes utilized within those organizations rather than upon their announced goals.<sup>239</sup> The central problem facing mankind, according to Sowell, is the limitation imposed by the fragmentation of knowledge among individuals, who each possesses only a minuscule portion of the overall fund of social knowledge.<sup>240</sup> What really determines the nature of a society is the pattern of incentives and constraints that the various social institutions utilize to distill knowledge from opinion and conjecture, shape what knowledge is brought to bear upon various decisions, guide the decision makers

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237 In the Preface to the 1996 republication, Sowell expressly acknowledges his "intellectual debt" to Friedrich Hayek. SOWELL, *supra* note 33, at xxii. He also notes there that Hayek's work "has inspired numerous other scholars, writers, activists and organizations around the world. I am proud to say that he inspired *Knowledge and Decisions* . . ." *Id.* at xxiii. The Acknowledgments section of both editions also recognized Hayek's great influence on Sowell:

If one writing contributed more than any other to the framework within which this work developed, it would be an essay entitled *The Use of Knowledge in Society*, published in the *American Economic Review* of September 1945, and written by F. A. Hayek, later to become a Nobel Laureate in economics. In this plain and apparently simple essay was a deeply penetrating insight into the way societies function and malfunction, and clues as to why they are so often and so profoundly misunderstood.

*Id.* at xxv; SOWELL, *supra* note 24, at ix.

238 Another current popular author who has obviously been influenced to some significant extent by Austrian thinking, but who has barely acknowledged this influence upon his work, is George Gilder. See, e.g., GEORGE GILDER, *THE SPIRIT OF ENTERPRISE* 260 (1984) ("The one group of economists most cognizant of entrepreneurs is the Austrian school . . ."). Gilder's book is much narrower than Thomas Sowell's work in that it focuses almost exclusively upon the phenomena of business entrepreneurship, and does not employ the broad range of Austrian concepts that Sowell utilizes.

239 SOWELL, *supra* note 33, at x.

240 *Id.* at ix.

who utilize that knowledge, and provide feedback concerning the consequences of those decisions.<sup>241</sup>

Sowell thus recognizes the central Austrian insights concerning the ubiquity of limited knowledge and the importance of maintaining proper incentives for developing and utilizing new knowledge. He focuses his attention upon the various social processes by which this dispersed knowledge is obtained, assembled, and coordinated. He makes little if any use of the neoclassical concept of equilibrium; questions of process and coordination take center stage. The close congruence of his approach with the Austrian framework is obvious.

Sowell also reaches typically Austrian conclusions concerning the marked advantages of decentralized, market-oriented processes over more centralized and authoritarian mechanisms. He consistently evidences a Hayekian respect for the organic and evolutionary nature of social processes and institutions, and displays a pronounced distrust of the consciously rationalized procedures often favored by modern intellectuals. He is in full accord with Hayek in believing that those organizations and institutions that successfully coordinate both conscious and tacit knowledge, and that thus succeed in winnowing out truth from falsehood and conjecture, will survive, and over time displace less effective institutions.

*Knowledge and Decisions* is a highly insightful and creative work. Sowell sets a new standard of scholarship in terms of the breadth and depth of his application of Austrian explanatory and normative principles to aid in understanding and evaluating key social institutions. Moreover, he goes beyond the standard Austrian framework to also apply some very useful, non-Austrian analytical concepts which further enrich his analysis.<sup>242</sup>

After developing his model of social processes in some detail in the first half of his book,<sup>243</sup> Sowell then turns to applications of his framework in the second half.<sup>244</sup> He first briefly discusses some general historical trends,<sup>245</sup> and then goes into substantially more detail

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241 *Id.* at xxii.

242 For example, Sowell places great stress on the distinction between the "incremental" trade-off oriented form of decision making that characterizes most market behavior, as opposed to the absolute, "categorical" form of decision making that characterizes governmental—and especially judicial—decisions. *Id.* at xii–xiii, 21–44. He also insightfully contrasts the advantages and disadvantages of "informal" and "formal" relationships. *Id.* at 21–44. He also places greater emphasis upon the role of "feedback" in the process by which entrepreneurial behavior is guided than have prior Austrian writers. *Id.* at xv–xvii.

243 *Id.* at 3–159.

244 *Id.* at 163–383.

245 *Id.* at 163–66.

with regard to particular trends in the areas of economics,<sup>246</sup> politics,<sup>247</sup> and the law.<sup>248</sup> While assessment of Sowell's analysis of general economic and political trends is outside the scope of this article, I will briefly summarize below his arguments and conclusions regarding the legal system.

## 2. Sowell's Framework Applied to Legal Questions.

The main theme of Sowell's discussion of trends in American law is that there has been a substantial shift in both the locus and mode of decision making during the past generation.<sup>249</sup> The trend he sees (and bewails) is the enlargement of the powers of courts and administrative agencies, at the expense of those of private individuals.<sup>250</sup> In his view, this has led to decisions, once made largely in an incremental manner and based upon knowledge communicated at relatively low cost through informal mechanisms, now being made in more absolute and categorical terms, with the flow of relevant knowledge to decision makers now impeded by rules of evidence designed to provide documentation for third parties.<sup>251</sup> Moreover, these new decision makers are much less subject to corrective feedback than were the prior decision makers, and thus the system is more susceptible to continuing on a given (and erroneous) course once begun.<sup>252</sup>

He details these trends in a number of areas of law, which I will only briefly identify here. He first discusses the dramatic expansion of the number and power of administrative agencies and commissions that combine executive, legislative, and judicial powers traditionally kept separate under our constitutional system.<sup>253</sup> He particularly emphasizes the power of these agencies to withdraw subsidies—now often vital for firm survival in an environment where a firm's major competitors are also often governmentally subsidized—as a means of avoiding constitutional restrictions on discriminatory government behavior.<sup>254</sup> He then criticizes recent free speech jurisprudence on the grounds that the courts have failed to adequately consider the social

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246 *Id.* at 167–228.

247 *Id.* at 305–83.

248 *Id.* at 229–304.

249 *Id.* at 229.

250 *Id.*

251 *Id.*

252 *Id.*

253 *Id.* at 232–37.

254 *Id.*

costs imposed when they attempt to prescribe substantive results rather than merely define decision maker boundaries.<sup>255</sup>

Sowell then offers his thoughts on questions of race in the law. He first criticizes the “state action doctrine” jurisprudence that has developed to limit discrimination against minorities as inconsistent and overly expansive.<sup>256</sup> He then advances a rather scathing critique of affirmative action efforts, arguing that the connections often assumed to exist between racial or ethnic disparities in representation and invidious discrimination have usually not been proven, and are often demonstrably false.<sup>257</sup> He challenges the historic *Brown v. Board of Education*<sup>258</sup> decision as resting on the false premise that racially separate schools are inherently unequal,<sup>259</sup> and uses the history of school integration and busing efforts to argue that “[t]he ability of courts to supersede the authority of other institutions is not the same as the ability to achieve the social results aimed at.”<sup>260</sup>

Turning to questions of criminal law, Sowell argues that recent court efforts to improve criminal procedure have ignored the inevitable tradeoffs involved in a criminal justice system, and consequently have unduly expanded criminals’ “due process” rights at a great and unacknowledged cost to crime victims and society generally.<sup>261</sup> Finally, he advances his view that the proper manner in which the Constitution should be interpreted is in an originalist fashion that treats the court system largely as an institution for defining and reinforcing limits on the decision making authority of itself and other actors, and not as a vehicle for seeking to achieve substantive results through activist measures.<sup>262</sup>

All of this analysis, apart from its evident anger and passion, has a decidedly Austrian flavor to it. Sowell repeatedly argues that it is crucial for a society to locate decision making authority in those social processes best designed to allow individuals to obtain and utilize the necessary and dispersed information, and to provide feedback—and incentives for its effective utilization—concerning the consequences of decisions. When decisions are removed from the control of market processes and informal relationships and placed within governmental agencies or courthouses, the result is poor decisions based upon less

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255 *Id.* at 238–46.

256 *Id.* at 246–49.

257 *Id.* at 249–60.

258 347 U.S. 483 (1954).

259 SOWELL, *supra* note 33, at 264.

260 *Id.* at 263.

261 *Id.* at 269–88.

262 *Id.* at 289–99.

relevant information, combined with a reduced ability to correct prior mistakes.<sup>263</sup> Sowell thus places an Austrian emphasis on the limitations of particular individual decision makers and of the wisdom of relying whenever possible upon market processes to disseminate needed information and correct entrepreneurial errors.

### III. AN AUSTRIAN FRAMEWORK FOR ENGAGING IN THE ECONOMIC ANALYSIS OF LAW

In this part of the Article, I will attempt to outline a coherent framework of Austrian explanatory concepts and normative premises that can be used for engaging in the economic analysis of legal rules and processes. As a first step in that undertaking, in Section A I will attempt to isolate and identify the central explanatory principles that have been developed in the recent Austrian law and economics literature summarized above. I will then briefly note the ways in which those principles were applied by those writers to legal questions. In Section B, I will attempt to identify the central normative principles articulated in this recent Austrian literature, and again note the ways in which those principles were applied. In Section C, I will draw upon those explanatory and normative concepts in outlining the contours of an Austrian framework that could provide an alternative to the neo-classical paradigm for engaging in the economic analysis of law.

#### A. *Austrian Explanations of Legal Rules and Processes*

As discussed above, the work done by Austrian writers prior to the past two decades dealt only tangentially with legal issues, and was primarily of a normative rather than an explanatory character.<sup>264</sup> Those earlier writers did not attempt to apply the core Austrian concept of individual action under conditions of ignorance and uncertainty in a focused effort to explain the contours or evolution of the legal system.

The first comprehensive attempt to consider questions of legal process and design from an Austrian perspective was probably Thomas Sowell's 1980 book.<sup>265</sup> As discussed above, his basic explanatory framework was the standard Austrian model of individual decision making under conditions of ignorance and uncertainty, taking place within a framework of incentives and constraints defined by the particular decision making process within which those individuals are enmeshed.<sup>266</sup> Sowell recognized that decision making processes are

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263 See *id.* at 299–304.

264 See *supra* notes 65–72 and accompanying text.

265 SOWELL, *supra* note 24.

266 See SOWELL, *supra* note 33, at ix–xxiii.



social institutions that are comprised by the collective conduct of the persons affected, and that they evolve over time in a natural selection process. He explained many of our recent legal developments as the consequences of a general movement away from informal decision making processes to embrace more formal decision making procedures applied by courts and administrative agencies, although he failed to offer an adequate explanation of what forces have driven this movement.<sup>267</sup> In his view, this shift has impeded the flow of primary information to decision makers, reduced their sensitivity to corrective feedback, and resulted in fewer decisions being made in an incremental manner, and more of them being made in categorical terms.

Sowell has thus elaborated in a series of what might be called "micro-legal" contexts the Austrian insight that the institutional constraints within which individuals act affect their access to new knowledge, their ability to act in an entrepreneurial fashion to utilize that information, and their opportunities and incentives to learn from and correct their errors. His explanations as to how particular developments in administrative law, free speech jurisprudence, civil rights law, and criminal procedure can each be understood as the inevitable outcome of the more centralized and governmental decision making procedures that have been implemented to make social decisions in these areas is a real breakthrough in Austrian thinking. However, his book does not fully develop what might be called a "macro-legal" model that would explain in Austrian terms—in other words, as the dynamic consequence of entrepreneurial behavior taking place under conditions of ignorance and uncertainty—why this broad shift in the locus of decision making and change in decision making procedures which gave rise to the changed pattern of incentives and constraints facing decision makers took place and still persists.

Turning to the other recent Austrian writers discussed above, the book by Gerald O'Driscoll and Mario Rizzo<sup>268</sup> develops a general concept of "pattern equilibrium" for use as an over-arching framework for understanding both the persisting and changing aspects of any network of social relationships. Their book is abstract and theoretical in its approach, and unlike Sowell's effort does not apply this framework in detail to any particular aspects of the legal system. However, it does provide some guidance for the formulation of an equilibrium-like theoretical concept that remains true to the Austrian commitment to viewing social change as a dynamic process, and how such a concept might be integrated into an Austrian explanatory framework.

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267 *Id.* at 229–304.

268 O'DRISCOLL & RIZZO, *supra* note 23.

Michael DeBow's article utilizes an Austrian framework for explaining the conduct of governmental officials, and incorporates the key Austrian ideas that such officials will tend to have even more limited knowledge than market participants and will be less motivated to correct their errors in response to feedback.<sup>269</sup> His article thus suggests some of the general contours of an Austrian explanation of the inadequacies of governmental actions.

Thomas Arthur's article<sup>270</sup> utilizes an Austrian model of the competitive process to describe the development of certain market structures and business practices often subject to critical scrutiny and condemnation under the antitrust laws. His article suggests that Austrian concepts could be rather directly and fruitfully applied to understand the consequences of various forms of governmental regulation of private business conduct.

Finally, Linda Schwartzstein's 1994 article<sup>271</sup> attempts to model the development of the common law through use of a conventional Austrian "market discovery" framework applied in the litigation context. Her approach characterizes lawyers as entrepreneurs operating in a market-like litigation setting before "customer" judges. Her model sheds light on the litigation process and the incentives litigation creates for the development, diffusion, and retardation of innovations in the common law. Her effort does not, however, go into enough specific micro-legal detail to enable one to understand how the particular balance is struck between innovation and stability in any particular area of law that determines the speed and direction of legal change. Nor does she explain how the overall macro-legal institutional framework of role expectations that guides lawyers and judges in their conduct itself evolves over time.

### B. *Austrian Normative Criteria*

As noted above, the classical Austrian writers such as Mises, Hayek, and Rothbard strongly embraced freedom from domination as the central normative premise.<sup>272</sup> In addition, they endorsed legal regimes of stable property rights, freedom of contract, and otherwise very limited government intervention into private affairs because of the assumed (though intuitively plausible) connection between such free market-oriented regimes and entrepreneurial behavior, and ulti-

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269 DeBow, *supra* note 161.

270 Arthur, *supra* note 168.

271 Schwartzstein, *Legal Process*, *supra* note 182.

272 See *supra* text accompanying notes 65–72.

mately the enhancement of human welfare due to the fruits of that entrepreneurial activity.<sup>273</sup>

The later Austrian writers discussed in this Article have essentially reaffirmed these normative premises and made the same implicit assumptions about the connection between free markets, entrepreneurial dynamism, and human welfare. In some instances they have applied these premises to offer normative assessments of particular legal rules or policy measures. Mario Rizzo, for example, concluded that strict liability is a preferable regime of tort liability to negligence.<sup>274</sup> He did so on the bases that 1) strict liability contributes better to the stability of expectations necessary to encourage entrepreneurship, and 2) the claimed benefits of utilizing negligence principles to allocate liability on the basis of *ex ante* comparative costs of precautions are chimerical given the absence of the information necessary to make such determinations.<sup>275</sup> Gerald O'Driscoll and Roy Cordato each came to the same conclusion for similar reasons.<sup>276</sup>

Christopher Wonnell, as another example, subjected certain contract law doctrines such as impracticability, fraud by non-disclosure, and unconscionability to Austrian normative scrutiny by considering their consequences for "entrepreneurial perceptiveness" and concluded that from an Austrian viewpoint some of these defenses were less desirable than they appeared to be when viewed from a neoclassical perspective.<sup>277</sup> Roy Cordato has applied Austrian normative concepts to reject the use of a Coasian framework of analysis for resolving property law disputes, arguing that fidelity to prior assignments of rights should take precedence over neoclassical efficiency considerations.<sup>278</sup> He also concluded that it is inappropriate for governments to intervene in market processes to attempt to internalize either positive or negative externalities.<sup>279</sup> Finally, Michael Spicer proposed evaluating public administration regimes by their ability to allow lower-level administrators to exercise significant discretion while still abiding by impersonal rules of just conduct.<sup>280</sup> He also suggested judging tax policy largely on the basis of its ability to achieve predictability and

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273 *See id.*

274 Rizzo, *Law, supra* note 73.

275 *Id.*

276 O'Driscoll, *supra* note 23; Cordato, *supra* note 23.

277 Wonnell, *supra* note 103.

278 CORDATO, *supra* note 23, at 92-110.

279 *Id.* at 15-37.

280 Spicer, *Public Administration, supra* note 221.

certainty given the unforeseeability of the consequences of tax policies with differential impacts.<sup>281</sup>

Some of these more recent writers have also made efforts towards developing a more general criterion for assessing the normative consequences of policies that might serve a role in an Austrian framework analogous to that played by the efficiency criteria in the neoclassical paradigm. Such an effort is daunting, however, given the Austrian distaste for equilibrium concepts and given the emphasis Austrians place on the continuing dynamic (and often unforeseeable) effects of a policy.

Roy Cordato, for example, has posited concepts of "social efficiency" and "catallactic efficiency" that focus upon a policy's impacts on the ability of individuals to pursue their objectives efficiently and with minimal conflict.<sup>282</sup> His discussions of these criteria do not, however, address the central questions of how and at what point in time such effects are to be measured or how those effects are to be aggregated across differently-affected persons. He therefore provides only a first step towards the development of such a criterion. Similarly, while Linda Schwartzstein in her recent work has identified "certainty" and "flexibility" as criteria that should be incorporated in an Austrian normative standard,<sup>283</sup> she has not formulated a precise criterion that would encompass the inevitable tradeoffs that exist between these objectives, either for a particular individual or for society at large.

### C. *An Austrian Framework for Explaining and Evaluating Legal Regimes*

Viewed as a whole, this body of recent work suggests several principles that should be incorporated in any attempt to design an Austrian framework for understanding and evaluating the legal process. First of all, a basic micro-legal model should be formulated which is sufficiently general and flexible to be used to characterize any situation that is being studied as though it was comprised of rational individuals, each alert to entrepreneurial opportunities, seeking to continually maximize their satisfactions over time in a dynamic process. That model should reflect that those individuals operate under conditions of ignorance and uncertainty that are continually modified by their new learning that results from their actions, with their preferences also evolving over time as a result of their experiences, and that

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281 Spicer, *Taxation*, *supra* note 221.

282 CORDATO, *supra* note 23, at 57-117; Cordato, *supra* note 121, at 237-44.

283 Schwartzstein, *Legal Process*, *supra* note 182, at 1066-78.

those individuals are subject to constraints of income and technological possibility that, once again, evolve endogenously over time.

The relatively stable behavioral regularities that exist in the particular situation being studied through the application of such a model should be identified and characterized as the more enduring institutional constraints—the “pattern equilibrium” of the situation in O’Driscoll and Rizzo’s terms. The persons playing the central entrepreneurial roles in the situation, and the dimensions of their freedom for entrepreneurial action within these pattern equilibrium constraints, need to be identified. All of these specifications should be done in as rigorous a fashion as possible, although given the Austrian recognition of the inherent unpredictability of the future and the admittedly counterfactual nature of the pattern equilibrium assumption, it would be unwise to attempt to reduce such a model to a neoclassical-style set of mathematical expressions or geometric depictions.

As is demonstrated by the previously discussed literature, such an Austrian micro-legal model of the legal process could be applied to explain social behavior in a number of contexts at least as well as does the neoclassical paradigm and, in addition, may help to identify and trace the effects of significant factors that the neoclassical framework is unable to recognize. This advantage is easier to appreciate if one views the Austrian approach as being essentially a more comprehensive and realistic generalization of the limited neoclassical framework. If, for example, one utilizes the radically simplifying assumption of a stable and widely known pattern equilibrium of a sort that strongly reinforces the security of property and contractual rights and effectively promotes broad dissemination of economically relevant information, the Austrian model could be applied to market settings in a conventional, neoclassical fashion to explain the processes of price and output determination and how they are affected by changes in the legal rules affecting entitlements. This particular simplifying assumption would therefore serve to essentially collapse the Austrian model into the basic neoclassical supply and demand framework, just as certain simplifying assumptions introduced in a modern physics model to eliminate relativistic or quantum mechanics complications would collapse the subsequent analysis into a more simple Newtonian form. The neoclassical paradigm can thus be seen in proper perspective as simply being a useful limiting case of the more inclusive Austrian framework—essentially bearing the same relation to the latter approach as Newtonian physics bears to quantum mechanics or to the theory of relativity—and not in fundamental conflict with it as some writers from each camp have at times suggested.

However, Austrian models could also be applied with less restrictive pattern equilibrium assumptions to market settings to illuminate the more complex processes of innovation, product differentiation, reverse engineering and copying, entrepreneurial initiatives, and transactions at non-equilibrium prices that the neoclassical model tends to ignore or at least obscure. They could also be used to help understand the behavior of governmental officials (or other members of organizations) that are acting within pattern equilibriums involving legal and other constraints that exist in non-market settings. They could illuminate how rules can create or limit entrepreneurial opportunities and provide or limit feedback and the incentives to alter behavior in response to that feedback. Finally, Austrian models could be applied to better understand both the common law and legislative processes of law-making by depicting the entrepreneurial opportunities and pattern equilibrium constraints inherent in those contexts and playing out their implications.

The prior literature provides much less guidance for the truly herculean effort of developing a macro-legal model along Austrian lines that could explain the broader social processes that shape major legal trends. From a macro-legal Austrian perspective that encompasses broad collections of individuals and a substantial period of time, it seems difficult or impossible to meaningfully define a stable institutional structure of behavioral regularities. However, without assuming some stable and exogenously determined social constraints upon behavior, it is hard to see how any concrete predictions are to be generated or how any possible explanations are to be ruled out. It may simply be the case that if one accepts the Austrian premise that human behavior is to some significant extent undetermined and "free," one then cannot offer explanations of more than local and temporary validity.

Both macroeconomics and other forms of grand-scale social theorizing thus appear from an Austrian perspective to be rather quixotic enterprises. Despite this apparent inability to offer comprehensive, large-scale explanations or predictions, Austrian macro-legal thinking may still be able to play a valuable "trashing" role in legal analysis.<sup>284</sup> Persons advocating a legal change often argue not only that the proposed change will have local and immediate beneficial impacts, but also make more sweeping assertions as to its broader and longer-term positive effects. The Austrian framework is particularly well-suited for demonstrating how speculative and problematic such larger assertions are likely to be, and how many dynamic social processes must be as-

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284 See generally Mark G. Kelman, *Trashing*, 36 STAN. L. REV. 293 (1984).

sumed to be unchanging, or changing in only foreseeable ways, for those assertions to be plausible.

Turning to questions of assessment, the Austrian normative writing, though relatively limited in both its scope and depth, does provide some guidance—primarily of a cautionary sort—to one seeking to formulate a comprehensive evaluative criterion. Those writers strongly suggest that any criterion utilized for assessment of the operation of a legal regime should focus primarily upon the extent to which that regime promotes a social process which enhances individual freedom and facilitates the exercise of entrepreneurial choice in markets or market-like contexts.<sup>285</sup> Such a focus identifies at least two desirable properties of such a criterion. First, all other things being equal, stable legal regimes appear intuitively to further these objectives more than do unstable regimes that increase uncertainty and thereby impede planning efforts, so the criterion should ideally reward rules for their positive effects upon indicia of legal stability. Second, more flexible legal regimes, again assuming all other things are equal, would also appear to further these objectives better than would more rigid frameworks, since they would allow individual actors greater latitude to utilize local knowledge and tailor their conduct to the specific situations they face. The criterion should therefore ideally reward rules that can be shown to enhance flexibility of action.

Concluding that an Austrian normative standard should incorporate both the stability and the flexibility aspects of a legal regime, however, only serves to bring one to the threshold of a large number of truly difficult problems involved in formulating such a criterion, *even if* one assumes that no other properties of a legal regime beyond its stability and flexibility merit consideration. First, and most obviously, how is one to measure in quantitative terms such inherently multi-dimensional properties as the “stability” or “flexibility” of a given law or legal regime with regard to the circumstances faced by particular affected individuals?

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285 See also Alan P. Hamlin, *On the Possibility of Austrian Welfare Economics*, in *AUSTRIAN ECONOMICS: TENSIONS AND NEW DIRECTIONS*, *supra* note 60, at 193 (Bruce Caldwell & Stephan Boehm eds., 1992).

This Austrian concern with the operating characteristics of processes, rather than their particular outcomes, provides the basis for an Austrian welfare economics. The central point here is that while a genuinely Austrian welfare economics cannot set out to evaluate states of the world seen as outcomes, it could set out to evaluate alternative institutional and procedural structures in terms of their feasibility and general operating properties.

Second, even if a legal regime's stability and flexibility for a given individual can be measured and quantified, it is not clear how the effects of these properties upon that individual are to be valued if one is to remain true to the Austrian perspective. Austrians are unwilling to assume the existence of stable individual preferences that are unaffected by the consequences of the imposition of a legal regime or to assume that individuals will have complete knowledge of the contours of that regime. An Austrian normative criterion would therefore also have to incorporate some mechanism for ascertaining the degree of each individual's knowledge of a legal regime, and the impact of that knowledge upon that individual's preferences.

Third, it seems clear that there is often a tradeoff between the stability of a legal regime and the flexibility of action it affords at least some of the individuals governed by it. In such instances, how will the consequences of the legal regime for each of those individuals whose freedom is simultaneously enhanced and constrained in different ways be assessed? An Austrian criterion would need to have some means for balancing these offsetting impacts to reach an overall assessment of the impacts upon each of these individuals.

Fourth, even if a quantified measure of the impacts of a legal regime on each affected individual can be obtained, how will the impacts on different individuals be aggregated into an overall social assessment? Some persons will likely be benefited and other persons will be injured. How will we decide whether the impacts are on balance desirable? All of the issues raised by the use of the Kaldor-Hicks wealth maximization criterion that is used in the neoclassical framework in an attempt to avoid the interpersonal utility comparison problem would have to be addressed in some fashion here as well.

Finally, looming over all of these other difficulties is the time of measurement problem which is particularly acute in the Austrian framework. Unlike the more static neoclassical paradigm that specifies a precise equilibrium end-state when the full consequences of a measure are to be assessed, the Austrian approach envisions a continuing dynamic process that never reaches such a stable equilibrium. This dynamic conception would appear to rule out the formulation of a criterion that would allow for making definitive normative assessments of the consequences of a policy at any single point in time.

These problems involved in developing a quantifiable Austrian normative criterion are obviously immense and probably insurmountable. Ludwig Mises and Friedrich Hayek were forthright in recognizing that Austrian principles are incompatible with the use of mathematical models to predict the economic consequences of policies; current Austrians need to be similarly candid concerning the im-



plications of their approach for quantitative normative assessment. They should frankly acknowledge that their unwillingness to make radically simplifying behavioral assumptions, analogous to those of the neoclassical framework, renders it impossible to formulate a quantitative welfare criterion that can play a role comparable to that served by the efficiency criteria under the neoclassical paradigm. They cannot have it both ways.

For better or worse, "welfare economics" as conventionally understood in Pigouvian or Coasian terms is not a game that Austrians can play. Efforts such as those engaged in by Roy Cordato and Linda Schwartzstein to develop a criterion labeled "efficiency" of one sort or another, but which in an Austrian framework cannot serve any of the functions played by the efficiency criterion in the neoclassical system, seem to be misdirected. Austrians may well find it inconvenient to have nothing of interest to say at gatherings of economists or policy makers where the "efficiency" of alternative policies is being discussed. Unfortunately, that is one of the unavoidable costs of embracing an alternative paradigm that encompasses much of the richness and complexity of life, but that does not make the heroic simplifying assumptions necessary to obtain such precise measures of performance.<sup>286</sup> In economic theory as elsewhere, there are, unfortunately, no free lunches.

However, it may still be possible for Austrians to develop a "softer," non-quantitative normative standard focusing upon process characteristics rather than end-state outcomes that is entirely consistent with their premises, yet still provides a modest degree of discernment across alternatives that goes beyond the traditional Austrian blanket endorsement of free market-enhancing policies and condemnation of all other measures. While such a normative standard would not have anywhere near the "precision" (which to the Austrians is entirely spurious<sup>287</sup>) of the neoclassical efficiency criterion, it could still provide useful guidance for making certain kinds of policy choices. This author would therefore encourage Austrian writers to continue their efforts along these lines, but to consciously limit themselves to developing an approach for the valuation of process characteristics. They should seek a fuller explication of the connections between market processes and the enhancement of human welfare and not waste their energy attempting to formulate an "efficiency" criterion.

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286 See, e.g., POSNER, *supra* note 1, and the accompanying text; Leff, *supra* note 2, and the accompanying text.

287 See, e.g., Hayek, *supra* note 4, and the accompanying text.

#### IV. ADVANTAGES AND DISADVANTAGES OF THE AUSTRIAN APPROACH TO THE ECONOMIC ANALYSIS OF LAW

To one who has patiently read this far, it should be clear that this author believes that the holistic (or, to its derogators, "complicationist"<sup>288</sup>) Austrian approach is quite valuable because its particular strengths complement very well the weaknesses of the highly reductionist neoclassical framework. Either paradigm when viewed in isolation has obvious and severe shortcomings, but the two approaches when considered in conjunction provide about all that can be asked of the theoretical enterprise. Both approaches consequently have their roles to play in explaining and evaluating social phenomena.<sup>289</sup>

The neoclassical models, as previously discussed, operate at a relatively high level of abstraction, making possible the use of sophisticated mathematical techniques to derive quantitative predictions and rendering diverse impacts commensurable for overall normative assessments. Sometimes such precise predictions and broad normative assessments are needed and neoclassical models are well-nigh indispensable. Their heroic simplifying assumptions, however, put one at substantial risk of overlooking essential aspects of the area of inquiry and may result in spuriously precise predictions of little relevance to actual circumstances, or in incomplete evaluations, or both.

Austrian models, with their emphasis on dynamic processes and their richer and more realistic depictions of the human condition, largely avoid these dangers of oversimplification, misaggregation, and normative over-simplification. These are obviously major advantages. Austrians certainly cannot be accused of "tunnel vision"<sup>290</sup> or of embracing "oversimplification"<sup>291</sup> or a "pretense of knowledge."<sup>292</sup> On the other hand, Austrians pay a steeper price for these advantages than they have sometimes been willing to admit. The Austrian explanatory framework can generally only provide, at most, suggestive descriptions and predictions, and not detailed, quantifiable forecasts. Austrian models resemble flashlights whose translucent lenses dimly illuminate a large area of ground rather than sending forth a bright but narrow beam of light. Sometimes such broad but dim illumina-

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288 See, e.g., POSNER, *supra* note 1, and the accompanying text.

289 The clearest analogy this author can present is that of the wildlife photographer, who needs to carry both a wide-angle lens and a close-up zoom lens in his camera bag, and uses the one that best fits the circumstances that he encounters.

290 See, e.g., Leff, *supra* note 2, at 477, and the accompanying text.

291 See, e.g., HUNDERT, *supra* note 3, at Part One frontispiece, and the accompanying text (quoting J.L. Austin).

292 See, e.g., Hayek, *supra* note 4, at 272, and the accompanying text.

tion of social processes is sufficient, but at other times clear detail is essential.

In addition, the resolving power of any Austrian normative criteria that have thus far been proposed is quite limited. Beyond offering a general endorsement of stable private property rights regimes and reliance upon consensual market processes rather than authoritarian directives as social coordination mechanisms, the Austrian normative framework is rather vapid. It has insufficient "bite" to provide meaningful guidance with regard to any social decisions except for the most fundamental markets versus comprehensive central planning social choices. These normative assessment problems, moreover, appear to be inherent in the complex nature of the analytical framework and in the Austrian commitment to incorporate time and uncertainty in a serious manner. Of course, Austrians can always respond that the seemingly more tractable neoclassical efficiency criteria "solve" these difficulties only by assuming away these very complexities and thereby provide meaningless and misleading assessments.

For the legal scholar or law reformer who regularly utilizes neoclassical economic concepts in his work, therefore, some facility with Austrian modes of explanation and assessment is an essential skill. Besides providing a helpful check on exactly the sorts of errors of omission and oversimplification to which neoclassical analyses are prone, even when conducted by experts, the Austrian framework can serve to strengthen one's peripheral social vision, so to speak, to reveal additional areas of fruitful inquiry and lurking normative issues. Once revealed, those avenues of inquiry and normative questions can then be probed more closely with the more focused neoclassical tools.

Moreover, the Austrian framework can also be of great value to many other legal scholars who do not currently utilize neoclassical economic concepts in their work, or who do so only sparingly. Two significant groups of academics who may be able to make particularly good use of Austrian concepts are the members of the law-and-society movement and those scholars associated with the emerging interdisciplinary field of socio-economics.

As Robert Ellickson has well described, there is currently a great chasm between law-and-economics scholars and the members of the law-and-society movement.<sup>293</sup> The latter group has its academic roots

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293 ROBERT ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* 6-8 (1991).

They publish separate journals. They gather at separate conferences. They seem rarely to read, much less to cite, work by loyalists of the other camp. . . . To exaggerate only a little, the law-and-economics scholars believe that the law-and-society group is deficient in both sophistication and rigor,

not in economics but instead in the more humanistic social sciences such as history, sociology, and anthropology.<sup>294</sup> Law-and-society scholars tend to regard human behavior as highly variable and contingent on historical circumstances<sup>295</sup> and consequently find little occasion to make use of the abstract neoclassical models favored by law-and-economics scholars. The Austrian approach, it would appear, could perhaps provide a "bridge" between these two different theoretical orientations, in that it rests upon the same core premises and analytical categories as the neoclassical framework,<sup>296</sup> yet incorporates the richness of life and complexity and contingency of human behavior in a comprehensive fashion. On the other hand, the extreme methodological individualism and commitment to libertarian premises of most Austrians may be somewhat off-putting to many law-and-society scholars.

A substantial number of legal scholars have recently expressed sufficient interest in the principles that underlie the interdisciplinary field of socio-economics,<sup>297</sup> and have signed a petition that has led to the formation of an Association of American Law Schools Section on Socio-Economics.<sup>298</sup> Those scholars have generally embraced the neo-

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and the law-and-society scholars believe that the law-and-economics theorists are not only out of touch with reality but also short on humanity. (footnote omitted).

*Id.*

294 *See id.*

295 *See id.*

296 *See supra* Part IA.

297 A succinct description of the core principles of socio-economics that makes clear their broad overlap with Austrian concepts is presented in SECTION ON SOCIO-ECONOMICS NEWSLETTER (Association of Am. Law Schs.), Nov. 1996.

Socio-economics begins with the assumption that economics is not a self-contained system, but is embedded in society, polity, and culture. Drawing upon economics, sociology, political science, psychology, anthropology, philosophy, history, law, and management, socio-economics regards competitive behavior as a subset of human behavior within a social context that both enables and constrains competition and cooperation.

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Unique among interdisciplinary approaches, however, socio-economics recognizes the pervasive and powerful influence of the neoclassical paradigm on twentieth century thought, and seeks to examine its assumptions, develop a rigorous understanding of its limitations, improve upon its application, and develop alternative, perhaps complementary, approaches that are predictive, exemplary, and morally sound.

*Id.* at 4.

298 That petition was signed by 120 law professors from 50 AALS member schools.  
*Id.*

classical paradigm to a greater extent than have most of the law-and-society scholars, but many of them have long been troubled by its reductionist assumptions and are actively seeking to develop complementary approaches of a broader sort.<sup>299</sup> The Austrian framework would appear to be almost ideally suited to their needs, particularly if a variant can be developed that attenuates this connection with libertarian political premises.

While it is therefore important for legal scholars of many different persuasions to understand and make use of the Austrian insights, it is perhaps even more important that law students be formally introduced to the Austrian framework in their law-and-economics courses. A scholar who regularly applies neoclassical economic principles to legal questions in a thorough and critical fashion will likely independently reach a number of the more central Austrian insights as to the limitations of his tools, even if he is unaware that he is, in effect, re-inventing a conceptual wheel that has a long and respected tradition. A neophyte law student who has had little economics background beyond sophomore-level Microeconomics 101, however, is not likely to develop an understanding and appreciation of the Austrian counterpoint to the more austere neoclassical analyses that are presented to him unless substantial class time is specifically devoted to that end. Unfortunately, very few teachers of law-and-economics courses now incorporate an Austrian module; this needs to change.

Law professors who attempt to incorporate Austrian concepts into their courses, either in discrete modules or pervasively, are likely to find that those ideas are relatively quickly grasped and well-received. This should not come as a surprise; the Austrian premises are in fact much closer to common understandings of human psychology and social dynamics than are the more heroic and austere neoclassical premises. It thus is actually less of an intellectual step for students to embrace Austrian principles than it is for them to accept the less intuitive premises of the neoclassical paradigm. Professors who punctuate their presentations with Austrian perspectives on the issues will likely encounter less skepticism than one sometimes faces when demonstrating the often highly counter-intuitive implications of neoclassical explanatory models and Kaldor-Hicks efficiency assessments.

## V. CONCLUSION

The use of economic principles in legal analysis is now pervasive and is recognized as leading to valuable insights otherwise not easily

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299 See, e.g., *supra* note 297.

obtained. Virtually all of this law-and-economics analysis, however, is confined to applications of highly reductionist and static neoclassical models that abstract severely from essential features of the human condition and the social process. The Austrian tradition, in contrast, is based upon a conception of society as a complex and dynamic process, constituted by individuals with malleable preferences and acting through time under conditions of ignorance and pervasive uncertainty and subject to an institutional order that is in continuous evolution. Laws are evaluated in this framework in accordance with their impact on the process by which these individuals are able to coordinate their efforts to achieve their objectives, not through a comparison of equilibrium end-state outcomes.

Over the past two decades there have been a number of efforts by Austrian writers to apply their approach to legal questions. While much remains to be accomplished in this research program, a number of insights have been obtained that collectively provide a valuable perspective from which to assess and counterbalance the limitations of the neoclassical paradigm as a tool of legal analysis. It is by now clear that the Austrian approach can be of great value to legal scholars of many different persuasions and to lawyers generally. One can only hope that the neoclassical and Austrian traditions will come to be regarded as complementary rather than conflicting approaches for applying economic principles to legal issues and that legal scholarship and education will no longer overlook the Austrian contribution.