ECONOMICS AS THE LAW

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Abstract

This Essay represents a version of a chapter in my forthcoming book “Trust and Honesty, America’s Business Culture at a Crossroad.” In designing legal protection from breach of trust and deception lawyers and judges have not only used this branch of economics as an information source but also adopted its objectives in substitution of the law’s objectives. The first issue in this Essay relates to the ways in which legal economics simplifies the world. This is the reasons for its attraction and rejection.

The second issue in this Essay relates to the autonomy of the law. It raises a concern that the soul and mind of the law are lost in the jargon and approaches of this special form of “imperial economics.” It suggests that the place of economics in law is the same as any other discipline. Economic objectives have a modest place in law just as the objectives of other disciplines have not.

This Essay represents a version of a chapter in my forthcoming book “Trust and Honesty, America’s Business Culture at a Crossroad.” While inquiring into the legal environment of fiduciaries in the past 30 years, the effect of one theory has emerged. It is a brand of economics that I call “imperial economics.” The relationship of this brand of economics and the law of fiduciaries is the subject of the Essay. Imperial economics has affected the approach to trust relationship and the legal protection from breach of trust and deception. To be sure, economics played a role in law before. But this branch of economics has attracted lawyers and legal academics, and has affected the law of trusting relationships in a special way.

Economics may cover broad or narrow subjects, and interact with different disciplines in different ways. As James E. Alvey noted, past great economists viewed economics as a social science and were concerned not only with countries’ economies but also with the effects of the economies on the well being of the world populations, and international relationships among nations. In fact, economists such as Malthus, Ricardo,
and Keynes did not use mathematics as their main language. They used words and concepts more prominently than many strands of economics do today. [Alvey, 53-73].

The extended use of numbers and statistics may have started with Nobel Prize winner Paul Samuelson in the 1950s. I speculate that the resort to numbers and mathematics may have developed with the availability of computers and large databases that can be manipulated with ease unknown before. With the age of computers economists began to resort to the language that fits computers; the language of numbers, algorithms and statistics. The human element, which is less precise, does not fit the language of computers. Therefore, it was altered to become more fixed and amenable to modeling. These developments may have also caused some economists to shift their view of economics from a social science to the more precise natural science.

This Essay deals with two issues. The first relates to the ways in which legal economics simplifies the world. This is its strength and reason for attraction. This is also its failure and reason for rejection. Like other simplified popular theories, such a theory presents a distorted world. Regardless of the intentions of its creators, it can provide support to abuse of trust and deception. If taken literally and absorbed into legal doctrine, it can harm the effectiveness of the legal system.

The second issue in this Essay relates to the autonomy of the law. It raises a concern that the soul and mind of the law will be lost in the jargon and approaches of this special form of "imperial economics." The approaches of economics and the search for an efficient law can significantly reduce the legal duties imposed on trusted persons. These are designed to control their temptation to abuse the trust vested in them. And these duties are watered down by Imperial economics.

Imperial Economics is a branch of economics that condenses the view of the world, simplifies it, and puts the whole world into a mold. The result of this approach is to leave little in the world outside the sphere of economics and almost nothing outside the sphere of the Imperial branch of economics. In the process, Imperial economics became popular among economists, so much so, that it began to be called traditional economics. It converted a sufficient number of lawyers, scholars, judges, and legal academics who began to view the law through the lenses of Imperial economics.

Theories Can Enlighten and Endanger. They can expand knowledge and new approaches, but also support rigid ideologies that exclude and threaten conflicting views. To accept economic theories without a serious critical evaluation of their impact on trust and honesty is just as risky as to reject them out of hand. There are many, including this author, who greatly appreciate the insights of economics and uses its approaches and techniques, when appropriate. But they reject economics as an all-encompassing view of the world and deny the hegemony of economic values as the guiding values for the law. There are legal economic scholars who believe in the "individualization" of the law; that is, in individuals as the lawmakers. But they do not necessarily subscribe to the markets

as the only lens through which the world can be seen. [Kaplow and Shavell] 2 In the past twenty years there emerged a view of the law through the lens of economics to make law a subset of economics for some academics, jurists and practitioners. There are varied strands of scholarship that relate economics to the law. Some adopt the overall hegemony of economics and some absorb only part of it. Most absorb its language. For the purpose of this discussion the differences matter less than the very existence of a strong attraction of translating the law into a branch of economics, especially to the economics of the "imperial" kind. This discussion may be less accurate with respect to one nuanced aspect of this or that scholarship, but it is accurate and true with respect to the general approach.

For example, cost/benefit analysis is a very useful technique. But suppose we want to evaluate certain costs and benefits of regulating businesses. If we calculate only the cost of regulation to business, we may reach a certain number. But if reduced regulation results in the higher costs of fraud, one must add to the calculation the cost of preventing fraud, and the cost of rising fraud, the sum of these costs is likely to be higher. These are just two items that are used to calculate a far more complicated environment. Models and theories help simplify and think clearly about segments of the world. But these models can be misleading when they are accepted as the true entire world.

Some theories aim at improving predictions. For example, certain atmospheric conditions may produce a hurricane. However, these theories work better when the environment, though complex, is relatively stable. In a chaotic system like the stock market, the predictive value of a theory is very weak because we cannot make assumptions that will be sufficiently stable yet reflect reality. That is why the past performance of market prices does not help predict future prices. Because the theory uses fixed assumptions, it will produce unreliable results. These are hardly helpful to decision making. Many investors make the mistake of assuming that the past trend in prices will continue. The model will not help predict when the prices will rise and fall, and is not very helpful in telling them that at some point the prices will indeed rise and fall.

THE STRATEGIES

Converting Observed Reality Into a Norm. Because People are Self-Interested, Self-Interested Actions Benefit Society. Based on the observation that people pursue their self-interest and self-preference in many of their activities, "imperial economics" has adopted this "reality." If self-interest and self-preference drives everyone, then this drive must be good. If people pursue their own interests, choose their own preferences, and seek to satisfy their own desires, society, as a whole will be better off. The perceived reality thus leads to a norm. "Self interest is, therefore self interest ought to be."3 If people in the United States are acquisitive, acquisition ought to be. If markets are prevalent in United States, therefore almost everything ought to be cast in the mold of a market, and so on.

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2 LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE (2002).
Some legal economists might argue that economics does not purport to establish norms of behavior. "Economics is a science," they would say, "not a philosophy." The legal economist creates a model of human behavior. The model helps predict future behavior.4

Yet one can question the assertion that economics does not lead to, or assert norms. After all, economists judge efficiency to be good. By defining efficiency, the legal economist proposes a measure for good and bad. If the legal economist does not factor into efficiency "a fair wealth distribution," he either fails to address the issue, in which case wealth distribution has no value of good or bad. Or he if chooses efficiency as a principle for distributing wealth, he proposes a measure of good and bad, that is, he creates a norm. An interest discourse occurred at the conference in which this Essay was delivered. One economist argued that involving employees in corporate governance would be more efficient, describing the German model. A legal economist then asked him: "If this form is more efficient, why do you not see it in the United States?" The question contained unspoken assumptions that the United States corporations or (corporate statutes) adopt the most efficient models of governance and that therefore the German model is less efficient. Both assumptions may be incorrect because corporate governance is based not only on efficiency but on culture, history, and political and social conditions, including the state of the economy. The question hid its narrow assumptions.

**Economics Does Not Speak the Language of the Law.** It does not provide direct commands, such as “Thou shall not kill.” It may inquire into whether a society in which people kill each other at random is efficient rather than require rules that would create a more efficient society. But we need not engage in the argument of whether these distinctions are meaningful. Even if the basis of economics is not normative, and even if its rules are not command-rules, the legal economist has a problem. That is because the law is normative and its rules are command-rules. Law states what is good or bad and requires people to follow the good or avoid the bad. The legal economist then is forced to convert, overtly or covertly, the “is” to “ought” and the reverse. He is forced to say: Here is a rule that requires a behavior which is justified by efficiency. Since the rule says that the behavior is good, and since the justification is efficiency, therefore efficiency is good.

In addition, "Imperial economics" helps simplify by converting things into numbers. It straightens the complexity of human behavior by assuming that people are rational, all behaving the same way. That helps modeling. Dealing with assumed rational behavior is far more appealing than dealing with real, imprecise, irrational and unpredictable behavior. The theory is attractive by offering clear conclusions and solutions, rather than forcing us to grapple with annoying contradictions and nuances, and to grope for vague directions.

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Imperial Economics Simplifies Contradictions by Re-defining and Absorbing Them. One can view morality and altruism and self interest as containing elements of contradictions. Yet, Imperial economics absorbs morality and altruism into self-interest and self-preference. Most people are self-interested, and yet have a strong drive to control their self-interested antisocial activities, and to contribute to others and to society. Perhaps because self-interest is stronger than the drive to obey society's law and give, most societies share a taboo on extreme selfishness and hold high the virtue of benefiting the social group. After all, giving and committing to others are crucial to the survival of the givers because most people share the fate of the group to which they belong.\(^5\) Thus, there is a powerful force that contradicts self-interest.

Imperial economics does not ignore the strong impetus to give, or the social rewards to behave in an altruistic way. Instead, it interprets self-interest to include most if not all acts of benevolence. After all, people who contribute to others must derive some pleasure and benefits from the contributions. Charitable donations can manifest egotism, and even fraud. Donors are self-interested persons who masquerade as generous persons, while enjoying satisfaction to their egos, and the benefits to their reputation, business, and networking. Even an anonymous gift can be interpreted as self-interested if the gift is given to loved ones, or for a desirable project. This strong assumption about a world of self-interested persons applies to trusted people as well, for example, to judges. One discovers that judges select self-serving judicial doctrines. And while shaping the law and deciding conflicts among the parties, judges seek to maximize their individual interests, "like everyone else."\(^6\)

Interpreting people's behavior through the lens of self-interest paints the behavior of goodness, morality, empathy for others and altruism with the color of self-interest, and makes it hard to distinguish between the focus on the self and the focus on others and the community. In addition, self-interest includes self-preference; the preference is left to each individual. Therefore, if altruism or empathy or compassion is not preferred by some individuals in their dealings with others, that is fine. If some individuals prefer altruism, that is fine too.

But even though in Imperial economics self-interest seems to embrace all preferences, values and desires of human beings, maximizing one's wealth by money or assets is viewed as the highest of interests and getting wealth is the strongest of the incentives to action. Money or wealth or some quantifiable measure is then attached to goodness, morality, empathy for others and altruism. Everything can be traded and measured by money. To be sure, like other aspects of this theory, money represents many things, like leisure, and presumably other "goods," like happiness. The problem here, as in all grouping under a specific heading, is that leisure may be entirely unrelated to money. Happiness, knowledge, honor, and many other important things to individuals and society, which in the language of economics are "goods," may have nothing

whatsoever to do with money. Yet, in this discourse, when money is a measure for leisure, happiness and honor, they are locked into money and are covered by its gleam.

Redefining the law helps to simplify the law and eliminate contradictions. Ambitious legal scholars, who are the followers of imperial economics, seek to create a true legal science. This ambition helps to expel morality, fairness, and other "soft" values from the law. As one judge declared, moral philosophy has no place in legal adjudication. Defining morality as "the set of duties to others . . . that are supposed to check our merely self-interested, emotional, or sentimental reactions to serious questions of human conduct," he rejected the role of morality in law. Morality, he wrote, is sometimes described as the "domain of duty," with "pretensions to universality... as a theory of how we should or ought to behave..."Morality is an individual preference. It is represented by the invisible hand of the “market for morality.” This view, which has followers, deems judging as a quest for scientific precision, shrouded in economics. To be sure, judges must follow the edicts of the legislatures and legal precedents. But judging is not an automatic function. A judge's beliefs are reflected in his approach to the law. That approach demonstrates at least one trend that influences American culture today.7

"Imperial Economics" Eliminates Competing Theories by Simplifying the Environment. There is no society; only individuals. The very notion of a community and social capital or social trust is questioned and even denied. If there is no community, there is no one to receive the benefits of a commitment to moral rules and altruistic behavior except other individuals. This approach has a number of implications.

First, it eliminates complexity by converting all relationships into personal relationships. For example, this brand of economic law reduces a corporation into an amalgamation of “nexus” of contracts. This is the language of economics. Second, one strand of this brand argues that the level of morality and the depth of commitment to others are not the business of policy makers. It becomes a purely private matter, as determined by each individual. Policy makers should not consider morality in making their decisions except to reflect the morality of individuals. "The only limit on what is included in well-being is to be found in the minds of individuals themselves, not in the minds of analysts."8 By eliminating society one strengthens individual freedom from social constraints, and even self-restraints.9

This interesting "post-modernist" idea seems to be an offspring of the "flower children" culture in the 1960s. To be sure, the flower children rejected materialism while this legal strand has adopted wealth maximization as one of its main goals. But like the

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8 LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 11-12 (2002); see also id. at 18-19 ; Ward Farnsworth, The Taste for Fairness, 102 COLUM. L. REV. 1992 (2002).

flower children, the movement has followed its parent culture by preaching freedom to choose one’s moral guideline. It rejects unified (imposed) moral principles. The flower children rejected government and its laws, especially as related to drugs and sexual behavior. This legal strand mimics this approach as related to financial and business behavior, as well as in the area of trust. This private moral standard that stems from looking inward rather than outside oneself has been proposed by Rousseau and followed today.

At first blush it seems reasonable that individuals, perhaps through the invisible hand of the markets, rather than the visible hand of policy makers, would lead us to true moral values. After all, morality and fairness are not free from debate. Why not reduce the power of lawmakers to dictate such imprecise values? Better to let each of us decide what is right and fair. But on second thought, the proposed alternative is far less attractive.

There are no reliable polls measuring how the members of the public feel or think about these issues. Fairness and morality are not directly measured by stock prices. Besides, there is sufficient evidence to suggest that stock prices do not reflect rational evaluation of the issuing corporations, let alone their morality and fairness components.

But then, if the regulators, the courts or the legislators dictate moral principles in business, would we not be ending with a subservient society and a paternalistic government? Even though paternalism is in disrepute, one should want to consider it. Many laws are paternalistic, in the sense of protecting one party against another. These laws usually apply when the power balance between the parties is unequal, for example, as the power between the shareholders and corporate management. Nonetheless, the weak parties may be strong enough to head for the door. Some view the securities laws as paternalistic, but many recognize that the weak persons' strength is their option not to interact. The strong persons' weakness is their desire to interact.

The law supports the "bonding" among the two that is cheaper than other guarantees or money that the strong would have to offer and deliver in order to convince the weak not to leave the markets. No paternalism there. Yet the argument continues because there is no agreement where the law should align the bargaining among the parties. There is no agreement on the balance of power.

Assuming that the law and policy should follow the investors' values, who has a better sense of the current public's values and morality? It is those who have a high stake in determining the public's sentiments. These are precisely the lawmakers and regulators, so berated by Milton Friedman,10 and the industries that interact with the investors and need their trust. The constituents of the lawmakers and the customers of industries are the source of information for the legislatures and the regulators. Industry and legislators may be the best judges of what these sentiments are. But the legal economist mistrusts them because they have “systemic incentives” to serve their own interests rather than the wishes of the population.

10 See Milton Friedman, Capitalism and Freedom 45-51 (1962).
Imperial Economics Establishes a Simple Uniform All-Embracing World.

Echoing Shakespeare's language it is that "All the world's a market. And all men and women merely contract traders." The world is a marketplace, in which independent people trade at arm's length and human relationships are exchange contracts. This world is not limited to business relationships. It covers many other relationships, personal, and institutional. Legal scholars have spoken of the markets for ideas, the market for state corporate laws. There is a market among legislators, a market for law enforcement [Becker and Stiegler, 2, 5] a market for social norms, a market for higher education "stars of academia," a market for spiritual movements and even a market for babies. This author admits to using the image of the "contestable market" theory to analyze a market for power. The supporters of Judge Posner, the author of the "market for babies," explain his article as use of "provocative language." He achieved the purpose of gaining attention and starting a market-based discussion. In other words, he really did not mean what he said in full, and certainty not as a judge and not entirely directed to law.

Similarly, the word "product" has absorbed trust services, and is used to represent what is sold rather than what and how it is produced. Thus, consumers are offered financial products, trust products and legal products. One of the courses offered to practicing lawyers advises how to make money by "offering 'Legal Commodities'." One should not complicate matters, create more categories, refine distinctions, or else one might enter the danger zone of losing the followers' interest.

This view of the world minimizes the role of the government and the laws, substituting for much of their authority the non-ruler, that is, the invisible, unidentifiable,

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15 Robert C. Ellickson, The Market for Social Norms, 3 Am. L. & Econ. Rev. 1 (2001); Robert Cooter, Normative Failure Theory of Law, 82 Cornell L. Rev. 947, 949 (1997) ("Just as regulations ideally correct failures in markets, laws ideally correct failures in social norms. No law is required when the market for social norms works, but when it fails, law may improve the situation by enforcing a beneficial social norm, suppressing a harmful social norm, or supplying a missing obligation. The theory of normative failures is a diagnostic tool for explaining if, when, and how the state should intervene by imposing law").
hand of the market. A leading economist has averred that law is unnecessary and private ordering is sufficient to regulate business and property transactions. It is the deus-ex machina, the law that descends from heaven; not human-made law. Without denying the existence of the community, influential economists denied corporate and business duties to community.

One of the founding fathers of an all embracing economic view of the world, the economist Milton Friedman argued for business's freedom from social responsibility. "In a free economy" he wrote in his 1962 book Capitalism and Freedom, "there is one and only one social responsibility of business -- to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engage in open and free competition, without deception or fraud."

In this statement he argues against limiting competition by imposing on corporations duties of "social responsibility," commitments to employees, communities, and charity. "The essence of a competitive market is its impersonal character" Milton Friedman wrote. "No one participant can determine the terms on which other participants shall have access to goods or jobs." There is truth in what Friedman was saying, but not a complete truth. And that is as it must be if capital can escape regardless of how it is used. But capital moves when people move it. And when people have complex or conflicting motivations the aggregate result may differ. To be sure, theories eliminate some details, and the question is what is the optimal elimination of details that can nonetheless leave us with a coherent theory. Imperial economics leaves us with too few details.

In addition, the technique of redefining and absorbing is used in this context as well. Market exchange absorbs any and all relationships, including relationships that require significant trust and are not usually deemed to be within the market sphere, such as adoption of babies, family relationships, or even rape, (a relationship of sorts). In fact, killing can also become an exchange; a market for the killed and killers is still waiting an analysis and embrace.

Similarly, the legal form and rules of contract, which represent exchange, absorb all other legal relationships and rules, such as fiduciary or trust relationships. The absorption of fiduciary law into contract changes the nature of the rules that govern trusted persons, strengthens private arrangements and weakens the judges and legislatures' rules. The absorption eliminates the duty to account for ill-gotten profits and

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22 Milton Friedman, Capitalism and Freedom 133 (1962)
erases the stigma of a breach of trust. Abuse of trust becomes a breach of a promise, like a late payment, which is expiated by waiver or at most by a finance charge.

One example of the conversion of fiduciary law into contract is a recent case of the Seventh Circuit.\textsuperscript{26} In this case an investment manager to pension funds hired a former broker to gain management business. The employee made a deal with a broker: brokerage business in exchange for investment management business ("introduction" to a client). The allocation of clients' brokerage business is prohibited except in particular cases, and this case was not one of the exceptions.

The broker in this deal bribed trustees of the Teamsters' pension fund to vote for transferring $260 million to the investment manager. When the bribe was discovered another trustee of the pension fund sued the investment manager for carelessness in causing the transfer. After all, the arrangement made by the investment manager's employee resulted in bribing the trustees.

The lower court held that the investment manager was not responsible for the bribery and was not negligent. The Teamers trustee appealed, and Judge Posner, writing for a unanimous court affirmed the judgment. There was nothing special about this decision and it is quite plausible.

Yet, the decision is astounding. The decision states that even if the investment manager breached its fiduciary duty to the client pension fund, the fund had no remedy! That is because the investment manager did not receive any value from the exchange of brokerage for "introduction." A judge well versed in economics declares that getting the business in a competitive environment is of no value. The client, on the other hand, said the judge, was not injured. The client paid the "market price" of 6 cents a share! In fact, brokers charge 3 or 2 cents a share for executing large transactions. As painful to the reader who is well versed in the subject is the disregard of (1) section 28(e) of the Securities Exchange Act of 1934, (2) the regulation of soft dollars in the pension fund (and mutual fund) area, and (3) the inattention to the institutional brokerage market.

Most importantly, the judge has cunningly produced a fiduciary duty without a remedy, that is, \textit{he eliminated the fiduciary duty} of the investment manager. He has converted it from a property right of the beneficiary pension funds into a contract right for the pension fund. Those who manage other people's money may get new business (no benefit) by promising brokerage business of the clients' assets (which does not belong to the clients) so long as the clients are charged "market price" (not the best price available).

Similarly, the difference between the sale of a "legal commodity" and the rendering of a "legal service" of a fiduciary results in the image of the relationship. Selling legal advice is like selling shoes. The legal consequences differ. A breach of a contract (breach of promise to another person) is not a breach of trust (misappropriation of another person's property). The victim of contract breach can claim damages. The victim of a breach of trust can also claim accounting for profits.

\textsuperscript{26} Wsol v. Fiduciary Management Associates, Inc., 266 F.d 654 (7th Cir. 2001).
Yet in Everything and everyone is ensconced within the market and commodity framework: organizations, markets, corporations, government units, States, courts, benevolent societies, families, individuals and criminals. All deal with each other by contract. All sell and buy for a price. When family and rape, love and prostitution, childbirth and adoptions are included in the straight jacket of a relationship and a context, some adjustments are made to accommodate what we know are different kinds of relationships. Nonetheless, if the starting point is contract in the market place, after the first jolt or outrage, one is forced to begin at the prescribed starting point and only then make adjustments. The starting point reigns supreme.

The Strategies of "Imperial Economics" Reinforce Each Other. Self-interest is saluted. By eliminating the category of community, self-interest becomes a doubly powerful message. Worry only about yourself because no one else is going to worry about you (unless you know that other person). A one-to-one relationship, under an individual and personal moral preference leads to the one and only contract. Contract leads to the one and only exchange. Exchange leads to the one and only (or almost one and only) market. Thus, the circle is closed with no avenue of escape. To be sure, there are economists that envision more than one form of interaction in addition to the markets. But most are exchanges, based on bargaining.

"Imperial economics" has made things simple and used simplification to undercut competing concepts, theories and values. Unfortunately, counter to Einstein's advice, it has also made things "simpler." The image of law as an income producing service has led some ambitious legal economists to a different view of the lawyer's role. To them, the lawyer's role is to "leverage" the law and produce revenues for clients in a competitive environment. In other words, the function of lawyers is to find possible legal loopholes that might reduce the clients' costs. Telling the clients that they may not engage in certain activities may also reduce the clients' legal risks and thereby save the clients some future costs. But it is not as productive as providing revenue producing in the present. They may come perilously close to designing, approving and hiding forms of abuse of trust.

The image of justice as a commodity for sale subverts our view of the courts, the law and the litigants. The litigants are trusting beneficiaries of the judicial system. The system consists of trusted individuals and organizations that exercise power for the defined purpose of maintaining peace, fairness, and justice in the society. The emphasis on the "market for courts' services" and on the courts as competitors blurs their primary function and real purpose, and most importantly, their obligations as trusted persons. Justice is not a commodity for exchange or purchase. Judges and courts have absolutely nothing to sell. Courts’ powers are not theirs to offer and exchange. Judges are not salespersons either. A view of law as a commodity manufactured by the courts subverts their fiduciary nature, and dilutes the respect owed to them as the depositories of our system of justice. Turning the courts into a production line endows the judges with the respect owed to salespersons of commodities, like salespersons of cars and shoes. If they do not deserve better, our society does.
Not everything can be squeezed into the mold of a market exchange. For example, suppose a teacher announces to the class that she will auction off the grades at the end of the semester, and facilitate a market in the grades. Would not that be efficient and beneficial to all? It would certainly benefit the teacher and perhaps some of the students. The system will be driven by everyone's self-interest. Yet, this solution is bad, as much as it is wrong. Grades should measure the students’ abilities, not by how much money the students have or can raise. In this context the students’ abilities are not commodities to be traded. Most importantly, if she accepted pay from the students, the teacher would abuse her power of grading.

With respect to this power she is a trusted person—a fiduciary. The power of grading is not hers to sell. It was given to her for the sole purpose of effective teaching, which includes a form of incentives to students to work hard, and help their presentation to future employers. This does not mean that grades cannot be commodities, subject to sale. In fact, students and others have stolen exams, and money has passed hands for the answers. Teachers are not known to have encouraged these actions, but not because the grades are not commodities, and not because no market can be developed in them. It is because doing that is wrong.

If grades were traded, how would students be evaluated for admission to graduate schools, and by future employers? In time everyone may assume that the value of the deceptive grades will deteriorate to close to zero. Then, perhaps a merit system will rise from the ashes. But at what cost to education and society! And if no controls are put in place, the corrupt system may emerge again, and the cycle will continue. The legal economist would resort to the market solution. Sooner or later the markets would adjust the grading signals. Besides, he would argue, there is no need for rules. Grades based on merits evolved without regulation as a mutually beneficial system; and have been self-sustaining for the same reason.

The answer is an economist’s answer. Law is like medicine. It interferes as a solution to a problem. Many systems evolve without legal intervention. The grading system is not free of rules or of law. It has evolved as rules in the schools, when verbal evaluations became too cumbersome and employers desired more quantifiable representations. Many schools impose grading constraints on teachers to avoid favoritism. The hand that imposed the rules is far from invisible. And if a teacher is found to have accepted valuables for grades, she would be dismissed and the court would uphold the dismissal as a breach of her fiduciary duties. No one would wish to wait for the market sanctions.

The Underlying Banner Ideas. Imperial economics offers two main ideas: Freedom from government, and the sanctity of private property. Both lead to the markets and exchange. The invisible hand of the market can substitute for government or reduce its involvement in economic and business affairs. This was Milton Friedman’s theme in a 1962 book *Capitalism and Freedom*. The idea of freedom ties well with the overall context of market and its ruling invisible hand. Dispersed power is preferable to
concentrated power, and private sector power is preferable to public (state and federal) power. No ruler is better than any ruler, even better than a good ruler. The invisible hand of the market rather than the visible and identifiable hand of the government should establish as many institutional rules of the markets as possible, if not all.

The market as a ruler is appealing, especially when it rules on production and prices. Imagine how much conflict the governance of the "invisible hand" eliminates. No need to nominate and elect rulers; no need to limit and control their possible abuse of power. And most importantly, enjoy total freedom from government and its bureaucrats. No one rules!

Economics As the Law Does Not Recommend Deception and Abuse of Trust. Nonetheless, It Reduces the Prevention of These Wrongs. It should be emphasized that neither Milton Friedman nor any of his followers, the advocates of the economic self-interested person, commend criminal activities, deception and fraud. Yet their model of a rational economic person can fit people that lack empathy, make cruel business decisions that are devoid of compassion; have a view of the law as the enemy of business, and the government as a threat to freedom.

Friedman did not reject the role of the government to ensure order, property rights, settle disputes, interpret the law, enforce contracts, promote competition, free from deception and fraud. Yet, he preached freedom from government interference in the activities of responsible individuals. The government's task was limited to dealing with "madmen." The government should protect "property rights and other rules of the economic game, adjudicate disputes about the interpretation of the rules, enforce contracts, promote competition" and perform other governmental functions. Yet the presumption that most people are responsible market actors is hard to accept in light of the "reality" of self-interested persons and the recent dishonest activities of leaders on Wall Street and Main Street. In fact, the corporate criminals use the theory and principles of economics as defenses.

Milton Friedman objects to government interference in the markets, with the exception for assuring "competition without deception or fraud." Had he followed Adam Smith, Friedman would have emphasized the need for infusing the markets with moral values including fairness. Adam Smith did not leave fairness to the markets. Neither did Adam Smith leave fairness and benevolence entirely to individuals. He noted the need for rules to establish a fair distribution of resources. Morality and fairness are important to a "free competitive market." Ridley notes that because the drive to give is presumed to be weaker than the drive to take, giving is idealized to achieve the balance between self-interest and commitment to others and

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28 Friedman. at 34.
29 Id. at 33-4
30 Id. at 133.
both law and religion are recruited to tilt the balance toward unselfish behavior; preaching goodness.\textsuperscript{32}

**Private Property Is Preferred To the Commons (Publicly Owned Property).**

In imperial economics what seems to be public property is somehow discovered to be private property. This idea ties well with the context of markets and exchanges. Much if not all that has any value of whatever kind is converted into a commodity destined for the private property category. For example, an examination of the court system uncovers its private property features. The court process is viewed as a "private good," not merely a government public function.\textsuperscript{33} This view is based on the assumption that people naturally assert property rights over things by turning them into commodities. People who argue against commodifying and quantifying what they love and cherish simply deny the obvious. They do exchange and evaluate what they get in return.\textsuperscript{34} And for most purposes they ought to quantify.

"Imperial Economics" uses extreme applications of ideas and thereby draws the crowds to a debate. A proposed market for babies and an analysis of an exchange in a rape relationship are two examples that raise interest, call for response, and advertise the theory. Another example is the statement of a renowned economist who taught economics to law professors. "There is no unemployment," he said facetiously. "For 20 cents a day there is much work to be done."

**HOW DOES A POPULAR THEORY ENTICE FOLLOWERS?**

People "herd" by following the opinions of others for a number of reasons. They may follow by inclination. For example, when the news of a suicide is published, the incidence of suicides rises dramatically.\textsuperscript{35}

\textsuperscript{32} Ridley at 40-42, 46, 141).

\textsuperscript{33} William M. Landes and Richard A. Posner, Adjudication as a Private Good, 8 J. Legal Stud. 235 (1978);
see Gary S. Becker & George J. Stigler, Law Enforcement, Malfeasance, and Compensation of Enforcers, 3 J. Legal Stud. 1, 2-5 (1974) (arguing that there is a market in law enforcement). Note that today law in the United States is a "public good" for which one need not pay to find out what the law is; if the power shifts to private institutions and the laws are privatized, one may have to pay for information about the law that governs one's activities.

The issue of access to laws by private individuals was raised in 1999. A website operator decided to post on the Web the building codes of two towns. The towns had adopted model codes prepared by a private organization. The operator copied the code from the private source, despite a licensing agreement prohibition on copying and distribution. The issue was whether model codes were subject to copyright protection. The district court held that the codes enacted by the two towns were protected by copyright. Veeck v. S. Bldg. Code Congress Int'l, Inc., 49 F. Supp. 2d 885, 888-90 (E.D. Tex. 1999), rev'd, 293 F.3d 791 (5th Cir. 2002) (en banc), cert. denied, 123 S. Ct. 2636 (2003), but the Fifth Circuit Court, held that "law" is "free for publication for all." Veeck v. S. Bldg. Code Congress Int'l, Inc., 293 F.3d 791, 795-800 (5th Cir. 2002) (en banc), cert. denied, 123 S. Ct. 2636 (2003). The majority of the court made some distinctions id. at 803-05 and a number of judges dissented. Id. at 814-15 (Wiener, J., dissenting). See Katie M. Colendich, Note, Who Owns "The Law"? The Effect of Copyrights When Privately-Authored Works Are Adopted or Enacted by Reference into Law, 78 Wash. L. Rev. 589, 602-611 (2003) (discussing cases).

\textsuperscript{34} Margaret Jane Radin, Contested Commodities 95-101 (Harvard U. Press 1996).

People may follow the herd to support their own ideologies and beliefs. Or they may follow even contrary to their information and convictions. They assume that if so many other people take a certain route, they must be right. Many investors trade their securities on the assumption that the aggregate information as reflected in stock prices, is better than their own information and judgment. The Supreme Court assumes that market prices affect investors' decisions. White-collar criminals utilize this tendency to draw investors and raise funds.

There are other reasons for people's herding. People may act against their inclination in order to maintain their own reputation, or to curry favor with others, to keep their jobs or to get promoted. People may follow others' opinions to be accepted in the communities, in which they live or please the people on whom they depend. The leaders of these herds may withdraw support from weak or hesitant followers. Hence, some follow vocally, while others merely keep silent.

Imperial economics has followers of all types. Some use the theory to justify their activities and approaches. Policy makers find the theory useful at times in service of their strategies. Young academics follow and develop the theory further, under the tutelage of the elders. Besides, the theory can be used in interesting ways, and especially when it produces "counter-intuitive" results.

THE THREAT TO THE AUTONOMY OF THE LAW

Subsuming the law Into Economics. Language, Focus, and Values. The language of economics and the law reflect their different focuses, values and objectives. For example, economists speak of "capital formation" to describe corporate raising of capital in the markets. Law has no such expression. It speaks of "issuers" who issue and sell securities to investors in the securities markets. Economics focuses on the money which corporations get; law focuses on who pays to whom, for what, and under what conditions, and uses words like "duties, liabilities and rights." Economists are less involved in these issues. While the focus of the law is on creating a fair balance between trusting investors and trusted corporate management to support their raising of capital, businesspersons see duties, liabilities and other people's rights as constraints on "capital formation." The two disciplines are interrelated, but their focus and emphasis are different. While the law helps corporations to achieve the goal of "capital formation," which economists applaud, law also limits the achievement of the goal to honest and trustworthy capital formation, which some economists and businesspersons criticize.

“Agency costs” is the language of economics. “Breach of fiduciary duties” is the language of law. Economics focuses on costs. Law focuses on preventing abuse of trust.

36 Basic Inc. v. Levinson, 485 U.S. 224, 247 (1988) (“An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price.”).
and deception. The two are interrelated. But their objectives and emphasis are different. “Moral hazard” is the language of economics. “Abuse of trust and embezzlement” is the language of law. Economics looks to the risk from fraud. Law judges fraud as a wrong and considers its punishment. They are interrelated. But their focus and emphasis and objectives are different. Most importantly, economics reaches the end of the inquiry at the stage of capital formation, agency costs, and moral hazard. Its focus is on creating wealth. Law reaches the end of the inquiry at the stage of coercive prevention and punishment. Its focus is on preventing antisocial activities, even if they create wealth. The two can clash.

When law becomes a branch of economics, rather than an autonomous body of knowledge, law loses the very heart of its existence. Like the traditional economist, the lawmaker might consider preventing abuse of trust a good thing some of the time because of its costs. That changes the rationale for preventing fraud. Like traditional economists lawmakers will weigh prevention costs against the costs of limiting the freedom of business actors and their profits. The law will be directed by economic standards to the notions of justice and fairness, the feelings of greed and lack of empathy, and the balance between the self and the community. The objectives of the law change. In the area of abuse of trust and deception, no longer will the law have as its primary and unconditional objective the prevention and strict punishment of deception and abuse of trust. No longer is its emphasis on wrongfulness and unfairness. Of course, economics also sees harm in deception and abuse of trust. It views social benefit in policing and constraining these activities. But it is the objective of the law to prevent this harm. This is not the objective of economics. When economics leads law to the goal of economics, law becomes the servant of economics and loses its independent goal. Preventing fraud becomes subsidiary to creating wealth.

THE DANGERS

The dangers of a theory of the sort discussed here are not in the opinions of its creators. Not even in the misleading impressions that it produces. Opinions, impressions, and ideas enrich us, whether we agree with them or not. A theory becomes dangerous when it is implemented to provide support for antisocial behavior, abuse of trust and deception. The economist would say: “Misusing a cost/benefit analysis is not bad. It is merely more costly.” This argument shows the danger of the theory. It forces everyone to use the cost as a surrogate for bad. It locks all evaluation and judgment into the straightjacket of cost. But we have a place for evaluating bad in other terms. A rule of law should not be evaluated in terms of cost benefits. Our world is not exclusively a dollar and cents world. It is far richer and more complex. Medical care, for example, should consider cost and benefits but not exclusively. Other, most difficult considerations must be faced, such as priorities among individuals and communities. Therefore we part ways at the very foundation on which the discussion is based. Some, like this author, refuse to be drawn into a discussion that is exclusively founded in economics over everything.
The other approach of the imperial economist could be to soften the coercive impact of his system. The economist might say: “IF you want prosperity THEN you must do things my way.” This approach hides its coercive nature by offering choices. If is only IF they want certain things that they may HAVE to do things the economist way.

This approach does not soften the coercive nature of the theory. You may, of course choose poverty. That is the extent of your freedom. The choices given are only for the good things, such as prosperity, freedom, and private property. Once the choices are made, there is only the one way: the imperial economist way. If one wants other things, such as compassion or empathy, one can trade them against prosperity or freedom; have less of these good things and more of the others. Here one falls into the clutches of the inescapable exchange. One cannot both exercise compassion for employees, for example, and prosperity; both freedom and social rules of morality. Regardless of the empirical data on these conclusions, the very foundation of the theory is coercive and questionable.37

What if the ways of imperial economics has been shown to fail, as in some countries that introduced free market and ended up with a free Mafia? The answer of the true believer in imperial economics is that the changes were not sufficiently thorough. There was not enough free market. Some things remained regulated. The same argument is heard with respect to regulation in the United States today. It is not that relaxed regulation opened the door to fraud. It is that the regulation was not sufficiently relaxed; that brought about business inefficiencies and consequently fraud. There are examples of rigid regulation that contributed to disaster, such as the limitation on the interest rates that banks and the savings and loan associations could pay for deposits while they charged borrowers interest that was three and four times higher. That brought an escape from these institutions and gave rise to the money market funds that absorbed deposit money.

The Road Paved With Good Intentions … The creators of popular theories do not necessarily intend the subsequent use (or abuse) of these theories. It is doubtful that Karl Marx envisioned Joseph Stalin and Mao Zedong or the way they used his theory. Clearly Jensen and Meckling, who advocated the award of stock options to corporate managers, did not envision, let alone intend, the excesses of some corporate top management that became a virus of corruption.38 The theorists of imperial economics do not expect fraudulent corporate management to use their theory in support of deception and abuse of trust. But that is how it is being used.

Imperial economics may aim high. It may aim at improving predictions about behavior. If you act in a certain way, the result will be this and that. Or the opposite: If

37 I owe these hypothetical arguments of the imperial economist to my colleague Professor Gay Lawson of Boston University Law School.
you aim at this or that result, here is the way to do that. In small bits and bites, a theory of this sort is very useful. If we try and do not succeed, little harm will be done. But a grand objective of a global theory cannot be implemented except in its grand splendor. The changes in society or the financial system must be grandiose. Airline deregulation must cover all airlines and provide them with maximum freedom to compete. Russia must convert into a market economy not step by step, in chosen areas, but in all areas and within a short time. If the theory has also some sparks of ideology, these grand views of a new world-paradigm can be tremendously destructive.

An ambitious theory especially if it is designed to apply in practice, can endanger the very objectives that the theory is designed to achieve and protect. If one of the objectives of economics is to encourage and protect the markets, the unabridged theory may have resulted in undermining the markets. Therefore, great care should be taken before allowing law to follow any theory, let alone be absorbed by it.

The Danger That The Market’s Invisible Hand Will Be a Human Hand; Worse Than Government. Milton Friedman was "fundamentally fearful of concentrated power." He sought a market led by a truly invisible hand. He really meant an unidentified hand, something uncontrolled that happens. But that may not have turned out to be the case. The transfer of government's power in economic matters to the market's invisible hand does not necessarily dissipate or eliminate power. In fact, it seems to have transferred much power to another real hand, but a hidden hand. Reduced government power was not dispersed, nor did it land in the hands of numerous individuals. It emerged in the iron grip of private power holders. Some are institutional investors. Some are the large corporations of the 1990s. Some of these holders of power were driven by self-interest. They were fervent believers in imperial economics, its methods and strategies. And although self-interest is justified among equal competitors, it is not justified among trusted and trusting persons or among persons with greatly unequal power. It is especially unfair when the governors are the other parties to the relationships. It is most disturbing when the governors remain invisible. One telling example is the case of Martha Stuart. The fact that she attempted to mislead government investigators may serve as a basis for her conviction.

But the important part of the story is the fact that when the broker heard the bad news regarding certain stocks he gave an order to call her. Even though this was not the basis for the conviction, it did not seem to be an exception but rather than rule of behavior. When you hear good or bad insider information you help your "best clients" to beat the market by selling or buying to their advantage. A legal economist, Henry G. Manne, who believes in market solutions has argued in the mid-1970s that insider trading is good for the markets. It allows for an orderly market at prices rise or fall with insiders' trading and people who are outside the charm circle get the message indirectly, through

39 Id. at 39.
the prices. Other arguments supporting insider trading include the cost of enforcement, and the desirability of adding to insiders another form of compensation (paid by those who trade in the markets), and the assertion that inequality among market traders is an acceptable fact of market life. Even those who support the prohibition on insider trading do not seem to resort to the argument that unfair advantage by those who receive insider information on a golden platter, as fiduciaries, whereas outsiders cannot receive this information except by stealing it or violating the law in other ways. Not only is the fairness factor missing, but the hostility to government interference is quite evident.

Big government is more powerful than individuals, and should be subject to greater accountability. But in the age of enormous corporations, controlling groups such as management and the board of directors may command as much power as big government. For example, as of 2002, Wal-Mart had 1,300,000 employees, according to Fortune Magazine. Thus, it would be the largest employer in 19 U.S. States, as the U.S. Department of Labor reports. In 2002 Wal-Mart had over $244 billion in revenues, according to Fortune Magazine. This figure is higher than the aggregate personal income of any of 39 states, as the Department of Commerce reports. Yet these groups are less accountable than government power holders are. While power holders’ interests may diverge from the interests of society, the rules of those hiding behind the invisible hand may be far more harmful to individual freedom and the security of people’s property than the rules of concentrated but open and controlled government.

**The Danger of Hostility to Law.** An important principle of scholars that follow imperial economics is that generally in economic activities, individual freedom is preferred to government intervention. Milton Friedman opened his 1962 book *Capitalism*...
and Freedom with an attack on President Kennedy's statement: "Ask not what your country can do for you--ask what you can do for your country."[Friedman 1][47] For Friedman these words implied dependence of those who ask the country to do something for them, and subjugation of Americans for having to do something for their country. For others John Kennedy’s statement could mean that people should not seek to exploit the commons -- the country -- but to replenish the commons; that people should not try to selfishly take from their fellow citizens but unselfishly give to them. Where Friedman heard a ruler's command, one could hear a chosen leader's call for voluntary patriotism. Those who cheered John Kennedy were not slaves but lovers of their country. With him they berated those who aimed to selfishly take advantage of their country. Freedom for Friedman was freedom from government and from arbitrary actions on the one hand, and empowering individuals on the other hand. But his freedom may include freedom to take other people's property, unless prevented by the owners, or freedom from government protection of weak owners.

The Danger of Inappropriate Simplicity. Simplicity can hide or eliminate important considerations that can lead people astray. The emphasis on self-interest eradicates a counter drive for self-limitation, which is crucial to an efficient protection of trust. The emphasis on the individual weakens the drive to commit to society and to others, which is crucial to protect trusted institutions and systems. Vesting in individuals the authority to determine moral standards in trusting relationships refocuses the power on the individual, for good but also for evil. Empowerment to individuals is good, but not when it shrinks their whole world into themselves. Having absorbed society in themselves they have lost the ability to be absorbed in the larger universe of society. They become small petty visionaries, because they have only themselves to be visionaries about. Leaders of this sort can destroy America.

Leaders should indeed be selfish and ambitious, but true leaders link selfishness to a vision for society and the cosmos. Michae Shermer wrote: “Good leaders have a vision for the larger society…[Some of these leaders are] young and rich, and they have these grand visions for colonizing Mars and creating a new society somewhere. They aren't in it to make money, retire, and play golf. You want a visionary leader who is selfish enough to really want to be successful because that is what will drive the company, but also someone who goes beyond that to think about how to improve society…”[48]

From these perspectives, the theory of imperial economics and its absorption of the law emerge with the full support of individuals in their rebellion against social rules and mores. While a few con artist rebels are welcome to shake us of lethargy, a leadership of such rebels undermines our social fabric, and can lead us to become a society of con artists. A theory calling for freedom from social moral standards and for

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47 Milton Friedman, Capitalism and Freedom 1 (1962).
48 David Rynecki & Michael Shermer, Has This Man Found The Root Of All Evil? Fortune, Nov. 10, 2003 at 64 (quoting Michael Shermer).
tolerating amoral or immoral behavior may become entrenched if powerful deceivers use it to justify their acts, especially if the theory resonates with the courts and the legislatures. That is the danger.

THERE IS HOPE

Paradigms Change. Imperial Economics Has Begun To Show Signs of Fatigue. Historically, while one theory reigns, another is waiting in the wings. Some theories are proven simply false. Others are proven of limited application. Imperial economics still commands a strong following and draws support from private-sector powerful institutions, academia, and some members of the judiciary. But the market world fits only a part, not all, of social reality. A rigid imposition of the market image on all aspects of life cannot be sustained. That is why the theory is beginning to show the signs of wear and tear. Some "chinks" have already appeared in its armor, as behavioral economics is developing and becoming a strong candidate to take its place. There is a strong interest in behavioral economics that considers less rigid models of human beings and their behavior, such as altruism and reciprocity and factors them into the equation. This movement pays great attention to empirical studies and is open to the findings generated by other disciplines.

A change in a theory requires inspiring leaders and devout followers. But before that takes place, the fundamental assumptions, the overarching market image and the norms of law and economics must be put in perspective. Economics has offered many useful insights and tools that should be preserved in the law. A new theory can retain the virtues of economics. But it should be less clear-cut and less "scientific." It must be more complex and less "logical." It should invite or even require compassion and understanding of the human side of humans, and emphasize truth and honesty. Lawyers, judges and legislators should be freed of imperial economics, return to the language of the law and follow precedents. Hopefully both economics and law that followed imperial economics will be more realistic, and far more humble.

With very few exceptions, all views are welcome in the world of ideas, (not necessarily in the market place of ideas) regardless of how pernicious some may consider these views to be. But not all views and ideas have a rightful claim to implementation in the real world. Economics in the clothes of the law may have to recede to academia and stay there as a useful theory, not as a basis for rules of law and public policy.

America has had in place mechanisms to contain fraud. What has happened to weaken these mechanisms? How has America changed from criticizing to accepting and legitimizing fraud?