TAKING PRIVATE ORDERING SERIOUSLY

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INTRODUCTION

In recent years, the rules and practices of private groups have attracted substantial attention within the field of law and economics. In applications ranging from Robert Ellickson's seminal work on rancher/farmer relations in Shasta County, California,¹ to Lisa Bernstein's investigation of extralegal contractual relations among wholesale diamond traders,² to Robert Cooter's study of aboriginal customs in Papua New Guinea,³ to Robert Scott and Alan Schwartz's analysis of the rulemaking procedures of the American Law Institute,⁴ an increasing number of legal and economic scholars have shown how private systems of rules work to regulate economic relations among the communities that adopt them. While much of this literature has been devoted to description—explaining how such rules arise, how they operate in practice, and what incentives they provide to group members—a significant portion of the discussion is explicitly normative, focusing on how well private rules perform according to the criteria typically used to assess publicly promulgated regulations. For economists and economically influenced lawyers, this typically means focusing on economic efficiency;⁵ and within this focus, two questions have been most

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¹ See ROBERT ELICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1991).

² See Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992).

³ See Robert D. Cooter, *Inventing Market Property: The Land Courts of Papua New Guinea*, 25 LAW & SOC'Y REV. 759 (1991).

⁴ See Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995).

⁵ A defense of the efficiency norm is beyond the scope of this comment. For a discussion of the assumptions of efficiency analysis, see A. Mitchell Polinsky, *Economic Analysis As a Potentially Defective Product: A Buyer's Guide to Posner's Economic Analysis of Law*, 87 HARV. L. REV. 1655, 1665-69 (1974). For a general discussion of the tension between efficiency and distributional equity, see generally ARTHUR M. OKUN, *EQUALITY AND EFFICIENCY: THE BIG TRADEOFF* (1975). For pragmatic arguments that it is reasonable to focus on efficiency alone when discussing rules of private law, see Richard Craswell, *Passing on the Costs of Legal Rules: Efficiency and Distribution in*

prominent. First, are the rules established by private groups likely to be efficient, either on an absolute scale or compared to regulations promulgated by the state? Second, and relatedly, to what extent should the state defer to existing private rules when making law?

The symposium Articles by Robert Cooter and Eric Posner are both important contributions to this overall discussion.⁶ Cooter presents himself as a tribune of legal decentralization, likening public lawmaking to central economic planning, and private group norms to the market.⁷ He argues that the same reasons that have led most contemporary economists to reject central planning in favor of market allocation—informational and incentive problems—should similarly lead lawyers to be skeptical of state-imposed legal rules and sympathetic to the customary norms of private business communities.⁸ Specifically, he concludes that lawyers should defer to norms that arise from an efficient incentive structure; that is, those norms that result from open competition among alternatives and do not impose costs on nonmembers of the community.⁹ For example, norms of price-fixing among cartel participants or of racial discrimination among a favored majority do not arise out of an efficient incentive structure and should not receive any public deference; but customary limitations on damages for breach of warranty, recognized by experienced merchants who deal with each other regularly, do and should.¹⁰

Posner, in contrast, is more skeptical of the claim that private group norms are efficient; and his Article develops a catalog of reasons why they might not be. Among these are externalities, strategic behavior, informational asymmetries, human emotions such as envy, jealousy, and spite (which can themselves be conceived of as externalities of a sort), and the traditional and widespread appeal of competing moral values such as distributional equity or

Buyer-Seller Relationships, 43 STAN. L. REV. 361 (1991); Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994).

⁶ See Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U. PA. L. REV. 1643 (1996); Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697 (1996).

⁷ See Cooter, *supra* note 6, at 1645-46.

⁸ See *id.* at 1657-77.

⁹ See *id.* at 1694-96.

¹⁰ See *id.* at 1677-81; *cf.* U.C.C. § 2-316(3)(c) (1991) ("[A]n implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.").

deontological justice.¹¹ He concludes that state institutions such as courts and legislatures may well be able to improve on community norms, if they can overcome the informational and incentive problems that Cooter identifies.¹²

These two Articles complement each other in that they nicely bracket the current theoretical debate over the efficiency of private group norms. While Cooter is skeptical of centralized state lawmaking, Posner is just as wary of private custom and tradition. While Cooter argues that public regulators should limit their scrutiny of private group norms to the question of whether such norms arose from an efficient structure, Posner suggests it may be possible for the state to evaluate such norms on their individual merits. But both authors agree that the comparison between public and private lawmaking depends on questions of incentives, information, and externalities, that neither public nor private institutions are fully efficient in all circumstances, and that choosing between the two kinds of institutions is thus ultimately a problem of the second-best. Cooter and Posner may differ in tone or disagree about where the burden of persuasion should be placed, but they agree in their basic thesis—that the proper role for state lawmaking is to correct for failures in what we might call the “market for norms.”

I have no disagreement with this thesis, and in Part II below I make a number of specific comments about the sorts of market failures that might occur in norm-creating communities. But I do want to critique the overall debate in which both authors are engaged, because I think it has overemphasized a single aspect of private ordering at the expense of other, perhaps more fruitful, ones. The question dividing Cooter and Posner—as well as several other contributors to this Symposium—is primarily one of jurisdiction, not substance. It asks which institution—court, legislature, or community—is best able to set norms, not what those norms should be. While the question of jurisdiction is important, it is not the only one worth asking, and it may not be the best way to go about thinking about private ordering at all. Accordingly, I want to raise the possibility that too much intellectual effort in law and economics has been devoted to issues of comparative institutional

¹¹ See Posner, *supra* note 6, at 1711-25.

¹² See *id.* at 1725-36.

competence, and that not enough has gone into the substantive solution of particular problems.

Before I make this argument, however, let me first engage Cooter and Posner on their specific claims. In the next Part of this Comment, I briefly sketch my own reactions to the general question of whether and when private community norms are efficient. The remainder of my remarks will then attempt to place this inquiry into perspective. As I will argue, Cooter and Posner are debating a familiar question, one that traditionally has been the central concern of welfare economics: whether state regulation can improve on private ordering. In the field of law and economics, this question is generally recognized as having been definitively framed by Ronald Coase, who taught us that the answers all depend on a comparison of the relevant transaction costs.¹³ Yet here we are, thirty-six years after the Coase Theorem, still arguing over the merits of private ordering. The debate has a certain irony about it, because even as the participants emphasize the importance of private ordering, they remain predominantly oriented toward issues of public-law reform. Even those who, like Cooter, argue for more deference to private ordering, address their arguments primarily to public policymakers.¹⁴

It seems to me that neither side of this debate really takes seriously the idea of private ordering. Doing so, I submit, would mean a more fundamental reallocation of our intellectual resources, a commitment beyond simply telling the state to leave private individuals and groups alone. Rather, it would mean that academic lawyers and economists would spend less time offering advice to the state and more time thinking about how to address the needs and interests of private actors.

In the later Parts of this Comment, I explore some of the reasons why such an intellectual shift has not yet taken place. My conclusion, perhaps appropriately enough, is that the primary explanation lies in the norms of our own community—the legal academy.

¹³ See R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

¹⁴ See Cooter, *supra* note 6, at 1673-75.

I. PRIVATE NORMS, EFFICIENCY, AND COMMUNITY FAILURE

To begin with, I think that Eric Posner is plainly right that private groups and communities are subject to the same kinds of qualitative failures as are market and governmental institutions, and that there is little theoretical reason to presume that private community norms will tend toward complete efficiency.¹⁵ Indeed, I would go further, and argue that community norms usually will not be fully efficient, because the very notion of a norm entails certain departures from the classic economic model of perfect competition. In this regard, I would stress the following "community failures," in addition to those that Posner identifies.

A. *The Public-Goods Nature of Norms and Rules*

Norms and rules, whether publicly or privately created, embody and convey information. They cannot be followed unless information is transmitted regarding their substantive content; they cannot be enforced unless information is transmitted regarding who has obeyed them, who has violated them, and who is to impose any associated punishment or reward. But information is a classic public good, nonrival and to a large extent nonexcludable. Once created, it is both costless to provide to the marginal consumer and costly to withhold from those who have not contributed toward its production. Complete efficiency, accordingly, demands that it be freely distributed to all who value it, but such a policy makes it difficult for those who produce information to cover their investment costs. As we know from the economics of intellectual property, some system of property rights in information is necessary to achieve even a second-best outcome.¹⁶ But there are no property rights in customary social norms; those who develop and maintain custom do not generally try to prevent others from following the prescribed rules of good behavior or to collect royalties from those who follow them. Even if the village gossips wanted to charge for their services, it is doubtful that they could. Thus, there is little reason to expect the amount or content of private rulemaking to be optimal—just as the absence of any

¹⁵ See Posner, *supra* note 6, at 1724-25.

¹⁶ See generally Stanley M. Besen & Leo J. Raskind, *An Introduction to the Law and Economics of Intellectual Property*, 5 J. ECON. PERSP. 3 (1991) (describing some of the "basic economic tradeoffs involved in intellectual property law").

property rights in judicially promulgated rules means that the stock of judicial precedent may be inefficiently underdeveloped.¹⁷

B. *Network Externalities*

As Cooter points out, the optimal content and scope of a social norm generally depends on how many people are already following the norms and what other competing norms are available.¹⁸ Because most social norms entail some amount of coordination, they become more valuable as more people use them. Each person who decides whether to follow a norm, therefore, imposes a positive externality on all who use it, just as each person who buys a copy of Windows 95 and learns how to operate it increases the market for complementary products (to the benefit of Microsoft and its existing base of customers and to the detriment of producers and consumers of rival operating systems). Some norms, such as traffic laws, may become valuable only if they can attain the allegiance of a majority of the population. Thus, even if a newly invented norm would be more efficient than the status quo, there may be no way for a decentralized community to coordinate its implementation. As a result, the incentives for innovation may be substantially inadequate, and the path of development of social norms may depend on historical accident.¹⁹

C. *Adverse Selection and Signaling*

As Cooter also observes, an important feature of social norms is their tendency to be internalized by group members.²⁰ As a result, an individual's willingness to deviate from the norm depends upon how well he has been socialized into the community—in economic terms, upon the cost he attaches to the disapproval of others and the value he attaches to conformity. Because such

¹⁷ See William M. Landes & Richard A. Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J.L. & ECON. 249, 271-75 (1976).

¹⁸ See Cooter, *supra* note 6, at 1661-64.

¹⁹ See, e.g., Paul A. David, *Clio and the Economics of QWERTY*, 75:2 AM. ECON. REV. 332 (1985) (suggesting that such network externalities led to a suboptimal standard for typewriter keyboards); Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 320-22 (1985) (concluding that incentives for innovation in private contract terms are generally inadequate); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757, 772-89, 822-25 (1995) (arguing that network externalities impede optimal development of terms in corporate charters).

²⁰ See Cooter, *supra* note 6, at 1661-66.

factors are largely subjective and vary among members and subgroups of the community, those who wish to rely on basic social norms such as honesty and courtesy face a problem: it is difficult to tell the extent to which one's acquaintances share those norms.

While the costs and benefits of conformity differ from norm to norm and from individual to individual, however, there are enough common components to socialization that a person who fails to conform to one norm (for example, by dressing unconventionally for a job interview) may signal that he is more likely than otherwise to deviate from others (for example, promptness). For this reason, a proposal to alter a standard form lease to allow for the installation of fixtures, or to accept a lower wage in exchange for being allowed to show up late for work once a week, will often be met with suspicion. As a result, people will have an incentive to conform to norms they do not respect in order to signal their allegiance to those they do. Thus, there will be inefficiently excessive pressure toward conformity as well as inadequate incentives for innovation.²¹

D. *Government Responses to "Community Failure"*

The observation that private group norms suffer from the foregoing deficiencies, of course, does not by itself provide sufficient reason to conclude that government intervention can improve matters, since state-set norms are obviously subject to similar limitations. For example, private investments in research and development, guided by the profit motive, may be better able than state-funded projects to discover and distribute information that consumers and producers will actually value. Government "industrial policy," even if motivated by the efficiency criterion and designed with the goal of internalizing network externalities, may instead lead to redistribution toward politically powerful interest groups. And private incentives to signal one's conformity may create strong pressure to comply with state-imposed norms as well as with communal ones—as public controversies over school prayer and the Pledge of Allegiance amply illustrate. But again, these are

²¹ Cf. Walter Kamiat, *Labor and Lemons: Efficient Norms in the Internal Labor Market and the Possible Failures of Individual Contracting*, 144 U. PA. L. REV. 1953, 1957-62 (1996) (explaining why concern for signalling propensity for deviance will prevent individual workers from bargaining for just cause protection against employer discharge even when such a term is more efficient than the traditional at-will arrangement).

questions of the second-best, and there is every reason to think that at least some state action will be part of the optimal second-best policy mix.

My own position on the appropriate balance between state regulation and private norms is a strictly pragmatic one: if public policymakers have good reason to think that a given private norm is efficient, based on their own independent analysis, they should defer to it, and if they have good reason to think it inefficient, they should not defer.²² In the absence of good information one way or the other, my view would be that the state should not act at all, both out of respect for individual liberty and on the general principle of "first, do no harm."

Similarly, once public lawmakers decide to provide their own norms, they should provide them as default rules rather than mandatory ones, absent some good reason to the contrary. Allowing people to opt out of the state-provided default rule, other things being equal, is efficient; it preserves private incentives to acquire information about norms and to put that information to its best use. In the context of such an inquiry, I agree with Cooter that the fact that a norm arises out of a presumptively efficient incentive structure, such as a competitive market with no externalities, should count as a reason to think it efficient.²³ But like Posner, I do not see why this reason should carry dispositive weight compared to the results of an independent and professional cost-benefit analysis.²⁴

The foregoing rules of thumb, however, merely constitute a common-sense practical guide to lawmaking; each one applies to private policymakers as well as public ones. Every lawmaker, public or private, should make decisions based on all the information available at reasonable cost. In the absence of good reasons to the contrary, every lawmaker should leave as much flexibility as possible to later, more decentralized, or more informed actors. The federal government should not unnecessarily restrict lawmaking by the states; private trade associations should not unnecessarily restrict the terms of agreements entered into by their individual members;

²² I am assuming here that efficiency is the only criterion under consideration; my position would be analogous if assessing other criteria such as equity or corrective justice. Whether deferring to private norms means enforcing them as public law or deferring to private actors to do the enforcement is a separate issue discussed by Lisa Bernstein. See Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1796 (1996).

²³ See Cooter, *supra* note 6, at 1668-75.

²⁴ See Posner, *supra* note 6, at 1701.

and individual actors should not bind their own future selves by entering into inflexible contract terms when there is no good reason to do so.

The reasons to restrict the flexibility of subsequent or subordinate actors, furthermore, are the same at all levels of decisionmaking. All lawmakers, public and private, need to take into account the problems of externalities, nonrival costs and benefits, strategic behavior, and informational asymmetry. Private lawmakers, accordingly, need good economic advice on such topics no less than public ones do.

II. WHERE HAVE WE HEARD THIS BEFORE? INSTITUTIONAL CHOICE AND THE COASE THEOREM

It is important to recognize that the debate in which Cooter and Posner are engaged, along with several other participants in this Symposium, is a variation on the basic framework of transaction-cost economics. Within this framework, the central question is: Which governance mechanism best coordinates the disparate plans and interests of the various individuals making up society? This has also been the classic question in welfare economics since Adam Smith's famous argument that the market would lead, as an invisible hand, to the optimal allocation of all resources to their highest and best use.²⁵

Smith's argument for laissez-faire began to come under attack in the nineteenth century with the development of economic theories of natural monopoly, oligopoly, and the regulation of public utilities.²⁶ In the twentieth century, this critique was expanded by Pigou and others into what contemporary economists call the theory of market failure.²⁷ According to this theory, Smith's invisible hand argument depends on a number of special assumptions about markets that do not hold in practice. For

²⁵ See ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 577 (Edwin Cannan ed., 1976) (1776).

²⁶ See James W. Friedman, *Duopoly*, in *THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS* 939 (John Eatwell et al. eds., 1987); William W. Sharkey, *Natural Monopoly*, in *THE NEW PALGRAVE*, *supra*, at 603.

²⁷ See generally A.C. PIGOU, *THE ECONOMICS OF WELFARE* (4th ed. 1932) (discussing the theory of market failure); Kenneth Arrow, *The Organization of Economic Activity: Issues Pertinent to the Choice of Market Versus Nonmarket Allocation*, in *PUBLIC EXPENDITURE AND POLICY ANALYSIS* 59 (Robert Haveman & Julius Margolis eds., 1977) (discussing various types of market failure); Francis Bator, *The Anatomy of Market Failure*, 72 Q.J. ECON. 351 (1958) (same).

example, if market participants act strategically to influence the terms of exchange, or if market exchange is characterized by externalities, scale economies, or asymmetric information, then there is no longer any guarantee that the outcome will be efficient. In such circumstances, government intervention can improve resource allocation, especially if the intervention takes the form of reforming market exchange to make it more closely resemble the classic competitive model—for example, by breaking up monopoly cartels through antitrust law or by internalizing externalities through the imposition of an excise tax.²⁸

Coase's criticism of the Pigouvian theory of market failure, which won him the Nobel Prize in Economics and the allegiance of a generation of scholars, was that the Pigouvians had only told half the story. Actual private markets fall short of the ideal of perfect competition, it is true, but so does state allocation. Because both markets and state institutions suffer from transaction costs, the choice among them is an exercise in the second-best: In which institutional setting are transaction costs less? Coase allowed that this was an empirical question, but he is usually read to have suspected, as Cooter does in his contribution here, that on the whole such costs are less in private institutions than public ones.

The Coasian theory of transaction costs can be, and has been, applied to various problems in institutional choice. Indeed, Coase, in his 1937 article, *The Nature of the Firm*, originally developed it to explain the existence of the ordinary business firm, which in his view exists in order to conserve on the costs of using the market.²⁹ The 1960 article that made him famous among lawyers applied the same idea to the question of government regulation, focusing specifically on common-law nuisances.³⁰ The literature that we are discussing in this current Symposium adds a fourth institutional possibility to the mix: relying on private groups and communities to establish norms and to allocate resources. Such groups are structurally different from markets, business firms, and governmental agencies; they face different constraints and use different procedures for making rules. Thus, they will have different

²⁸ See generally PIGOU, *supra* note 27, at 331 (noting that certain industries may be most efficiently managed through public intervention); Bator, *supra* note 27.

²⁹ Such market transaction costs include the costs of discovering relevant prices, of negotiating and writing individual contracts under conditions of uncertainty, and the like. See Ronald Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386, 390-98 (1937).

³⁰ See generally Coase, *supra* note 13.

transaction costs and will be better suited to solving certain sorts of allocation problems and worse suited to solving others. But this is the same problem that Coase analyzed, and he has already sketched out the framework in which to solve it.³¹

Thus, much of the recent discussion of private group norms in the economic analysis of law, ranging from Robert Ellickson's Shasta County study³² to the present Symposium, employs observations and arguments analogous to those that have long been made in the traditional debate over *laissez-faire*. The only difference is that instead of arguing whether government regulators should defer to market outcomes, we are now arguing whether they should defer to the rules developed, either spontaneously or deliberately, by private communities.

III. WHAT DOES IT REALLY MEAN TO BE A COASIAN?

Now one might argue that studies like those of Ellickson, Cooter, and Posner are precisely the work we should be doing in light of Coase's analysis—trying to identify those transaction costs that give one institution a comparative advantage over another. But I would argue that this is a misunderstanding: it is only a part of the work we should be doing.

It is true that the Coase Theorem tells us to pay attention to transaction costs and to focus on the question of how to minimize them. It is also true that one aspect of minimizing transaction costs is to allocate rulemaking jurisdiction to the institution best able to

³¹ As an aside, it is worth mentioning that economists were hardly the first to recognize the importance of transaction costs in the design of legal institutions, even if they were the first to use the particular term. Coase's analysis resonated for lawyers in the 1960s because the groundwork had been laid by legal process scholars of the 1950s, such as Henry Hart and Albert Sacks, who stressed comparative institutional capacity as the justification for the separation of governmental powers. *See generally* HENRY HART & ALBERT SACKS, *THE LEGAL PROCESS* 158-74 (William N. Eskridge Jr. & Philip P. Frickey eds., rev. ed. 1994). In the legal process view, the legitimacy of judicial decisionmaking flows from particular features of courts that allow them to decide cases in a way that the citizenry can recognize as fair, such as insulation from immediate political pressures, limitations of standing, mootness, and ripeness, and the obligation to produce a written statement of reasons. *See id.* at 640-47. Also, general policymaking jurisdiction is properly granted to the legislature, which can best canvass and reflect the preferences of the public; and specific implementation of policies is reserved for the executive branch and for administrative agencies, which can better take advantage of scale economies in the collection of information and thus in expertise. *See id.* at 687-702, 844-63. In Coasian terminology, such considerations ultimately boil down to differences in transaction costs.

³² *See* ELLICKSON, *supra* note 1.

recognize and respond to transactional problems. But that is not the end of the inquiry. Once jurisdiction is settled, whether in public or private institutions, the substantive work of lawmaking remains to be done. To state the point another way: In the thirty-six years since the Coase Theorem was formulated, too much of the discussion relating to transaction costs has been devoted to the question of who—who should decide, who should have jurisdiction, who is the least-cost avoider. Too little discussion has been devoted to questions of how and what—how should jurisdiction be exercised and what substantive arrangements best conserve transaction costs.

This problem can be illustrated by a not-so-hypothetical argument that might arise at a law-and-economics workshop or conference. Someone, perhaps the speaker, raises a substantive regulatory issue—risk allocation, the appropriate default rules for contract formation, or the tradeoff between flexibility and opportunism in contractual planning—and proposes that it be addressed in a particular way. The objection is then made, often in chorus, that there is no need for us to worry about this substantive problem. The Coase Theorem, as everyone knows, tells us that private parties will take care of it.

Regular participants in such events will recognize both the form and substance of the exchange; I have played both sides myself at various times. What is interesting about this standard objection, however, is that it assumes that we, the workshop audience in particular and the legal academy in general, should not worry about substantive issues faced by private actors. But this implicit assumption gets it exactly backwards. If we in the legal academy really took seriously the idea that private nongovernmental actors are the best decisionmakers, then we would spend more time and effort addressing ourselves to them. We would view private practitioners as our primary audience, just as the doctrinal scholars and treatise writers of previous generations did. Such a route is surely still open to us, even for those who do not follow the traditional doctrinal approach to legal scholarship.

More specifically, we could devote our energies to helping private parties; we could write contracts and create organizational forms that more efficiently allocate risk, set default rules, and balance the need for flexibility against the threat of opportunism. In doing so, we would be operating as what Ronald Gilson has

called "transaction cost engineers."³³ We could help potential litigants design and learn to use dispute-resolution devices with better incentive properties, as Robert Gertner and Geoffrey Miller have done in their work on settlement escrows.³⁴ We could study trade association rules, not for the purpose of advising courts and legislators whether to defer to such rules, but for the purpose of helping other trade associations decide whether to imitate them or instead to draft their own new forms.

More generally, we could argue within the private communities to which we belong in favor of more efficient and effective norms—writing op-ed pieces, attending neighborhood meetings, serving on volunteer committees, and the like—the very work that in previous generations helped make lawyers the leaders of their communities. This will mean, however, directing our attention to the needs and interests of private individuals and groups and figuring out how to make our theoretical knowledge about externalities, strategic behavior, and imperfect information games both relevant and accessible to them. If we can do this, it will both improve the quality of private lawmaking and help to answer the increasingly common criticism made by practicing lawyers and traditional scholars alike that the contemporary legal academy has lost touch with the practical needs of actual lawyers and clients.³⁵

The irony in all of this is that despite its frequent citations to the Coase Theorem and its professed support for private ordering, the law-and-economics community is still primarily oriented toward public-law-reform scholarship. Much of the literature centers on transaction costs and comparative institutional choice, to be sure, and the conventional wisdom in the field often supports policies of deregulation and decentralization. But the focus of attention is still on the state and on advising government policymakers. In this

³³ Ronald J. Gilson, *Value Creation By Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 255 (1984) (explaining that a lawyer adds value to a transaction by helping to structure it so as to maximize the total benefits to the parties).

³⁴ See Robert H. Gertner & Geoffrey P. Miller, *Settlement Escrows*, 24 J. LEGAL STUD. 87 (1995) (proposing that using a settlement escrow lessens the expected costs of pretrial bargaining).

³⁵ See, e.g., Harry T. Edwards, *The Growing Disjunction Between Legal Education and the Legal Profession*, 91 MICH. L. REV. 34 (1992) (criticizing contemporary legal scholars for spending their time on interdisciplinary research removed from the needs of the profession). See generally Symposium, *Legal Education*, 91 MICH. L. REV. 1921 (1993) (including various responses by legal scholars and by practitioners to Judge Edwards's critique and a rejoinder on his part).

sense, even the Coasians among us have not taken to heart the real lesson of the Coase Theorem: that private lawmaking is as important as public lawmaking, if not more so. This continued focus on public regulation is telling, and it is worth speculating on why it persists.

IV. WHY EVERYONE ALWAYS TALKS ABOUT PRIVATE ORDERING BUT NO ONE EVER DOES ANYTHING ABOUT IT

What, then, might be the reasons for why scholars who profess support for the idea of private ordering continue to address themselves primarily to a hypothetical audience of government policymakers? One response might be that private actors are interested in profit, not efficiency, so that scholars interested in efficiency have no alternative but to address themselves to the state. Another might be that time is short and research support scarce; addressing oneself to state actors reaches the largest possible audience for a given amount of effort. A third might be that although private actors might be interested in scholarly advice if offered privately, they have little interest in published scholarship, since once such advice becomes generally available it can be appropriated by rivals and contractual partners, removing any competitive advantage to its use.

None of these explanations, however, provide reasons that could appeal to a committed Coasian, since they are all variants of the standard Pigouvian theory of market failure. While private actors are indeed motivated by the prospect of private gain, a Coasian would argue that the profit motive encourages them to exploit any potential efficiencies they can find. Similarly, while the state is indeed a powerful and large audience, decentralized private actors have an incentive to seek out any public information that is relevant to their needs. If there are scale economies in the production and transmission of economic insights, private actors can always form collective arrangements such as private law libraries and think-tanks to take advantage of them. And, while some economic and managerial advice is useful only in competing with rivals, other information is genuinely productive even when it is made generally available, as is illustrated by the substantial market for such publications as the *Harvard Business Review* and the *Wall Street Journal*.

One answer defensible on Coasian grounds is the one that the infamous Willie Sutton supposedly gave when asked why he chose

to rob banks: that's where the money is. In our legal and political system, it is just a matter of *realpolitik* to focus on government lawmakers. They have the power to divest private parties of lawmaking authority and need to be persuaded not to exercise that power if private ordering is to have any scope. On this view, advocates of private ordering address the state for the same reason that administrative law scholars spend more time addressing the federal government than the several states. It is also why constitutional scholars have in the thirty years since the Warren Court spent more time addressing the Supreme Court than addressing Congress.

This supposedly pragmatic answer, however, does not stand up under close examination. Law-and-economics scholars may well have been justified in making deregulation a scholarly priority in the 1960s and 1970s, given the then-prevailing political winds. With the success of the deregulation movement in the last twenty years, however, continuing to emphasize public regulatory issues in the 1990s—at the overwhelming expense of ignoring private ordering—betrays a serious lack of proportion. There is plenty of leeway for private lawmaking in our legal system and in those of other Western democracies, especially in the areas of commercial and contract law. While there are still some minor restrictions burdening what private actors can do, we basically have a capitalist economy and polity, and that is not going to change any time soon. In the meantime, private actors need substantive economic advice in order to make good use of the substantial authority already allocated to them. Furthermore, to the extent that freedom of contract still needs to be championed in public debate, its defenders will be more effective, as well as less likely to avoid excess, if they can show that it is currently being exercised wisely.

Another possible justification for focusing on public-law reform is that private actors do not need theoretical advice when they are operating in a competitive market. Even if they act randomly, this argument goes, the process of natural selection means their norms will approach efficiency over time, as those who behave most efficiently drive their rivals out of business.³⁶ Even if one puts aside the objection that natural selection will more quickly approach an efficient equilibrium when agents act with foresight, however, this evolutionary argument still depends on the existence of perfect

³⁶ See Posner, *supra* note 6, at 1707-10, 1723-24 (discussing evolutionary rationales for the efficiency of private ordering).

competition. In order for natural selection to yield efficient results, there must be no externalities, strategic behavior, or scale economies. As Part I of this Comment noted, however, social norms inherently imply the presence of both network externalities and public goods. Such an observation is hardly fatal to the Coasian perspective, since the Coase Theorem does not assume perfect competition and does not claim that planning and coordination are unnecessary. What it claims, rather, is that private actors can engage in such planning as easily as public ones.

An alternative strategy might be to avoid and confess—to acknowledge that there is plenty of private-sector demand for legal and economic advice, just not for academic advice. This situation might be due to the fact that our work is too far removed from the practical world to be of any use to private lawmakers (in which case it is unclear why government actors should listen to us either) or, less immodestly, because the institutional features of the academy give us a comparative advantage at advising the public sector when doing academic scholarship. If such a comparative advantage exists, then it is reasonable for us to specialize in public-law-reform scholarship while leaving the problems of private ordering to the practicing bar.

This last argument is a more difficult one to dismiss out of hand. A comparative advantage in public-law scholarship might arise either out of accumulated experience or out of the fact that academic researchers face relatively low costs in acquiring centralized information of the sort necessary to advise government, but relatively high costs in acquiring decentralized information of the sort necessary to advise private parties. Such decentralized information is available only from private clients; it is acquired only in the course of providing individualized professional legal services, and its sensitivity prevents its open publication in traditional scholarly channels.

Still, I think that an argument founded in comparative advantage cannot justify the academy's overwhelming focus on advising public lawmakers. The fact that we have been accustomed to using centralized information does not mean we cannot learn how to use information now held in private hands; scholars of business administration and those in other fields of economics have done so. Any sensible assessment of comparative institutional transaction costs, of the sort we will have to engage in to answer the questions that Cooter and Posner raise, is going to turn on detailed factual inquiry. I see no *a priori* reason for one category of detailed facts

to be systematically harder to obtain than the other. Furthermore, the comparative-advantage argument assumes that advising private actors and advising the state are mutually exclusive alternatives rather than complementary activities. If experience in advising private actors increases our competence in advising the state—which would seem plausible if our advice to the state centers on comparative transaction costs and regulatory issues—then sectoral specialization is inefficient, not efficient. Moreover, our classrooms are filled with law students who are going to graduate and then specialize in advising private actors engaged in private ordering. Shouldn't we care about teaching these students to be competent counselors?

Finally, we might defend our scholarly priorities as follows: We in the legal academy do sometimes address the needs of private actors as private consultants, but because this research is done for proprietary purposes, it is never published. Our public scholarship, on the other hand, is not done for profit, but is *pro bono* work. Governmental lawmakers and the society at large are more deserving objects of such volunteer efforts, it might be argued, than are private profit-seeking actors who can afford to pay for research at the standard consultant's rate.

I do not know whether or not this last claim has any empirical validity or whether anyone would actually make it explicitly, although it strikes a certain familiar chord. Nonetheless, I find it unconvincing. It is questionable whether there is any efficiency basis for restricting access to private-law scholarship to those who can pay. The private sector may require restrictions on publication of research in order to motivate its production, but in the academy we usually claim to be motivated by loftier considerations than profit. Furthermore, it is far from obvious that public lawmakers, or the general body of citizens they represent, are the most appropriate beneficiaries of our public-spiritedness. The government has professional economists and lawyers on salaried staff already and can usually find funds to pay for additional consultants even if political constraints make other expenditures a higher priority. In contrast, there are many deserving private parties and groups who have difficulty affording good economic and legal advice. If it is true that private ordering better suits their needs than public regulation would, then it is *pro bono publico* to provide them the necessary training and knowledge to make use of it. It is not as if governmental actors take the free advice offered by academics in their scholarly writings with any great frequency anyway.

CONCLUSION: ON THE NORMS OF THE ACADEMIC COMMUNITY

In the end, while my conclusion is based only on introspection and my own social observations, I think the main reason law professors continue to focus on addressing public lawmakers has to do with community norms—that is, with the norms of the legal academic community to which we belong. Under our own rules of good social behavior, we are expected to address ourselves to matters of public import and, thus, to the state. This is the way we display altruism, public-spiritedness, good citizenship, and allegiance to professional and scholarly norms. It is the way we express and reinforce our commitment to the legal and constitutional order to which we belong: by devoting ourselves to its betterment. In sum, it is the primary way one gets status in the legal academy, with all the good things that accompany that status: tenure, publications in elite law journals, invitations to symposia, and the like. There is just not as much status in our community attaching to work that devotes itself to the betterment of private lawmaking by private individuals and private groups.

Consider a modest suggestion: perhaps this norm should change. Perhaps we should devote less attention to the jurisdictional question of who is the best lawmaker—a question ultimately addressed to state institutions and to the citizenry in its collective capacity—and learn to pay more attention to addressing the substantive concerns of private lawmakers. I am not saying that we should stop caring about public-law reform, or that Eric Posner and Robert Cooter should not continue their research into the comparative transaction costs of courts, legislatures, and private communities and associations. Indeed, they should, in as much specific factual detail as they can, for the questions they debate are both valuable and interesting. Perhaps, however, such questions do not need to be at the top of everyone's research agenda.

In this regard, economically influenced legal scholars in search of guidance on the subject of professional responsibility might look to the writings of John Maynard Keynes. In Keynes's view, economists should not aspire to be physicists, philosophers, or technocrats: nothing so glorious as that. Instead, he proposed something that many might regard as rather more mundane, that "[i]f economists could manage to get themselves thought of as humble, competent people on a level with dentists, that would be

splendid!"³⁷ Perhaps Keynes's proposal is not such a bad aspiration for legal economists as well. If we aspired to be like dentists, we might be required to get our hands dirty a bit more often. Our advice might cause some pain, as therapeutic treatment sometimes does, but all for the greater good of the patient.

So I conclude by trying to practice a bit of what I preach: by trying to influence the norms of my community in a possibly more efficient direction. In sum, I have suggested that there has been a misallocation of intellectual resources in law and economics; we have spent too much time on advising government policymakers about the problem of comparative institutional choice and not given enough attention to advising policymakers, public and private, about the substantive decisions they must face. If this suggestion is correct, then the current allocation of resources is inefficient—which means we can do better. But this would require a change in our current norms.

³⁷ JOHN M. KEYNES, *ESSAYS IN PERSUASION* 373 (1932).