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Introduction to Socio-Economics: An Ethical Foundation for Law-Related Economic Analysis

Robert Ashford

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**INTRODUCTION TO SOCIO-ECONOMICS: AN ETHICAL
FOUNDATION FOR LAW-RELATED ECONOMIC
ANALYSIS**

*Robert Ashford**

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I. INTRODUCTION

As advocates, one of the most important duties of lawyers is to assist clients in identifying and securing their essential rights and responsibilities.¹ As officers of the court, lawyers are called upon to assist in the administration of justice. As public citizens in a democratic society, one of the most important duties of lawyers is to improve the law and the legal system not only for the benefit of their clients but also for the benefit of society (“the public”).² In a democracy, because improvements in the legal system generally require democratic support, the duty to improve the law includes a duty of public education regarding rights and responsibilities. In all three roles, lawyers are to act with competence³ and candor.⁴ An important category of rights and responsibilities in a market economy is the category of economic rights and responsibilities. Although legal scholars and law review editors are not, as such, client advocates, their opportunity to promote understanding and sow confusion carries with it an ethical responsibility to do the former and avoid the latter. Legal scholars who write on the confluence of law and economics share this responsibility.

To formulate legal policy, legal competence requires a consideration of all materially relevant principles and insights, a willingness to question underlying assumptions, logical coherence, a prioritizing of issues commensurate with their legal importance, and the marshaling of replicable evidence that reveals whether theory and logic

1. Robert Ashford, *Socio-Economics: What Is Its Place in Law Practice?*, 1997 WIS. L. REV. 611, 615 (1997).

2. MODEL RULES OF PROF'L CONDUCT Preamble (AM. BAR. ASS'N 2016).

3. MODEL RULES OF PROF'L CONDUCT r. 1.1 (AM. BAR. ASS'N 2016).

4. MODEL RULES OF PROF'L CONDUCT rr. 3.3, 4.1 (AM. BAR. ASS'N 2016).

conform to reality. This Symposium Issue on Law and Socio-Economics is offered to show that employing a socio-economic approach as the foundational starting point for law-related economic analysis, rather than a so-called “law and economics” approach, better enables lawyers to act competently and candidly to assist clients and the public to identify and secure their essential economic rights and responsibilities by revealing important insights that are excluded from a law and economics analysis.

In support of the foregoing proposition, this Symposium Issue presents nine Articles by ten authors (four of whom hold not only J.D. degrees but also Ph.D. degrees in economics). These Articles offer various socio-economic approaches to legal scholarship covering a wide range of important issues. Most of the Articles will be understandable to people with little or no prior understanding of economics. Several may prove more challenging, at least in part. The issues discussed include (1) the importance of values in economic analysis,⁵ (2) the important connection between the distribution of the opportunities for earning (an economic right) and the practical ability of people to exercise seemingly non-economic rights such as reproductive rights,⁶ (3) the beneficial socio-economic effect of (and irrational opposition to) the federal estate tax,⁷ (4) the important connection between economic ideology and systemic corporate crime and civil fraud,⁸ (5) anti-trust policy in light of socio-economic principles,⁹ (6) the harmful economic effects of homeschooling on the democratic right to and necessity for public education,¹⁰ (7) an explanation of the General Theory of Second Best—a theory widely acknowledged by economists, but largely ignored in the law and economics literature that undermines the assumption that legal rules and policies that seemingly enhance economic efficiency in particular contexts will enhance rather than worsen overall efficiency within an economy,¹¹ (8) a rigorous socio-economic empirical analysis

5. Hon. Guido Calabresi, *Values and the Law: 2010 AALS Annual Meeting Luncheon Keynote Address*, 49 AKRON L. REV. 311 (2016).

6. Terry O’Neill, *What Does the Minimum Wage Have to Do with Reproductive Rights?*, 49 AKRON L. REV. 319 (2016).

7. Richard Gershon, *The Socio-Economics of the Federal Estate Tax: Why Do So Many People Hate (or Love) This Centenarian?*, 49 AKRON L. REV. 329 (2016).

8. William K. Black & June Carbone, *Economic Ideology and the Rise of the Firm as a Criminal Enterprise*, 49 AKRON L. REV. 371 (2016).

9. Jeffrey Harrison, *A Socio-Economic Approach to Antitrust: Unpacking Competition, Consumer Surplus, and Allocative Efficiency*, 49 AKRON L. REV. 409 (2016).

10. George Shepherd, *Homeschooling’s Harms: Lessons from Economics*, 49 AKRON L. REV. 339 (2016).

11. See *infra* Part XI. See also, Richard S. Markovits, *The General Theory of Second Best and Economic-Efficiency Analysis: The Theory, its Negative Corollaries, the Appropriate Response*

showing inequality in family law,¹² and (9) the explanation of a socio-economic market means to substantially alleviate systemic poverty by identifying and securing for all people “the competitive right to acquire capital with the earnings of capital.”¹³

As disparate as these subjects are, the Articles share common foundational principles needed to enhance the understanding of essential economic rights and responsibilities and to do justice to those subjects and society. First, competent law-related policy analysis in a broad array of contexts requires competent economic analysis. Second, competent economic analysis requires a consideration of all materially relevant principles and evidence drawn not only from the entire discipline of economics (not merely neoclassical economics) but also from disciplines other than economics. Finally, distribution is important to the socio-economic analysis both normatively (in terms of values) and positively (in terms of facts). In general terms, this is the socio-economic approach to law-related economic analysis. A fuller articulation of socio-economic principles is set forth below.

II. SOCIO-ECONOMIC PRINCIPLES

The term socio-economics has been used for over a century. Its use grew beginning in the last quarter of the nineteenth century, with emergence of economics in academia as a discipline distinct from its historical roots in the older “political economy.” The term socio-economics has been employed with various meanings in disparate contexts. Usually, however, the varied meanings share an underlying conviction that the developing abstract principles of neoclassical economics (that dominate contemporary economics, economic ideology, politics and public discourse) cannot be separated in their effect from the more complicated reality of social context.

However, before 1997, socio-economics did not exist within legal education as a specially defined field with a specifically defined methodology; and law-related economic analysis was almost exclusively dominated by the approach known as “law and economics,” which (contrary to the falsely implied breadth of its brand name) continues to

to It, and a Coda on the Economic Efficiency of Reducing Poverty and Income/Wealth, 49 AKRON L. REV. 437 (2016); Robert Ashford, “*The General Theory of Second Best*”—An Overview, 49 AKRON L. REV. 433 (2016) (providing an introduction to Professor Markovits’ Article in this Symposium).

12. Margaret F. Brinig, *Result Inequality in Family Law*, 49 AKRON L. REV. 471 (2016).

13. Robert Ashford, *Why Working But Poor? The Need for Inclusive Capitalism*, 49 AKRON L. REV. 509 (2016).

be almost exclusively limited to “law and neoclassical economics.” Since then, a particular definition of socio-economics has gained broad support among law teachers in recent years as a useful statement of its methodological principles. Accordingly, in this Symposium, “socio-economics” refers to the statement of principles set forth in the petition signed by over 120 law teachers from 50 American law schools that established the Section on Socio-Economics of the Association of American Law Schools (AALS). The statement reads as follows:

Socio-economics begins with the assumption that economic behavior and phenomena are not wholly governed or described by any one analytical discipline, but are embedded in society, polity, culture, and nature. Drawing upon economics, sociology, political science, psychology, anthropology, biology and other social and natural sciences, philosophy, history, law, management, and other disciplines, socio-economics regards competitive behavior as a subset of human behavior within a societal and natural context that both enables and constrains competition and cooperation. Rather than assume that the individual pursuit of self-interest automatically or generally tends toward an optimal allocation of resources, socio-economics assumes that societal sources of order are necessary for people and markets to function efficiently. Rather than assume that people act only rationally, or that they pursue only self-interest, socio-economics seeks to advance a more encompassing interdisciplinary understanding of economic behavior open to the assumption that individual choices are shaped not only by notions of rationality but also by emotions, social bonds, beliefs, expectations, and a sense of morality.

Socio-economics is both a positive and a normative science. It is dedicated to the empirical, reality testing approach to knowledge. It respects both inductive and deductive reasoning. But it also openly recognizes the policy relevance of teaching and research and seeks to be self-aware of its normative implications rather than maintaining the mantle of an exclusively positive science. Although it sees questions of value inextricably connected with individual and group economic choices, socio-economics does not entail a commitment to any one paradigm or ideological position, but is open to a range of thinking that treats economic behavior as involving the whole person and all facets of society within a continually evolving natural context.

Unique among interdisciplinary approaches, however, socio-economics recognizes the pervasive and powerful influence of the neoclassical paradigm on contemporary thought. Recognizing that people first adopt paradigms of thought and then perform their inductive, deductive, and empirical analyses, socio-economists seek to

examine the assumptions of the neoclassical paradigm, develop a rigorous understanding of its limitations, improve upon its application, and develop alternative, perhaps complementary, approaches that are predictive, exemplary, and morally sound.¹⁴

III. SOCIO-ECONOMICS AND “LAW AND ECONOMICS” COMPARED

The approach followed by socio-economists stands in contrast to the dominant so-called “law and economics” approach to law-related economic analysis that is employed in much legal scholarship. The dominant law and economics approach usually restricts law-related economic analysis to neoclassical economics. Thus, when used to describe the dominant approach, the term “law and economics” can be a seriously misleading misnomer because it implies that neoclassical economics speaks for the entire discipline of economics when, in truth, it does not.¹⁵ This restriction is problematic because it excludes not only other schools of economic thought, but also important insights from other disciplines that have an important bearing both on the essential rights and responsibilities of people and on the just resolution of controversies among them.

This is not to say that neoclassical principles are not an important part of socio-economic analysis. Quite to the contrary, neoclassical principles rigorously applied in an appropriate context with candid recognition of their limitations are an essential component of socio-economic analysis.¹⁶ When properly applied, neoclassical principles supply essential insights in aid of socio-economic analysis; however, improper application must be identified and corrected to preserve the

14. Society of Socio-Economists, *Statement of Socio-Economic Principles*, <http://events.r20.constantcontact.com/register/event?llr=fikx5dkab&oeidk=a07ebzo4e39db97fd6e> (last visited May 19, 2016) (with minor amendments from the original).

15. *Cf.* MODEL RULES OF PROF'L CONDUCT r. 4.1 (AM. BAR. ASS'N 2016). For an extensive analysis of the misleading consequences and dubious ethics of passing off law and neoclassical economics as though it is law and economics, see Robert Ashford, *Socio-Economics and Professional Responsibilities in Teaching Law-Related Economic Issues*, 41 SAN DIEGO L. REV. 133 (2004) (Published in a Symposium edition entitled *Teaching Law & Socioeconomics*). One is left to wonder whether the modern law and economics approach would have been so effective in winning widespread acceptance if it had been properly labeled law and neoclassical economics.

16. In an early AALS Section on Socio-Economics, a prominent participant noted that she was a “card carrying member” of the Law and Society Organization and astutely asked what is the difference between the Law and Society approach and the socio-economic approach. The explanation given by this author was that one could be a member of Law and Society and advance scholarship in that tradition and yet never need to address the principles of neoclassical economics. In contrast, little if any socio-economic scholarship is published that does not address principles of neoclassical economics.

rigor and integrity of positive and normative legal analysis, to enable people to identify and secure their essential rights and responsibilities, and to avoid injustice.

IV. ASSUMPTIONS UNDERLYING WEALTH-MAXIMIZING CLAIMS OF LAW AND ECONOMICS

An extremely important but problematic aspect of neoclassical economics is its faulty theory of aggregate, interpersonal, and individual wealth maximization. On the aggregate level, wealth maximization is colloquially referred to as maximizing the “size of the pie.” On the interpersonal level, wealth maximization refers to maximizing the benefits that people derive from their voluntary choices regarding mutual cooperation and exchange. On the individual level, it refers to benefits derived from freely determined individual choices.

According to neoclassical economics, the aggregate size of the pie is maximized by the (“optimally”) “efficient” allocation of scarce resources.¹⁷ However, for this allocative form of wealth maximization to be “optimal,” a number of counter-factual conditions must be satisfied: (1) economic actors act individually and rationally, and are fully informed; (2) preferences, skills, and technology are constant; (3) there are no transactions costs; (4) all external costs are reflected in prices; (5) markets operate competitively, with no barriers to entry, and distribute income earned from production in accord with the value of the marginal productivity of the contributions to production; (6) positive and normative considerations regarding issues such as wealth distribution, race, gender, class, and nature can be ignored or encapsulated within the market; and (7) economies “gravitate” toward stable equilibrium rather than undergoing evolutionary and revolutionary change.

Based on the false premise that the efficient allocation of resources is the primary, if not exclusive, mechanism of wealth maximization (discussed more fully in Part XIII below) and the factually dubious premise that the foregoing assumptions are even approximately accurate, the dominant law and neoclassical economics approach considers that these assumptions and their implications are the best foundational starting point for law-related economic analysis. This assumption places on those who disagree with this starting point the burden of establishing (based on some unarticulated standard of proof or persuasion) some better starting point. In contrast—and in harmony with legal reasoning—

17. Resources are scarce in economic terms either because more are desired by people than are available or because they are costlier to access than people can afford.

before accepting the neoclassical approach to economic analysis rather than other schools of economics as the preferred foundational starting point in a particular context, socio-economics requires sound basis for doing so.

Some important implications flow from accepting the law and economics approach as the presumptively appropriate starting point for law-related economic analysis: (1) the economy operates at or near full capacity, (2) all unemployment (beyond transitions from one employment into another) is voluntary, and (3) any attempt that might aid people who are presently economically disadvantaged presumptively compromises aggregate wealth maximization and redistributes wealth.¹⁸ In addition, there is a general assumption that wealth is maximized on the aggregate, interpersonal, and personal level by legal policy that minimizes both transactions costs and the substitution of government choice for private choice. As explained more fully below, consistent with principles of legal competence, the socio-economic approach questions every one of the foregoing assumptions, and many if not most socio-economists would go further to note that every one of these assumptions are contradicted both by casual observation and empirical measurement.

V. MARKET EFFICIENCY, ADAM SMITH'S "INVISIBLE HAND," AND THE ROLE OF LAW

To whatever extent the foregoing conditions exist, they do so only with the aid of the law, including (1) property rights and liability rules, (2) the provision of public goods needed to maintain a more efficient market structure open to all (usually paid by taxes), (3) the required internalization of external costs not born by market participants to enhance efficiency, and (4) other government action needed if in reality a market system is to approach market efficiency. Thus, while recognizing that economic principles have an important bearing on the formulation and effects of legal policy, socio-economists observe that legal policy fundamentally affects how economic theory works in reality. Accordingly, whatever the processes of wealth maximization

18. For example, the widely invoked standard of Pareto Optimality is a standard that assumes an economy in which all wealth-enhancing voluntary transfers have occurred (i.e. an economy operating at full capacity). Conceptually, this leaves people who are excluded from effective access to opportunities unequally distributed to others in an assumed zero-sum game and therefore in a position in which any attempt to equalize opportunity must be justified as a taking from someone else. Such is the consequence of the so-called value-free, false assumption that a more equitable distribution of economic opportunity cannot yield a positive increase in the "the size of the pie."

may be, the invisible hand of economics cannot fulfill its wealth-enhancing promise alone but must work hand-in-hand with the visible hand of law.

VI. VALUES AND EFFICIENCY

One quality of a competent lawyer is the ability to identify and bring to light what is *not* being talked about by those who would obscure, frustrate, and deny realization of essential rights. For example, the foregoing conditions widely advanced as the conditions assumed to be necessary for neoclassical wealth maximization make no reference to moral values. Surely such values are “goods.” But it is by no means clear that such values can be reduced to single variables and discretely priced in exchange for material goods priced in markets, nor is it clear that such goods are subject to the law of diminishing returns like other goods priced in the market.

The Article entitled *Values and the Law: 2010 AALS Annual Meeting Luncheon Keynote Address*¹⁹ was written by Judge Guido Calabresi, Dean Emeritus of Yale Law School. Judge Calabresi is “unanimously recognized as a founding father of the Law and Economics movement, [whose] insights have become established as indispensable for understanding the rationale of legal rules.”²⁰ A preeminent critic of the oversimplified misapplication of law and economics analysis in legal scholarship, Judge Calabresi discusses the pervasive importance of values in such scholarship.²¹

There are those who, when advancing the law and (neoclassical) approach argue that it is “scientific” and “value-free” at least beyond the

19. Calabresi, *supra* note 5.

20. Roger Van den Bergh, *Introduction: The Impact of Guido Calabresi on Law and Law and Economic Scholarship*, 1 ERASMUS L. REV. 1 (2008).

21. Included in his welcoming remarks to the 2008 Annual Meeting of the AALS Section on Socio-Economics, entitled *Adam Smith Was a Socio-Economist*, Judge Calabresi, Co-Chair of the Section on Socio-Economics made the following observation: “When Robert Ashford first approached me with the prospect of serving as its co-chair during the tenth anniversary year of its existence, I noted that I had been a socio-economist long before he formulated the three-paragraph definition on which the Section was launched, and I am proud of that. Robert replied that the same could be said for Adam Smith. That is surely true. I believe Adam Smith would be pleased . . . pleased to see so many of you here to carry on the work of the Section. I have no doubt that the increasing acceptance of the socio-economic approach to law-related economic issues will enhance the development of legal education, practice and service . . .” Hon. Guido Calabresi, *Adam Smith Was a Socio-Economist*, (Jan. 3, 2008), <http://journaloflawandsocioeconomics.com/GuidoCalabresiWelcomingRemarks080103.pdf>.

value of efficiency.²² But accepting the initial distribution of wealth without a consideration of the values exercised, rewarded, and compromised in accumulating that wealth and the rights of those affected by the accumulation, is itself a value judgment as is the judgment to segregate allocative efficiency from other values inextricably connected with it and to elevate allocative efficiency above other values not readily reflected in market prices and other contributors to economic growth.

VII. THE DISTRIBUTION OF WEALTH MATTERS BOTH NORMATIVELY AND POSITIVELY

The conditions assumed to be necessary for neoclassical wealth maximization make no reference to distribution of wealth other than the premise that it is distributed according to the marginal productivity of the contributions to production. Although, the advocates of law and neoclassical economics readily acknowledge that distribution has moral consequence (which they generally relegate to the political sphere for resolution), their analysis fails to disclose that distribution also has important positive consequence.²³ Yet, it is elementary to neoclassical economics that just as prices determine distribution, so too does distribution determine prices. Thus, there is no single wealth-maximizing, optimal allocation of resources independent of distribution, but rather many optimal allocations based on many alternative distributions of wealth.²⁴ In a capitalist economy, contributions to production are made not only by labor but also by real capital.

22. See *infra* note 36 and accompanying text.

23. For example, Harvard Professor of Law and Economics Steven Shavell declares: “[T]aking the effect of legal rules on distributional factors into account . . . would not alter our conclusions . . . [because] society has an income tax and transfer system that it can utilize to redistribute income.” Steven Shavell, *FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 3* (Harvard University Press 2004). Similarly, Judge Posner states: “[T]he efficiency ethic takes the existing distribution of income and wealth and the underlying human qualities that generate that distribution as given, and within very broad limits (what limits?) is uncritical of the changes in that distribution that are brought about by efficient transactions between persons unequally endowed with the world’s tangible and intangible goods.” RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW 241* (6th ed. 2003).

24. Warren J. Samuels, *Maximization of Wealth as Justice: An Essay on Posnerian Law and Economics as Policy Analysis*, 60 *TEX. L. REV.* 147, 153-54 (1981) (reviewing RICHARD A. POSNER, *THE ECONOMICS OF JUSTICE* (1981)) (“[T]here is no unique wealth maximizing result, only results specific to the rights structure that supports the existing distribution of wealth.”); WARREN J. SAMUELS & A. ALLAN SCHMID, *LAW AND ECONOMICS: AN INSTITUTIONAL PERSPECTIVE 2* (1981) (“[T]he concept of efficiency as separate from distribution is false.”); A. Allan Schmid, *Institutional Law and Economics*, 1 *EUR. J. L. & ECON.* 33, 37 (1994).

Significantly, law and neoclassical economics takes the initial distribution of wealth (including capital) as a given without regard to how it was acquired, how it is concentrated, and the consequences of such concentration on the rights and opportunities of many other people to contribute to present and future production.

Important issues raised by the distribution of earning opportunities related to reproductive rights and inheritance are considered respectively in (1) *What Does the Minimum Wage Have to Do with Reproductive Rights?*²⁵ by Terry O’Neill, President of the National Organization for Women (NOW) and former Tulane University Professor of Law, and *The Socio-Economics of the Federal Estate Tax: Why Do So Many People Hate (or Love) This Centenarian?*²⁶ by Professor Richard Gershon. Viewing the question of distribution globally, U.S. Supreme Court Justice William D. Brandeis said, “We can have democracy in this country or we can have great wealth concentrated in the hands of a few, but we can’t have both.”²⁷

VIII. THE OPPORTUNITY TO LEARN

Closely related to the opportunity to earn is the opportunity to learn. The founders of the United States of America risked their lives to establish a democracy (albeit imperfect) in an historical context in which no democracy had survived for more than a few centuries before morphing into a succession of undemocratic, despotic regimes. The founders believed that democracy would not long survive without widespread, private opportunity to acquire property and widespread opportunity for public education. They realized that the opportunity to learn is inseparable from the opportunity to be productive and the capacity for democratic self-governance.

Based on a rarely questioned assumption (made without regard to the distribution of wealth) that quantity and quality are almost always enhanced by competition, advocates of the law and neoclassical economics approach advance free-market competition as support for vouchers, charter schools, and homeschooling based on the premise that such competition will enhance parental (consumer) choice and incentivize the improvement of public education. But such argumentation ignores important realities.

25. O’Neill, *supra* note 6.

26. Gershon, *supra* note 7.

27. JOSEPH R. CONLIN, *THE MORROW BOOK OF QUOTATIONS IN AMERICAN HISTORY* 48 (William Morrow & Co., 1st ed. 1984).

In an Article entitled, *Homeschooling's Harms: Lessons from Economics*,²⁸ Professor of Law and Economics George Shepherd notes that public education is a public good that enjoys the benefit of positive network externalities. As such, it will attract insufficient private investment in light of the social benefits it provides and therefore requires public support to achieve those benefits. Permitting people to opt out of public schools can result in adverse selection and a prisoner's dilemma that works to the advantage of the affluent and to the disadvantage of most others. Fortifying these theoretical points with empirical evidence, Professor Shepherd presents an economic analysis that reveals the troubling impact of home schooling on the quality of public education that should be of concern to anyone who values the importance of education to equal opportunity and democracy.

IX. EFFICIENCY AND FINANCIAL FRAUD

The conditions assumed to be necessary for neoclassical wealth maximization make no explicit distinction between lawful behavior and fraud that gives rise to criminal or civil liability. Not all wealth maximization that results in measurably greater allocative efficiency is consistent with normative values reflected in criminal and civil law. The dynamics and social consequences of wealth maximization based on lawful behavior and financial fraud are not the same. The persistence of financial fraud undermines the assumed validity of the conditions assumed necessary for allocative efficiency because such financial fraud obstructs the efficient operation of markets in a number of ways including: (1) (anti)competitive advantages that benefit the defrauder, (2) imposition of costs not reflected in market prices, and (3) barriers that prevent market participants from being fully informed. Theoretically, law can require disclosure and prohibit various criminal and fraudulent activities, but enforcement only partially succeeds and experiences diminishing returns. The idea that there is an efficient level of crime and fraud is a fundamental oxymoron. The neoclassical prediction that reputational losses will control wrongdoing falls on the disbelieving ears of many aggrieved victims of fraud including, for example, employees of the now bankrupt Enron who lost their retirement plan assets on the reputational strength of financial audits of Arthur Andersen, the once premier global accounting firm.

In an Article entitled, *Economic Ideology and the Rise of the Firm*

28. Shepherd *supra* note 10.

as a *Criminal Enterprise*,²⁹ Professors Black and Carbone address this tension in the context of the firm—the institution, indispensably protected by law, that is used to produce most wealth in all major economies. The authors explain how the ideology of misapplied neoclassical principles as typically reflected in law and economics scholarship has served to narrow the beneficial scope of fiduciary duties, to shift fiduciary focus from the long-term, wealth-enhancing practice of corporations to short-termism, and to increase incentives to use the corporation as the weapon of choice for those who would prosper at expense of others.

X. THE REALITY OF IMPERFECT COMPETITION AND SOME OF ITS IMPLICATIONS

Contrary to the reality of crime, transactions costs, externalities reflecting costs not reflected in market prices, the essential need for public goods, market barriers to entry by would-be competitors, and the imperfections inherent in all human creation, neoclassical economics assumes the conditions necessary for markets to operate competitively or nearly competitively to distribute income earned from production in accord with the value of the marginal productivity of the contributions to production. Yet there is widely accepted economic authority that no major economy operates competitively.³⁰ None operate without government protections for favored producer and labor markets, without oligopolies and regulatory barriers that restrict competition from new entrants, and without substantial spending and employment by governments that do not operate competitively within the economies their laws and practices maintain. None operate without crime, externalities, tax-supported public goods, transactions costs, and other competitive impediments. To their credit, both economics and law recognize this reality; and within this context of imperfect competition, antitrust laws were enacted to minimize anti-competitive behavior so as to maximize the benefits of competition.

In an Article entitled *A Socio-Economic Approach to Anti-Trust*:

29. Black & Carbone, *supra* note 8.

30. According to a widely accepted economic authority, “a large volume of work . . . suggests that [the neoclassical assumption of] perfect competition corresponds to an extremely special, limiting case of a more general theory of markets” and that “no important market fully satisfies the conditions of perfect competition and that most would not appear even to come close.” 3 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS AND THE LAW 837-38 (John Eatwell, et. al., eds., 1987).

Unpacking Competition, Consumer Surplus, and Allocative Efficiency,³¹ Professor of Law and Economics Jeffrey Harrison offers a socio-economic analysis that highlights deficiencies in the law and neoclassical economics analysis of competition and monopoly. These deficiencies are traceable to externalities, the distribution of income, values in fairness and justice not well reflected in prices, anti-government political bias prevalent in Supreme Court decisions, and other factors that seemingly compromise values, social welfare, and benefits that competitive markets are supposed to provide. These deficiencies work to the advantage of those who (by reason of wealth and market position) operate more freely from competition and to the disadvantage of those more highly subject to it and to the disadvantage of many others. Exploring a conflict in fundamental assumptions regarding the nature of human beings that exists among disciplines, Professor Harrison discusses important anti-trust legal policy implications that emerge from contrasts between the limited profit-maximizing conception of human beings based on the dominant approach of neoclassical economics and the more realistic understanding of the human psychology advanced by the widely accepted Maslow's hierarchy of needs.

XI. THE GENERAL THEORY OF SECOND BEST AND THE DUBIOUS
NEOCLASSICAL STRATEGY OF IMPROVING NEOCLASSICAL EFFICIENCY
IN PARTICULAR CONTEXTS TO ENHANCE SOCIETAL EFFICIENCY

In response to many of the considerations noted above, many proponents of law and neoclassical economics would likely say: "We know all of that and take it into account." And surely some of the more sophisticated scholarship in law and economics do take these considerations into account and analyze and advance neoclassical refinements and solutions to address externalities, public goods, transactions costs, crime, monopolies, imperfect competition, institutions, technology, distributional issues, and other considerations not reflected in market prices. A major noteworthy advance in economic theory is behavioral economics, which reveals a much more robust, complicated, and nuanced understanding of human psychology than the standard profit-maximizing *homo economicus* assumed in much neoclassical economics. Thus rather than rationality, there is "bounded rationality"; rather than maximization, there is "satisfaction," "prospect

31. Harrison, *supra* note 9.

theory,” and other motivating considerations such as fairness, altruism, and trust. As welcome as these improvements are, for several reasons, they fall far short of correcting the harmful impact of the widespread misapplication of neoclassical theory as the exclusive or primary market mechanism for promoting wealth maximization. One reason is revealed by the General Theory of Second Best, discussed in the paragraphs that follow. Another reason is discussed further below in Part XIII.

Law and neoclassical economics scholarship frequently acknowledges one or more realities undermine the conditions necessary for what might be called “perfect” (or “first best”) wealth-maximizing allocative efficiency in particular contexts. One response however is to apply more nuanced neoclassical analysis to prescribe how law can be structured to provide incentives, protections, and default rules to approximate hypothetical bargaining to minimize these realities or their effect and thereby move particular imperfectly competitive relations closer to perfect competition and thereby provide a “second best” level of efficiency and wealth maximization in particular contexts. However, the scholarship that pursues this “second best” approach almost universally fails to disclose and address the General Theory of Second Best. This theory teaches that attempts to structure legal policy to produce greater market efficiencies in particular contexts are as likely to decrease aggregate economic efficiency in the entire economy as they are to increase aggregate economic efficiency.

In an Article entitled *The General Theory of Second Best and Economic-Efficiency Analysis: The Theory, its Negative Corollaries, the Appropriate Response to It, and a Coda on the Economic Efficiency of Reducing Poverty and Income/Wealth Inequality*,³² Professor of Law and Economics Richard S. Markovits, an internationally recognized expert in this field, explains the General Theory of Second Best and offers an analytical approach for predicting whether a policy that would decrease or increase the number and magnitude of an economy’s economic imperfections to specified extents will thereby decrease or increase overall economic efficiency. However, the approach requires both a theoretical and an empirical component beyond the expertise of most legislators, regulators, judges, and policy decision makers. Without such an analysis, there will be no reason to believe that legal rules that reduce inefficiencies in particular contexts will be more likely to better society-wide, efficient outcomes than to worsen such outcomes. Thus, without taking into account the General Theory of Second Best, the vast law and

32. Markovits, *supra* note 11.

neoclassical scholarship offered to analyze issues relating to legal policy and its effect on efficiency in the context of particular economic choices is scholarship based on an important, undisclosed premise that impedes people and their advocates in their attempts to identify and secure their essential economic rights. The article concludes with an important application of the proposed analytical approach that explains why, contrary to the claim of most economists that a trade-off must be made between equality and economic efficiency (i.e., the claim that redistributive attempts to increase equality will decrease efficiency), tax and redistribution policies that reduce poverty and inequality are likely to increase economic efficiency.

XII. THE NEED FOR EMPIRICAL EVIDENCE

The best of intentions guided by economic theory can have harmful legal consequences. The socio-economic importance of empirical evidence, when obtainable and relevant, is recognized and well-presented in the Articles by all of the authors who have contributed to this Symposium Issue.

However, the most comprehensive example of the benefit of socio-economic empirical research is presented by Professor of Law and Economics Margaret Brinig in an Article entitled *Result Inequality in Family Law*.³³ In this Article, based on data obtained from random samples of Arizona and Indiana child custody cases, Professor Brinig presents and analyzes the socio-economic impact of a legislated presumption of supposed benefits resulting from shared parental custody (an approach now followed in an increasing number of jurisdictions based on a number theoretical advantages).³⁴ According to her analysis, the data suggest that the legal presumption “requiring equal parenting time for all couples leads to inequality based on income, marital status, race and ethnicity, and in instances of domestic violence.”³⁵ Accordingly, Professor Brinig concludes that contrary to theoretical conjecture, the shared parental custody legal presumption “in fact drives some of the least attractive aspects of the picture of family dissolution, and that replication into future generations suggests that some changes need to be made immediately.” Her Article demonstrates how carefully

33. Brinig, *supra* note 12.

34. “Because both parents, at least in theory, win and because judges need not make difficult binary custody determinations, shared parenting presumptions have been seen as vindicating parental rights, forcing parents to cooperate in the reconstituted family, and ensuring children the two-parent influence so many lack at parental dissolution.” *Id.* at 476-77.

35. *Id.* at 474.

constructed and executed empirical analysis based on socio-economic principles can be decisive in formulating policy related to law and economics needed to enhance the prospects of achieving greater equality not only in family law but in all areas of the law.

XIII. THE WEALTH-MAXIMIZING TECHNOLOGICAL ELEPHANT IN THE LAW AND NEOCLASSICAL ECONOMICS ROOM: TECHNOLOGY AND THE DISTRIBUTION OF PROPERTY RIGHTS AS A MAJOR CAUSE OF WEALTH MAXIMIZATION

As noted above, two of the most important intellectual tasks that lawyers need to do to help people identify and secure their essential rights and responsibilities are (1) to identify what adversaries are *not* talking about and (2) to address those topics according to their importance. One immensely important reality that law and neoclassical economics rarely discusses is the causal effect that advancing technology and the distribution of its ownership has on wealth maximization.

Directly related to this failure, one of the most serious and pervasive, but least recognized, false impressions resulting from passing off neoclassical economics for the broader discipline of economics is the widespread confusion that results from treating the theory of neoclassical efficiency (which assumes constant technology) as though it were synonymous with a comprehensive theory of societal wealth maximization or growth (which is achieved largely by reason of advancing technology).

In advancing his neoclassical approach to the analysis of law, for example, Judge Posner states, “What Adam Smith referred to as a nation’s wealth, what this book refers to as efficiency, and what a layman might call the size of the pie, has always been an important social value”³⁶ Judge Posner compounds his error by declaring that the connection between efficiency and growth is “rather

36. POSNER, *supra* note 22, at 252. Judge Posner offers no theory for the relationship between economic principles and wealth-maximization growth other than those neoclassical principles based on allocative efficiency. In many contexts, Judge Posner equates efficiency with wealth-maximization. For example, in discussing the moral content of the common law, Judge Posner declares, “Efficiency or wealth maximization is an important thread in the ethical tapestry [of the common law], but it is not the only one.” *Id.* at 265. Another example of falsely advancing the maximization of efficiency with total wealth maximization is evident from the following: “[W]hat is socially optimal under any measure of social welfare is for the net amount of pie produced to be as large as possible—this is efficiency—and then for the pie to be sliced up and distributed in a way that is best according to the particular measure of social welfare under consideration.” HOWELL E. JACKSON ET AL., *ANALYTICAL METHODS FOR LAWYERS* 351 (2d ed. 2011).

uncontroversial.”³⁷

As a matter of both political reality and positive economics, however, Judge Posner is wrong. Politically, his proposition is highly controversial. It has divided people for several centuries into polarized controversies between people on the left- and right-wing of politics. As a matter of economics, efficiency and growth are quite distinct concepts. Microeconomic efficiency (the primary focus of neoclassical economics) is *not* a general theory of growth or wealth maximization (the primary focus of Adam Smith’s *Wealth of Nations*). In a shrinking economy, every transaction might be neoclassically efficient. Moreover, neoclassical efficiency, even when positively related to growth and wealth maximization, is only one component of a much more complicated dynamic process that requires a recognition that technology and skills are not constant but constantly changing in immensely important ways.

To better enable people to identify and secure their essential rights and responsibilities, Adam Smith was rightly morally concerned that people develop a deeper understanding of national per-capita economic growth because such growth produces the material basis (at least in theory, if distributional issues can be resolved) for providing a rising material standard of living for all people within the economy.

If one takes an extremely long-run view, anthropoids like gorillas, monkeys, bonobos, and orangutans are not remarkably more productive per-capita today than they were fifty thousand years ago. On Earth, only humans are.

What best explains the increase in per-capita growth in human production? In his pre-industrial era world-view, Adam Smith believed that it was labor specialization. In the modern post-industrial era, the focus has shifted to productivity. With neoclassical economics, the focus is on productivity at the margin or marginal productivity. As between these ways of understanding per-capita growth, the modern neoclassical focus on marginal productivity is superior because very little labor specialization can occur without the real capital (e.g. tools, machines, and structures) needed for most labor specialization. Shoe makers cannot make shoes without shoe-making tools; and farmers cannot farm without farm tools, animals, and vegetation. And the value of the tools, animals, and vegetation must somehow be accounted for in terms of their contributions to production if increased efficiency and growth are desired to be achieved via market transactions. But conceiving gains in

37. POSNER, *supra* note 22, at 253.

per-capita growth in terms of increases in labor specialization or productivity (even if those gains can be measured empirically) does not establish either conception as the *cause* of the growth.

Likewise, although the substantial per-capita growth in the United States that has occurred since Adam Smith wrote can be characterized by the efficient allocation resources just as it can be characterized by labor specialization and increasing human productivity, that characterization does not establish allocative efficiency as the *primary cause* of the per-capita growth. In reality, despite over two centuries since Adam Smith published his inquiry into the cause of the economic growth of nations, the discipline of economics has yet to arrive at a single, coherent, widely agreed-upon, non-controversial, causal theory of per-capita growth.

Observing modern day human behavior from outer space, the observer might conclude that umbrellas cause rain. Based on pre-conceived assumptions, what may appear to be a cause may be only a residual effect. The lesson here is that although empirical evidence is essential for both good socio-economics and competent lawyering, the perception and interpretation of facts are often dependent on preconceived rules for determining them, which in turn depends on foundational assumptions.³⁸ At their epistemological foundation, both socio-economics and the adversary system assume that there is always another way of looking at things.

Another way of understanding the cause of per-capita growth is of course to focus on the advancing technology (a four syllable word for knowledge) reflected both in the skills of people and also in the structure of the things they employ in production. Although exactly how it happens remains a scientific mystery, people readily accept the idea that knowledge can be somehow embedded in human brains in ways that enhance skills and thereby make people more productive. However, there is less widely-shared appreciation of how knowledge can also be embedded in things in ways that make them more productive. Consider, for example the productive capacity of a washing machine. It can do work as surely as people washing clothes by hand do work. Next

38. See Thomas Kuhn, *THE STRUCTURE OF SCIENTIFIC REVOLUTION* (2d ed. 1970). Thus, although empirical evidence is always important to lawyers and socio-economists, it is not always decisive in determining causation in the real world. Empirically, the time of the sunrise can be predicted on September 10, 2043; but the perception of a sunrise is an illusion based on the false assumption that the sun orbits the Earth. It was only after the truth of a spinning Earth orbiting the Sun was understood that the foundation could be laid for the causal explanations provided by Newton's Laws (the foundation of modern science) for the motion for all bodies from atoms to stars traveling at speeds not approaching the speed of light.

consider its capacity to do work if it is melted down to a blob of metal, plastic, and rubber. It has the same molecules, but it no longer has the productive capacity to wash clothes because the knowledge imbedded in its former structure has been destroyed.

Property rights in things distribute income earned from their productive capacity as surely as the right to employment in nondiscriminatory environment. Thus, free individuals can earn from the accumulation of knowledge by way of (1) their increased labor skills, (2) working with more productive things (even though no more, and often less, labor skill is needed to employ them), and (3) property rights in the things employed in production even though the owner does none of the labor (if any) needed to employ them. Yet according to neoclassical economics, the *distribution* of productive capacity via property rights is viewed as only an *effect* but not a *cause*, of per-capita growth. Such a view obscures the importance of the distribution of property rights and cannot help but to confuse people rather than to enlighten them in their attempts to identify their essential economic rights and responsibilities in society.

Since the dawn of the industrial revolution, technology has brought forth vast increases in per-capita productive capacity that are not primarily the result of the gains promised by allocative efficiency resulting from increased marginal productivity. For example, consider the great per-capita gains in wealth experienced in the United States beginning in the 1850s. These great gains are not continuous increments driven by marginal prices with causes rooted in constant technology and short time frames (which are the domain of neoclassical economics). Rather, these gains are discontinuous, sometimes explosively large changes in productive capacity and in the distribution of productive capacity and demand with causes rooted in technological progress, real capital investment, and the distribution of property rights subject to limited competition and aided by government definition, regulation, and the protection of property rights.

In this context, consider the wealth-enhancing contribution of major corporations to the economies of the world. By legally defined, default rules, these corporations are endowed by law with a bundle of property rights essential to their wealth-enhancing power that in their essential entirety could not be privately negotiated (including limited liability, centralized management, primary claim on corporate revenues, and stable, perpetual, independent existence and capacity to contract legally unaffected by changes in the ownership of corporate shares). Corporations are financial infrastructure as surely as roads and canals are

physical infrastructure. Both channel and facilitate the opportunity to be productive. These legally protected corporate property rights enable corporations to produce goods and services and to distribute income on a scale far beyond the capacity of individuals whether acting alone or in cooperation with others. And although personal ability, ambition, labor, and luck play a prominent role, access to this wealth-enhancing, super-human, legal infrastructure is also substantially influenced by the distribution of wealth.

These major corporations flourish or fail in the surplus generated long before market prices of their factor inputs and products approach perfectly efficient equilibria. In this context, corporate wealth maximization requires maximizing both (1) “normal profits” (those earned in perfectly competitive markets) and (2) “economic profits” (those earned in the context of substantial technological advances and other conditions of imperfect competition). The major contributions to economic growth observed in market economies experiencing substantial growth—and achieved by corporations earning economic profits—occur when relevant markets are far from achieving perfect efficiency, when prices are far from the theoretical equilibrium, and when any growth effects resulting from market prices taken as signals that reveal relatively efficient resource allocation may be comparatively low or even negative. This is not to say that efficiency is not an important consideration in wealth-maximizing analysis, but it does not play the exclusive or primary, unambiguous, causal role in wealth maximization that neoclassical law and economics ascribes to it.

There seems little doubt that the employment of an additional unit of capital or an additional unit of labor to produce something in an economy at equilibrium according to an accurate assessment of the relative marginal productivity of each unit will result in a maximization of wealth if that decision is viewed in isolation and all other considerations are held constant. However, to characterize the great per-capital growth beginning with the industrial revolution and continuing until the present day as a phenomenon *caused by* the efficient allocation of resources is to conclude that the efficient tail is wagging the technological elephant.

Some people who advocate neoclassical economics as the only proper approach to economics or the most appropriate starting point for law-related economic analysis would like people to believe that our nation’s founders saw a strong, principled, conceptual connection between the *laissez faire*, invisible-hand, market principles advanced in Adam Smith’s *Wealth of Nations* and the democratic principles

advanced in the Declaration of Independence (published in the same year). However, history reveals that most of the founders were more interested in replacing the British hand of King George not with the invisible hand of Adam Smith, but rather with the American hand that included a good measure of protectionism for America's fledgling industries. In fact, Thomas Jefferson harbored a widely and deeply held conviction that wide-spread access to property ownership is an essential requisite for individual wide-spread economic well-being and sustainable democracy. As an inventory of the libraries of the founders of Colonial America would reveal, the economic principles that influenced the founders are more likely found in the property analysis in John Locke's *Second Treatise of Government* than in Smith's *Wealth of Nations*.³⁹

It would probably surprise most of our founders that the *distribution* of property rights in "things employed in production" (i.e., "real capital") is not fundamentally important to the wealth-maximizing promise of the economic theory that presently dominates economic analysis in the study of law.⁴⁰ They would probably be more comfortable with the socio-economic approach. According to neoclassical analysis, the fact of ownership is *indirectly* important based on the assumption that people who own things are more likely to be motivated to allocate the employment of such things to more productive uses than people who do not own them but merely use them to do work. But researchers of legal scholarship would be hard pressed to find any law and neoclassical economics literature that expresses the view that wealth maximization might be greater if capital acquisition and income were more broadly distributed via market transactions.

In *Why Working But Poor: The Need for Inclusive Capitalism*,⁴¹ Professor Robert Ashford offers a wealth-maximizing theory of per-capita growth that focuses on advancing technology, the productiveness of real capital, and the distribution of its acquisition. According to this theory, a broader distribution of capital acquisition with the earnings of capital not only enhances the earning capacity of poor and middle-class people but also promotes more per-capita growth than a narrower distribution. Based on that theory, he presents an analysis that suggests that the most important economic right that poor and middle class people need (but do not know they need) is "the competitive right to acquire

39. Robert Ashford, *Economics, Democracy, and the Distribution of Capital Ownership*, 40 FORUM FOR SOCIAL-ECONOMICS 361 (2011).

40. *Id.*

41. Ashford, *supra* note 13.

capital with the earnings of capital.”⁴² Building on this analysis, the Article suggests that the most important, untried market strategy to reduce poverty and to achieve wealth maximization on the aggregate, interpersonal, and individual level is one that seeks to broaden capital acquisition with the earnings of capital by opening the system of corporate finance to all people so as to democratize the competitive right to acquire capital with the earnings of capital and thereby to establish an inclusive capitalist economy.

According to Professor Ashford, structured to operate via voluntary transactions and without redistribution, the inclusive capitalist economy could substantially enhance the earning capacity of poor and middle class people by supplementing their labor income and transfer payments with capital income, reduce unemployment, raise wages, enhance working conditions, reduce taxes and tax rates, and promote sustainable economic growth. The Article then urges legal scholars, lawyers, law schools, law school clinics, and advocates for poor people to learn, teach, and advocate enhanced understanding of the importance to poor and middle class of securing for them the competitive right to acquire capital with the earnings of capital.

XIV. CONCLUSION

By advancing and demonstrating the enhanced economic understanding that results from employing the socio-economic approach to law-related economic issues rather than an approach limited entirely or primarily to neoclassical principles, the Articles in this Symposium Issue of the *Akron Law Review* provide an important contribution to legal scholarship by better enabling people to identify and secure their essential economic rights and responsibilities in a market economy. I am grateful for the excellent assistance of the editorial team and staff of the *Akron Law Review*, faculty members of the University of Akron Blake McDowell Law Center, especially Professor Stefan Padfield, and the contributing authors in bringing this project to fruition and express my hope that other publications and scholars will continue the important work of advancing the principles of socio-economics in legal education and higher education.

42. *Id.* at 534.