

BOOK REVIEW

RESEARCH HANDBOOK ON AUSTRIAN LAW AND ECONOMICS

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Few scholars disagree that Austrian economists and their fellow travelers have made significant contributions to law and economics. Anyone familiar with the works of Carl Menger, Friedrich Hayek, Ludwig von Mises, Murray Rothbard, and Israel Kirzner recognizes their undeniable additions to law and economics, particularly in analyzing institutions, monopoly and antitrust laws, and regulations and their (unintended) consequences. The contributions in the *Research Handbook on Austrian Law and Economics* build on and expand the work of these great Austrian economists by applying what editors Todd Zywicki and Peter Boettke (2017, p. 21) call the “propositions that are the

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defining substantive position of the contemporary Austrian school of economics" to a large variety of areas in law and economics. Such areas include property rights and conflict resolution in the absence of formal rules (Krause), criminal constitutions (Skarbek), the efficiency of the common law (Zywicki and Stringham), family law (Horwitz), and rule reform (Coyne).

Because many of these contributions build on the work of the great Austrian economists, they share common themes that are not necessarily emphasized in mainstream law and economics:

- 1) The institutions that define the rules of the game, particularly property rights, matter. They "have been devised by human beings to create order and reduce uncertainty in exchange" (North 1991, p. 97).
- 2) Competition is not a state of affairs but a market "process of entrepreneurial discovery" (Zywicki and Boettke, 2017, p. 21).
- 3) Utility and costs are subjective.
- 4) Individuals, including those working in government and the courts, face a knowledge problem and operate under uncertainty.
- 5) Formal institutions are not necessarily superior or better-performing than informal institutions if those formal institutions are not being recognized as beneficial by the members of the group or society operating under those (competing) institutions.

The third and fourth themes are important because they lead Austrian economists to conclude that government usually cannot do a better job than markets. The fifth theme lies at the core of chapter 2, "Property Rights, the Coase Theorem and Informality" (Krause, 2017), and chapter 8, "Self-Governance, Property Rights, and Illicit Commerce" (Skarbek, 2017). Krause (2017, p. 31) shows that people living in slums in poor and developing countries, despite lacking a formal definition of private property rights or a formal justice system, have recourse to voluntary solutions as well as informal mediation services to resolve disputes between neighbors. He provides several examples showing that people have incentives to negotiate an outcome that benefits both parties, as predicted by Coase (1960), even when property rights are not formally defined. Even when there is a formal justice system, Krause (2017, p. 35) shows that, in the case of Peru, the

overburdened administrative authorities eventually accepted the decisions of the informal organizations in the slums.

Krause (2017, p. 31) also draws another lesson from these natural experiments: “informal solutions of disputes among neighbours follow a ‘rights’ approach and do not intentionally look for efficiency, although this may be an unintended or secondary result of allocating rights.” According to Krause (2017, p. 39), “this speaks against a cost/benefit analysis on such decisions since making the allocation of property rights dependent on a judge’s evaluation of a net result would bring instability back.”¹ Krause’s discussion of dispute resolutions in slums represents another piece of empirical evidence supporting the idea that people have incentives to voluntarily resolve their disputes outside the government authority. His work also complements Williamson and Kerekes (2011), who, among others, show that formal institutions are not necessarily superior to informal institutions when it comes to securing property.

Skarbek (2017, p. 178) “challenges the legal centrism hypothesis by examining the internal governance institutions of prison gangs, arguing that order and property rights can emerge without the state” or, more accurately, despite the state. His chapter discusses how one of the largest prison gangs in Northern California, *Nuestra Familia* (*NF*), which operates outside the law both in and out of prison, has developed “effective self-enforcement internal governance mechanisms to limit opportunistic and shirking behavior” (Skarbek, 2017, p. 178). As Skarbek discusses (2017, p. 181), *NF* recruits members primarily in prison, and one of its main revenue sources is drug trafficking behind bars. Skarbek’s analysis of the internal organization of *NF* is consistent with the idea that prison gangs operate like a profit-maximizing enterprise that seeks to reduce shirking, opportunism, and turnover when it comes to retaining its best employees.

NF recruits its members and associates by offering them protection against predatory inmates and rival gang members. In exchange, recruits swear lifetime allegiance to the *Familia* and work for the *Familia* while in prison and after release (Skarbek, 2017, p. 183). In

¹ A similar discussion occurs in Zywicki and Stringham’s chapter, “Austrian Law and Economics and Efficiency in the Common Law” (Zywicki and Stringham 2017), that I discuss below.

addition, *NF* has rules that its members and associates must follow and punishments for breaking those rules. *NF* has also established rules that govern interactions outside the gang. Those rules are just as important as the rules governing interactions within the gang, because intergang violence diverts resources away from *NF*'s main source of profit: drug trafficking. All these rules have been codified in a written constitution that, similarly to what corporate culture does, sets workable principles and routines that create shared expectations for group members (Kreps, 1996).

Much of Skarbek's work on the prison gangs' internal organization echoes Peter Leeson's work on the internal governance institutions of pirate ships (Leeson, 2009). Whether pirate ships or prison gangs, it is in the interest of these criminal organizations to develop self-governance mechanisms to mitigate moral hazard and adverse selection so as to maximize their profits. They cannot use the government to enforce contracts or to arbitrate conflicts.

These two chapters by Martin Krause and David Skarbek undoubtedly represent important contributions to the law and economics literature, particularly as it relates to the development of self-governance institutions to coordinate human interactions in the absence of government or, in the case of criminal organizations, in spite of government. However, it is unclear what makes these two contributions uniquely Austrian. Challenging the legal centrist assumption that without government, there are no property rights, does not make one's contribution uniquely Austrian.

When it comes to the economic analysis of the law and particularly property rights, Austrian economists have long disagreed with mainstream scholars on efficiency. Building on the Austrian literature, Zywicki and Stringham (2017, p. 193), in their chapter "Austrian Law and Economics and Efficiency in the Common Law," are highly critical of Posner and his followers who argue that "the common law is efficient (Kaldor-Hicks efficient) because judges view wealth maximization as a normative ideal." Zywicki and Stringham (2017, p. 195) acknowledge not all mainstream economists agree that the common law maximizes wealth. The problem is these economists who argue in favor of changes to make the common law more efficient ignore that judges suffer from the same problems that public choice scholars identify with legislatures: interest-group pressures, rent-seeking, and rent-dissipating (Zywicki and Stringham, 2017, p. 196).

Since costs and benefits are subjective, judges cannot predict how specific decisions will affect litigants' willingness to pay. Willingness to pay might make sense in markets where willingness to pay changes as market conditions change, but within the context of the courtroom, judges face the same challenge as those "of a Soviet-style economic central planner" (Zywicki and Stringham, 2017, p. 197). In light of this conclusion, Zywicki and Stringham (2017, p. 198) argue that "the primary purpose of the law is not to try to impose rules that bring about the wealth maximizing 'outcome,' but instead to provide a stable institutional framework that will enable individuals to plan and coordinate their affairs in a world of constant dynamism." If the rules that individuals operate within are constantly changing, it will indeed be much more difficult for individuals to coordinate their plans, and we should expect much more judicial intervention. Higgs's (1997, 2012) concept of "regime uncertainty" defined as "a pervasive lack of confidence among investors in their ability to foresee the extent to which future government actions will alter their private-property rights" illustrates the point made by Zywicki and Stringham when applied to explain why the Great Depression lasted so long.²

Zywicki and Stringham (2017, p. 198) also believe, like other Austrians such as Block, Kirzner, and Rothbard, that the law should be evaluated "using extra-economic means," that is, "society-wide shared ethical perspectives" (Kirzner, 2000, p. 85). They argue that "Austrian economics is a positive discipline that does not say what any given policy or any given law should or should not be" (Zywicki and Stringham, 2017, p. 198). This argument echoes Mises, Kirzner, and Rothbard's position about economics being "a value-free science" that cannot tell us anything about whether a policy or a law should be passed or repealed. At best, economics might be able to tell us whether some goals are incoherent (Rothbard, 2006, p. 251).

² However, for Higgs (2012), regime uncertainty means "more than uncertainty about the government's laws, regulations, and administrative decisions." He also includes, for example, uncertainty on how "differences between judiciaries create uncertainties about how the courts will rule on contested laws and government actions." Therefore, in this respect, we can see how Zywicki and Stringham's concerns about some mainstream law and economics scholars pushing for evaluating and tinkering with the law in order to maximize Kaldor-Hicks efficiency echo Higgs's point when it comes to regime uncertainty.

Zywicki and Stringham (2017, p. 202) take their argument further and argue that Hayek ought to be praised for his analysis of the common law. However, his belief that “ultimately judges must be subservient to the legislature which can step in to alter the law when common law reaches a ‘dead end’ through adherence to precedent or when the law develops in ways that are inconsistent with the market economy” runs into the same problems that judges would face if they were to maximize Kaldor-Hicks efficiency when deciding cases (Zywicki and Stringham, 2017, p. 202). Instead of relying on the government to “improve the law,” Zywicki and Stringham (2017, pp. 203–204) argue that we should allow for competition in law in the same way that we allow for competition in the market process, which enables entrepreneurs to discover unexploited profit opportunities to better satisfy consumers.

We can find precedent in the Middle Ages, when litigants sought out private judges for their expertise, judges who competed *de facto* with each other since part of their pay came from litigants’ filing fees. Competition made judges more efficient in adjudicating cases and also resulted in better laws and procedures to meet parties’ needs (Zywicki and Stringham, 2017, p. 204). As the authors remind us, to some extent today, “competition takes place alongside government law, as with modern arbitration, mediation, and other forms of alternative dispute resolution,” which suggests that “consumers” do not necessarily value government law since they use those alternative mechanisms of dispute resolution (Zywicki and Stringham, 2017, p. 205).

There is little doubt that competition as a discovery procedure is a better mechanism than government to sort out the rules and enforcement procedures that people actually value. But before reaching that conclusion, the authors spend two-thirds of the chapter arguing against Kaldor-Hicks efficiency—which no law and economics scholars claim is the panacea—without providing an alternative way to evaluate the law. More importantly, when Zywicki and Stringham (2017, p. 202) say that “the real test of the usefulness of a legal rule is found in the *unseen* effects of the rule in terms of the number accidents avoided or conflicts averted, not the *seen* effects of the cases that come before the judge,” they seem unaware that by writing this, they are saying that the law’s role is to minimize the costs associated with accidents or conflicts—which is another way of saying that the law’s role is to maximize wealth.

Similarly, as discussed previously, Zywicki and Stringham's argument that the law's role is "to provide a stable institutional framework that will enable individuals to plan and coordinate their affairs in a world of constant dynamism" (2017, p. 198) sounds a lot like the argument that the law's role is to ensure that people can pursue their activities in an environment that fosters peaceful cooperation as opposed to plundering or, to be more accurate, to foster an environment where people are discouraged from engaging in violent wealth-extraction-type behaviors—and it is the law's role to do this because it allows people to maximize wealth. This is why theft is illegal: if stealing were allowed, people would spend resources trying to perfect their craft in stealing other people's property while others would spend resources attempting to protect their property. Tremendous resources would be wasted on activities that do not create wealth.

Nobody denies that we can rely on noneconomic means such as ethical principles to explain why theft should be and is illegal, but certainly efficiency and wealth maximization seem to be useful tools to explain why theft should be and is illegal. It is curious that Austrian scholars who have written on the tragic consequences of alcohol and drug prohibitions would argue that we should either rely on society-wide ethical principles or, better yet, abstain from evaluating any law or policy. It is partly because of those society-wide ethical principles that most drugs remain illegal in the United States despite the obvious inefficiency of the war on drugs and its tragic consequences, intended and unintended. If Austrian scholars want mainstream economists to pay attention to their work, we should avoid telling them that economists should rely on noneconomic means to evaluate a law or a policy, and we definitely should avoid telling them that economists should abstain from evaluating a given law or policy because economics is a positive science.

Steven Horwitz's (2017) chapter, "Family Law, Uncertainty, and the Coordination of Human Capital," shows how Austrian economics can contribute to both the economic analysis of the law and to the economic theory of the family. His chapter updates Gary Becker's model of the family in several ways. First, Horwitz integrates the Austrian theory of capital into his analysis to help explain how "marriage and the family can be understood as structures of

human capital formed in the face of uncertainty and intended to create an ongoing enterprise of cooperation to achieve a set of goals at lower costs than feasible alternatives" (Horwitz, 2017, p. 398). To complicate matters, members of the family produce not only for the market to earn income but also for the household when engaging in childcare and other household activities. Therefore, family members have to decide how much "market human capital" and "household human capital" they will respectively invest to make the whole venture successful (Horwitz, 2017, p. 398).

With an Austrian theory of marriage and the family, a law and economics analysis of family law will then investigate to what extent "the law facilitates or complicates the coordination process by which couples form marriages and decide on questions of market and household production" (Horwitz, 2017, p. 399). Horwitz (2017, pp. 407–408), for example, shows how laws that favor granting custody to the mother can alter significantly both parties' decisions regarding how much to invest in market human capital versus household human capital. This phenomenon also can help us understand part of the gender pay gap, since the mother will be less likely to invest in market human capital and more likely to invest in household human capital if she is more likely to end up with custody of the children.

When it comes to no-fault divorce law, its effects are more ambiguous. On the one hand, no-fault divorce law somewhat increases the uncertainty about how long the marriage will last compared with fault divorce law, thus decreasing incentives for both parties "to invest in the sorts of relationship-specific forms of human capital that are necessary to sustain the marriage and the large family that might result" (Horwitz, 2017, p. 411). On the other hand, "no-fault divorce can be seen as an effective institutional adaptation" to reduce the costs of exiting a bad marriage when one or both parties realize that they are not a good match and the probability of having a successful marriage and family is low (Horwitz, 2017, p. 413). Horwitz's analysis of family law as it applies to custody and no-fault divorce is further evidence that rules matter when it comes to coordinating human action, whether in a market or a nonmarket environment.

One thing Horwitz does not address (maybe because it is beyond the chapter's scope) is the impact of low-skilled immigration

on women's incentives to invest in market human capital while still attempting to have a family. There is evidence not only that increased low-skilled immigration allows women to increase their labor supply, but also that increased low-skilled immigration that provides affordable household services leads to increased fertility among college-educated women (Furtado and Hock, 2010; Cortés and Tessada, 2011). Therefore, when it comes to analyzing marriage and the family, such empirical evidence shows that other laws, such as immigration law, can indirectly impact women's human capital investment decisions.

Christopher Coyne's (2017) "The Law and Economics of Rule Reform" represents the best chapter in this volume and should be recognized as an important Austrian contribution to which mainstream law and economics scholars should pay attention. In this chapter, Coyne (2017, p. 92) combines the tools of mainstream law and economics with those of Austrian economics to explain why some rule reforms succeed and others fail. His work builds on North's work on institutions as well as the works of Mises and Hayek and their intellectual heirs analyzing why central planning is bound to fail. As Coyne (2017, p. 92) explains, the goal of rule reform is to make "changes to existing rules in order to achieve a preferable state of affairs from the standpoint of the reformer." When analyzing rule reform, mainstream law and economics scholars tend to focus on how to generate the proper incentives such that the "relevant players" prefer those new rules to the old ones.

Certainly, incentives are a necessary but not sufficient condition for success in rule reforms. As Coyne (2017, p. 93) points out, a vast empirical literature shows that failures in economic, political, or social rule reforms attempting "to improve the human condition" abound. The major reason for these failures is what Austrian economists call the "knowledge problem," which "emphasizes that planners lack the context-specific knowledge to effectively achieve their ends through rational planning" (Coyne, 2017, p. 93). As Coyne (2017, p. 93) tells us, "determining the appropriate incentives is a difficult task given that the perceptions of citizens in other societies are grounded in a cultural context that often cannot be understood by outsiders in a manner that can be effectively incorporated into policies." For Coyne (2017, p. 93), the core of the problem with determining the appropriate incentives so that

rule reform will succeed resides in “the distance between the local knowledge and the knowledge possessed by those designing the rules.” The greater the “knowledge distance” between the rule reformers and “the locus of knowledge associated with the problem they seek to address,” the more likely the rule reform is to fail (Coyne, 2017, p. 93).

Similar to how Buchanan argues that Hayek was warning us not only against “rational constructivism” but also against “‘romantic constructivism’ which attempts to design rules while ignoring ‘culturally evolved rules for human behavior that constrain the set of institutional alternatives,’” Coyne warns us against “romantic rule reform” (Coyne, 2017, pp. 103–104). The more disconnected reforms are from “the underlying realities of the society in which they are imposed”—the less rule reform appreciates people’s underlying beliefs and attitudes and the informal rules they operate under—the more likely such intervention will fail, regardless of how well intended the reformers are (Coyne, 2017, pp. 103–104). The overarching implication of Coyne’s work is that rule reformers are significantly constrained in what they can do and, therefore, sometimes the *status quo* is the least bad option.

Other chapters in the *Handbook* deserve attention, also. But—though this is not necessarily a bad thing—too many of those chapters read like a literature review of what Austrians have said on a particular law and economics topic rather than novel contributions. As mentioned at the beginning of this review, there is little doubt that Austrian economists have made significant contributions to law and economics, and the *Research Handbook on Austrian Law and Economics* is additional evidence of that.

When it comes to catching the attention of mainstream scholars, a problem Austrians face is that mainstream law and economics journals, with a few exceptions, tend to publish papers on narrow topics relying on advanced statistical analysis. One problem for mainstream law and economics is that the research question has become subservient to the methodology. Austrians, by contrast, agree that the research question should dictate the methodology used to answer that question; therefore, they are more able to tackle a larger variety of questions using whatever methodology is necessary. Some of the chapters reviewed, particularly Krause, Skarbek, Horwitz, and Coyne, are evidence of how much more

versatile Austrians are when it comes to tackling some interesting law and economics questions. Those chapters also answer partially some of the three questions Zywicki and Boettke (2017, p. 426) think “demand our attention in the field of law and economics,” questions about the emergence and evolution of norms and the dichotomy between market and government in creating law.

Finally, it is also this reviewer’s viewpoint that Austrian scholars should not shy away from engaging mainstream law and economics scholars, even using their preferred methodology when appropriate, but also scholars in other fields. Many topics covered in this volume certainly are of interest not only to law and economics scholars, but also to scholars in political science, criminal justice, management, finance, sociology, and other subjects. Austrian economics can shed new light on questions that scholars in those other fields are interested in answering, questions that mainstream law and economics scholars might sometimes refrain from tackling because they cannot be addressed using their preferred methodology.

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