Commentary

"Can Lawyers Say Anything About Economic Growth?" Comment on Frank Cross's *Law and Economic Growth*

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Like Los Angeles, the scholarly literature on law and economic growth is amorphous and overlapping. Frank Cross provides an insider's tour that is remarkably concise and complete. Instead of prescriptions and controversy, he explores themes with balance. In this brief Comment, I will discuss one of his themes: What is the role of legal scholars, as opposed to economists, in understanding economic growth?¹

I once heard William Miller begin a lecture on the Icelandic sagas by describing a householder who, having found that his departed guest had left a valuable gift, jumped on his horse and tried to overtake the guest in order to kill him. It seems, according to Professor Miller, that the householder did not want to owe a moral debt to his guest. In recent years, the law has accumulated a large intellectual debt to economics. The imbalance in accounts fuels the resentment of lawyers and the numerate pride of economists. Modern law and economics did not begin this way. Instead of using economics to understand law, Ronald Coase intended to use law to understand the economy.² Cross's article provides evidence that lawyers can balance these intellectual accounts.

Transaction lawyers are especially important in this task, as I will explain. Houses are constructed and forests grow. Intellectuals once imagined that an economy could be planned and constructed, like a house. In recent years, however, states have abandoned not only centralized planning, as in the communist countries, but also indicative planning, as in France. "Growth," not "construction," is the right word for a flourishing economy.

Economic growth causes a lot of individuals to make money; or, more accurately, a lot of individuals making more money than they used to constitutes economic growth. People make more money than they used to when they bet on new ideas and win. For people to bet on ideas with their

own money, the odds must be favorable. When many individual investors face good odds, the conditions favor economic growth.

In the 1990s, a consensus emerged among growth economists in Washington. As recently formulated by Gerard Roland, the “Washington Consensus” holds that economic growth requires three policies: liberalize, privatize, and stabilize. This trilogy reduces approximately to free trade, capitalism, and monetarism, respectively. In the new century, however, the Washington Consensus has eroded. I recently participated in a conference of USAID officials where much of the discussion concerned the institutional and legal foundations of economic growth. As I listened, I could picture officials at the World Bank searching their hard disks for “Washington Consensus” and replacing the phrase with “The New Institutional Economics.”

At his untimely death, Mancur Olson was working on a book with the theme that two conditions guarantee development in the modern world. First, individuals must have a broad set of secure rights, especially contract and property rights. Second, owners must not suffer predation by private individuals or the state. With secure contracts and property, people will bet on productive ideas with their own money.

Regardless of whether this view dominates the runway of intellectual fashion in Washington, secure contracts and property must count among the fundamental causes of economic growth. This fact makes law foundational for a theory of economic growth. One particular kind of contribution by lawyers is central to my own writing. Centralized planning is a way of making commodities and laws. Economic centrism is discredited, but legal centrism remains the main way that people think about making law. By “legal centrism,” I mean that high officials in the central government decide the law and impose it on the nation. An alternative approach is to build business law up from commercial practices. Legal decentralization, which is essential to secure contract and property rights, is little appreciated by economists. By studying the common law, codes like the UCC, or the restatement of law, lawyers learn how to build law case by case.

The decentralization of contract and property law depends partly on the innovative role played by transactional lawyers. Like trees in the forest that compete for light, individuals compete with each other to make money. A

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5. For a summary of Olson’s argument, see *id.* at 195–99.

6. *Id.*

7. *Id.*
successful competitor, who is clever and lucky, finds the winning strategy that eludes others. As attested by their own modest wealth, economists cannot predict who will make money. Lacking such predictions, economists have advanced the "efficient market hypothesis," which asserts the impossibility of predicting who will make money in the stock market based on public information. Whether or not the efficient market hypothesis is true, the strategic character of economic competition limits the predictability of aggregate growth. Consequently, the observer of a flourishing economy should expect surprises.

Transactional lawyers play a central role in business organization and innovation. Instead of solving technical legal problems for businessmen, good transactional lawyers help to create value by developing new forms of property and contracts. Once a new form of property or contract appears, economists can explain why it appeared by showing how it creates value. To illustrate, Silicon Valley developed new forms of finance that funneled large sums of money to creative engineers and programmers. The emergence of "angel investors" and "venture capitalists" was difficult to predict. After they emerged, the intellectual task remained of explaining what they do. Explaining what they do requires mastering the details of new financial institutions, including a new kind of law firm. When law grows by decentralized, competitive pressures, I call the process "market modernization" of law. Transactional lawyers, who play a central role in market modernization of law, can help to understand it and explain it to economists.

Another theme developed by Mancur Olson is that contract and property rights are most secure in democracies. In the twentieth century, democracy and dictatorship fought for supremacy in much of the northern hemisphere, and dictatorship lost. According to the Freedom House index, the proportion of democratic states in the world rose sharply between 1970 and 2000—from approximately 26% to 63%. Now, at the beginning of the twenty-first century, the established democracies have no worthy opponents. In developing countries, however, democracy is often absent, or democracy paralyzes politics and the military suspends it from time to time. Democracy's worst enemy in the new century is itself. Developing countries desperately need democratic forms that will take root and flourish. Finding them requires a combination of social science and law, especially as applied

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to constitutions. I have argued that developing countries need democratic forms that implement the median rule, rather than democratic forms that implement political bargaining. Regardless of whether this specific proposal is right or wrong, development agencies need a better theory of constitutional law. The required theory must emphasize the consequences of alternative legal forms for prosperity and stability. Constructing such a theory, which hardly exists, is a joint venture of law and economics.¹¹