

University of Southern California Law

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Legal Services Needed; Lawyers Need Not Apply

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Gillian K. Hadfield

Why a globalized U.S. economy requires new legal infrastructure devised and controlled by innovators (who will probably be something or someone other than law firms or lawyers).



The process of opening the markets that generate legal infrastructure to investors, managers and others who aren't lawyers is already under way in the U.K. (Illustration by Jim Frazier)

“Law is too important to be left to lawyers.”

Paraphrasing the famous adage about war and generals, [Mark Chandler, general counsel at Cisco Systems Inc.](#), shared this observation with me in the spring of 2007. We were speaking over Cisco's stunning [TelePresence video-conferencing system](#) — he traveling on the East Coast, me on the West — while he grabbed a quick sandwich between meetings. Others had referred to Chandler as one of the most innovative senior lawyers in Silicon Valley, and I was picking his brain about the impact of law on innovation as part of the early phases of a research project that I was heading up at the University of Southern California law school.

His observation turned out to be the key lesson of the project.

During the four years following this initial interview, I have spoken with dozens of general counsel, entrepreneurs, business leaders and experts in innovation about how well the American legal system is supporting the innovative enterprise powering the global economic transformation under way since the fall of the Berlin Wall and the birth of the Internet. They have been uniformly optimistic about the pace of innovation in their industries — but uniformly despondent about the legal tools available to them to support their efforts to ride the surging waves of the new global economy. One complained about the great “DNA gap” between lawyers and business thinkers. Another bemoaned the need to resort to a patchwork of law firms around the world to manage operations that are “global from day one” in a new economy firm. A third shared his frustration with lawyers who produce reams of paper — erudite analysis memos or long complex contracts —

when what is needed, and fast, is targeted business advice or short documents that memorialize key commitments.

If I had spoken instead with consumer or employee organizations, public-interest groups or government regulators, I would likely have heard a similar complaint about the mismatch between what we need from our legal system and what we get. How do you regulate global emissions or build an improved health care system or govern a 21st-century financial sector without drowning in ideological politics, 2,000-page statutes and endless litigation?

Surprisingly, the complaints I hear focus far more on the *value* of legal work than on the cost. This focus is surprising because during the last decade or so, the cost of legal services and procedures has soared. One recent industry survey concluded that law firm prices had increased 75 percent since 2000, far outstripping a 20 percent growth in non-law firm costs. [The Berkeley Patent Survey of 2008](#) found that the average cost to obtain a patent in a technology startup firm is now \$38,000; more than a third of the survey's respondents cited cost as the most important reason they chose not to patent.

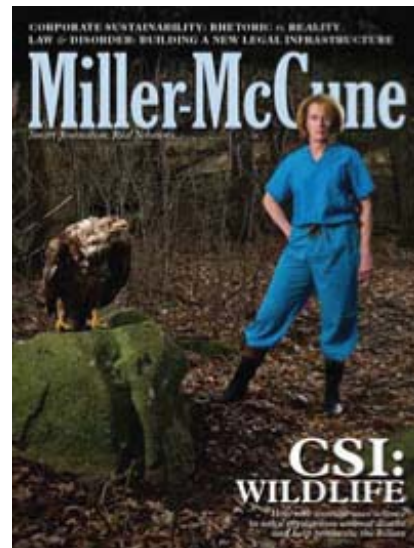
So cost is certainly a major concern. But the cost problem only sharpens the sting of complaints about value: Clients feel that they are paying more and more for legal work that helps them out less and less.

There is a way out of the legal morass that surrounds our most innovative businesses, but it involves loosening the near total grip that lawyers have on creating the law and supplying legal services in the U.S. In America, such a notion is often dismissed as a flight of fancy, in no small part because lawyers here so jealously guard their prerogatives. But the process of opening the markets that generate legal infrastructure to investors, managers and others who aren't lawyers is already under way in the United Kingdom, creating possibilities for legal innovation — and enormous economic advantages — that ought to interest Americans whether they are lawyers or not.

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In the words of famed Harvard law professor Lon Fuller, "Law is the enterprise of subjecting human conduct to rules." And although most students head to law school with visions of social justice and important constitutional rights dancing in their heads, most legal work in modern market democracies involves the management of economic activity. For reasons that are central to my point — that law is too important to leave to lawyers — we have very little hard data about what lawyers actually do because lawyers don't like to collect data. But based on my own research, I estimate the share of legal work geared to achieving economic objectives is on the order of 60 to 70 percent. Depending on how you count, it may be more: In one of the few studies of the distribution of legal work (this one conducted in Chicago in 1995), researchers found that only 16 percent of legal effort was devoted to representing individuals in civil rights, criminal defense, divorce, family or personal injury matters. Only 8 percent of all lawyers work in government and 1 percent in legal aid or public defender offices. Most legal work is performed for businesses and organizations. Among large law firms, which scoop up the top law school graduates, the percentage of corporate clients is pretty close to 100.

Legal rules and the work lawyers do — the advice they give, the documents they generate, the litigation they conduct, the lobbying they engage in — are basic elements of our economic infrastructure. In fact, I refer to the set of legal materials available to economic actors as "legal



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infrastructure.” Although most people in business think of lawyers as a necessary evil required to defend against silly lawsuits and comply with burdensome government regulation, the truth is that law is a critical piece of the economic puzzle. To know why, one only has to look to developing countries around the world as they try to build market economies: Foreign and domestic businesses and governments bemoan the absence of the rule of law to ensure contracts are kept, profits are shared, loans are paid back, intellectual property is safeguarded and regulations are followed.

To even better see why legal inputs are economic inputs, imagine that you are one of our modern-day heroes — the Internet entrepreneur. You and a few friends hatch the idea for a new social networking platform. You all decide to quit your jobs to build the idea, working around the clock and sustaining yourselves with savings and funds borrowed from family and friends. You need to lease space to work in and to pay a Web-hosting service. You need to hire and pay programmers. You need to develop terms of use for the website to ensure that you can easily do things like drop people if they are abusive. You need to know what regulatory compliance and liability risks you face. You need, perhaps most of all, to raise venture capital to grow the business, and this means managing relationships with potential investors: how much to tell people when and how, what types of control you might be willing to give up and what protections you want for your own long-term involvement in the business.

How effectively you and your friends achieve these goals and build a successful business depends on the quality and cost of the legal infrastructure available to you. Are you all willing, for example, to share your ideas with one another freely at the beginning, or is anyone worried that he or she might be cut out of the venture? That depends, in part, on the background legal rules. In most U.S. states, for example, a partnership is formed between people who start behaving like partners and, unless they agree differently, they’re all entitled to an equal share in the profits of the partnership. Similarly, trade secret statutes can protect a person who discloses commercially valuable information to someone in confidence, unless they agree differently. That “unless they agree differently” proviso means the legal impact of both partnership and trade secret law depends on contract law and what counts as an agreement: Is just going along without objection enough, or do you need a written, signed document?

Anyone who has seen the film *The Social Network* will appreciate that the question of who ends up with money in their pockets on the way from dorm-room idea to billion-dollar company turns on more than just the rules you can find in law books. What good are the rules if you can’t find or afford lawyers to decipher them? If the lawyers you turn to are uniformly risk averse and lack good business sense, how can they possibly help you decide which risks matter and which can be ignored? How useful, really, are the templates those lawyers use to draft contracts if the contracts are indecipherable by ordinary humans and hence routinely ignored — until someone files a lawsuit, at which point they contain a wealth of unwelcome surprises? What good do the rules do you if the ambiguity of the procedures worked up by courts render the cost of litigating a dispute so expensive and unpredictable that you are better off cutting your losses and moving on to something else?

The quality and cost of rules, lawyers and procedures will play a major role in the success or failure of our imagined social networking venture. Just like the broadband Internet connections that will link up the members of the network, the educational system that will generate programmers and the real estate developments that will provide office space, the available legal infrastructure is an economic factor that directly affects the calculus of profit or loss. And right now, for every Facebook that survives the legal morass and builds an Internet blockbuster, thousands of well-hatched plans are destroyed by unmanageable arguments among partners, investors and regulators, or sunk by an unwillingness among investors to put up money in the face of legal costs and uncertainty.

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Two basic types of legal inputs determine the quality and cost of our legal infrastructure. On one hand are legal rules and procedures and on the other, the legal expertise — advice, documents and representation services, for example — that implements those rules and procedures. Let's start with legal expertise. I'll get back to legal rules later.

It may seem perverse that I use the circumlocution "legal expertise" in describing this category. Don't I just mean "lawyers"? Yes and no — and that's the problem.

In any American state today, legal services must be provided by someone who has earned a doctorate in jurisprudence, or JD (in most states, from a law school accredited by the American Bar Association), and passed the bar exam. Until relatively recently, legal work had to be done by individual lawyers working, at most, in partnerships with other lawyers; it could not be provided by any corporate entity. Today, a limited liability corporation can provide legal goods and services in many states — but only if it is owned and managed entirely by lawyers. According to regulations passed by individual bar associations and adopted by state courts, only lawyers can practice law. The definition of what counts as "practicing law" is left up to lawyers and judges to decide, but, to date, that definition has pretty much been whatever today's lawyers do.

So, it is natural to think that when we are talking about the process for producing all the things that lawyers do today, we are talking about how lawyers are produced. Historically, this analysis has focused policy on a very narrow question: Are there enough seats in law schools? But the question of how many lawyers we have is beside the point. The number is not the real policy problem.

The real problem is that we don't seem to be producing either people or organizations that provide legal inputs appropriate for the rapid changes of the new economy. And this failure has come about precisely because we have treated legal inputs as the province of lawyers alone.

It's not that lawyers aren't smart or committed enough to produce good quality legal services. The problem with the way in which U.S. markets for legal inputs are structured is that they are entirely closed off to the potential quality-improving and cost-reducing innovations that might be produced by people who are not already heavily invested in our existing ways of handling legal problems. Those existing approaches are the problem: too costly, too poorly informed about rapidly changing business and regulatory realities in a global economy, too risk averse, too slow and cumbersome.

So why not let people other than JD-trained, bar-examined lawyers and organizations that aren't 100 percent lawyer-owned and -financed compete to supply advice about managing legal and regulatory risks, complete required document filings, design documents and organizational policies, negotiate contracts and manage legal disputes? Certainly, there are some things for which only the most experienced and conventionally trained lawyer will do. But there is also a huge landscape of legal work that could be better done by differently trained lawyers, lawyers trained out-of-state, lawyers working in partnerships with nonlawyers, and companies that are owned, managed and financed by business-minded folks, rather than (or in addition to) legally minded folks.

The potential for corporate provision of legal inputs on a national or international scale opens up many possibilities for creating legal services that match the needs of the global economy. Expanded scale, together with the more robust financing that corporations attract, could spur the development of large-scale data analysis that could be incorporated into business decision-making in any number of areas, including: how to respond to liability or regulatory risks; how much effort to put into negotiating contractual detail; and how to assess the risks of a target company

in an acquisition or a new financial vehicle.

Partnership with nonlawyers makes integrated finance, accounting, tax and legal support for mergers and acquisitions possible. Access to out-of-state or even out-of-country legal advice creates the potential for an integrated solution to managing a far-flung enterprise. Integrating legal expertise with business expertise promises the potential for innovating legal solutions that are better calibrated to risk and reward. A new venture, after all, often needs and gets away with a quick and short agreement right now, rather than the overly long and detailed document that would take months to hammer out.

Once you start to think about legal inputs in the economic sphere as essentially economic inputs, you get to an idea we adopt in most other economic markets: Don't regulate who can provide goods and services without good reason to think that the regulated market will do better than the unregulated market. And there is no good economic rationale for lawyers to have exclusive rights to supply and control all legal inputs. If the idea of allowing people and organizations other than lawyers and law firms to supply legal inputs sounds pie-in-the-sky, consider what is happening in the U.K. right now.

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The U.K. has never had an unauthorized practice-of-law rule: Anyone may provide legal advice, so long as he or she doesn't call him- or herself a solicitor. So if a serial entrepreneur has discovered a market niche in providing advice on how to navigate venture capital agreements, he or she can provide that service. And, given his or her expertise in startup ventures, the advice may well be of higher quality and lower cost than the legal opinion available from law firms.

But even this long-standing level of legal openness hasn't been good enough for the Brits. In 2007, on the recommendation of a commission headed by a banker rather than a lawyer, the U.K. adopted legislation pulling the regulation of the legal profession out of the English equivalent of our bar associations and placing responsibility for oversight in a Legal Services Board with a chairman and a majority of members who are nonlawyers. This regulatory body can accept applications from any entity that wishes to be recognized as an approved regulator of providers of legal services.

The definition of what counts as "legal" is relatively narrowly defined; it does not include "everything today's lawyers do." There are now eight different bodies authorized to license providers of legal services, all competing to serve different market niches. In addition to barristers and solicitors (who are now freer to compete with one another), there is a Legal Executives Institute, for example, that licenses people who pursue a community college track in legal training rather than conventional university-based law school. Legal executives can provide many of the same services that solicitors and barristers provide.

But the U.K. went further still, striking down restrictions on the organizational form and financing of legal entities. So now it is entirely possible for nonlawyers to partner with lawyers, or to form entities financed by either private equity or publicly held shares, or to delegate management of the organization providing the services to nonlawyers.

This new set of rules is just rolling out this year, so it's too early to say what may result. But the possibilities are significant: A merger between an investment bank and a corporate law firm, for example, could provide integrated support for corporate acquisitions and initial public offerings. An electronic document-processing firm might simultaneously innovate and manage the technology of document search and provide sophisticated legal advice about document retention and document production in litigation. Large retail entities could provide consumers with low-cost legal help alongside banking, eye exams and watch repair in their stores. And online advisory systems

could serve up integrated data analysis, document preparation and legal advice to consumers and small business owners. None of these options is effectively available under the American regulatory regime.

There's an important implication to the U.K. shift in regulatory regime: It not only opens up competition among differently trained and specialized legal experts within the British Isles; it also opens up the U.K. markets to global competition. As a member of the European Union, the U.K. is bound to treat providers from other European countries on an equal footing. More important, by authorizing businesses that are not exclusively owned and managed by licensed lawyers to provide legal goods and services, the U.K. invites robust access to its legal markets by providers in non-European countries. This includes, for example, India, which is emerging as a major center for low-cost legal process outsourcing. LPOs conduct legal research and due diligence, manage contract compliance, review documents for litigation and so on. In the U.S., bar associations routinely require access to LPOs to be supervised by in-state licensed lawyers.

At the same time, as U.K. lawyers are likely to feel increased competition from foreign providers, they are also likely to enjoy greater access to currently closed but lucrative markets, such as India. As it stands, only Indian citizens can become licensed advocates capable of providing advice on Indian law to Indian businesses. U.K. firms are in a far better position to negotiate access to Indian markets because the U.K. government already offers open markets in return.

But the U.S. cannot dangle the prospect of access to the New York or Silicon Valley legal markets to induce reciprocal access to India. Indeed, the U.K. is several steps ahead strategically on this count, precisely because it has made legal policy an element of national economic policy. In the U.S., policy is not merely vested in lawyers; it is vested in the lawyers and supreme courts of the 50 individual states, acting independently. There is no national policy role in legal markets in the U.S. With one of the most expensive legal systems on Earth, the U.S. is putting itself even further behind the global competitive curve by letting lawyers, and only lawyers, call the shots.

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In terms of cost and quality, most discussion of legal policy as an economic concern focuses not on legal expertise but on legal rules. Businesses and public-interest groups lobby legislatures heavily for rule changes: extension of or protection from tort liability or regulations, for example. Even if the cost and quality of legal expertise were significantly improved, poorly designed, excessively complex rules could still drive legal bills up and the achievement of legal objectives down.

The standard way of thinking about this problem is to think about improving political processes in legislatures and regulatory agencies. After all, these are the entities that have to produce legal rules, right? Well, maybe not right.

It is true that nearly all of our law is now produced by public entities, but this hasn't always been true. At the birth of the commercial revolution in medieval Europe, merchant guilds produced law for their members and ultimately for a wide range of commercial transactions involving nonmembers. Before the Securities and Exchange Commission was created in the 1930s, private stock exchanges set their own rules. Trade associations have long provided rules for their members; indeed, they secured federal law in 1925 to ensure that decisions issued by private arbitrators in contract disputes would be enforceable in public courts.

For law that secures political legitimacy — law protecting equality in the workplace or the right of free speech, for example — it is of course essential that the rules be produced in publicly accountable settings. But as we've seen, much of the law produced is fundamentally economic in character.

The rules governing contracts between corporations or setting up the relationships between the shareholders and managers of a corporation are examples of fundamentally economic rules. What we want from such rules is not that they be fair and just but that they be efficient, supporting investment, innovation, cost reduction and quality improvements. This is not to say that the rules should be unfair — in many cases, fairness is efficient, because it gives economic actors the confidence to risk an investment or rely on a contract. Nor is it to say that we cannot publicly regulate corporate contracts or governance systems to, for example, protect third parties from fraud or anti-competitive behavior or the exploitation of workers.

But the myriad rules that corporate entities use to protect themselves against loss of investment or control or profits are, in character, really no different from the other bits of economic structure that these parties rely on, such as communications technology or banking services or building management. These rules include such questions as: When does negotiation to set up a joint venture progress from just talking to contractual obligation? To what extent can entrepreneurs or corporate managers take advantage of economic opportunities and not share them with their partners or shareholders? What information must management share with the holders of equity or debt in the company? When is a purchaser entitled to cancel a contract, and how much, if anything, does it owe in compensation to the seller? How should the terms of a license be interpreted to decide whether it has been violated?

It's hard to see why these fundamentally economic rules are best designed by politicians, bureaucrats and judges, as most of them now are.

Many of these rules of business engagement can, at least in theory, be chosen by the people and entities involved through contract. But this is why the control of legal infrastructure is so important: Legal infrastructure sets the backdrop against which any effort to tailor the rules through contract takes place. Let's take a recurrent issue in contracting in the new economy: When does negotiation pass over from just talking to contractual obligation? This question comes up all the time in the new economy because of the velocity, complexity and fluidity of relationships in modern industries. In the stable, well-defined world that most law contemplates, negotiating parties could write an agreement that defines exactly when their discussions should be deemed to have matured into an enforceable contract: when formal documents are executed by the negotiators' boards of directors, for example. That's a nice crisp line.

But it's also one that may not serve negotiators well in the uncertain, rapid-fire and highly competitive world in which they operate. In many cases, drafting lengthy formal agreements will delay contractual obligation long past the point at which one or both parties have to invest significant resources in the venture. But precisely because the environment is complex and fast, some legal protection is needed. So it is very likely, and happens all the time, that the parties will find themselves relying on the background contract law of California or New York or France or Slovakia (they may argue about which one applies) to decide when and if contractual obligations come into existence. And believe me — I teach this stuff — this reliance on general principles is not a pretty sight, once business specifics come into play.

But it's a picture that could easily be improved.

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There is a real role for markets to play in providing legal infrastructure that meets the needs of the new worldwide economy.

What if private companies were allowed to compete to provide the rules and procedures governing business negotiation? Maybe Private Contracting Inc. would come up with a good package: For a

price, PCI will provide a set of rules and adjudicators to decide when and if a contract comes into existence. Its rules, the company advertises, are simple and clear, and adjudication costs never exceed a set price. Perhaps Modern Contracting Services offers a different package. It reaches an agreement with the negotiators up front to have all communications stored in MCS databases, where MCS's patented algorithms — constantly updated based on large-scale data analysis — search for indications that particular commitment thresholds have been crossed, generating specific obligations for one or both parties. New Age Contractors might provide ongoing counseling and mediation services to help negotiators recognize when their level of commitment is growing out of step with the written agreements they have reached. And so on.

If you're like the smart but skeptical audiences I usually talk to about these ideas, you may be itching to ask the economist's \$20 question: If profits really are lying on the sidewalk here, why isn't anyone picking them up? The reason harks back to the restrictions I identified in the markets for legal expertise. Almost any alternative system — particularly in a nascent new industry of private legal production — would have to incorporate elements of existing legal systems. A company that reviews communications, predicts liability based on large-scale data analysis and adapts contractual instruments or informs the parties accordingly is probably engaged in what bar associations would deem "the practice of law." A mediation system that monitors commitments and formal agreements to give advice about legal mismatches almost definitely is. Even an entity that offers a set of clear alternative rules for contracting may well find itself skating close to the edge with bar associations if it is offering this to the public and not just its own members.

As proof of this assertion, we need only look at what has happened with arbitration in America. Arbitration promised lower cost, more expert and more confidential adjudication from private judges than litigation conducted in public courts. While it has achieved greater expertise and confidentiality in many settings, it has not accomplished the goal of reducing cost. Why not? It has been almost impossible to dislodge procedure in arbitration from the forms of procedure that lawyers use in public courts. This is where lawyers' expertise lies and what they know; it's what they advise their clients to adopt. The private judges they seek out and recommend are retired judges from the public courts who are also expert, of course, in conventional procedure and its values. And, if that were not enough, in several states, lawyers have succeeded in establishing bar association rules that deem representation in private arbitration to be the practice of law — something only lawyers are authorized to do.

One consequence of the lock lawyers have exercised over the markets for legal expertise is a tremendous lack of diversity in the training and experience lawyers acquire. All lawyers complete a JD degree, which follows a uniform pattern in almost all law schools. Almost all lawyers work in environments in which their co-workers are also lawyers — meaning there is little opportunity to learn how other types of specialists see and solve problems. But diversity in problem-solving approaches is an essential feature of any robust system of innovation. So one reason lawyers don't invent better systems is that they all think more or less alike. (It is generally with some pride that law schools talk about teaching novitiates how to "think like a lawyer.") And if they do anything that involves the practice of law, lawyers cannot partner with nonlawyers who bring the diversity in problem-solving that they need to be truly creative.

Perhaps even more important, the evolution of innovative rule-production systems like Modern Contracting Services or Private Contracting Inc. is hampered by the rules preventing lawyers from obtaining nonlawyer equity financing. Even those lawyers who do have innovative ideas about how to solve legal problems more effectively and cheaply can't access "friends and family" investments or venture capital to bring their ideas to market. Of course, you don't need venture capital if you are just starting a slightly new form of law firm. For this, traditional bank financing is probably enough.

But the type of innovation we need in law is just as revolutionary as a new social networking platform. For that type of transformation, there is a need for startup capital investments to sustain the potentially long and certainly risky process of working out a business model and building sufficient scale to turn a profit. Legal innovation is choked off because it is isolated from this type of financing.

Overcoming these blockages in innovation in the area of private contracting and corporate governance would carry a secondary benefit: If we started in the easy realm of contracts between corporate entities, we might learn enough to figure out how to get competing private entities to come up with better ways to achieve not just transactional but also regulatory goals.

Market-based regulation is, of course, a hard nut to crack, because the public interest in regulation goes well beyond ensuring efficient transactions. But there are clearly policy options to think through here. Instead of engaging in the nitty-gritty of regulation, what if state and federal legislatures simply set out the criteria for acceptable regulatory regimes? They might set targets for workplace accidents or health and cost outcomes or pricing efficiency. They might serve as a super-regulatory body overseeing the work of multiple approved regulators (as the regulatory scheme for lawyers in the U.K. now prescribes). Might we not benefit from the creation of a profitable industry that rewards creativity in designing regulatory systems for complex and fast-paced environments?

This idea — like the idea that we might lower the barriers to the practice of law — may also seem pie-in-the-sky, but I think it is closer to reality than most people realize. Legal scholars have for a few decades now been studying whether better systems of corporate governance are generated when corporations get to choose their state of incorporation, thus encouraging “regulatory competition” between state legislatures, courts and legal professionals. The problem of integrating international securities markets has other legal scholars ruminating about the potential for portable securities regulation: Instead of requiring all companies with stock traded on U.S. stock exchanges to be regulated under SEC rules, allow them to choose between SEC rules and the regulations provided by other countries that meet minimum standards.

Economist Paul Romer has proposed that one way for poor and developing nations to get out of the trap of bad rules would be to establish “charter cities” where generating and enforcing legal rules conducive to economic growth could be constitutionally delegated to a third-party government with a good track record. Mauritania, for example, might partner with New Zealand and Norway to establish better governance in such a variation on the concept of a special economic zone. The government of Honduras has just adopted the initial constitutional amendments necessary to create the first charter city.

Once we have recognized that one political body might be the source of legal rules for a group of people and businesses in a different jurisdiction — people and businesses that do not have political oversight of the rule-provider — it is a short step to opening up the set of potential rule providers to include private entities like my imaginary Private Contracting Inc. or Modern Contracting Services. Romer’s charter cities, for example, might not only look to foreign governments to provide a stable framework for judicial appeals or administrative action; nonprofit organizations might also be able to fulfill this role.

Such changes in the creation and enforcement of regulations are far from simple and straightforward. Indeed, I generally hesitate to give examples of what more open markets in legal expertise and more market-based production of legal rules might look like, precisely because it is their ability to harness diverse, on-the-ground, invested thinking about complex problems that makes markets valuable in the first place.

Indeed, Mark Chandler’s insight is dead-on. Law is too important to leave to lawyers because legal

policy is in many respects economic policy. Although lawyers are good at lots of things, they aren't particularly good at economic policy. If they were, after all, we'd be happy to have lawyers and courts set wages and prices in the same way we now let them control the legal infrastructure and markets that constrain — and in some cases even kill — our most promising and innovative businesses.

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