

University of Southern California Law

From the Selected Works of Gillian K Hadfield

December, 2006

Don't Forget the Lawyers: Legal Human Capital and The Role of Lawyers in Supporting the Rule of Law

Gillian K Hadfield



Available at: <https://works.bepress.com/ghadfield/18/>

DON'T FORGET THE LAWYERS: THE ROLE OF LAWYERS IN PROMOTING THE
RULE OF LAW IN EMERGING MARKET DEMOCRACIES

Gillian K. Hadfield*

INTRODUCTION

Americans have a paradoxical relationship with the law. At home, we vilify lawyers and the legal system—particularly the tort system—as a landscape of waste, strategizing and dissembling. Yet on the world stage, we trumpet the rule of law and the genius of the American system, and we vigorously promote its adoption in emerging market democracies. From constitutional law to corporate and commercial law, American models have been advocated by the army of American economic and legal experts that have provided assistance to emerging market democracies in developing and post-communist countries.¹ The critiques and kudos

* [Kirtland Professor of Law and Professor of Economics, USC Gould School of Law. Thanks to participants at the 12th Annual Clifford Symposium for helpful comments and especially Stephan Landsman, Marc Galanter and Stephen Burbank.](#)

Formatted: Superscript

¹ See Jacques deLisle, *Lex Americana?: United States Legal Assistance, American Legal Models, and Legal Change in the Post-Communist World and Beyond*, 20 U. PA. J. INT'L ECON. L. 179 (1999). In fact, United States constitutional models appear to have been adopted widely, but corporate laws in many transition countries have followed European, U.K., and U.S. models. Katharina Pistor, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, 1 EUR. BUS. ORGANIZATION L. REV. 59 (2000) (noting, however, the influence of the U.S. Aid efforts and the prevalence of U.S. legal advice, as well as pressures to harmonize with EU laws for accession to the EU); cf. Katharina Pistor et al., *The Evolution of Corporate Law: A*

come from academics as well as practitioners and policymakers.² Professors Kagan and Langbein, for example, decry the cost of the American adversarial system, but an emerging literature attributes higher economic productivity in common-law countries to their legal systems³ and emphasizes the value of American-style procedures such as juries and highly independent judges.⁴

It is tempting to attribute the appearance of a paradox to lawyers themselves: it is American *lawyering* that leads to abuses of the United States system and undermines the rule of law—a rule of law that remains a model for the rest of the world. When Jeffrey Sachs, a leading economic adviser to many governments in transition, said, “Russia doesn’t need economists. It needs lawyers,” a New York lawyer and legal adviser to several Eastern European governments

Formatted: Font: Italic

Cross-Country Comparison, 23 U. PA. J. INT’L ECON. L. 791 (2002) (discussing evolution of corporate law in origin countries and evolution of law after it is transplanted to other countries).

² ROBERT A. KAGAN, *ADVERSARIAL LEGALISM: THE AMERICAN WAY OF LAW* (2001); John H. Langbein, *The German Advantage in Civil Procedure*, 52 U. CHI. L. REV. 823 (1985).

³ See, e.g., Simeon Djankov et al., *The New Comparative Economics*, 31 J. COMP. ECON. 595 (2003); Edward L. Glaeser & Andrei Shleifer, *Legal Origins*, 117 Q.J. ECON. 1193 (2002);

Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); [Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 \(1997\)](#); Rafael La Porta et al., *The New Comparative Economics*, 31 J. COMP. ECON. 595 (2003); Paul G. Mahoney, *The Common Law and Economic Growth: Hayek Might Be Right*, 30 J. LEGAL STUD. 503 (2001).

Deleted: ; Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997)

Deleted: b

⁴ Much of this literature is, however, focused on legal origins and historical explanation, and does not specifically address the details of modern institutions and their relationship to supporting markets and economic growth.

responded that “[t]he mere presence of an army of lawyers representing different and normally opposing interests and clients could not have been what Professor Sachs contemplated.”⁵ Only “at their idealistic best . . . act[ing] as exacting public spirited legislative craftsmen” can lawyers implant the rule of law in fledgling market democracies.⁶ Certainly, blaming lawyers for the problem with law is widespread in the public debate, even among lawyers and judges. Professor Judith Resnik has noted the central role that federal judges have played in criticizing the American legal system and advocating alternatives to its use.⁷

I believe that taking lawyers out of the rule of law equation, however, is a major error. This is not just because lawyers are experts in drafting legislation⁸ and in solving problems in the interest group politics that produce legislation, as Professors Grajzl and Murrell have recently argued.⁹ In my view, the largely exclusive focus of much of the legal reform effort on the content of static legal rules—legislative or otherwise—while perhaps important for transitional purposes, is misplaced. As I argue in recent work, the dynamic properties of a legal system—its capacity to adapt to local and changing conditions—are more important to the vitality of a

⁵ Jenik Radon, *Permitted Unless Prohibited: The Changed Soviet Mentality*, 20 *FORDHAM INT’L L.J.* 365, 365–66 (1996).

⁶ *Id.* at 366.

⁷ Judith Resnik, *Trial as Error, Jurisdiction as Injury: Transforming the Meaning of Article III*, 113 *HARV. L. REV.* 924 (2000).

⁸ Radon, *supra* note 5, at 366.

⁹ See Peter Grajzl & Peter Murrell, *Lawyers and Politicians: The Impact of Organized Legal Professions on Institutional Reforms* (October 2004) (available at http://ideas.repec.org/p/umdu/umdeco/grajzl_murrell_1.html#provider)

Deleted: cf.

market democracy in the long run.¹⁰ As many have observed, but analysts sometimes forget, it is not the law on the books but the law in action that matters.¹¹ Moreover, even those who focus on legal reform through legislation recognize that merely importing statutory provisions from one country to another, particularly from a mature market economy to one still in its infancy, is ill-fated because it fails to take local circumstances into account.¹²

This Article claims that lawyers are essential to the dynamic capacity of a legal system and the rule of law because they are the carriers of “legal human capital”—the raw material on which a legal system draws in the process of interpreting, implementing, and adapting legality to local and changing conditions. In this context, I use legal human capital to mean the shared knowledge accumulated within the legal profession—judges, lawyers, legislators, and law professors—about the real-world impact of legal regulation.¹³ In recent work, I present a model

¹⁰ See Gillian K. Hadfield, *The Quality of Law: Judicial Incentives, Legal Human Capital and the Evolution of Law* (2006), available at <http://works.bepress.com/ghadfield> [hereinafter Hadfield, *Quality of Law*]. For an analysis emphasizing the importance of the dynamic attributes of corporate law, see Pistor et al., *supra* note 1.

¹¹ See, e.g., Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *The Transplant Effect*, 51 AM. J. COMP. L. 163 (2003).

¹² See, e.g., deLisle, *supra* note 1, at 179–80, 256–74.

¹³ There are other types of legal human capital, such as the capacity to apply formal legal reasoning or attain coherence among a set of legal principles. I emphasize knowledge about the economic and social impact of law because this is an important factor in the dynamic adaptation of law to different environments and the capacity of law to effectively promote particular real-world effects.

Deleted: w

Deleted: in Civil Code and Common Law Regimes

of the evolution of law that emphasizes the role of legal human capital in determining the likelihood of legal error—meaning mistakes that reduce social welfare—in the application of general rules to particular circumstances.¹⁴ I examine how the accumulation of legal human capital depends on creating incentives for litigants to invest resources in developing legal arguments that connect their particular experiences to the legal system. These investments accumulate as shared legal human capital in a legal system. Expertise developed by a lawyer while prosecuting or defending an antitrust case or a tort action is initially shared with the lawyer’s colleagues; in time, it is shared with the legal profession as a whole through the publication of legal decisions, scholarly writing, conferences and symposia. Ultimately this shared knowledge enables future lawyers and courts (as well as legislators and legal commentators) to assess the application of antitrust or tort law with greater detail and complexity. This process is reflected in the well-documented increase in the growth of law firms and the increasing specialization in the American legal profession.¹⁵ Increasing returns to human capital predict these effects.¹⁶

Specialization and increasing legal human capital are not necessarily good for the rule of law. Indeed, there is the potential for legal human capital to be “disinformative” and decrease the capacity of a legal system to accurately interpret, implement, and adapt legal rules over time. Disinformative legal human capital is created when litigants mislead courts about the facts or law to obtain favorable results. The extent of this phenomenon is, I believe, an open and

¹⁴ See Hadfield, *Quality of Law*, *supra* note 10.

¹⁵ JOHN P. HEINZ, ET AL., *URBAN LAWYERS: THE NEW SOCIAL STRUCTURE OF THE BAR* (2005).

¹⁶ For a general discussion of the increasing returns to human capital, see Sherwin Rosen, *Specialization and Human Capital*, 1 J. LAB. ECON. 43 (1983).

Deleted: 10

understudied question. Moreover, increasing legal human capital implies increasing legal costs, which undermines the delivery of legality in fact. The problem is not, however, with lawyers themselves, but rather with the structure and regulation of the market for lawyers, including the unconstrained tendency of legal reasoning to generate increasingly complex rules—a topic I explored in earlier work.¹⁷

This Article examines the relationship of lawyers to the rule of law in practice, both in the effort to establish the rule of law in emerging market democracies and in the effort to maintain the rule of law in established market democracies such as our own. I focus on the “market” part of “market democracies,” although I believe the ideas extend also to the “democracy” part. Part II examines the ways in which lawyers function to promote the rule of law and the failure in many legal reform projects to recognize the importance of lawyers to this process. Part III explores the relationships between what lawyers do and the accumulation of legal human capital, as well as between legal human capital and the evolution of effective legal regimes. Part IV discusses the potential disadvantages of lawyers’ efforts and the ways in which existing legal markets in advanced market economies tend to undermine the rule of law.

II. LAWYERS AND THE RULE OF LAW

Those who seek to replace centrally planned, authoritarian regimes with decentralized market economies commonly think of the rule of law as something ordered by the state through rules of conduct enforced by public prosecutors. The model is one of criminal law: law is the public designation of zones of prohibited and permitted behavior. Yet the essence of market economies is decentralization, in which relationships are loosely structured around private

¹⁷ Gillian [K. Hadfield](#), *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 MICH. L. REV. 953 (2000) [[hereinafter Hadfield, Price of Law](#)].

creative efforts to learn, adapt, and respond to a changing environment. The same is true of the legal system and the role of lawyers in a market economy. Lawyers are nodes in the networked arrangements in this decentralized world, connecting individuals to firms, firms to each other, and all to the public and private bodies that recognize, coordinate, and regulate these relationships.

The rule of law means very little apart from the practical world in which law is communicated and implemented in millions of ground-level decisions and interactions. This is true for the rule of law generated both by public law, such as economic regulation, and by private law, such as contract and corporate law. If the law is ignored in the behavioral decisions made by individuals and firms, it has no effect. Investment in public resources for enforcement can address this problem in the public law sphere by forcing compliance through fines and penalties. But in the private sphere, a change in the law of contracts, for example, is a dead letter if contracting parties are not aware of the law or do not rely on it in fashioning their transactions or enforcing obligations. Even in the public law sphere, as a practical matter, it seems impossible to expect public regulation to be effective without substantial private assessment of the bounds of legality and voluntary compliance. Thus, the rule of law cannot be assessed or created without focusing on the work of lawyers in a given environment. The rule of law cannot be established by putting laws on the books, by devoting resources to public enforcement, or even by eliminating corruption—although these are all important steps. To be effective, the rule of law must also be integrated into the complex, decentralized choices made by millions of individuals and entities. And it is here that the contribution provided by lawyers plays a role.

In the most basic sense, lawyers act as repositories of the complex of legal rules and principles relevant to structuring relationships and resolving disputes within them. They

communicate these rules to their clients, advising them about what the legal consequences of a particular organizational form, or contract provision, or business strategy might be. They predict for them the success that customers, suppliers, and governments might have in challenging their conduct or resisting challenges. This is not merely an information transmission function; it can be a deeply creative one. Few legal rules, particularly in transitional or dynamic market environments, are clear cut. Statutory provisions and case law must be interpreted and their implications evaluated in light of both a particular client's circumstances and the accumulated experience of the legal profession and the judiciary as a whole. Alternative strategies—for contract or organizational design, financing, intervention in administrative regulation, dispute resolution and so on—have to be generated, evaluated, communicated to clients, and implemented, all within the framework of legal rules and the likelihood of how they will be invoked or implemented in practice.

But these legal functions—which are, in fact, economic services—depend on far more than knowledge of the rules. They require knowledge of complex environments and relationships—the risks facing a joint venture, for example, or the organizational structure of an employer seeking to reduce the risk of sexual harassment or tort liability. They also require knowledge of the way other lawyers and judges will interpret these relationships and the package of legal materials that might be relevant to the resolution of the dispute. As every experienced law professor knows, the challenge of legal education often involves getting students to realize that it's not just about knowing the rules, it's about becoming a member of legal culture and developing judgment within that culture: assessing what arguments and strategies are possible, which arguments and strategies are strong, and how those assessments depend on the subtleties and vagaries of facts and the possibilities of proof. Students are often very surprised to discover

that people can see a set of facts and read a contract term or a legislative provision very differently. Navigating that world is the work of the lawyer, and much of it is accumulated only through experience, mentoring, and dialogue with other lawyers. What is learned about law is constructed through the shared practice of law.

As a consequence, the rule of law depends on more than a well-schooled legal profession. Generating a rule of law in an environment in which there has not been one, or in which the rule of law has focused more heavily on state regulation and planning than on facilitating decentralized relationships, requires more than didactic education of a collection of people as lawyers. It depends on the ongoing structure of legal work and markets for legal services. If what lawyers learn depends on what lawyers do, the demand for and supply of their services is a factor in the pattern of what is accumulated as legal knowledge. If what lawyers share with other lawyers depends on the organization of legal services, then the regulation of legal organizations by a legislature or by the bar is a factor in the accumulation of legal knowledge.

In Slovakia, following the fall of communism, for example, there were rules—written by the bar and enacted by the legislature—establishing minimum prices for legal services, prohibiting pro bono services except in extraordinary circumstances, and forbidding the employment of one lawyer by another, which effectively limited the size of law firms and the capacity of junior lawyers to work with senior lawyers.¹⁸ Organizational rules such as these have an impact on the rule of law through their impact on the price and distribution of legal services

¹⁸ I visited Slovakia during 2003 and 2004 on a project for the World Bank to assess the nature of the organization and regulation of the legal profession. My observations in this Part are based on my review of Slovak law and interviews with lawyers, judges, and officials in the [Ministry of Justice](#).

and the capacity of the legal profession to transmit accumulated experience and to develop specialized expertise. If lawyers cannot employ other lawyers, law firms can grow only through the addition of more partners, rather than through the addition of associates who perform legal work not directly for a client, but for a partner. The latter organization allows a partner with an established reputation and a network of clients and potential clients to expand the scale of that partner's work.¹⁹ This can reduce the cost of legal services to clients by increasing the information available about potential legal representation—choosing among a smaller set of established partners with track records poses lower search costs than choosing among a wider set of lawyers with varying levels of experience. It also allows the experienced partner to share that experience with, and offer the opportunity for generating experience for, entering lawyers. Larger law firms also support increased specialization, reaping the benefits of increasing returns to investments in human capital. For law firms serving the emerging business entities in a new market democracy, for example, this can mean critical investments in the high cost of understanding and working with new laws on incorporation, property transactions, bankruptcy, contract enforcement, state regulation, and so on.

Consider one of the classic rule of law problems in transition and developing market economies: one likely at the forefront of the experience that led Jeffrey Sachs to say that Russia didn't need more economists, it needed more lawyers: the enforcement of contractual bargains. Collecting on promised payments is a fundamental problem for most businesses in new market

¹⁹ See *generally* MARC GALANTER & THOMAS PALAY, *TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM* (1991); Ronald J. Gilson & Robert H. Mnookin, *Coming of Age in a Corporate Law Firm: The Economics of Associate Career Patterns*, 41 *STAN. L. REV.* 567 (1989).

economies. In an important sense, of course, the problem is about money—or the lack thereof. But it is also a problem of law, as emphasized in research done by Professors Johnson, McMillan, and Woodruff on contracting in transition economies in Central Europe and Vietnam.²⁰ Their work identified a significant relationship between the willingness of businesses to extend trade credit and the perceived enforceability of contracts. Like other work on the role of the legal system in supporting contractual commitments, however, this research does not identify the particular legal attributes that undermine enforcement.²¹ The problem with the law

²⁰ [Simon Johnson, John McMillan & Christopher Woodruff, *Courts and Relational Contracts*, 18 J.L. ECON. & ORG. 221 \(2002\)](#); [John McMillan & Christopher Woodruff, *Dispute Prevention Without Courts in Vietnam*, 15 J.L. ECON. & ORG. 637 \(1999\)](#); [John McMillan & Christopher Woodruff, *Interfirm Relationships and Informal Credit in Vietnam*, 114 Q.J. ECON. 1285 \(1999\)](#); [John McMillan & Christopher Woodruff, *Private Order Under Dysfunctional Public Order*, 98 MICH. L. REV. 2421 \(2000\)](#).

²¹ See Johnson, McMillan & Woodruff, *supra* note 20, [app. C. at 273](#), (asking respondents to identify “which of the following third parties can enforce an agreement with a customer or supplier” and listing as possible responses: court, national government, local government, nongovernmental organizations, other and “no one”). There are two problems with this question. First, it could be interpreted [as asking](#) about the theoretical capacity of these institutions to enforce contracts; second, it does not identify the nature of the problem with enforcement by courts. [For a discussion on](#) the multiple ways in which contract enforcement might fail in a legal regime, [see](#) Gillian K. Hadfield, *The Many Legal Institutions that Support Contractual Commitments*, in HANDBOOK OF NEW INSTITUTIONAL ECONOMICS [175](#) (Claude Menard & Mary M. Shirley eds., 2005).

- Deleted: .
- Deleted: .
- Deleted: 549,
- Deleted: .
- Deleted: .
- Deleted: .
- Deleted: 1085,
- Deleted: .
- Deleted: .
- Deleted: 2421,
- Deleted: ; S. Johnson, J. McMillan & C. Woodruff, *Courts and Relational Contracts*, 18 J.L.,ECON. & ORG. 221 (2002).
- Deleted: 22
- Deleted: -
- Deleted: to ask
- Deleted: or abstract
- Deleted: I discuss
- Deleted: in

might be a lack of judicial reliability and, in particular, the problem of judicial corruption that is thought to plague new market economies. From a pure “law” perspective it seems a very simple matter of what the law should be: if you promised payment for the goods or services received, you have to pay. And yet the capacity of a system to generate performance of these contracts—to implement the rule of law in contractual relationships—is also deeply related to the structure of the markets for legal services and the conduct of lawyers. Even with honest judges, it takes access to lawyers—lawyers with skill and ingenuity—to reduce the risks of contracting and hence extend the reach of market relationships.

Legal expertise and experience can allow lawyers to craft more complex contractual relationships, ones that sequence performance and payment to reduce risk, for example. They also allow lawyers to design payment vehicles, such as escrow accounts or securitization, with lower joint costs than the reliance on complete collateralization that is often seen in new market economies. Legal creativity can result in innovations such as the design of private contract enforcement mechanisms, as we have seen in trade associations²² or internet²³ or transborder²⁴

²² Lisa Bernstein, *Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992); Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001).

²³ Gillian K. Hadfield, *Delivering Legality on the Internet: Developing Principles for the Private Provision of Commercial Law*, 6 AM. L. & ECON. REV. 154 (2004).

²⁴ Doreen McBarnet, *Transnational transactions: legal work, cross-border commerce and global regulation*, in Michael Likosky (ed.) *TRANSNATIONAL LEGAL PROCESSES: GLOBALISATION AND POWER DISPARITIES* (2002).

Formatted: Line spacing: Double

Formatted: Font: 12 pt

Formatted: Font: Italic

Formatted: Small caps

transactions in established market economies. Knowledge of the complex interrelationship between legal rules, legal arguments, and evidentiary resources can be employed to make better predictions about which obligations can be enforced and at what cost, in light of the possibility that even honest judges will misunderstand the transaction and how to apply the rules to a particular transaction. Legal expertise can even assist in the reduction of corruption; lawyers can evaluate the likelihood that a judicial decision can be explained as a good-faith application of the appropriate legal principles to the established facts. At a minimum, the lawyers exchanging information about judges can reduce the cost of navigating the legal system and direct more cases to reliable judges, sorting the good from the bad and perhaps even modifying judges' incentives.

The capacity of lawyers to provide input to the ultimate enforcement of contractual bargains is a function of accumulated legal human capital in a system. The determinants of legal human capital are numerous and subtle. Legal human capital is costly to acquire and so those who might use legal services need incentives to expend resources on the production of legal human capital. Specialization has to be valuable, legal creativity has to be valuable, and the prediction of legal outcomes has to be valuable. As I will explore in more detail in the next Part, there is an important equilibrium relationship between the value of legal human capital to litigants and transacting parties and the level of legal human capital deployed by the courts that resolve disputes and interpret transactions. Promoting the rule of law through lawyers requires that we understand the relationship between lawyers, litigants, courts, and legal human capital.

The work of lawyers is important to the rule of law for reasons that go beyond the value of their services in a given transaction or adjudication. The first mistake of many legal reform efforts is to focus only on the content of rules and not the implementation of those rules; the

second is to assume that the achievement of the rule of law is a static problem of identifying *the* rules that a market economy should seek to implement. Far more important, I believe, is the dynamic capacity of a market economy to interpret, apply, and adapt rules in light of local and changing conditions. The rule of law is not effective in a decentralized system if courts apply rules in such an erroneous or inappropriate manner that individuals and firms either avoid the law or find it useless to plan their relationships or resolve their private disputes in light of the rules. A private-law rule that is transplanted from a very different environment or that does not keep up with the pace of change in an economy may be as ineffective as one that is never communicated to those whose behavior it seeks to organize. Widespread disregard of public laws—enforced by public prosecutors—also undermines the rule of law in a society: the resources available for enforcement are scarce and the creation of a rule of law requires substantial voluntary compliance. Moreover, widespread disregard of the law may alter the capacity for enforcement by throwing into question culpability for a violation. Thus, the extent to which a rule is reasonably well adapted to local or changing conditions is important for the establishment of the rule of law in the long run.

Lawyers play a critical part in this dynamic aspect of the rule of law. Indeed, the vitality of the legal profession may be more important for the long-term achievement of the rule of law than it is for the static implementation of a given set of rules for a particular set of clients. The legal profession as a whole—including not only lawyers in private practice but also judges, hearing officers, legal scholars, and those employed by the executive and legislative branches—defines the industry in which the costly creative and analytical work of interpreting, applying, adapting, and designing legal rules takes place. It is the factory in which the rule of law is built.

The value of the product created is short-lived if it does not continue to adapt to changing costs, demand, and competition.

Much of the value of the product of law in a dynamic sense depends on the accumulation and distribution of legal human capital. Legal human capital consists of what the profession and its various constituent parts know about law and the environment in which law is being implemented. Developing an effective antitrust law, for example, depends on the extent to which lawyers, judges, and legal scholars develop expertise about the competitive environments in specific industries, the likely responses of firms to bright-line rules as opposed to standards, and the impact of injunctive remedies on consumers. When a government sues Microsoft, for example, alleging an illegal tying arrangement between the operating system and a browser or media player, the legal profession requires expertise about network externalities, technology, the likely impact of compulsory licensing, and the effect of erosion of patent rights on the incentive to innovate in this specific industry, in order to resolve cases in a way that generates effective rules for competition. If the expertise is not generated within the profession—if there are no lawyers who have accumulated experience with cases like this, if judges are either not adept at understanding the issues at stake or poorly educated by litigants who lack an incentive to present expertise to the court, if legal commentators have little information about what evidence has been presented in past cases and what arguments and reasons have been used by courts—then the rules that emerge are either so unpredictable as to lose their identity as rules or so wrongheaded from a practical perspective that they will be routinely ignored. In either case, a legal system that does not generate a reasonable level of expertise in the interpretation, application, and adaptation of rules over time does not generate an effective rule of law.

The dynamic ability of a legal regime to generate legal human capital to improve the quality of law is, therefore, an important consideration in our discussions about the rule of law. Moreover, as I will explore in more detail in Part IV, it is possible that the returns to legal human capital are at some point negative. While some level of expertise is important to ensure that legal rules are applied and interpreted with nuance and refinement, sensitive to specific characteristics of a local or evolving environment, too much expertise may generate excessive costs and even introduce excessive uncertainty. There too the rule of law may disappear, lost in hundred-page opinions, enormous evidentiary records, expert testimony that requires an advanced degree to interpret, and litigation that takes millions of dollars and several years of appeals to resolve. Before reaching this discussion, however, I turn to the basic analysis of the incentives for lawyers that are broadly understood to generate legal human capital.

III. THE ACCUMULATION OF LEGAL HUMAN CAPITAL, LEGAL ERROR, AND THE EVOLUTION OF LAW

I want to consider here the way in which legal human capital accumulates within the legal system. It is shared legal human capital, I argue, that has an impact on the dynamic quality of law and on the capacity of a legal regime to engender and maintain the rule of law. Implicit in the concept of accumulated legal human capital is the idea that much of what is learned in a legal system is accumulated through learning-by-doing. Practical experience comes from observing the impact of particular rules in particular settings, discussing strategies and constraints with clients, being educated about an industry on behalf of a litigant seeking to enforce or avoid legal liability, and consulting experts who are paid to look at data, interview people, or construct models. It is not the kind of learning that comes from abstract analysis; it is inductive, not deductive, although deduction will play a role in weaving what is learned into the web of legal concepts.

The importance of this kind of learning is evidenced by the tremendous returns to experience and specialization that we see in the legal profession. The work of the transactional lawyer, for example, is infused with reference to other similar transactions that this particular lawyer, or the lawyer’s firm, has put together in the past. Indeed, law firms collect these models and organize them as contracting precedents, available in a database to which their members contribute and draw. In adjudication, the experienced lawyer is highly prized; a lawyer with experience with this particular cause of action, in this industry, in this jurisdiction, before this judge, is prized even more. In the common-law system, which is the major focus of my discussion here,²⁵ the structure of legality itself is based on the idea that it is only by looking at what is learned in fact-specific opinions from earlier cases that a judge or lawyer can come to know what the rules are. The constitutional requirement of a case or controversy as the basis of a court’s jurisdiction speaks to the fundamental importance of what can be known only by learning from real events and disputes. The same is true of rules of appellate review, which defer to the capacity of the trial judge who is immersed in the full factual record as it develops and thus really “knows” the case. The common requirement that judges have experience as practitioners prior to ascending to the bench is rooted in the belief that the capacity to judge the law can be acquired only by doing the law.

Thus our conception of law is a fundamentally organic one. We have to look at the process by which legal human capital grows in a distributed way, based on what lawyers do and so what they can learn, and how what they learn is disseminated to others. This is a largely unstudied topic, one that provides a rich agenda for research among those interested in the

²⁵ I ~~have~~ previously explored the question of how legal human capital accumulates in civil code jurisdictions. See Hadfield, *Quality of Law*, *supra* note 10.

Deleted: have

Deleted: Error! Bookmark not defined.10

productivity of a legal system and its capacity to generate both high quality and effective legal rules. I will confine myself here to discussing the results from my other work in an effort to model this process.²⁶ This simplified analysis allows us to look at particular pieces of this puzzle and should not be misunderstood to be a complete account of learning-by-doing within the legal profession.

Imagine a simple world in which there is a legal rule that requires attention to only a few criteria. For example, suppose there is a per se antitrust rule against vertical restraints by which a manufacturer imposes controls over the territory in which a retailer may resell its products. Lawyers arguing a case under this rule for either the plaintiff or the defendant develop the evidence relevant to the rule—whether the manufacturer has in fact imposed control over the territory. They develop expertise in identifying the ways in which such control might be exercised (overt contractual provisions, implied obligations, practices of terminating retailers who do not follow “suggested” territorial divisions) and in arguing about whether the rule, properly interpreted, covers those particular facts. In this setting, legal human capital refers to the product of the investment of time and resources that these lawyers, and then the judge or judges who decide the case, invest in learning about the facts of a particular case and developing and evaluating creative legal arguments. Those case-specific investments in legal human capital then contribute to the accumulation of shared legal human capital within the profession through a number of avenues: mentoring, peer discussions, and documents retained within the law firm that represented the clients involved, conferences, bar meetings and informal networking among attorneys and judges, legal journals, casebooks, treatises, publicly available opinions, and briefs and case files. The greater the investments made by individual lawyers, judges, and legal experts

²⁶ *See id.*

Deleted: /

in a case, the greater the potential accumulation of shared legal human capital within the profession.

Note that as experience with the rule accumulates, at least initially, the likelihood of legal error and unpredictability in the application of the rule decreases.²⁷ It may be hard, at first, to determine whether anything other than an overt contractual provision establishing the territory in which a retailer may sell the manufacturer's goods falls within the ambit of the rule. Experience with less overt forms of control, and the impact of such controls on the capacity of retailers to compete within the same territory, gradually fills in and leads to more predictability over a wider range of cases. Judges with access to the analysis generated in other fact-specific cases become more adept at seeing the flaws and virtues in different legal arguments and different factual settings. This rule becomes more effective as those subject to it are able to plan their relationships and design their contracts in reliance on the rule and choose voluntarily to comply with the rule given better predictions about the likely outcome of litigation challenging it. Accumulated experience assists the transactional lawyer, who must advise a retailer whether it can resist a territorial restriction demanded by a manufacturer (with the credible assertion that the provision would not be enforceable) or to assess the risks associated with breaching such a provision.

The accumulation and sharing of legal human capital in this context assists in the improvement of the rule of law in a static sense: getting the rule right over time. This is important for the rule of law, but it does not yet capture the dynamic quality of the rule of law that I emphasized in Part II. To see that dynamic quality, imagine that into this simple world we

²⁷ See *infra* Part IV, (considering the possibility that initially, error may increase).

Deleted: notes

Deleted: 31-38

Deleted: , in Part IV,

introduce a new type of product—such as a television²⁸— that requires considerable investment by a retailer in showroom space and knowledgeable salespeople. Perhaps in the original environment there is high quality information about or experience with the product readily available to consumers, whereas consumers in the new environment are unfamiliar with the product or have more restricted access to information as a result of literacy or other constraints. Manufacturers of the product in this new world are frustrated by the rule against territorial restrictions; they have difficulty convincing retailers to invest in adequate showroom facilities and employees because they lose sales to customers who browse and research in their store but then cross the street or go online to buy from a seller with low overhead who can undercut them on price.

28 Although it seems anachronistic in 2006 to appeal to a television as a novel product, the reference here is to *Continental T.V. Inc., v GTE Sylvania Inc.* 433 U.S. 36 (1977) in which the Supreme Court rejected the per se rule against vertical territorial restrictions in favor a rule of reason that would allow consideration of economic benefits from such a restriction. The decision was explicitly informed by legal human capital about how markets for products “unknown to the consumer” might most efficiently be marketed: “Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. See, e. g., Preston, Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards, 30 Law & Contemp.Prob. 506, 511 (1965). For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer.” 433 U.S. at 55.

The rule of law will likely be undermined, in such a setting. Manufacturers will look to avoid compliance with the law. They may find legal ways to do this, such as vertically integrating into retailing and thus internalizing the free-rider problem that plagues the independent retailer, even if this is inefficient. They may devise arrangements that substantially increase the cost of discovering and proving the violation, such as complicated incentive schemes that have the same effect as territorial restrictions and reduce the capacity of public officials to enforce the law.

If territorial restrictions become widespread, public officials may simply stop enforcing the law. Contracts between manufacturers and retailers may, if the problem is sufficiently severe, be withdrawn from public enforcement into private enforcement through arbitration by industry insiders who understand that territorial restrictions are essential. Manufacturers may seek waivers of the antitrust defense from retailers, allowing them to enforce the territorial restrictions. Thus, the law in action will diverge from the law on the books. This is the experience that many transition and developing economies have had with the importation of legal rules from advanced economies: the rules look good on paper, but because they are not responsive to the new environment, they are ignored, circumvented, and ultimately rendered ineffective.

In this setting, establishing or maintaining the rule of law depends on the capacity of the system to adapt effectively to the new circumstances, whether a new technology or a different country. The capacity of the system to adapt effectively depends on legal human capital: what legal actors know and are able to learn about the “new” product and the problem of free-riding among retailers. How might this knowledge and expertise accumulate? In the common-law system, it accumulates largely through litigation. Manufacturers seeking to enforce their

territorial restrictions or avoid antitrust penalties have an incentive to hire lawyers and legal experts capable of presenting evidence to the court about the impact of the per se rule on the capacity of manufacturers to sell their product and on their organizational decisions. They have an incentive to pay their lawyers to develop creative arguments about the use of per se rules as a regulatory technique, to offer alternative interpretations of the governing law and to generate alternative rules that a court might adopt. These are investments in case-specific legal human capital which, as we have seen, can eventually accumulate as shared legal human capital through the system.

Manufacturers will face these incentives assuming that three other conditions are also met: (1) the cost of these investments—the price of legal and expert services—does not exceed the damages they face or the cost of adopting alternatives to territorial restrictions; (2) the judge they face will be receptive to hearing this evidence and argument; and (3) the investments are expected to pay off because there is a reasonable likelihood that the judge will understand the evidence and arguments presented and “get it right.”

Conditions (2) and (3) also depend on the level of shared legal human capital in a legal system. In particular, they depend on the shared legal human capital available to the *judge* and the likelihood that a given judge is able to interpret possibly complex evidence and arguments accurately. I refer to this as the risk of judicial error, not in the narrow sense of “reversible on appeal,” but in the more general sense of diverging from an accurate reading of the facts and failing to understand that modifying or refining the rule is desirable from society’s point of view. Judges are more likely to read facts and understand arguments accurately if they have a broader base of accumulated legal human capital on which to draw. The greater the likelihood of judicial error—the smaller the stock of legal human capital on which the judge may draw—the smaller

the likelihood that a judge will be willing to risk departing from the simple, well-articulated, and established per se rule, and thus the smaller the expected payoff for the manufacturer's investment in presenting evidence and argument in a given case.

The mechanisms of investment and distribution in legal human capital thus set up an important feedback loop between the incentives of litigants to expend resources on lawyers (and hence for lawyers to specialize and share their expertise with associates) and the incentives of judges to adapt the law over time to new and changing circumstances. Litigants have no incentive to invest in the case-specific investments that ultimately accumulate as shared legal human capital if judges are unwilling to risk novel evidentiary presentations and legal arguments. But judges may be unwilling to take these risks if these investments have not, in the past, been made and shared so as to reduce the likelihood of judicial error. Moreover, litigants have no incentive to invest in case-specific investments if even those judges willing to make mistakes make too many of them,²⁹ and these judges never gain access to a body of legal human capital that may help protect against mistakes.

Thus, the capacity of a legal system to adapt to new or changing circumstances is both a dynamic and an equilibrium phenomenon. Clearly, if all judges simply refuse to depart from a strict application of the per se rule, perhaps because they see it as a violation of their role as a judge or because they expect that they will be identified as an "activist" judge and never

²⁹ As I will discuss in Part IV, this statement is not exactly correct: it assumes that "litigants" are all "good" in the sense of the example I am exploring here, that is, manufacturers that wish to correctly claim that society would be better off if their territorial restrictions were allowed and enforced.

promoted to a higher court,³⁰ the law will not adapt. But even if some judges are willing, in the absence of error, to entertain evidence and argument about modification of the rule, if legal human capital is low, the system as a whole may never move towards adaptation and reduced legal error because the disincentive of litigants to invest is in equilibrium with the judicial incentive to play it safe and stick with existing rules. As a result, the rule of law itself is a dynamic and equilibrium phenomenon, one in which the work of lawyers and the legal profession plays a central role.

IV. THE PRICE OF LAW: COST, ERROR, AND COMPLEXITY

If lawyers play an important role in making the rule of law effective through the services they provide, the price of lawyers obviously plays a role too. If lawyers are too expensive, relationships will be designed and disputes resolved without reference to the law, and legal human capital never accumulates. This is both a short-term loss to particular relationships and transactions and a long-term loss to the system and the rule of law as a whole. For this reason, the cost of legal services should be a factor in our assessment of the rule of law.

The cost of legal services in advanced market economies, such as those in the United States, is an increasingly critical reason why some perceive the rule of law to be waning. Particularly among individuals, as opposed to businesses, access to lawyers for anything beyond routine legal services (such as drafting wills) is increasingly remote. Implicitly, many relationships are structured and disputes resolved outside of the law. Some of this extralegal relational work and dispute resolution is desirable and welcome. For example, when employers and employees can find mutually satisfying relationships, when divorcing parents can agree

³⁰ For a discussion of the complex issue of judicial incentives, see Hadfield, *Quality of Law*,
| *supra* note_10.

amicably on the division of property and the custody of their children, when businesses can productively and efficiently resolve their payment disputes with their suppliers, when consumers can rely on the discipline of reputation and “no questions asked” return guarantees for the products they buy, and when those injured in automobile accidents can quickly collect insurance payments to fully cover their medical expenses and income losses, then the demand for legal services is low and the rule of law fades in importance as order and fairness are generated by norms, markets, reputations, and goodwill. But when such disputes or relationships are not resolved in socially desirable ways, but rather in ways that conflict with the goals that motivate law in the first place—the reduction of transaction costs, the achievement of efficiency, the redistribution of power, the protection of children or poorly informed consumers, the compensation of the injured—then the affordability of legal services is a *sine qua non* for an effective rule of law.

This provides a second reason to focus on the accumulation of legal human capital and the evolution of law as factors in the effective implementation and maintenance of a rule of law in both new and established market democracies. The price of legal services, as determined by a market for lawyers in a market democracy, increases as legal human capital accumulates, specialization becomes more extensive, and law becomes more complex as it adapts more.³¹ A lawyer who wishes to perform more sophisticated legal analysis has to make more costly investments in education and experience to become competent and thus the returns to legal practice must be high. Indeed, as the increasing specialization of American legal practice attests, sophisticated legal analysis may require giving up the effort to stay abreast of multiple fields of law in order to maintain competency as a lawyer in certain markets. As legal human capital

³¹ See Hadfield, *Price of Law*, *supra* note 17.

accumulates, a lawyer seeking to analyze the law in any given setting has to devote increased amounts of time and research in order to provide competent advice and strategies and compete with other lawyers for those opportunities.

Complexity is also costly because it affects competition in the market for lawyers.³²

First, the more specialized a legal market becomes, the more likely it is that an individual lawyer or law firm has market power in the sense that others are not able to offer a substitute performance. For example, in some complex matters, the stakes are so high and the issues so unique that hiring the one or two lawyers or firms who have extensive experience in that area is significantly more valuable than taking the next-best alternative. That lawyer or firm can command a premium.³³

Second, the more complex the law becomes, the harder it is for clients to assess the quality of the service provided, and for the lawyers involved to assess whether investing additional time in a case will make a difference in the outcome. Complex law is a “credence good,” one the quality of which is hard to assess, even after the good is “consumed.” Markets do not work well in the face of such information constraints because it is difficult for suppliers to compete on price or quality and for consumers to direct their purchases accurately on the basis of a price/quality tradeoff. Complexity is costly because it contributes to the failure of competitive markets for legal services. A legal system in which complexity continues to grow is thus one in

³² *See id.* (discussing several reasons)

³³ In economics, this is known as monopolistic competition and it exists to varying extents in markets in which there are unique attributes associated with a good, such as physical location, brand name, or consumer experience.

which access to legal services becomes constrained and distorted, away from low-dollar matters to high-dollar matters.³⁴ This creates a constrained and distorted rule of law.

Complexity and the accumulation of legal human capital may diminish the rule of law not only through their impact on the price of lawyers but also through their impact on the predictability of legal results and the likelihood of legal error. The effect of unpredictability is relatively well known. Some level of unpredictability may increase the impact of law on contracting relationships and deterrence³⁵ and expand the body of information available to a court that is adapting rules.³⁶ However, if unpredictability grows too great, the rule of law breaks down as people and organizations are unwilling to use the law to structure relationships or disputes and increasingly ignore the law, due to the inability to pattern their activity in a rational way to avoid penalties or gain benefits. This is a key reason why corruption in a legal regime is so costly: it not only distorts particular outcomes, it makes law unreliable and less valuable as a basis for planning conduct and relationships and resolving disputes.

The effect of complexity and the accumulation of legal human capital on legal error is not as well understood. In Part III, I assumed that increasing amounts of legal human capital can

³⁴ See Hadfield, *Price of Law*, *supra* note 17, (discussing the distortion away from legal matters involving the interests of individuals to those involving the interests of organizations, such as corporations, wielding aggregate wealth).

Deleted: 31

³⁵ See Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J.L. ECON. & ORG. 279 (1986); Gillian K. Hadfield, *Judicial Competence and the Interpretation of Incomplete Contracts*, 23 J. LEGAL STUD. 159 (1994); Gillian K. Hadfield, *Weighing the Value of Vagueness: An Economic Perspective on Precision in the Law*, 82 CAL. L. REV. 541 (1994).

Deleted: , e.g.,

Deleted: ,

³⁶ Gillian K. Hadfield, *Bias in the Evolution of Legal Rules*, 80 GEO. L.J. 583, 610–11 (1992).

Deleted:

Deleted: REV

reduce legal error because it allows judges to more accurately distinguish between cases and adapt legal rules to changing and local conditions. Greater legal human capital in the form of experience with and expertise about vertical territorial restrictions, for example, allows courts to more accurately implement antitrust law in a way that is productively tailored to the differences between markets in which territorial restraints merely constrain competition and those in which they overcome an important market failure. But we can also imagine that the experience and expertise that accumulates as legal human capital may also degrade the capacity of courts to accurately implement and adapt legal rules. Not all of the evidence and argument presented to courts in the context of litigation is designed to increase judicial accuracy; indeed, the goal of half of those who appear before courts (call them “bad” litigants) is, knowingly or not, to encourage a court to make a mistake. Whether bad litigants also contribute to shared legal human capital is an open question of epistemology—or, as Robert Proctor has framed it, agnotology (the study of the cultural production of doubt).³⁷ Even if distortionary evidence or argument leads a particular court into error, does the legal profession as a whole become more able to distinguish good from bad evidence and argument when it can look at a collection of cases or other materials that includes those presented by good and those by bad litigants? Can we tell what is right about an argument only when we have also heard efforts to employ it incorrectly? Can we decide what it is about a particular market that merits different treatment under the antitrust laws only when we have reviewed efforts to analogize that market to ones that do not merit differential treatment? If so, then accumulating legal human capital, whatever its

³⁷ ROBERT N. PROCTOR, CANCER WARS: HOW POLITICS SHAPES WHAT WE KNOW AND DON'T KNOW ABOUT CANCER 8 n.* (1995).

Deleted: 2000

provenance, is good from the point of view of reducing legal error and hence improving the rule of law over time.

But if bad litigants distort legal decisionmaking, the efforts of individual lawyers to devise legal strategies for clients that exploit legal errors may increase the rate of those errors over time, undermining the rule of law. Suppose, for example, that as the body of evidence, expert testimony, and legal argument from manufacturers who do not actually face downstream free-rider problems, trying to get courts to relieve them from strict per se application of the antitrust law prohibiting vertical restraints grows, courts become more confused about vertical restraints, free-rider problems, and the market for television sets. Over time, legal errors in these cases may go up, and error-filled rules may become more frequent. Even without deliberate efforts to mislead courts, the sheer accumulation of case-specific evidence and argument could decrease the capacity of courts to accurately sort the wheat from the chaff. Thus both the composition (provenance) and quantum of accumulated legal human capital is a potential problem for the rule of law. One of the reasons to be concerned about the problems Professor Marc Galanter identified long ago as the imbalances between the “haves” and the “have-nots”³⁸ is because of the risk that given the potential for legal outcomes to be determined by resources and not reason, over time, the rule of law is undermined by a body of experience and expertise that gets it wrong.

IV. CONCLUSION

Lawyers and their efforts play a critical role in the generation and maintenance of the rule of law. In part, lawyers communicate legal rules to individuals and organizations and represent

³⁸ Marc Galanter, “*Why the Haves Come out Ahead: Speculations on the Limits of Legal Change*,” 9 *LAW & SOC’Y REV.* 95 (1974).

Deleted: 0

Deleted: .

their interests in planning and adjudication against the backdrop of legal rules. Even these static and straightforward roles are sometimes overlooked in legal reform efforts, both in advanced and emerging market democracies. The far more fundamental role that lawyers play in promoting a rule of law is found in the dynamic and subtle relationships between what lawyers do, the legal human capital that accumulates in a legal regime over time, and the way legal rules adapt to local and changing conditions. It is an error—one lawyers themselves make—to characterize what lawyers do solely in terms of their advocacy of particular interests in a zero-sum setting.

Lawyers do indeed work within a strategic setting, and these strategic concerns must be taken into account in evaluating the role of lawyers in the rule of law. From an economist's perspective, the problem is not, however, whether lawyers play an important role, but rather what their optimal role is. What is the optimal level of complexity in a legal regime in light of both the benefits and the costs of legal specialization and the accumulation of both good and bad legal human capital? Lawyers become immersed in the complexities of the interactions of rules, choices, circumstances, goals, perceptions, and costs. Their professional expertise is the capacity to take those complexities and relate them to statutes, cases, and legal principles, and not merely to draft legislation that puts the rule of law on the books. The complex details of the structure of decentralized decisionmaking in a market economy are the raw materials that inform the development of a vital and effective rule of law over time, which lives up to the promise of shaping and channeling private and public behavior in ways that a democratic society deems desirable. The legal profession is a crucial component of that process in both new and advanced market democracies, and promoting the rule of law in both settings requires careful attention to the cost, organization, incentives, norms, and evolution of the lawyers' work.

