THE EFFECT OF LEGAL INSTITUTIONS UPON ECONOMICS[1]

Among the major trends of the social sciences today is the urge toward integration of their various branches.[2] Lawyers, in particular, have been turning to economics for light on the nature and function of law. They need to. Economists are turning to law for light on the facts and theory of economics.

The first results of this bridge-building seem contradictory. The foremost jurists are preaching something akin to economic determinism in the law. Against this we find Professor Commons, in his *Legal Foundations of Capitalism*, stressing the determining part which law plays in economic life—so much so, that he would introduce into economic theory, as a vital factor in every unit transaction, the law official who makes and enforces the rules under which the transaction is concluded.

This contradiction, like most, proves only one of emphasis. The jurist is protesting against the dogma of his fathers that law is unchanging, eternal, discoverable always by deduction. Only recently has he come to see it as a thing in flux, and made discovery of non-legal factors which condition its growth and action. Whereas the economist takes that for granted. Law exists. If it serves economic life well, he has ignored it; if ill, he has pithily cursed it and its devotees, without too great effort to understand the reason of disservice. When, then, an economist—like Professor Commons—spends half a life-time wrestling with the law, it comes as a shock to find law not only an obstruction, but a tool; not only a brake, but a lubricant; not only conditioned by, but itself conditioning economic life. The spheres of mutual influence seem not wholly the same. Basic economic changes shift the general character of legal rules and institutions; the property system depends on the stages of the food quest.[3] The effects of law on economics, though powerful and pervasive, are doubtless less fundamental. The facts are time-worn. Yet inquiry into the obvious is still a fruitful labor in social science.

[1]Paper read at the Thirty-seventh Annual Meeting of the AMERICAN ECONOMIC ASSOCIATION, held in Chicago, December 30, 1924. The present paper makes little claim to originality in its details. Much of the synthesis, too, has been indicated by various writers from time to time. The writer is particularly conscious of indebtedness to Sumner, Holmes, Veblen, Commons, and Pound; but the borrowings are legion and often unconscious.

[2]See especially the preface to *Social Theory of Georg Simmel*, by Nicholas J. Spykman; and the recent work of H. E. Barnes and E. C. Hayes.

[3]Although "economic" determinism here, too, must be taken with a grain or two of salt; political and other conditions have powerful, and it may be not wholly derivative, effects, as well.

This paper makes no attempt to cut into current issues—rate regulation, tax exempts, or minimum wage; the monograph is already the order of the day. The more reason, here, to look rather at legal institutions in the large, with an eye to their function and their trend.

I offer, then, no apology in propounding as the outstanding fact regarding legal institutions—the fact which conditions every other—that law operates under the principle of scarcity.[4] The energy available for social regulation at any given time and place is limited.[5] The community must eat, sleep and reproduce; it cannot use up all its energy on government. Because of this fact, control by law takes on the aspect of engineering. We require to study the behavior of the subject-matter of control, men in groups; and to invent such machinery as, with least waste, least cost, and least unwanted by-product, will give most nearly the result desired. This problem of legal engineering and administration runs throughout the present paper. That problem assumes the end; it deals only with the means.[6]

Also, and at least partly because of this same principle of scarcity, control by law takes on a second aspect, that of economy: how to apportion the available energy. To accomplish one policy means to sacrifice another. It is clear that this policy-shaping depends itself, in part, upon engineering; for the virtue of a policy depends, among other things, on its cost. For the rest, that virtue depends on other and non-legal factors commonly thought of as ethical. They are hardly in place here.

The laws of engineering fix the limits within which any control by law can operate. A rule must not run counter to the ways of the community at large. But difficulties arise where even a relatively small number of interested persons obstruct enforcement. The Volstead act or child labor laws afford instances. The regulation of public utility rates, contrasted with the attempts to fix commodity prices during the war, is peculiarly instructive. It may be suggested that the variant results depended in large part upon the ease with which the energy available for enforcement could be applied. Where demand is stable and localized; where the market is either local, or subject to

[4]Commons, "Law and Economics," 34 *Yale Law Journal*, 371. But his emphasis is on the fact that law, and especially the law of property, takes as its *subject-matter* those things which have scarcity value. Here the emphasis is on the scarcity of human energy available for social control, which conditions the extent and manner of legal regulation, rather than its subject-matter.

[5]Of course there is no fixed fund of energy; more work will be spent on social regulation whenever regulation comes to be deemed immediately essential: martial law. Nor is it intended to assume that there may not be rules which call for little supervision; it needs no policeman to make gold coin current.

[6]Pound has insisted on "social engineering" as the present problem of law. His term covers both legal engineering and policy shaping. See also Spykman, cited note 2.

easy inspection—there control can be had, even over resistance, without prohibitive cost.[7]

This problem of finding the best fulcrum for the government lever is familiar in taxation. And, to the extent that either production or the market becomes closely organized, we may expect to see the centers of organization made the pressure point of control, as in the Pure Food and Drug act, or the demand that the date of canning appear on canned food.[8] And the manufacturing concern, already the engine for shifting losses through industrial accident, may tomorrow be used with like effect on risks of unemployment.

Besides this art of finding a controllable point to force regulation upon even the unwilling, stands the art of laying down rules—or, as will appear, of getting rules laid down—which are so far in line with the ways of the governed as hardly to call for check-up. This brings us to the outstanding legal problem of the day, and that perhaps most intimate to economics: how common, general rules, judge-made or statutory, are to control transactions under high specialization. For our legal system was modelled to attempt like rules and like service to all men and all localities. With this same system we now face the controlling of infinitely diversified technical activities.[9]

[7]Thus the "just price" worked in medieval markets. Possibly favorable public opinion was more uniform then. But query whether the local and open character of the market was not the more effective factor. Compare also housing and rent regulation. No inference is intended as to the wisdom of rate regulation, nor as to the long-run effects of fixed prices which yield so far below the current returns as to discourage upkeep or new production. Such rates, in housing, have given rise to collateral experiments: throwing the cost of repairs on tenants, in Germany; tax exemption of new buildings, in New York; government building, in Britain. But the question here is merely of the conditions under which price-fixing is working at all.

[8]Those modern cases on sale of food which tend to throw upon a retailer absolute responsibility for the wholesomeness of food sold—in the original package or otherwise—while refusing the consumer any remedy against the packer, are an excellent instance of legal maladjustment. It would seem obvious that if the risk of wholesomeness of canned or package foods is to be shifted from the consumer, it could most simply be spread, and even lessened, by throwing it on the house under whose brand the food is sold. Retailers other than chain stores are in no position either to cover the damage when it happens or to insure. The brand invites confidence and can fairly carry responsibility. But a lawyer has only two concepts to apply to the case: *negligence,* which throws on the consumer an almost impossible task in proving his case against a manufacturer; and *warranty,* which is a responsibility effective only between the two parties to a sale, and therefore does not operate against the manufacturer or wholesaler in favor of one who bought not from them, but from the retailer. The judges have done what they could with these concepts; but the concepts have no relation to a modern marketing system. For the law, see 27 *Yale Law Journal,* 1068; 29 *ibid.,* 782, and Perkins, 5 *Iowa Law Bull.,* 6 and 86. The most recent developments have emphasized the points above, except for some tendency to make a showing of sickness resulting from eating, create a presumption that the food was negligently prepared. But that is clearly of no value as against the anonymous small packer whose product is marketed under a jobber's brand, nor yet against the jobber who did not do the packing.

[9]Pound's phrase is "the complex, urban, industrial community of today." *The*

Even now, such common rules for all have wide legitimate scope. Legal institutions provide a general atmosphere of security from personal aggression without which economic life could hardly be expected to unfold, an atmosphere wholly distinct from the particular technical regulation of any particular activity. The law of murder, robbery, rape, does not relate to banking; yet only as it is effective does banking become possible. Division of labor requires a relative security of person; as practiced today, it seems to require also a relative security of property. The triteness of which observation is softened as one thinks of Europe, investments in so-called undeveloped countries, or the intervention of the military as industrial or night-riding conflicts become acute.

In this connection three points should be noted. The first is that what we may call the economically undifferentiated community (men so far as they fall under the law-in-general rather than the special rules of their pursuits) is conservative, and conservative not only by inertia but by conviction.[10] This means that economic, and especially industrial struggle, must, to avoid crushing legal control, work itself out at any given time within the bounds of the then existing order.[11] Too much is made of the conservatism of the courts in this regard; conservative they are, but behind them is the popular sentiment which can be stampeded into criminal syndicalism acts, and the popular inertia which leaves those acts in force. This in turn means that legal institutions-at-large act not merely to make economic specialization possible, but also as a four-wheel brake on sharp changes in the conditions and especially in the reward-distribution of that specialization.

Secondly, this phase of legal action, like others, is subject to the principle of scarcity. As governmental energy is put to blocking robbery, it is drawn off of prohibition. As the motor car gives criminals power to strike and get away, the output of energy needed to block robbery increases. Where single criminal efforts offer great

Spirit of the Common Law, passim. The problem is peculiarly difficult because different parts of the community are at widely differing stages of complexity, industrialization and—urbanity.

[10]Sumner, *Folkways, passim.* "Conviction" is used without connotation of reasoned choice. In few fields is cultural lag more apparent than in law, as has been developed at length by Ogburn and Veblen. But occasionally legislation is more than abreast of the times, and proves either abortive or educative. Compare the reforms of Joseph II with the Federal Reserve act.

[11]Not that "the existing order" is a static condition. No order would, today, long continue if it were not capable of important change, sometimes amazing in rapidity and scope. In a quarter-century Britain has seen the Trade Disputes act become a fact and a capital levy become a political issue. The sovereign state seems to hold its sovereignty on a number of conditions. None the less, subject to that rare phenomenon, a successful revolution, and despite the apparent challenge of the Trade Disputes act, the text holds true.

potential gain, bank vaults and private guards argue the inadequacy of the official energy available. And where the felt need for order goads to martial law, daily activities limp while it lasts.

The last point is that in this field, save for the objecting group in any instance, the felt needs of our whole community largely coincide. Truly *common* rules are therefore possible, and adjudication of disputes by courts of *general* jurisdiction is, in the main, desirable. The judge is in his proper field. The judicial machinery, while far from adequate, at least approaches adequacy as nearly as any time-worn and be-barnacled institution may be expected to.[12]

But the legal feature of this age remains, not the persistence among all men of an interest in general security, but the emergence of diverse and specialized groups with a need for specialized control.[13] In part, our inherited legal institutions fill the need. Some hope has lain in specializing courts—courts for settling estates, for small claims, juvenile courts. And unspecialized judges have labored to shape the necessary special rules.

Nowhere does this show more clearly than in the legal devices aimed at making credit liquid, chief among which was the adoption of the merchant's customs on negotiable paper. That central money markets are, without some such legal device, almost unthinkable, is ancient learning[14]; that new stability is offered a credit structure when collection rests not with the original creditor, but with a disinterested transferee, is commonplace.

But liquidity is not enough; we need security of credit. Soundness of credit depends upon performance. But security additional to the

[12]To this, one who believes that the present industrial order requires some remodelling would make an exception of labor cases. And any person whose particular interests are out of adjustment will make his own reservations.

[13]It is curious to observe the most divergent groups in harmony on this point. Corporate interests, coöperatives, soviets, guild socialists, and men in feudal conditions, differ on whether to base the lesser unit on territory or other industrial function, or capital contribution; on whether control should be according to birth, ownership, membership, or service; on whether the rewards should be divided according to military power, ownership, extent of member's use of the service, the needs of the workers, or their day-to-day service contribution. They differ as to whether the state or national supervising control should be apportioned by territory or function, etc. But they all concur in the common platform that the central supervising body should, outside of one central field common to all men as men and to the particular system as a whole, do no more than lay out the field within which each smaller unit operates and state the rules of interaction among units; and, especially, that to the local or industrial or other functional unit should be left autonomous control of its own activity within those limits. The problem of achieving adequate small-unit rule-making is therefore neither new nor American, but only peculiarly acute in view of the character of the legal institutions which the present generation in this country happen to have inherited. In Europe, for instance, the existence of specialized commercial courts lightens the burden materially.

[14]Although the actual non-negotiability of great quantities of current paper challenges to reëxamination of the foundations of this ancient learning.

debtor's solvency and good faith requires legal sanction or it is valueless; it is never called on unless that solvency and good faith fail. It is to the judge-made law that we owe those institutions which leave the goods or land in the full use of the borrower, and make the secured production loan a possibility; by creating, out of an original absolute transfer of land, the mortgage. This is no mean institutional achievement; nor is it unique; nor have the courts turned from creation.[15]

But, in all fairness, the adjustments of the courts are and must continue laggard and partial; inelastic and sometimes mistaken; fraught often with by-products as unwelcome as unlooked for. Take this same mortgage. When applied to a business so specialized that reorganization is the only means of realizing the security, a mortgage becomes hardly more than a first claim on income. Yet, though it take three hundred pages, the old form must be preserved. And a private tax on every corporate issue is paid to those counsel skilled enough in weathered technicality to make rights to income assume the fictitious form of rights to land. Again, whereas a mortgage on truck or truck-garden is valid, a similar mortgage on a merchant's stock in trade continues void.[16]

The causes are not far to seek. Judges are neither industrial workers, business men, nor bankers. Like other men, they are specialists in their own single field. Hence in a vast body of their cases they sit as laymen, groping to solve a controversy they cannot understand, by a rule whose import they cannot guess.[17]

[15]Thus the decisions on letters of credit since 1920 have been admirable, and those on foreign exchange contracts satisfactory. On the other hand, those on sliding-scale contracts and contracts with options to cancel have tended to be formalistic maladjustments.

[16]In a few states such a mortgage is valid. See Caskey, 34 *Yale Law Journal,* 175. Judging by the major uniform commercial acts, this particular defect in the law may be cured everywhere within about thirty years, by the gradual passage of the proposed Uniform Chattel Mortgage act. The uniform acts in general afford some index of the speed of law reform on any substantial scale, even in fields where business needs press.

[17]There are other important inhibiting factors. There is the training which forces most judges to think largely in terms of precedent, and to innovate with extreme caution. There is the still powerful traditional fiction that judges never make, but only *find* the law, which causes many to innovate only when they can by dialectics convince their readers, and even themselves, that their innovation is in truth a logical deduction from a preëxisting rule. There is the healthy feeling that before a new rule or institution should be given legal sanction, it must have established itself in practice rather certainly as the best of the competing adjustments to a given situation. There is the fear of unsettling transactions which arises—and not alone in rules of property—from the ex post facto character of judge-made law, the fact that the rule laid down will under our present practice govern even future cases whose facts have occurred before this new rule was made. This fear has induced many courts to follow precedents they disapproved. Yet it would be simple to decide the particular case on the old precedents, while announcing at the same time that in future cases, another new and different rule would be applied. See Freeman,

The first remedy has been by recourse to the legislatures, and at times, as with the recording statutes, with results. Yet legislatures, too, though better adapted for general policy-shaping than courts, are both by size and membership hampered in doing the legal engineering necessary to their purposes.[18] Legislators, too, are only men; and, in technical fields, laymen.

The introduction of administrative law has in part stopped the gap.[19] Whether the work of special commissions or of executive subdivisions, its virtues are the same. It offers means of developing experts specialized in their field, of getting quick decisions, and, above all, of getting a wealth of *detailed, specific* rulings.

For the settlement of disputes, large though it bulks to lawyer or disputant, is but a minor function of the law. Each case has value chiefly for the light it sheds on the rights of ten or ten thousand people not in court. Wherever custom has not crystallized, rules can really *regulate* conduct, *prevent* evils and disputes, only where the approved rules are known to men before they act. Rules only to be found by expert searching are not known. They may be admirable for decision of disputes; they cannot be *working* rules[20] which will prevent such disputes. Nor can they, if, when found, they are vague: "do right"; "do not perpetrate a combination in restraint of trade." Not that knowledge means obedience; but without knowledge obedience is impossible, conformity an accident. And given knowledge, our general *mores* of obeying law—when not too bothersome—join with whatever enforcement may exist to make enforcement superfluous. Thus, the specific character of administrative rulings on those technical points

"The Protection Afforded against the Retroactive Operation of an Overruling Decision," 18 *Columbia Law Review,* 230, especially note 63.

[18]The Clayton act must serve as a single example: despite its purpose of changing the status of striking workmen in the courts, its language was bravely unadapted to that purpose. American Steel Foundries *v.* The Tri-City Central Trades Council (1921) 257 U. S. 184; Duplex Printing Co. *v.* Deering (1921) 254 U. S. 443. And one may sincerely regret these decisions without being able to deny the legal soundness, or the language of the act, in the light of the English act, of the court's construction. The instance also brings home that the legislature's words have always to be read by the courts; which creates as many chances for trouble as for improvement.

[19]See Parkinson, "The Relation of Administrative Procedure and Devices to the Restatement and Clarification of the Law," 10 *Proceedings, Acad. Pol. Sci.,* 35, for a summary of the rationale of administrative control. Pound has suggested that the growing point of the law today lies in commissions rather than in courts or even legislatures. Certainly this is largely true with regard to *official* law-making.

[20]Pound has developed the idea of rules of law as "norms of conduct," as opposed to standards of judgment or rules of decision of disputes. Commons has married this concept with Sumner's "folkway," in his concept of *working rules,* which may be law-created, but more commonly are created by men's experiment, and only later taken over by the law. See note 38. Such seems to have been the almost universal process in primitive law. Compare Jenks, ***Law and Politics in the Middle Ages.***

which ethics and even custom hardly touch, or touch with no uniformity, is an engineering device of rare value.

Yet the device has limitations. We make administrative law—like statutes— subject to the general courts. Not without reason. Administrative Poo-bahism,— plaintiff, judge, hangman all in one—is not always happy.[21] But the courts remain laymen; and in reversing administrative rulings, judges have forgotten that the non-technician can more wisely tell the technician what to do, than how to do it.[22] Nor are all fields open to administrative control. Scarcity is itself a limit, and one reinforced by the restiveness of our population—and of our Supreme Court—at unaccustomed control. And personnel problems reach a peak in these commissions. To find and place a good man is a political feat; to keep him, an economic triumph. The business of advocating private interests before the commissions has a siren's voice.

Indeed it may be queried whether any sane public regulation of economic activity in the public interest—whatever that may be—is not largely accidental. The way of growth seems to be along whatever balance results from the pull and prodding of this and the other private interest.[23]

For private interests seem to have been the influential factors in law's major changes in the past. Their working constitutes the striking phase of law's relation to economics today. Increasingly, associations are forming which adopt their own rules of action and even settle their own disputes. Corporation, labor union, manufacturers' association, farmers' coöperative—their number, size and experience increase. And the rules which, by permission of the state, and within limits which the state prescribes, such associations lay down and apply, are part of the body of our law. They are working rules; the working rules of a technical activity; the very type of working rules which the official legal institutions are unable to construct. Their justification consists in that they are, and that they work. Within their sphere they are like law in all but the numbers they affect, and can be dealt with on that basis with propriety. I like to call them

[21]Compare Henderson, *The Federal Trade Commission.*

[22]E. g., the Mennen and National Biscuit Company cases, (1923) 288 Fed. 774; (1924) 299 Fed. 733. In both cases the statutes and the precedents would have lent themselves as well to sustaining the orders as to reversing them. In neither case was weight attached to the probably sound conclusions, as to desirable policy, of the body of supposed experts whose orders were reversed. See discussion by Oliphant, 9 *Am. Bar Assoc. Jour.*, 210.

[23]See, e. g., the discussion of proposed change in the copyright law in *N. Y. Times*, July 13, 1925. The text does not touch the *desirability* of laissez-faire, especially as now interpreted.

by-laws; the laws of a lesser group, of more or less voluntary constitution.[24]

Equally big with consequence are standardized contracts. They, too, are working rules—in Commons' term, the common law of an economic activity; a common law this time not within a unit, but between units, but here, too, specialized to the needs of those interested, limited to them, and flexible. I am tempted to call these rules of action by-laws, too; certainly so, where, as is increasingly true, disputes under them are enforceably arranged to be referred to arbitrators.[25]

Of these standardized contracts there are the lop-sided and the balanced. First the lop-sided: leases, say, or mortgages. The one party is, typically, professional; and other, typically, casual. The professional gathers experience and, clause by clause, builds an agreement wholly jug-handled in effect, but which, adopted by all of the professionals, becomes the only form of bargain available. Any concerted agreement speeds the process. Or, as with the terms enforced by a strong union or a strong employer, or the buying and selling contracts of the United States Steel Corporation, the determining factor may be a single unit's commanding bargaining position.

There is more hope in such jug-handled contracts than at first appears. They go some distance to prevent dispute. True, their certainty is less before than after the event—who reads his lease or policy?—but largely for that very reason, some correction is afforded by the courts. Judges—to use their own phrase—construe the contract most strongly against the party drawing it. Thus life insurance has become almost a commodity, the insured being given about the protection he might decently believe he was buying, without too close regard to the exceptions of the policy. Or there may be more drastic correction, by the legislature, as when a standard exclusive policy is laid down, exceptions to which are void unless in large, fat type.

Such intervention is typical both in its incidents and in its limitations. Outsider's law can hold inequity somewhat within bounds; it has little machinery to effect a cure. Household rules stand in place

[24]There are the further differences that membership in the state is compulsory, and that the state takes unto itself a monopoly of physical (and to some extent, financial) coercion. But these differences are being minimized. There is an economic coercion forcing associated action on increasingly numerous groups. And there is some physical pressure—not alone in the labor field—exerted within or without the law on prospective dissidents, when the need for coöperation is acutely felt. But without respect to these developments, the association-made rules are like enough to law to deserve careful attention. Significant is the present encouragement to business organizations offered by the Department of Commerce.

[25]On this general field see Julius Henry Cohen, *Commercial Arbitration and the Law*, especially chapter II, and Rosenbaum's report there referred to; and see a valuable article by Wesley A. Sturges, "Commercial Arbitration or Court Application of Common Law Rules of Marketing?" 34 *Yale Law Journal*, 480.

of law; limits there are, with legal penalties for non-support, wife-beating, cruelty to children; but the state blinks, and must, at petty tyranny.

The more hopeful movement is the meeting of organization with organization: collective bargaining, whether in industrial dispute or elsewhere.[26] There were the conferences between shippers, carriers, and bankers which led to the uniform railroad bill of lading. And even more important and extensive is the introduction of the balanced standardized contract without official stimulus. A dramatic instance is the motion picture industry. The field was hardly promising. Accepted ways of action are the product of conditions long enough settled to permit ways to grow fixed. But the movie industry has been notoriously sudden. Disputes, moreover, spring from unforeseen changes in profitable conditions whose continuance the disputants had tacitly assumed. A film is not a stable commodity. None the less, the success of the standard agreement is enlightening. With the detailed clauses we have here no concern. But—like the agreements of the British Trade Association, like well-made wage bargains—the movie contract provides for arbitration of all disputes arising under it. That provision merits attention.

To begin with, such an agreement to arbitrate is in most states still unenforceable at law, as "encroaching on the jurisdiction of the courts." That rule once had a reason, of a sort; today it cries out for abrogation as New York has already abrogated it, by statute. Meantime, the working of the provision without official sanction evidences how far by-laws are the *working* law.

Now the results of the standard contract, as the movie industry reports them.[27] First, as already noted: rules of action made by the parties interested, adjusted to their needs, detailed and relatively clear. Second, when disputes arise, speed of decision; commercial arbitrators are unhampered by procedural technicality, nor are their dockets clogged by other business. Third, decision by men who know the background and import of their ruling.[28] Fourth, a *working* decision. At law one man is right; the other wrong. What road is open to a court to find a *working* rule? Here is the arbitrator's opportunity. He can recognize that both are partly wrong; that *working* justice comes of

[26]See Robert L. Hale, "Law Making by Unofficial Minorities," 20 *Columbia Law Review*, 451.

[27]Address of Charles C. Pettijohn, general counsel of the Films Board of Trade, reprinted in *Arbitration News*, April, 1924. Since then, there has been some dissension and dissatisfaction on the part of some smaller eastern interests; this may limit the number affected by the contract, but not the effect among those still contracting.

[28]But still subject to judicial review. Stefano Berizzi Co. *v.* Krausz (N. Y. 1925) 146 N. E. 436. So far as that case applies to an arbitrator chosen for his background as well as his impartiality, it is decidedly unfortunate.

sacrificing rights. His task is not compensating wrongs which are past and dead, but the shaping of rights to make them work in the live sentient future.[29] He is a governor of a going concern which he must not disrupt.

The standardized contract with arbitration is thus a shining engine of control for any highly specialized going concern within, and partly independent of that greater going concern, the state.[30] Its hope for the future is based in no slight degree upon its freedom from the past. Law is not free. Rights as declared by judges are the result of expectations—more, of fairly general expectations. General expectations change but slowly. The machinery for officially determining such expectations is intricate; the technician hardens in learning the technique.[31] Even legislation must move upon the base of the existing order.[32] But collective bargaining can and does move upon the special

[29]For this reason the common objection that arbitration tends to a mere splitting of the difference does not seem to me weighty. That tendency is the practice of the merely impartial, uninformed arbitrator; not of the arbitrator with technical background. And decision too closely according to past precedent is exactly what arbitration is to avoid. Compare the results described by James H. Tufts, "Judicial Law-Making Exemplified in Industrial Arbitration," 21 *Columbia Law Review,* 405; see also Morris L. Ernst, "The Development of Industrial Jurisprudence," *ibid.,* 155. W. Jethro Brown's articles in 27 and 28 *Yale Law Journal* show the same general attitude at work in a special industrial court. Contrast the essentially disruptive character of redress at law, by damages or by injunction. Sturges, cited *supra,* note 25; and compare Pres. Brassil of Employing Bookbinders of America, *Proceedings 20th Ann. Conv.,* 1921, pp. 5-6. In discussing arbitration care must be taken to distinguish the ideal situation of habitual dealers on both sides, with technically grounded arbitrators—the situation here under discussion—from the jug-handled case, or the functioning of merely impartial but uninformed arbitrators.

[30]Hale, cited note 26, *supra,* argues that there is no true independence, since the parties may, and do appeal to the state for enforcement of the contract, and derive from the state's protection most of their bargaining power.

[31]See Morris R. Cohen, "Legalism and Clericalism," *New Republic,* November 26, 1924.

[32]Here an effect of institutions at large needs mention. Existing institutions provide a means of accomplishing desired results. But they also constitute a frame-work within which efforts *must* move. If negotiable paper is used as between the buyer and seller of goods chiefly to close out stale accounts, it will be hard sledding to get such paper, even under the label of "trade acceptance," used by those parties for any other purpose. If the law recognizes as methods of business association only the stock corporation and the partnership, an attempt to run a plant according to any unusual ethics as to rights and powers of the workers can be subjected to uncomfortable guerilla warfare from dissenting stockholders, as witness Mr. Ford's difficulties with the Dodges, and the case of the traction lines in Philadelphia. And so attempts at coöperative organization of farmers, before the enabling statutes, repeatedly broke down because any penalties to keep members in line, although agreed to in advance, were held void as being in restraint of trade; an organization not a corporation or a partnership was, of necessity, a "combination." Hence legal institutions act not only as a brake on economic change, but as a shaping or twisting force, coercing development into forms unforeseen and largely accidental. Thus Marshall's belief that the power to tax is the power to destroy put into our constitutional law a rule which, with the introduction of the income tax, led to an unforeseen redistribution of productive energy through the flow of capital into tax-

needs of the morrow and the immediate yesterday; as does the arbitrator. In an age of headlong change he may even realize his own precedents outworn in time to struggle free from them.[33]

Clearly, this process offers peculiar hope in industry. Not that arbitration solves industrial struggle. One need be no Marxian to follow Tawney[34] when he urges that workers, present and future, will never rest content within the assumptions of our present order. But arbitration alone affords machinery to remodel working rules at once and workably around each shifting focus collective bargaining may fix.[35] The law has no such power.

Indeed, to one culling cases of ill-adapted legal engineering, the berrying is richest in the field of labor.[36] This is commonly credited to the inherent conservatism of the law, and to the age or class prejudice of the bench.[37] But there is a co-factor seldom adequately stressed—another legal institution: the profession. For more to the bar than to the bench belongs the great bulk of credit or blame for legal institutions, for the modern common law itself. A judge's function and his work do not lie in thinking out ways to fit new law to novel needs. The argument of counsel shows the way; the judge has but to choose.[38] Nor is this confined to single law suits. The strategy of

exempt issues. Thus, to take a final instance, the fiction of corporate entity has served to obscure, in industrial matters, the whole question of combination, coercion and conspiracy.

Such twisting of new by old institutions is of course common to all social fields. Inability to perceive change, unwillingness to recognize it, and the dependence of the human imagination on the past in coping with new problems—these affect the innovator much as they do his fellows. But there is a further and quite distinct inertia aspect of institutions, which is forcibly imposed even upon the innovator who sees a wholly novel way of doing things. That aspect, too, is found in other social fields: in the refusal of those in authority—high pontiffs, business executives—to permit innovations by a subordinate; and in the familiar refusal of the herd to follow a digressing leader. Such inertia, restricting the field of possible change, is thus not peculiar to, but is peculiarly powerful in the law. And under our system of constitutional adjudication it is more powerful than in most other modern polities.

[33]Even a forward-looking law-trained man is slow to see this as desirable. Compare Ernst, cited *supra,* note 29.

[34]*The Acquisitive Society, passim;* see especially p. 116. For illuminating discussion of the sphere and limitations of arbitration in industrial disputes, see Elizabeth Sanford, *The Printing Trades in New York* (now in preparation).

[35]Beautifully illustrated in Tufts, cited supra, note 29.

[36]But for illustrations in business law see notes 8 and 16.

[37]See note 17; see also the text, above, on the general public.

[38]So Commons, in *Legal Foundations of Capitalism.* But one would gather from his discussion that the legal laity, the landlords, business men, etc., were the creators of the practices among which the judges exercised their selection for survival. The intermediate function of the legal profession becomes of steadily increasing importance, at least from the time of Coke, whatever may have been the case in Year Book days, and despite the creative influence of the judges like Mansfield and Marshall. Commons, too, somewhat understresses the vital fact that the range within which judges (or counsel, or, indeed, the interested public) *can* select, is limited by social and physical conditions. See note 32.

association or corporate counsel extends through series of decisions. And even deeper is the influence of counsel in the office. Voting trusts, mortgage, cumulative voting, the untold host of legal adaptations—they cost hard thinking; but of lawyers first, and only then of judges, or of legislatures. And it may be noted that among these adaptations was the suit against the Danbury Hatters under the Sherman act.[39] In this aspect the conservatism of the common law takes on new meaning.

In business, legal adjustments, though still slow, are relatively rapid. The best brains of the profession engineer them. But in the labor field these same brains hamper change. It was a feat to make the emancipation amendment sprout liberty of contract, or to turn the injunction to enforce the criminal law. And in monopolies, utilities, and taxation —business fields—does not the lessened legal engineering power, as compared with other business fields, go back largely to the alignment of the profession not with, but against the policies which the official lawmakers attempt?[40]

Those fields suggest, too, the boundaries of this private legal engineering. Veblen points out that the enterpriser—and so his counsel—centers on the creation and continuance of price differential. By-law making by agreement is essentially the building of working rules of a going concern. It can hope to smooth out the processes of production and marketing, to lighten the troubles incident on any shifting of the norms of distribution. Being conditioned on the treatment of the concern *as going*, it tends to and rests on the stabilization of economic institutions. And, curiously enough, it stabilizes not by hindering, but by helping change: change in the direction of long-run thinking, say, by smaller price differentials in long-run contracts, compensated by avoiding risks of fluctuation; by increased wage rate and wage security, compensated in lessened labor turnover; in general, by a sort of vertical integration between opposing bargainers, through long-run contract and dealing. All of which means a share in lessening cyclical fluctuation.

The limits on the value of the movement are twofold. In the first place, such integration between producing bargainers may threaten the unorganized consumer, or, if demand be inelastic, the primary user of a service, say the shipper. So, especially, where the good or service is one deemed a necessity; coal is a case in the public eye today. Until counter-organization of consumers develops, the only help for such a case lies along lines of government action. Bargaining power persistently unbalanced means new public utilities. And while

[39] Loewe *v.* Lawlor (1908) 208 U. S. 274; Lawlor *v.* Loewe (1915) 235 U. S. 522.

[40] It hardly needs mention that no suggestion is intended of concerted action by the profession at large, nor any imputation of sinister motive. Neither is necessary, to explain the fact of net group action, despite individual cross-purposes and variations.

that does not of itself promise adequate adjustment, it does suggest at once a limit on the value of private by-law making, and the place at which policy-shaping by the general authorities is called for. And what was said above as to relative ease of control where an industry is closely organized applies again. Whereas, if the good or service can be substituted or eliminated from consumption, competition offers, in the long run, some promise of automatic cure.[41]

The other limitation on the value of the movement toward contract by-laws seems more threatening. Price differential as the *terminus ad quem*, taken in conjunction with our present investment structure, forebodes increasing trouble to any long-run operation of business. The history of financiering in our railroads sets the picture. As long as it best pays those in control to operate a now going concern, not as a concern to continue going, but as a show-case to be dressed up for financiering jugglery, much of the hope in by-law making must languish. And such jugglery does pay the juggler. Water may no longer be a prime element in natural philosophy; it remains one in industrial finance. Spasmodic regulation of such financiering we now have; perhaps we may expect adequate regulation to appear—as with railroad finance—a generation after the presently profitable damage has been done.

Granted, then, some bearing of legal institutions upon economic life and change, what may law have to contribute to economic theory? A lawyer will do well to walk warily here. Still, he may claim laymen's license, and simply talk ahead. He may, too, borrow from those economists who have already wrestled with the problem.

In the first place, legal institutions fix and guarantee the presuppositions on which the economic order rests: that physical violence will be penalized and in large part prevented; that gains by fraud will be penalized, restored, prevented where possible; that anything a man can gain without violence[42] or fraud is rightfully his, for all time; and that changes in these presuppositions will be, in general, slow and long heralded. The presuppositions themselves are for the orthodox economist axiomatic, for the economics of apologists almost ultimate. So they are also for the law. Law and legal theory are incrusted with the past. The twists and angles of disputes are unforeseeable; the decision is always after the event. But the economic theorist can, if he wishes, face the future, criticize, see trends, prophesy evils, advocate cures. Even so, the law's experience is the

[41]Some such condition now maintains in the printing trade in New York. See Sanford, cited *supra*, note 34.

[42]Robert L. Hale, "Coercion and Distribution in a Supposedly Non-coercive State," 38 *Pol. Sci. Q.* 470, makes it clear that "violence" and not "force" is the correct descriptive term.

classic teaching as to the possibility of conscious change in institutions, as to the conditions of effective change, as to how far a speculation may be made a fact.

In the second place, law affords more of the machinery for the working out of competition than can be appreciated without some pondering. Obviously, the accumulation and flow of capital is dependent on transferable contract and divisible transferable ownership. But so is any national market, any extension of selling territory, any use of large business units, dependent on letting one man speak for and obligate another—the legal institution we call agency. Lease, sale, consignment, option—there is no end to the examples. And clearly the effectiveness of competition between sellers of the same class of goods, but especially of indirect competition among differing types of capital employment, depends on the adjustment or maladjustment of these legal institutions.

In the third place, "free" competition is rarely, if ever, free in fact, and law is one major instrument of restriction—for a variety of ends. Discriminatory price practices are penalized; discriminatory transportation rates often are maintained. In each case the aim is to equalize the approach of unequally situated sellers to a given sales territory. Or wilful destruction of produce after reaching a given market is penalized. Narcotics are forbidden sale except as medicine; filled milk is forbidden sale at all.[43] Patents create monopolies. Other monopolies are shackled by rate regulation. Such restrictions are friction factors which in their every detail are vital to an understanding of what "competition" means in life. And not less vital are those other legal friction factors which, because unintended, are less advertised.[44]

In the fourth place, the legal institutions of taxation and public welfare legislation have obviously far-reaching effects not only on distribution but on production; as has any government ownership or operation. This needs no argument. But it is worth stress, when one considers the tremendous shaping effect of persistent use of a given taxation type, such as the tariff, or of a given rate-making policy, such as the second-class mail rates, or of the continued absence of a given taxation type, such as that on unearned increment or on inheritance, or of a given state-operated service, such as parcel post until recently, or telegraph. Such conditions, when continued, not only build themselves into the price level and the institutional structure of production, merchandizing, and investment, not only redistribute

[43]Hebe Co. *v.* Shaw (1919) 248 U. S. 297.

[44]The patentee, e. g., is given legal protection in withholding as well as in using the patented device. This produces not new competition, but a stabilization of industrial change; a curiously unanticipated result.

population and wealth, but enter into expectations almost as vested rights. The effect on public opinion, through accumulated wont and inertia, is amazing. Take tariff history, with sugar to point its present application. Or the expressed views of public men that inheritance taxation is in essence confiscatory. Or the views of the Supreme Court on the constitutionality of novel extensions or limitations of the state's function.

In the fifth place—a striking contribution of Professor Commons—bargaining between two persons is limited not only by the desirability of the commodity, the availability of another buyer or seller, and the ability of each bargainer to go without, but also by the working rules which govern the bargaining. The displacement of *caveat emptor* by a rule of reasonable warranty, making a seller answer for the quality of his goods, must be regarded as affecting prices; under the new rule the seller incurs new risks and the buyer procures some insurance with his commodity. The law's machinery is increasingly put to revealing unheeded costs of production, and thereby shifting the whole basis of bargaining. Workmen's compensation throws heavy additional burdens on manufacture. One challenging subsequent phenomenon has been, apparently, a reduction of industrial injuries. This opens a whole new field of control, with the question: whether placing by law an insurer's obligation on the party not only best able to distribute, but best able to prevent, may not be a potent instrument of reform. In New York, blasting operations carry liability for damage, without reference to fault. Is it an accident that steel-chain rock-curtains are used in New York City blasting? The growing common law tendency to force an insurer's liability on the manufacturer of articles which, like automobiles, are dangerous if improperly made, heads in the same direction.[45] The original objective is not the same in all these cases. In one, the producing laborer is the object of concern; in one, the bystander or neighboring owner; in a third, the consumer. But all alike recognize the dependence of laborer, bystander or consumer on an industry with which as an individual he cannot cope; all alike show the legal tendency to throw risks of industrial civilization in the first instance upon the industry to which they are chargeable as costs. Something similar has been worked out by the verdicts on railroad accidents,[46] and is in inevitable development in regard to automobile

[45]For the similar tendency regarding food, see note 8, *supra*.

[46]When, despite the court's instructions and the evidence on contributory negligence and assumption of risk by the passenger or track-crosser, the jury finds for him in his suit against the railroad, it is clear that the loss is shifted in part to the place whence it can usefully be spread. Statutes or constitutions making the question of contributory negligence, etc., wholly one for the jury, aid the process. It is wasteful; too much goes into contingent fees. It is inaccurate. But it answers in a rough manner to a social need, though the immediate animus may be only a desire to stick the corporation.

accidents.[47] And this legal risk-shifting has major consequences. The new burdens imposed on a dangerous industry are heavy; those on a less dangerous, relatively light. Surely as a result either relative price levels, relative profit levels, or relative wage levels shift; and with such shifting the basis of bargaining, and of competition between industries, shifts as well. Therefore unheeded real costs have been forced to the bargainer's, and so to the investor's attention, through his pocket.

Again, bargaining is vitally limited by the expectations of the bargainers as to reasonableness of price. To rouse a sense of unfairness makes a bargain impossible save under pressure of utter necessity. And views of fairness are shaped by law and by-law, by the working rules. Hence so far as study of legal institutions sheds light on the nature or content of such rules, on their sphere of effectiveness, and on the nature of their change, it illuminates a baffling problem of the price system: the limits, often unconscious but always present, within which any given bargain moves.

Finally, though indirectly, law offers a significant method of comparative study. Law is a preëminent field of striking, documented, varied examples of that double phenomenon: that institutions are used to perform a variety of functions;[48] and that a variety of institutions are used to perform a single function. Sometimes the former means division of the institution into specialized branches, as the history of the King's Council shows.[49] Sometimes, however, the single institution is used, without division and specialization, to perform two functions simultaneously. If so, then only by a marvel will one of the functions fail to clog the other. To build for speed means sacrifice of strength. And it has seemed strange to me to find so little attention paid, in this connection, to the double function of the market in a price economy. When that single institution is used at the same time to admeasure each man's share in society's joint product and to distribute society's productive energy, it seems clear that no aspect of its work in either function can be understood or judged without constant reference to the corresponding effects of that aspect in the performance of the sister function. To an outsider it would seem that new light on the market as a device of distribution could be had from this angle; especially, e. g., by comparing its ordinary operation with its operation

[47]See Robert S. Marx, "The Curse of the Personal Injury Suit and a Remedy," 10 *Am. Bar Assoc. Jour.* 493; and the growing tendency toward more stringent liability all over the country.

[48]Nathan Isaacs, "Business Security and Legal Security," 37 *Harv. Law Rev.* 201; and see an excellent statement by M. M. Knight, 10 *J. Soc. Hyg.* 257. Knight's view that specialization of the institutional structure is a later stage than confusion, perhaps needs minor qualification in this: that such later stage is not always attained.

[49]G. B. Adams, *Growth of the English Constitution.*

when, by some such intervening fact as war or government control, the decision that a certain type of goods or service should be produced had been reached by other means, and only the problem of distribution remained. If this should prove true, it would be a benefit to social science approaching in value the new understanding economics has brought to the law.

I do not like to close without making some acknowledgment of the contributions of economics to the functional study of the law. When one approaches the law, not with the idea of formulating its rules into a system, but with an eye to discovering how much it does or can effect, and to the principles both of its effect and of its change, economic theory offers in many respects amazing light.

I do not refer simply to the dependence of law on economic conditions. It is rather that such a concept as that of scarcity of energy for law enforcement, with the corollaries of necessity for choice among policies and of the problem of legal engineering, is borrowed directly from economics. So, too, the thought that more or less social energy is apportioned to the enforcement of law according to the intensity of the felt need for order, and according to the adequacy with which other means of community discipline cover the necessary ground, is not only derived from but is illumined by the economics of supply and demand and the doctrines of competing and substituting commodities.

Finally, when one attacks the effect of the law in shaping conduct, in the profusion of cases where established morals or habits of self-discipline seem to make law unnecessary, one is led to hope that the marginal concepts may point the road to understanding.[60] The rules of law against assault come into active play only at the individual margin when passion crosses the threshold of self-control, and come into play socially only with that marginal individual who falls below the standard of self-control commonly developed by early education. For it seems clear that, if the marginal individual were not restrained at least in the bulk of cases, either in self-defense or by imitation, laxity in the matter would spread through the group; such is the process of cut-throat competition. So, too, with the enforcement of contract obligation; and this regardless of delays, costs, and occasional acquiescence in the breach of contracts. And, indeed, in dealing with the law's delay, we meet the economist's problem of time preference.

Another phase of functional study of law in which the marginal concepts prove of immense promise, is the discovery of the functions which are well performed by institutions. Study of legal adjustments has overemphasized the proverbial sore thumb. Those portions of the

[60]This illuminating suggestion I owe to conversations with my friends, Max Radin, of the University of California Law School, and W. J. Couper, of Yale.

mechanism which work well are harder to understand. And nowhere does one get greater light on what an institution—or a principle—is accomplishing in unobserved quiet, than when watching the operation of that institution at its own margin. It is the limitations on private property which reveal the value of that institution. It is the rules restricting liberty of contract or testamentary disposition which point out most clearly the purpose of so much of the institution as is unrestricted; and so through the law of the family, or the principle of compensatory damages, or the insistence that fault shall precede liability, etc.

There is neither space nor necessity to elaborate. But the acknowledgment of indebtedness should be made.

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