Methodological Individualism and the Foundations of the ”Law and Economics” movement

Jean-Baptiste Fleury, Alain Marciano

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Jean-Baptiste Fleury, HDEA Sorbonne Université, (France)

and Alain Marciano, MRE and Université de Montpellier (France)[1]

Abstract

The purpose of this paper is to discuss the methodological foundations of the law and economics movement, with a special emphasis on the role and place of individuals within their framework. Reviewing the works of the main contributors—the founders, indeed—to the law and economics movement, we show that all of them considered that the analysis of legal phenomena had to start from individual behavior, even as these very behaviors were embedded, to various degrees, though not determined, in legal and institutional frameworks. The all use social, systemic, institutional and anti-reductionist individualistic methodology. This is not inconsistent or contradictory. Indeed, methodological individualism does not imply to conceive human beings as (isolated) atoms living as if they were suspended in a social vacuum.

Keywords

Law and economics, economic analysis of law, methodological individualism

Introduction

Originally, "law and economics" consisted in studying the economy by taking into account the institutions and, more narrowly, the legal rules that affect them. This "law and economics" movement, in its modern form, can be traced back to Henry Simons in the 1930s at the University of Chicago—he was the first economist to be hired at the Law School there. Subsequently, the field started to take shape and be structured in the second half of the 1940s, emerging from the Free Market Study (1946-1952) and the Antitrust (1952-1957) projects, which aimed at understanding the

[1] Corresponding author: University of Montpellier, Department of Economics, Rue Raymond Dugrand, CS 79606, F-34960 MONTPELLIER, France; e-mail: alain.marciano@umontpellier.fr.

legal underpinnings of competitive markets.[2] In the 1960s, other seminal contributions moved the field forward, notably Ronald Coase's acclaimed article "The Problem of Social Cost" (1960), Guido Calabresi's "Some thoughts on risk distribution and the law of torts" (1961) as well as Gary Becker's Crime and Punishment: An Economic Approach" (1968)—to mention only the major founders of the field. These contributions suggested important shifts in how to construe the links between economics and law, because they led scholars to develop an economic analysis of law, which no longer focused on economic phenomena but consisted in using economics to analyze any type of legal phenomena. In this "new law and economics movement", Richard Posner stands as the leading figure, after his seminal *Economic Analysis of Law* (1973).

In this paper, these two approaches will be (and still are) labeled "law and economics," although they are substantially different in many respects.[3] Indeed, the biggest difference probably lies in the scope of economics' methods and the boundaries of economics. Early law and economics scholars simply enriched traditional economic analysis with considerations taken from law. "New law and economics" scholars pertained to the broader movement of expansion of economics' scope: microeconomics now encompassed legal problems. In spite of these differences, both kinds of scholars used economics as their main tool of analysis. In other words, both kinds of scholars were methodological individualists. The present chapter describes, consequently, both approaches (and the historical shift from the former to the latter), with a special emphasis on the role and place of individuals within their framework. Indeed, the phenomena that economics, and even more specifically law and economics, studies necessarily have a social dimension or can be viewed as having an aggregate dimension, a sort of social nature that go largely beyond mere individual decisions (Arrow 1994, p. 3; Basu 1996, p. 269). Reciprocally, all individual actions are necessarily part of a legal or institutional system in such a way that one can hardly separate individual actions from these rules. How did these scholars handle the analytical relationship between social entities and individual behavior?

Some answered by arguing that it was difficult for economists, impossible indeed, to explain such social phenomena only in individual terms. For instance, Robert Ahdieh wrote that using methodological individualism "offers a poor window into important areas of legal and economic analysis. In these areas, it is essential *to go beyond an individualistic focus*, and engage the place of social and institutional factors as direct causes, and not merely indirect influences, in the explanation of social and economic phenomena." (2011, 56; italics added) This view echoed Joseph Agassi's

[2] For an historical perspective and details about the scope of these projects, see, for instance, the works of Robert Van Horn (2009; 2011).
[3] For a discussion of these differences see Medema 1998, Harnay and Marciano, 2009; Marciano, 2016.

(1960, 1975) on “institutional individualism”, which, to some commentators (Toboso 2001) could easily be viewed as standing halfway between methodological individualism and methodological holism. Therefore, even those unwilling to embrace methodological holism would be forced to abandon what some have termed narrow and “reductionist” (Rutherford 1994, p. 27) or “strong (strict)” (Neck 2022) methodological individualism in favor of a “weak (mild)” (ibid.), degenerated form of methodological individualism. This is not far from saying that methodological individualism cannot really be used in economics and law and economics. Or, as Geoffrey Hodgson said about institutional economics, that the term may be “unwarranted” (2007, p. 220).

Such a distinction between a “strong” and a “weak” for of methodological individualism seems to be a mere philosophical abstraction. Most of the major methodological individualists like Carl Menger, Max Weber, Georg Simmel, Karl Popper, Friedrich Hayek, Raymond Boudon were supportive of a social, systemic, institutional and anti-reductionist individualistic methodology. For instance, Raymond Boudon defines methodological individualism as being such that

> “any social phenomenon must be analyzed as the effect of individual actions obeying reasons and motivations configured by the context”.[4]

Indeed, methodological individualism does not imply to conceive human beings as (isolated) atoms living as if they were suspended in a social vacuum. To the contrary, Raymond Boudon insists, the social, political, cultural and, for that matter, legal, contexts in which individuals are embedded represent parameters of individual behavior, although they should not be counted as causes that determine it (Boudon, 2010).

Thus, from this perspective, law can be viewed as one of the parameters that allow individuals to reach their ends and that affect the social outcome. Eventually, though, these parameters are endogenized, that is, the analyst have to provide an explanation for the origins and functioning of the social context in terms of individual behaviors. Under that perspective, law becomes an object of study in itself. Law and economics developed in two strands that perfectly illustrate that view of methodological individualism. This is what we show in this chapter. Old law and economics studied the effect of legal rules on individual choices and social outcomes, whereas new law and economics studied the rules themselves as the result of individual choices.

[4] The original quotation states that “le paradigme de l'IM” is such that “tout phénomène social doit être analysé comme l'effet d'actions individuelles obéissant à des raisons et à des motivations paramétrées par le contexte” (2010, 16).

1. Law and Economics: the origins at Chicago

One of the first economists who played a major role in the development of "law and economics" was Aaron Director. A professor of economics at the University of Chicago Law School, as Henry Simons before him, Aaron Director "is often considered the father of Chicago law and economics" (Van Horn 2011, p. 1527). His interest in law came from his desire to understand how and how far competitive markets should be regulated. Hence, Aaron Director was primarily interested "in the analysis of the abuses of competition or monopoly and the meaningfulness of such devices as tie-in arrangement" (Levi 1966, p. 4; see also Posner 1975, p. 758). As George Stigler (1992, p. 455) later stressed, when he reviewed of the history of the field, "the first systematic application in America of economics to law was the use of price theory to explain economic phenomena involved antitrust cases. Director made creative use of price theory to phenomena such as tie-in sales and patent licensing and assisted colleagues such as John McGee and Lester Telser in their respective studies of predatory competition and resale price maintenance."

George Stigler was himself another prominent figure of Chicago economics and an indirect actor in the development of law and economics. Like Aaron Director, George Stigler was interested in questioning the regulation of the economy and the control of monopoly. In the late 1930s and early 1940s, George Stigler wrote on monopoly (Stigler 1938; 1942). Later he discussed regulation (Stigler 1964a; 1964b; 1971; Stigler and Friedland 1962) and antitrust (Stigler 1955; 1963; 1966). George Stigler's concerns with monopoly can also be illustrated by the research program that he set when he was recruited at Chicago in 1957, with the monies of the Walgreen fund. George Stigler aimed at studying "causes and effects of governmental control over economic life" (Stigler to Walgreen, cited in Nik-Khah and Van Horn 2016, p. 31). From this perspective, George Stigler has repeatedly claimed that, among the many tasks economists should fulfill, one was to contribute to the formulation of economic policy. In that regard, he found "two pieces of knowledge" to be "essential": first, measuring "the quantitative effects of various policies" (Stigler 1972, p. 5) and, second, evaluating "the influence of governmental structure on economic policy" (p. 6).

These details illustrate a major feature of the law and economics movement as it emerged at Chicago in the 1940s and 1950s. The economists who pushed it "had no interest in the law or, for that matter, in legal problems" (Priest 2006, p. 354). They were not interested in the origins of the legal rules that frame economic activities. They viewed economics as defined by its subject matter – economic activities, the production of wealth – and paid attention to rules because of their influence on economic activities. Rules mattered because they formed the context in which these activities took place. Studies such as G. Warren Nutter's (1951) dissertation—an empirical study on "The Extent of Enterprise Monopoly in the United States, 1899-1939"—, Arnold C. Harberger's (1954) article on “Monopoly and Resource Allocation”, George Stigler’s (1955) “Mergers and Preventive Antitrust Policy”; George Stigler and Claire Friedland’s (1962) study of the effects of the regulation of electrical utility rates, stand as good illustrations of what these economists were doing.

Looking at their attempts to study the effect of the institutional context – in particular legal rules – on the functioning and structure of markets, and eventually on economic outcomes, one may think at first sight that such an approach bore resemblance to that of the old institutionalists, who nonetheless were known for having adopted methodological *holism* rather than individualism. It is deceiving. First of all, these economists were—at least from their perspective—using a “theoretical” approach grounded on microeconomics (“price theory”). They were not pragmatic like lawyers (Stigler 1972, p. 8), nor inductive like old institutionalists.[5] That was one of the major advantages of applying price theory to legal problems: to provide a rigorous theoretical framework to legal scholars who are mainly interested in case studies.[6]

In George Stigler’s view, economics as a science should rest on abstract even if unrealistic assumptions, and among them, that the basic units of analysis are the individuals. These individuals behave rationally and maximize their utility or profit. Moreover, firms were viewed as black boxes within which it did not matter to look. As a corollary, power relationships within firms did not matter, whereas they did matter greatly for the old institutionalists. Then, economists assess various rules or law (or public policies) in terms of efficiency (rather than in terms of justice).[7] And the ways to assess these inefficiencies rested on individual premises: the costs and benefits, although measured at the aggregate level, were solely based on individual evaluations. Important conclusions stem from these individualistic premises, for instance that “[t]he ineffectiveness of regulation [of the electricity market] lies in two circumstances,” one of them being that each individual user “may move” and choose a different provider in George Stigler and Claire Friedland’s (1962) study.

Contrary to John Commons’s and other old institutionalists, Aaron Director, George Stigler and the Chicagoan law-and-economics scholars can be said to have used an individualist methodology in that they did not study the legal foundations of capitalism (as the title of Commons’s 1924 book read), nor did they study how laws and courts underpin or shape the economic system and its evolution. They did not consider, contrary to Commons, that “the role of the legal system” was “the centerpiece of [their] analysis” (Medema, 1994, p. 189). In law and economics grounded in

[5] “The lawyer does not have a theory of legal processes comparable to the economist's theory of economic processes, so the lawyer's contribution to policy formulation is entirely pragmatic” (Stigler 1972, p. 8).
[6] When he referred to the origins of law and economics and the first applications of economics to law, Stigler (1992, p. 455) explained that “professional economic analysis was replacing amateur economics of the lawyer.”
[7] “The basic question of policy formulation for the economist is not whether the goal is desirable but whether the means are efficient. Is the end in view actually achieved, and at the least cost?” (Stigler 1972, pp. 4-5).

price theory, the legal system, laws and courts, form the context in which individuals maximize their objective functions. They do not *determine* the choices individual make.[8] This might be one of the ambiguities of this kind of approach that will also characterize Ronald Coase's and Gary Becker's works. The environment simply shapes the set of constraints, under which individual rational choice is made, but not individuals' very motives and motivations. Moreover, market competition and other abstract features of the economic system were not necessarily shaped by law: they are somewhat a distinct social entity, which legal rules and policy decisions disturb. That was different for the old institutionalists who resorted to arguments closer to methodological holism, in claiming that individuals cannot be seen as rational *because* they were influenced by rules, customs and other environmental factors. Indeed, the influence of various institutions such as technology or norms and cultural forces were not the prime focus of scholars in price theoretic law and economics.

2. Ronald Coase: from Old to New Law and Economics

Although the situation did not really change after the publication of Ronald Coase's article, "The Problem of Social Cost" (1960), the paper is widely acknowledged as a turning point in the history of the field, marking the "origin [of]… the modern law and economics movement" (Hovenkamp 1990, p. 494) also labeled ''new'' law and economics (Posner 1975). Indeed, Ronald Coase's subsequent influence came from his insistence on the centrality of property rights—in his view, exchange dealt primarily with property rights instead of goods and services.

In "The Problem of Social Cost" (1960), Ronald Coase started his analysis of how to deal with the divergence between the social and private costs in presence of harmful effects by considering that external effects were a reciprocal problem, in which both parties, the tortfeasor and the victim, were involved. Assuming that transaction costs were nil, these parties can easily bargain to decide who will bear the costs of the external effect, irrespective of the initial assignment of liability for the damage. In other words, in a world without transaction costs, institutions and the initial delimitation of legal rights do not matter. The negotiation that then takes place is very similar to a market transaction, in the standard (neo-classical) sense of the word. It is not a surprise if George Stigler characterized the "Coase theorem" without referring to transaction costs, and that he mentioned competition instead: "[t]he Coase theorem thus asserts that under *perfect competition* private and social costs will be equal" (Stigler, 1966, p. 113; italics added). "Perfect competition" evacuates the reference to institutions and to the legal environment in which transactions take place. In that case, the analysis can be said to be individualistic (see Marciano, 2018a; Medema, 2020). This result would

[8] To clarify this point, we could refer to Lars Udehn's (2002, p. 489) point about social institutions that "appear only in the explanandum or, better, the consequent of an explanation, but never in the explanans, or antecedent."

prove eventually highly influential on subsequent developments of the economic analysis of law, in Richard Posner's work notably (see below).

However, Ronald Coase did not believe that transaction costs could effectively be equal to zero. He maintained throughout his career that the economist should consider a world of positive transaction costs. Transaction costs were of significant importance in constraining market exchange of these rights. In doing so, Ronald Coase's work departed slightly from the univocal relationship between law (seen as a constraint) and the workings of competitive markets that characterized Aaron Director's and others' work. Pure market transactions were not to be opposed to constrained ones: exchange was unescapably embedded within an institutional arrangement that implied a specific set of transaction costs and consequences on the allocation of resources. Transaction costs mainly captured the essence of the constraints on agents' choice derived from the institutional-legal context. Some commenters even noted (see for instance Pratten 2016, p. 121) that Coase collapses the many "different aspects of social reality (those aspects necessary to achieve co-ordination) into a single category", transaction costs. In any case, as Steven Medema (2016) put it, "the legal regime both determines the initial resting places of rights and influences the level of transaction costs", while "transaction costs, in turn, impact the ability to exchange legal rights."

Having acknowledged the existence of positive transaction costs, Coase also insisted on the need to minimize them, "either by the competitive process or by careful regulation" (Pratten 2016, p. 121). The way Coase approached the relationships between economics and policy was to consider that policy was a form of institutional change (Bertrand 2016). Where government intervention was called upon, alternative institutional arrangements had to be analyzed to establish that government rules or regulations would be efficient. Ronald Coase insisted in the careful historical and empirical examination of the legal institutional setting to provide the analysis with realistic assumptions and evaluation of the benefits of various institutional changes. In many cases, this provided the starting ground for policy recommendations that aimed at maximizing allocative efficiency with the help of the market mechanism.

Therefore, Ronald Coase's reliance on the benchmark of economic efficiency, which is itself based on individual valuation, has an individualistic dimension. However, efficiency is always viewed within an institutional framework. In a number of famous studies, Ronald Coase pinpointed that inefficiency came from a lack of definition of property rights. Once these defined and enforced by the regulatory institution, exchange between individuals would ensure that resources are allocated to their most productive use. This can be illustrated notably by Ronald Coase's recommendations to change the broadcasting policy in the UK. Ronald Coase offered to break the public monopoly by giving a transferable property right to each frequency and let bargaining set the prices that led to an efficient allocation of resources. Yet, he also considered that individuals' preferences were embedded in a certain set of social conventions. He notably proposed that the system remains public, and criticized a conservative proposal to introduce privately run companies to add to the public supply, as he was well aware that such a proposal would be met with intense skepticism by a population attached to public service (Levy and Peart 2020, p. 250).

Thus, Ronald Coase's analysis remains individualistic in the sense that no social entity is endowed with agency: only individuals do act. Yet, Ronald Coase departed from the radical individualistic stance characterizing some of the more formal post-World War II economic theories by rejecting reductive assumptions about individuals, refusing notably to assume that they were utility maximizers. Indeed, Ronald Coase (1978a, p. 208) found economic theories of utility "sterile" because they do "not tell us why people choose as they do" (Coase 1988, p. 5), what are "the purposes which impel people to action" (Coase 1978b, p. 244) and "for which they engage in economic activity" (Coase 1978a, p. 208). He insisted on this very point, economics is "the study of man as he is and the economic system as it actually exists" (Coase 2012). He also criticized economic theories of the firm because they presuppose the existence of firms and focus on how they function (the process of production) without explaining why individuals come to create firms (Coase 1988, p. 5).

In a way, Ronald Coase's approach reminded of Aaron Director's, George Stigler's, and the economists who had preceded him in that he was endeavoring to enrich mainstream economists' individualistic analyses of exchange and allocation of resources with considerations regarding the legal environment. Contrary to how his "theorem" would be used in subsequent economic analyses of law, his interest in law and economics remained that of ''an economist'' (see, for instance, Coase in Epstein et al. 1997, p. 1138), as he, for instance, wrote "The Problem of Social Cost" as "an essay in economics" that was "aimed at economists", not legal scholars. What [he] wanted to do was to improve our analysis of the working of the economic system," not of the law (Coase 1993, p. 250).

Nonetheless, improving the analysis of the economic system required to provide individualistic explanations for the emergence and functioning of institutions. For instance, in "The Nature of the Firm" (1937), he opened the door to an analysis of institutions as emerging out of individual choice. Indeed, the choice of having interactions through a market or to set up a firm to organize interactions is a matter of transaction costs (Coase 1937). From this perspective, the existence of firms remained explained in individualistic terms. Firms are a nexus of contracts that are decided and signed by individuals. Regarding the regulatory regime, Ronald Coase also sketched ideas about legal change, as he addressed the reinforcing dynamics between individuals and institutions (Medema 2016). A given property rights distribution implied some benefits and costs, thus, in return, incentivized those who lose to pressure for legal change. Although not the center of his work, "Coase's analysis of the regulatory environment in Britain is replete with illustrations of business interests attempting to shape state action to their own benefit" (Medema 2016, p. 299).

3. Law as an Incentive towards Social Optimum: the Birth of an Economic Analysis of Law

Besides "The Problem of Social Cost" (Coase 1960), another article, published in 1961, played an important role in the development of a new relationship between law and economics: "Some Thoughts on Risk Distribution and the Law of Torts," written by Yale law professor Guido Calabresi. With this article, Guido Calabresi did what Aaron Director, George Stigler and Ronald Coase had not done: he used economics to analyze a legal problem. Guido Calabresi's article thus contributed to change the nature of the field, and accordingly to a change in its methodology. Partly, this was due to how Guido Calabresi envisaged the nature and role of law. To Guido Calabresi, the purposes of law, in the specific case of his article, accident law, were both to spread losses and minimize the costs of accidents. Not long after his first paper, Guido Calabresi (1965a) introduced the concept of "deterrence" in his analysis to characterize another goal at which accident law should aim. Guido Calabresi's focus on deterrence implied that law could act as an incentive on individual behaviors. This means, as a corollary, that analyzing how individuals react to laws and other rules becomes crucial to understand how the law can minimize the costs of accidents. Therefore, an analysis of the functioning of the legal system can be made at the individual level. This is exactly what Guido Calabresi did when he discussed how individuals would react to different types of liability rules. Although he argued that individuals were not as rational as economists assume, Guido Calabresi nonetheless also claimed that they were sufficiently rational to react to the incentive effect of legal rules. In other words, although the legal system was depicted as having a collective objective, the analysis proceeds by using an individualist method—at least, partially, as we will show in the next section. With this approach, Guido Calabresi departed from the standard and admitted view about tort law as a mechanism to ascribe liability to faulty individuals, who should consequently pay for the accident they had caused. More broadly, in the 1960s, a "fundamental tension" existed between those who saw tort law as "an instrument for admonishing currently undesirable civil conduct" and those who see it as "a means for compensating injured people" (White 1980, p. 147).

Besides Guido Calabresi, some economists also endowed law with a social purpose, and made its deterrent effect one of its mechanism.[9] One of them was Simon Rottenberg, whose 1965 article on liability used an individualist approach while ascribing a collective objective to the law. Rottenberg (1965, p. 108) explained that "the primary economic object of a liability rule applied to

[9] Harold Demsetz's 1964 "The Exchange and Enforcement of Property Rights" is yet another example.

activities causing personal injuries or death is the prevention of accidents, and this because either of these occurrences deprives society of the output the injured or dead person may have produced had the accident not occurred." In other words, preventing accidents was meant to "maximize… social welfare" (p. 108). Elsewhere in his article, Simon Rottenberg mentioned the need to reach a "social optimum" (p. 113). Thus, accident law and liability rules have an instrumental role to play and indeed, to use Rottenberg's words, a "social purpose" (p. 108). To reach this goal, and to define a proper liability rule, however, one could use economics and an individualistic method. It was, in Rottenberg's view, a matter of incentives that "may take the form of costs imposed upon those whose behavior causes accidents." (p. 108) For instance, Simon Rottenberg analyzed how air carriers would react to different types of legal rules. He ended up with a liability rule that incorporated "self-insurance." This was the most appropriate rule because it would "cause the maximizing behavior of the carriers to coincide with the requirements of the interests of society in the aggregate" (p. 114).

Another landmark paper in the analysis of law and deterrence is obviously Gary Becker's (1968) "Crime and Punishment: An Economic Approach." Gary Becker's article does not seek to provide an economic analysis of law *per se*. The object is not to study how laws are defined or devised. Like Guido Calabresi and Simon Rottenberg, Gary Becker wrote a paper about the proper amount of sanction (legally defined) and probability of arrest (determined by the whole law enforcement process) that maximize social utility. In other words, his goal was to study what are the best ways to control crime. Thus, because crime combat is costly, an optimal response to criminal activities imply to allow for a certain amount of crime that is too costly to deter, and answer the question "how many offenses *should* be permitted and how many offenders *should* go unpunished?" (Becker 1968, p. 170, emphasis in original).

Anticipating his later definition of economics as an approach to human behavior (e.g. Becker 1971; 1976), Gary Becker used an economic model to analyze crime, thus offering a very different approach from the criminological mainstream of the time, dominated by the influence of the delinquent subcultures approach inspired by sociology (see Fleury 2021). In Gary Becker's initial model, self-interested and rational individuals maximize an expected utility function. Thus, individual calculations are the basic unit upon which a social welfare function that aggregate individuals' welfare can be built. However, Gary Becker's objective remains to minimize social costs. He indeed moved to the minimization of a social cost function, which, again, balances the costs of producing enforcement as well as the harm generated by crime, all calculated from the aggregation of *individual* costs and harms. Gary Becker (1968, p. 181) notably claimed that such an approach to crime control would enable to "go beyond catchy phrases" and give "due weight to the damages from offenses, the costs of apprehending and convicting offenders, and the social cost of punishment." Subsequently, scholars in the economics of crime modeled social welfare functions to compute the difference between aggregate individual gains and harms of crime measured in monetary units (see, for instance, Polinsky and Shavell 2000).

As with other above-mentioned approaches, Becker's economics of crime control starts with individuals and focuses on how their responses to incentives influence the level of crime. But here again, individual choice is partly influenced by the institutional and cultural setting for a few different reasons. First, in Gary Becker and George Stigler's 1974 article, the malfeasance of enforcers who accept bribes depends partly on what the authors call "the supply of honesty" (p. 3), although strictly economic considerations such as repeated interactions also play a strong part. Secondly, because, as illustrated by Gary Becker's 1968 paper, rules that lead to a certain level of punishment appear only to be prices or costs that are included in the individual cost-benefit analysis. So these rules are part of the constraints individuals have to take into account to make their decisions. These rules are exogenously given. They are not explained, not even in individual terms. This will also characterize the economic analyses of law enforcement that were developed after Gary Becker's seminal paper. These works explored various types of punishments, from fines to imprisonment, the effects of various liability rules, and discussed their links with individuals' behaviors toward risk and final social outcome in terms of crime control (see Polinsky and Shavell 2000).

Overall, the economic analysis of optimal enforcement is largely an endeavor at normative economics. An important question, in this respect, explores whether law enforcement should be a strictly public matter or whether there is room for private enforcement (see Polinsky and Shavell 2000). Gary Becker and George Stigler (1974), notably, argued in favor of perfect competition among private enforcers, suggesting that the public monopoly of enforcement may be inefficient. The assumption that institutions, particularly legal rules, emerge to improve efficiency, provides generally the intellectual link bridging normative analysis of crime control to a more positive analysis of legal rules.

Gary Becker's discussion of fines, although still within a normative outlook, certainly paved the way for the subsequent development of more "positive" economic analyses of law. To Gary Becker, fines are, in numerous cases, an optimal sanction from the collective point of view, because they ensure that individual harm done by criminals or delinquents has been correctly compensated at a very low cost (far lower than imprisonment and other heavier sanctions). This led him to consider that sanctions, as said, mostly defined by law, should be studied from the point of view of economic theory. Of course, the first aspect that comes to mind is the magnitude of sanctions: Becker provides a policy guide to establish optimal criminal sanctions, defined by criminal laws, in order to maximize social wealth.

But that is not all. Gary Becker's analysis of fines addresses the nature of sanctions as well. As he (1968, p. 193) noted, "legislation usually specifies whether an offense is punishable by fines, probation, institutionalization, or some combination." Here, the overarching model is one reminiscent of Arthur Pigou's welfare approach. Crime is defined as uncompensated harm, and fines act like a tax to bring compensation and induce criminals to reduce their production of negative external effects. Gary Becker, then, conjectures that if fines were to be adopted as the primary mode of punishment, then it would change the social purpose of law and enforcement policies, as fines aim primarily at compensating harm, and less at deterring or inflicting vengeance. Under that approach, legal proceedings would become an activity that seeks to assess the amount of harm done and to devise optimal fines. "Much of traditional criminal law would become a branch of the law of torts, say, 'social torts'… A criminal action would be defined not by the nature of the action but by the inability of a person to compensate for the 'harm' that he caused" (Becker 1968, p. 198).

4. William Landes and Richard Posner: Towards an Economic Analysis of Law

Discussing the nature of sanctions and their social effect opened, therefore, the door to a positive analysis of how law enforcement and sanctions emerge and evolve in society, in both the private and public realms. The intellectual trajectory of William Landes illustrates nicely the shift from law and economics to an economic analysis of law, thus anticipating Richard Posner's work.

William Landes initially studied, from a traditional law and economics perspective, the effects of fair employment laws on economic outcomes and unemployment in the mid-1960s. More precisely, William Landes (1967) had used expected utility theory to model the decision of firms to comply or violate anti-discrimination laws. Then, after having defended his PhD in 1966, William Landes used the same framework to analyze a phenomenon that was troubling him: that less than 10 percent of criminal cases went to trial. To solve this puzzle, William Landes analyzed "the conditions under which a pretrial settlement or trial will take place" (Landes, in Downs *et al* 1969, p. 505). In his model, pre-trial arrangements were the results of individual optimization. Indeed, William Landes assumed that that not only the suspect (1969) or the defendant (1971) but also the prosecutors were utility maximizers—"the basic assumption of the model is that both the prosecutor and the defendant maximize their utility, appropriately defined, subject to a constraint on their resources" (Landes 1971, p. 61). More precisely, the utility of prosecutors is assumed to depend on "the expected number of convictions weighted by their respective *S*[entences]" (Landes 1971, p. 63). Therefore, he argued, "the prosecutor and defendant would reach a plea bargain on a sentence if both could be made better off compared to risking an uncertain trial outcome" (Landes 1997, p. 34). That was the Coase theorem applied to prosecution. Landes, therefore, shifted emphasis from an analysis of the effects of specific laws on economic behavior, to an economic analysis of legal procedures, here, pretrial arrangements. Moreover, the shift in emphasis exemplified the individualistic analysis of a social entity (the judicial process).

William Landes's work also foreshadowed important conclusions in the economic analysis of law: that the judicial process tended to move toward efficiency. This idea had already been developed by Guido Calabresi about some areas of the common law in the 1960s. In William Landes's work, the optimal level of conviction, which depended on the amount of resources prosecutors devoted to cases, was reached as the result of prosecutors' individual rational decisions. In other words, prosecutors' individual behavior contributed to the efficiency of the legal system. Yet, William Landes does not clarify the premises on which such an individualistic outlook rest. Indeed, on the one hand, the only consideration taken into account in prosecutors' calculus is the expected number of convictions while, on the other hand, prosecutors make their decisions by maximizing "the community's welfare for a given resource level" (Landes 1971, p. 63). How does the individual decision rule coincide with a social optimum? William Landes does not answer the question. He thus does not explain the articulation between individual choice and social ouctomes.

A similar difficulty characterized Richard Posner's work on the economic analysis of law, that he developed alongside (and sometimes in collaboration with) William Landes.[10] Richard Posner followed both paths of Ronald Coase and Guido Calabresi by discussing the efficiency of the entire Anglo-American legal system, using, like Guido Calabresi (1961; 1965; 1967; 1970), a framework based on the tools of economics (see Posner 1971, p. 202; 1973a, p. 3; 1973b, p.399). This resulted in Posner framing the common law as method "to allocate responsibilities between people engaged in interacting activities in such a way as to maximize the joint value, or, what amounts to the same thing, minimize the joint cost of the activities" (Posner 1973a, p. 98). Common law was understood by Richard Posner as "a pricing mechanism designed to bring about an efficient allocation of resources" (Posner 1987, p. 5). In cases when high transaction costs prevent markets from working properly, the common law replaces the market: "[T]he common law prices behavior in such a way as to mimic the market" (Posner 1992, p. 252). As such, judicial decisions can be said to be made "as if" they intended to replicate the functioning of a perfectly competitive, efficient, market (Backhaus 1978; 2017; Marciano 2018).

Richard Posner's defense of the efficiency of the common law was nonetheless individualistic, partly because the social efficiency of markets, as the result of exchange among maximizing individuals, constituted the benchmark. To Richard Posner, wealth maximization is a

[10] Richard Posner is a key scholar in the development of the economic analysis of law. The field, ever since its creation in the early 1970s, addressed topics ranging from judicial decisions and the formation of rules within the legal system, to informal rules and norms in primitive societies.

superior criterion of justice, firstly because it derives from consent—as it necessarily comes out of market transactions. Moreover, wealth maximization avoids the pitfalls of utilitarianism, in particular interpersonal comparisons. Indeed, Richard Posner claimed, “a dollar is worth the same to everyone” (2000, p. 1,170). Precisely because “it treats a dollar as worth the same to everyone” (2000, p. 1,154), wealth maximisation, or the Kaldor-Hicks criterion, ‘leaves out of normative consideration…distributive justice” (ibid.; see also Posner 1985a, p. 104). What matters only is allocative efficiency, in other words “welfare is increased when a policy inflicts a dollar loss on the losers from it and confers a dollar and five cents gain on the winners even though the losers are not compensated” (Posner 2000, p. 1,170). To Richard Posner, questions of distributive justice concern only the legislatures – public policy, not courts. Hence, methodological individualism grounds the judge’s calculus of wealth maximization, as it is based solely on the aggregation of individual evaluations in money estimates.

Another aspect of the individualistic dimension of Richard Posner’s work comes from the links between the efficiency of the system and the behavior of judges. Richard Posner insisted on that the Common Law is an efficient legal system and this was because it was a judge-made law. He indeed believed (and claimed) that judges “are guided by concern with economic efficiency” (Posner 1971, p. 223) and “think in economic terms” (p. 224), so that one can “assume that judges make their decision in accordance with the criterion of efficiency” (Posner 1973a, p. 325). Or, one could say, *each* judge decides in accordance with the criterion of efficiency by comparing the costs and benefits associated with the action under scrutiny. Thus, the criterion for judging the results of judicial decision was strictly grounded on individual welfare. Yet, as with William Landes’s 1971 weakly justified decision rules for prosecutors, precise reasons for why individual decision-making and social efficiency coincide were not provided. In other words, Richard Posner jumped from an individualistic analysis to a global, aggregate conclusion. Thus, scholars such as Rutherford (1994) have noted that Posner’s approach actually leaned closer to functionalism. Indeed, what Posner initially did was to give purpose (efficiency) to a social entity (law).[11]

Thus, in a way that was very similar to Gary Becker’s and William Landes’s works, Richard Posner was not interested in judicial behavior in itself. From this perspective, Richard Posner’s (1993) later economic analyses of judicial behavior —in which judges are assumed to be “rational” (Posner 1993, p. 3) and to “respond rationally to ordinary incentives” (p. 1)— were a by-product of his primary interest in the efficiency of the legal system (Marciano, Melcarne and Ramello 2020).

[11] In functionalist approach, different social institutions perform a specific function that contributes to the stabilization and survival of societies.

During the 1970s and 1980s, the rapidly growing subfield of the economic analysis of law, occasionally bolstered by some contributions in the fields of public choice, developed analyses of rules, constitutions, norms and customs, which relied on strong individualistic premises. In these cases, social institutions are shown to emerge from repeated games. Although these approaches rested on a narrower conception of methodological individualism, where agents are not influenced by external and environmental factors (such as ethical views, norms, etc.) – they are only driven by the maximization of a very limited set of variables, generally income—these models are not devoid of considerations for the social context. One may mention, for instance, that the origins of the rules of the games to be repeated are not specified, and ultimately imply some sort of reliance to an institutional environment, or that there is common knowledge among agents. Such description extends to the larger movement labeled "New Institutional Economics," comprised of the Property Rights approach developed by Armen Alchian and Harold Demsetz (1973, for instance), Oliver Williamson's works in the theory of organizations, as well as works in history, such as those of Douglass North. Like Richard Posner's work, that movement also , sought to endogenize institutions in an economic framework based on individual choice (Rutherford 1994).

5. Heterodox economic analysis of law: Calabresi

To conclude our overview of the use of an individualist methodology in the law and economics movement, it is important to come back to the views of one of the founders of the field, already mentioned in a previous section, Guido Calabresi. He stood as one of the most important representatives, if not the leader, of the so-called "New Haven School of Law" (Medema and Mercuro 2006), a school that studied the place of courts in the regulatory regime, the latter aiming at solving market imperfections. Although he was the first to claim that law had deterrent effects on individuals (whether or not the latter are rational), and the first to formulate the intuition for the Coase theorem, Guido Calabresi's work deserves a section of its own because of his use of methodological individualism that differs slightly from what the other scholars above-mentioned did.

Guido Calabresi (1961, p. 506) was one of the firsts to claim with his "pure loss distribution theory" that, from the perspective of economic analysis, the assignment of the burden of costs, the distribution of losses and the assignment of liability to one party or the other have no impact on the final allocation of resources: "[t]here are naturally, some situations where… it actually does not matter who bears the loss initially" (1961, p. 506; see also Calabresi, 1965a, p. 725-726; 1968, p. 67). Guido Calabresi, to put it in clearer terms, reached the same result as Ronald Coase and [12] scholars

[12] The story has been recounted many times, including by Guido Calabresi himself: the first version of his 1961 article, written in 1957, included a reference to causation, and accordingly a pre-Coase version of the Coase

eventually talked about the Coase-Calabresi theorem.[13] The similarity between the findings of Ronald Coase and Guido Calabresi seems even clearer when the latter insisted on the importance of bargaining: "situations in which it will not matter which of two activities initially bears the cost of an accident are all the situations in which the two or more possible accident-causing activities are related by bargaining" (1965a, p. 725-726). Indeed, through bargaining, "the least expensive way to minimize the loss will be sought out and used whichever of the two is initially liable" (p. 726). From this perspective, Guido Calabresi's analysis is as individualistic as Ronald Coase's.

Furthermore, like Ronald Coase, Guido Calabresi doubted of the practical validity of that result because it could hold only if the economy was perfectly competitive. But Calabresi also departed from economists in claiming that a bargaining process would work only if individuals were perfectly rational. None of these two conditions are actually fulfilled in the real-world. Monopolistic firms benefit from a strong market power in a potential bargain while human beings have little bargain power because of the several cognitive biases that affect them.[14] Monopolies and other forms of deficiencies in competition exert a strong influence on the choice set of individuals. Therefore, Coasean bargains—so dear to Richard Posner and George Stigler—could not work in the real world. It was indeed unlikely that the optimal amount of activities could be reached by "voluntary" arrangements among members of society. What such arrangements could bring was necessarily influenced by the power firms benefited from. For instance, Guido Calabresi (1970, p. 50) wrote that, in the case of accidents, "people individually do not or cannot voluntarily insure against accident risks to the degree they collectively deem desirable," which hinted at the need for accident laws to take into account that market failure.

This had implications on how Guido Calabresi approached methodological individualism. Guido Calabresi claimed that automobile manufacturers were most of the time in the best position to determine how to minimize the costs of accidents. From this perspective, it seems that firms (or workers or drivers and pedestrians) are treated as categories. It is unclear however whether Guido Calabresi treated these categories as individual entities or, to the contrary, if reasoning with categories meant that individuals disappeared behind the categories to which they belonged. It is likely that here, drivers or pedestrians are not considered as individuals but, rather, as the expression

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theorem. Although convinced that he was right, Guido Calabresi removed this passage after Ward Bowman had told him that he was wrong because of what Pigou had written. And he eventually regretted it (see Kalman, 2014). Had he not followed Bowman's suggestion, a "liberal version" of the Coase theorem "would have been available at the creation," and those who "tried to make of economic analysis of law a basis for blindly supporting the status quo would have found their path more difficult" (Calabresi, in Shapiro 1981, p. 113).

[13] For an analysis of the similarities and differences between Ronald Coase and Guido Calabresi, see Alain Marciano 2012, and Steven Medema 2014.

[14] This is why it could be argued that "Many of the ideas of behavioural law and economics were hence already implicit in Calabresi's writings" (Faure, 2008, p. 75).

of a specific group, acting only as members of a group. The treatment of the individuals by Calabresi is methodologically ambiguous. It certainly alters the individualistic dimension that characterizes the Coasean bargaining process.

Consequently, the claim that it did not matter who bears the loss initially was no longer valid. To Guido Calabresi, starting points, that is the rights initially granted to individuals, do matter in the bargaining process. In the case of accidents, because workers or pedestrians were not able to assess the risks of accident as employers or car manufacturers were, whether the liability was put on the firms than on the drivers, or on the employers rather than on the workers was crucial to minimize the costs of accidents.

Pushing the analysis further, Guido Calabresi also argued that, since starting points and liability rules matter, distributional problems should be taken into account in the analysis. This meant that Calabresi opposed Posner and many economists, for whom economics should focus on the allocation of resources, while distributional questions should be rejected as outside the realm of economic analysis of law. Now, such questions play a significant part in conditioning individual choice. In standard economic theory, individuals are assumed to agree with the condition of choice, and with the initial distribution of wealth. Guido Calabresi rejects that starting point, as we said above. To Calabresi, the traditional stance that wealth distribution is outside of the scope of neoclassical economics does not apply for legal issues: legal decisions and rules determine conditions of choice and starting points, hence, they have to be considered by the legal scholar.

Therefore, Guido Calabresi departed from Richard Posner's work by insisting that criterions of fairness and justice be used to judge the various methods to reduce costs suggested by an economic analysis of law. What mattered, ultimately, was that legal rules "comply with our general sense of fairness" (Calabresi 1970, p. 26). Contrary to Richard Posner, efficient solutions that violate a general sense of fairness are to be abandoned, as when a decision would, for instance, overly favor rich people against poor people. Law and economics is conceived as a discussion that goes back and forth between distribution problems and choice. On the one hand, there are general goals and collective values decided at the collective level. On the other hand, there are concrete everyday questions that are too complex to be dealt with collectively. In the latter case, economics brings interesting analytical tools, although, again, economics does not offer ultimate goals. This is why Guido Calabresi argued for a certain level of loss spreading in accident law, partly to compensate for individuals' lack of rationality, partly to avoid "social dislocation" (see Hackney 2007, pp.115-120).

Perhaps one recurrent difficulty in Guido Calabresi's approach was that he seemed to have failed to offer a precise theory that would explain how these goals and criterions of justice would be determined (Hackney 2007, p.138). Efficiency is one important goal; however, Guido Calabresi's own take on contemporary society's preferences over the distribution of wealth led him to advocate a system that also protects the poor and the aged (Hackney 2007, p. 139). This is the source of Guido Calabresi's "middle theorizing": using a quite individualistic scientific framework alongside considerations about collective value judgments where one relies also on "indications of society's distribution preferences" (ibid. p. 139). Here, Guido Calabresi's position clearly departed from the standard neoclassical analysis of law, according to which, notably after the clarifications of Steven Shavell (1981, see also Kaplow and Shavell 1994), made clear that distributional concerns should only be tackled through the tax system, leaving law dealing only with efficiency (see also Hackney 2007, p. 147). But although economists have consistently striven to produce narrowly individualistic accounts of both legal problems and the tax system within the frameworks of economics and game theory, Guido Calabresi's attempts to tame economics with justice and ethical considerations have resulted in a less individualistic and perhaps fuzzier methodological approach that was regularly criticized by, among others, Richard Posner.

Conclusion

In this chapter, without trying to be exhaustive, we have reviewed the theoretical approaches and results adopted by the main contributors—the founders, indeed—to the law and economics movement. Our goal was to reflect on their use of methodological individualism. *All* of them considered that the analysis of legal phenomena had to start from individual behavior, even as these very behaviors were embedded, to various degrees, though not determined, in legal and institutional frameworks. In that, they followed on the path opened by the authors mentioned in the introduction. With this method, economic approaches have led to original and influential outcomes, both in the study of how legal rules shape economic outcomes (the "old" law and economics) and in the economic analysis of law. It allowed analysts to provide a clearer, and, to many, a more rigorous way of evaluating the outcomes of rules and decisions, based on individual welfare.

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