

The Role of the Law Schools in the Recovery from the Current Depression

The Atlantic: A Failure of Capitalism

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The law schools were caught by surprise by the financial crisis of last September and the ensuing descent into what, realistically, must be regarded as the first depression (as distinct from merely a recession) since the Great Depression of the 1930s. (This is not--so far, at any rate, a repeat of the Great Depression--but it is a depression.) When I say they were "caught by surprise" I mean first of all that the training and research of academic lawyers have not been oriented toward macroeconomic issues or even issues of financial structure. There are many able professors of bankruptcy law, secured transactions law, and the legal regulation of securities (including futures contracts and other derivatives), but very few who study financial intermediation as a whole, and almost none who combine a deep knowledge of the financial system with an understanding of the economics of the business cycle, important as the financial system is to the cycle, as we now know.

To these limitations of knowledge must be added a career structure in academic law today that is inimical to research oriented to practical solutions to current problems. This limitation has two aspects. First, recruitment of academics from practice has declined, as academic law has become progressively "academified" and specialized. Increasingly, in imitation of more conventional academic disciplines, legal academics are expected to focus the research component of their work (and this inevitably influences the teaching component) on specialized research the results of which are publishable in academic journals read mainly by other academics in the author's specialized subfield. The preparation and publication of such research are time-consuming endeavors and therefore are ill adapted to responding constructively to rapidly evolving current issues, especially ones that cross disciplinary and subdisciplinary boundaries.

As a result, with a few notable exceptions, such as Lucian Bebchuk, Edward Morrison, and Steven Schwarcz, academic lawyers (and Bebchuk and Morrison have Ph.Ds in economics, as well as law degrees) have not made a contribution to the understanding and resolution of the current economic crisis, even though it bristles with legal questions. And I don't mean only or primarily legal questions that can be readily answered on the basis of orthodox legal materials; for those questions can be answered adequately by the large, sophisticated law firms engaged in a commercial or corporate practice. I mean rather legal issues that cannot be resolved intelligently without consideration of issues of policy--in the present instance issues of economic, including macroeconomic, policy. And not only legal issues, but issues of economic policy to which legal knowledge is relevant, even if the issue itself is, for example, legislative in character, rather than requiring the application of existing law.

I will list a few issues of both kinds (application of existing law, and whether to create new law), in no particular order:

1. Whether, given the economic emergency presented by the collapse of the global banking industry last September, Federal Reserve chairman Ben Bernanke is right in claiming that the

Federal Reserve lacked legal authority to save Lehman Brothers, which was at or near the center of the crisis. (I have touched on this issue briefly in a previous blog entry.)

2. Whether a bankruptcy judge should be permitted to cram down the mortgage on a primary residence (that is, reduce the mortgage to the current market value of the mortgage property).

3. In a bankruptcy, should government bailout loans be given priority over claims of secured creditors?

4. Is there any constitutional limitation on the federal government's abrogating a private contract, for example a contractual obligation to pay bonuses to employee of AIG?

5. In cases in which the depression prevents a firm from honoring a contract, can it ever appeal to such doctrines of contract law as impossibility and frustration, or to such common contractual provisions as force majeure clauses and material adverse conditions clauses, to be excused from performance without incurring legal liability for nonperformance?

6. Should bankruptcy law be amended, with respect to the bankruptcy of financial institutions, to bring it closer to the "resolution" procedure by which the Federal Deposit Insurance Corporation winds up the affairs of banks that go broke. Were that done, would resolution still be a superior method of dealing with bankrupt financial institutions (not limited to banks)?

These are issues of law and policy that cannot be sensibly resolved without considering the impact of their resolution on the macroeconomy. Will a suggested resolution reduce or increase the likelihood of a future depression? Will it retard or promote recovery from the current depression? What other costs and benefits is it likely to produce? These are not questions that a lawyer can answer, but they are questions that a law professor steeped in macroeconomics and financial economics, or working with a macroeconomist or finance theorist, can contribute materially to answering. But to be able to make this contribution before the train leaves the station--before the workaday legal and political systems grave an answer in stone--will require a change in the outlook, work habits, and even recruitment criteria of academic lawyers.