2014

Magnus Magister: An Affectionate Appreciation of Armen Alchian

Fred S. McChesney
University of Miami School of Law, fmcchesney@law.miami.edu

Follow this and additional works at: https://repository.law.miami.edu/fac_articles

Part of the Law Commons

Recommended Citation
Fred S. McChesney, Magnus Magister: An Affectionate Appreciation of Armen Alchian, 10 J.L. Econ. & Pol'y 589 (2014).

This Article is brought to you for free and open access by the Faculty and Deans at University of Miami School of Law Institutional Repository. It has been accepted for inclusion in Articles by an authorized administrator of University of Miami School of Law Institutional Repository. For more information, please contact library@law.miami.edu.
MAGNUS MAGISTER: AN AFFECTIONATE APPRECIATION OF ARMIN ALCHIAN

Fred S. McChesney

When my life is through
And the angels ask me to recall
The thrill of them all
Then I will tell them I remember you.¹

The story of Hayek’s prediction that neither Ronald Coase nor Armen Alchian would ever win the Nobel Prize in economics is now familiar to most economists.² Hayek was, of course, proven half wrong when Coase was awarded the prize in Stockholm, but alas, he was half right. Armen Alchian never acceded to Nobelism.

At least the Scandinavian gods sometimes get it right—their recognition of Jim Buchanan is another such example.³ It is hardly obvious that Armen’s exclusion from Valhalla means much, if anything. A review of those honored with the prize, since it was first awarded in 1969 to Ragnar Frisch and Jan Tinbergen, indicates that laureate status is not a sufficient condition for truly long-run economic greatness or even for durable impact in the profession.

Nor is it a necessary condition, as the life of Armen Alchian proves. His manifest durability is a function, of course, of his numerous and important contributions to our economic understanding.⁴ But Armen’s continued greatness is assured not just by his creating a new way of thinking

¹ De la Cruz/Mentschikoff Professor of Economics and Law, University of Miami.
² VICTOR SCHERTZINGER & JOHNNY MERCER, I REMEMBER YOU (1941). The song, supposedly written by Johnny Mercer for Judy Garland, was first recorded in the early 1940s by Jimmy Dorsey and has been sung by many. It was a big success for Frank Ifield, reaching number 1 on the British and number 5 on the American charts in 1962.
⁴ Per my commission, this paper largely concerns Armen Alchian. However, I cannot write about Armen without some mention of another honoree at this conference, Jim Buchanan. Knowing Jim has likewise been a memorable part of my life as an economist. He was, of course, one of the few greats in economics. But he was also a delightful person, except, perhaps in some seminars at the University of Virginia, and later at Virginia Tech, in which Jim did not suffer fools gladly. And he was just a wonderful raconteur. He was a Southerner, after all.
⁵ “If time is the ultimate test of the value of these ideas, Armen’s work has met that test.” John R. Lott, Jr., ARMEN A. ALCHIAN’S INFLUENCE ON ECONOMICS, 34 ECON. INQUIRY 409, 411 (1996).
about economic problems, but also by his work to pass it on to the next generation. Even among Nobelists, there can have been no better, more patient a teacher than Armen Alchian.\(^5\)

That is an empirical claim, and so empirical evidence of Armen’s pedagogic talents and influence are desirable. In this short piece, I offer a slight bit of evidence that I hope is convincing. It is based on a small sample: myself. Unlike many Alchian acolytes, I was not a teaching colleague or graduate student of his, although I was the beneficiary of learning from many who were: Louis De Alessi, Dave Haddock, Ken Clarkson, Roland McKean, Don Martin (bless him), just to name some.\(^6\) And so I came to understand, indirectly, what a careful and patient teacher Armen was. But I was fortunate to have more direct, unforgettable experiences with Armen Alchian.

Indeed, my induction into the ranks of card-carrying economists is partly due to him. While a fellow at Henry Manne’s Law & Economics Center at the University of Miami in the 1970s, I read Armen’s justly celebrated article with Harold Demsetz on the firm.\(^7\) The focus of the Alchian–Demsetz article was the problem of worker shirking in firms and how to mitigate it. One way to do so, they noted, was profit sharing. Profit sharers have a reduced incentive to shirk themselves and, in particular, have greater motivation to monitor shirking by nonsharers.

The fundamental Alchian–Demsetz thesis today is routinely acknowledged for its insights, and at the time (still short of my doctorate), I had no quarrel with it, for the most part. The idea of profit sharing to mitigate shirking made complete sense. However, it did not, I thought, explain all profit sharing. To me, in a brief and rather inconsequential application of their model to law firms, the authors had erred.

I did not think that law firms’ general use of the partnership form, with multiple owners sharing profits, was explained by shirking. Lawyers had

---

\(^5\) A notable exception is James Buchanan. Although Buchanan promoted public choice and Alchian promoted property rights, both sought to create a new way of economic thinking and to inspire a generation of adherents to spread the word to the profession.

\(^6\) As Jim Buchanan is also being feted at this conference, I should note that I have learned much from Jim’s students, as well, including Richard Higgins, Jim Miller, Bob Tollison and, particularly, from Charles Goetz, whom Jim always singled out as “the best graduate student I ever had.” Charlie was the first reader on my dissertation (i.e., chairman of my committee at the University of Virginia) and has been a long-time coauthor and close friend. Few people are aware that after Jim’s expulsion from the University of Virginia, and during his year as a colleague of Armen Alchian’s at UCLA, it was Charlie Goetz who realized that the student uprisings at UCLA would greatly upset Jim, and he seized the opportunity to call Jim to suggest that heading back to the calmer academic world in the Commonwealth of Virginia might make sense. Jim quickly agreed and moved back East to join Charlie at Virginia Tech.

\(^7\) See generally Armen A. Alchian & Harold Demsetz, Production, Information Costs and Economic Organization, 62 AM. ECON. REV. 777 (1972) (discussing mitigation of the shirking problem within firms).
many ways of monitoring intrafirm performance, I argued (and detailed with descriptive evidence). Moreover, if shirking explained resort to partnership, the number of partners should increase at an increasing rate as the total number of lawyers (including associates) rose, increasing the ease of, and so the amount of, shirking. However, my econometric tests showed that the number of partners decreased as the number of lawyers rose and so the supposed amount of shirking was increasing.

Instead, I claimed, profit-sharing status in law firms reflected a division of labor in the firm. Those who were essentially producers remained nonsharing associates; those who could market the firm ("rainmakers") became partners, where they shared in the profits from clients they generated. There is little opportunity for shirking in landing clients; the source of the firm's clients is easily tracked.

I had written all this in a paper that Henry Manne, then Director of the University of Miami's Law & Economics Center (LEC) had read. It so happened that Armen was about to come spend some time at the LEC, as he often did. I was an Olin Fellow at the Center, and Henry urged me to talk to Armen about my alternative hypothesis for profit sharing in law firms. I tried unsuccessfully to beg off, fearing that an interchange with such a famous economist (whom I had never met) would be too demoralizing.

I was therefore stunned by Armen's reaction. I told him I thought he and his coauthor were wrong about the reasons for profit sharing in law firms. He instantly brightened and asked me to explain. When I did, he at first said nothing—confirming my fears of discouragement. He finally responded, speaking carefully and slowly. He said he did not think he and Demsetz really knew that much about law firms and that my alternative hypothesis (buoyed with actual empirics) made more sense to him.

My head was spinning as I left the room—I was so thrilled. I was pleased, of course, by his positive "take" on my idea. But more stunning was his genuine interest in what I proposed, my economic thinking behind it, and especially his great patience throughout our conversation. I thought to myself that Armen seemed to actually enjoy our exchange and hearing what I was thinking.

So encouraged, I successfully submitted the paper, my first publication of any significance. And, at the suggestion of the first reader on my dissertation committee—Charles Goetz—I included the article, once accepted for publication, in my dissertation as a way to convince my balky third reader.

8 The importance of Armen Alchian in sparking Manne's perception of the power of economics to elucidate law remains a largely untold tale, but one worth telling. See infra note 23 and accompanying text.

9 Fred S. McChesney, Team Production, Monitoring, and Profit Sharing in Law Firms: An Alternative Hypothesis, 11 J. LEGAL STUD. 379, 379 (1982). Inexcusably, I forgot to include Alchian in the acknowledgements! Armen was famous for advising authors to mention anyone who might deserve it, pointing out that acknowledgements were free.
to approve it. Charlie was right as usual—if peer-refereed professional journals were accepting my work, how could that third reader object? As I was awarded the doctorate, I silently thanked Armen Alchian.

Part of my surprise had been Armen’s interest in my statistics, as rudimentary as they were (t-tests of differences in means, “multiple” regressions—two independent variables!). From his work, I had assumed that he was closer to the Buchanan attitude toward empirics: “I don’t need statistics to prove that water runs downhill.” At the time, I was unaware of Alchian’s deep background in statistics. He had been trained statistically by several extraordinary teachers (e.g., Allen Wallis) while a graduate student. Then, while in the Air Force, he did statistical evaluations of Air Force cadets as part of their training for pilot and other positions. When he came to UCLA, he was given the choice of joining the economics or the statistics department. He taught statistics for years in the economics department. I learned all this from subsequent conversations with Armen.

As I would encounter him over the ensuing years, I realized that my experience was hardly atypical. Ronald Coase was right: Alchian “is classical in manners as well as thought.” He truly enjoyed imparting economics to those who could carry it further. Fortunately for me, our future encounters were frequent, thanks again to Henry Manne and the Law & Economics Center. Alchian visited the Center often, sometimes as part of a conference but often just to be in residence. But perhaps most frequently, Alchian was at the LEC as part of its economics institutes for law professors. This aspect of Alchian-the-Teacher’s life is less familiar, perhaps, to many, but was enormously influential.

There is another facet to Alchian’s career that is less known but of huge significance outside of purely academic economics. In 1971 Professor Manne... organized a summer institute in economics for law professors.... These “summer camps” for law professors continued at various universities for a total of 23 years and were attended by a total of over 600 law professors from the United States and abroad. Armen Alchian did the lion’s share of the teaching in every single one of these programs and thus maybe said to be, in a way, not generally recognized a founder of the field of Law and Economics.

Based on the success of the law professors program, Manne and the Center moved on to establish a similar program for federal judges. Once again, the bulk of the teaching came from Armen Alchian (with “assistants” like Harold Demsetz, Martin Feldstein, Milton Friedman, and Paul Samuelson).

Alchian always said that the judges were the best students he ever taught and, if that was so, the judges certainly reciprocated in their appreciation for him. Many of the judges developed

---


a special bond with Professor Alchian and stayed in touch with him for years. Alchian continued to be the faculty mainstay of that program for over 25 years and thus had an influence on law which is probably greater than that of any non-legal academic.\textsuperscript{12}

Alchian's prolonged participation in the two Center programs, for over two decades, illustrates his indefatigable interest in and energy for economic education, with a particular gusto for those who knew little but were keen to learn more. But in terms of this personal essay, his participation in the lawyers-and-judges institutes was particularly important. Because his lectures were at the Law & Economics Center, first at the University of Miami (where I had been) and then moved with the Center to Emory University (whose faculty I joined), I was always able to stay in touch with Armen by attending many of his lectures as a very interested spectator over the years.\textsuperscript{13}

Those continued contacts were in themselves enlightening, but also led later to a wonderful collaboration. I had conceived an idea that, in 1994, I pitched to the Western Economic Association, to put together for \textit{Economic Inquiry} a series of essays by "sub-laureate" economists of great eminence, in which they would identify and discuss what they viewed as their most important works. I mentioned that the series would begin with Armen Alchian. The Association was uninterested in a series, but was already planning an Alchian \textit{Festschrift}. The editors would be pleased to have me work with Armen to produce the sort of précis I had described, with him to focus on the three articles he thought his best.

I contacted Armen to see if he would be interested in such a thing, with him supplying the conversations, e-mails, and so forth, and me turning it all into a finished article. At first, he demurred. But finally, he agreed, writing, "After my first inclination to say No, I've softened. It probably won't be so hard after all." Thus did I become the avid amanuensis of an economic giant.\textsuperscript{14}

Typical of him, Alchian was reluctant to speak of his work directly. He decided to talk about the three works he thought his best, but only to illustrate points what he thought would be helpful to young economists coming into the trade. He thus titled his essay \textit{Principles of Professional Advancement}, using his three chosen articles as a springboard to discuss

\begin{itemize}
  \item \textsuperscript{12} \textit{Id.}
  \item \textsuperscript{13} My Emory colleague David Haddock, who had taught at UCLA with Armen, often accompanied me to observe the master's techniques.
  \item \textsuperscript{14} My role is described in \textit{An Introduction to Alchian's "Principles of Professional Advancement."} Fred S. McChesney, \textit{An Introduction to Alchian's "Principles of Professional Advancement,"} 34 \textit{ECON. INQUIRY} 519, 519 (1996). This time the acknowledgements were done right, with Louis De Alessi, Tom Borcherding, Frank Wykoff, and Mark Zupan appropriately thanked for their input, through me, of points Alchian covered. \textit{Id.} at 519 n.*.
\end{itemize}
five basic suggestions for success in the profession. The articles concerned uncertainty and evolution in the theory of the firm, measurement of costs and outputs, and information costs. Our work proceeded in fits and starts, as his busy schedule dictated ("Hello Fred. Life has been hectic here the past couple of weeks.") , but was completed in three months.

As we worked on the draft, there were any number of surprises in Alchian’s Principles and in his choice of articles to illustrate them. First, the articles he chose were in two cases predictable: his notable pieces on uncertainty and costs and outputs. But his third choice, on information costs, was relatively obscure. Yet, Alchian wrote, “I like to regard this paper as my best.”

It is interesting that, although Alchian does not mention it, this paper almost never saw the light of day. His UCLA colleague Axel Leijonhufvud recalled years later:

[Alchian] heard some tape of mine where I was worrying about price adjustments in competitive markets .... And so he came to me .... [And] then he gave me out of his desk drawer his classical paper on “Information Costs, Pricing and Resource Unemployment” ....

... Why was that paper in his desk-drawer? I have no idea how long it had been there, but the version I got was pretty yellow. I think of this every week ....

Armen explained to me why it was still in a drawer: “I just started to try to write up the idea in an expository paper, for my own information and understanding.”

19 Alchian, Principles, supra note 15, at 525.
20 Axel Leijonhufvud et al., In Celebration of Armen Alchian’s 80th Birthday: Living and Breathing Economics, 34 ECON. INQUIRY 412, 421 (1996).
21 The story brings to mind Alchian’s Uncertainty and Evolution article, which initially was just a manuscript that he had written for a classroom handout, but was urged to send to the Journal of Political Economy by a UCLA colleague. Alchian, Principles, supra note 15, at 521. It is also reminiscent of how Jim Buchanan’s close colleague, Gordon Tullock, came to publish his most important contribution. Alice Vandermeulen, coeditor of the fledgling Western Economic Journal for the Department of Economics at UCLA, called Gordon in the mid-1960s inquiring whether he had anything he would like to submit to the new journal. Gordon reached into his drawer and sent Vandermeulen a manuscript that had been rejected so many times elsewhere that he had stopped circulating it. Vandermeulen published
Leijonhufvud’s account illustrates another recurring part of Alchian’s pedagogical life. Not just his graduate students, but his colleagues were also among the educated. His ability to enlighten the *cognoscenti* stemmed in part from his talent at applying economics to matters that, substantively, were new to him but that, methodologically, were just grist for the economist’s mill. Wielding the economic tool kit permitted Alchian to size up and to begin providing answers to questions brought to him by others who had already been pondering them for some time.

Alchian’s including the *Information Costs* paper on his list in a world without scarcity would make some sense. But given the limit of just three articles to discuss that of which he was most proud, Armen’s third and final choice foreclosed mention of anything for which he is probably most famous: the theory of property rights and insistence on their importance (theretofore almost totally neglected) in economics. The first two articles he identified made clear contributions to economists’ (a) theory of the firm and (b) theory of costs. But what of Alchian’s work in property rights, a

---

22 Armen’s colleague Dave Haddock was teaching the industrial organization course at UCLA, and wanted to talk to his class about basing-point (“delivered”) pricing. He naturally turned to the then-definitive article on the subject: George J. Stigler, *A Theory of Delivered Price Systems*, 39 AM. ECON. REV. 1143, 1143 (1949). Haddock wanted to convert Stigler’s reasoning into economic diagrams, but found that was impossible because, as he tells the story, “Stigler was wrong.” Haddock then put together some notes and diagrams of his own, and took them to discuss with Alchian. Alchian agreed with Haddock’s analysis (he, too, had thought Stigler wrong). Thus encouraged, Haddock formalized and published his work. See generally David D. Haddock, *Basing-Point Pricing: Competitive vs. Collusive Theories*, 72 AM. ECON. REV. 289 (1982) (analyzing uniform-price auction rules and creating a strategic means to underprice when the seller has an interest in ownership dispersion).

23 In the late 1950s, Henry Manne heard Armen present a paper on property rights at a Volker Fund conference at Claremont College. He approached Alchian to talk about property rights and corporations, a subject famously misanalysed in Berle and Means’ *The Modern Corporation and Private Property*. See generally ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932) (discussing corporations, stock ownership, and property rights in the private enterprise context). Armen suggested he read Anthony Downs’s *An Economic Theory of Democracy*, and thereafter Manne developed his path-breaking theory of the market for corporate control. See, e.g., Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 110 (1965). That article’s influence can be seen in the enormous number of citations it continues to generate. See generally William J. Carney, *The Legacy of “The Market for Corporate Control” and the Origins of the Theory of the Firm*, 50 CASE W. RES. L. REV. 215 (1999) (describing the whole of Henry Manne’s contribution). Manne later remarked, “I have no doubt that if [Alchian] had really turned attention to the topic, we would have understood the market for corporate control much earlier than we did. It all seemed so obvious to me six years later that I am sure he saw the connection even then.” Letter from Henry Manne to author (on file with the author).

24 Perhaps some mitigation of scarcity still would not have caused Armen to include his work on property rights. He wrote to me that he had enjoyed writing about the three articles discussed in his *Principles*, and said he was ready to add commentary on two more. Neither of them had anything to do with property rights.
field he practically defined? As Coase wrote, "He played the leading role in the development of a theory of property rights." The *Fortune Encyclopedia of Economics* selected him to write the entry on property rights, stating, "Most of his major scientific contributions are in the economics of property rights," repeating later that, "Alchian's large impact was in the economics of property rights."

So, why was Armen's (admittedly short) list devoid of any article on property rights? Only one reason has ever occurred to me: because his seminal property rights pieces appeared in somewhat obscure places. But this cannot be the entire explanation; as one would expect of him, Alchian was relatively indifferent to publishing pedigrees. But still, it may explain some of the failure to mention his property rights work. Apropos of the second article he chose for his *Principles of Professional Advancement*, he wrote,

"Costs and Outputs"... was accepted for publication in the American Economic Review. But then I was asked instead to include it in a collection of papers being prepared by Moses Abramovitz and others of their Stanford colleague—and my old teacher—Bernard Haley. I declined the invitation to publish in the AER in favor of the Haley festschrift. I regret that it did not get into the AER where more people would have seen it.

Collaboration with him on the *Principles* yielded a third surprise—I am tempted to say shock—when Armen sent me an e-mail having nothing to do with the subjects of the three articles he had chosen. Out of the blue, he wrote, "Fred: I like to brag I did the first 'event' study in corporate finance, back in the 50s and 60s." He then recounted how at RAND he was

25 Coase, supra note 10, at 8.
27 See generally Armen A. Alchian, Corporate Management and Property Rights, in POLICY AND THE REGULATION OF CORPORATE SECURITIES (H. Manne, ed. 1969) (pointing out that property rights are defined differently in different institutional contexts and that such differences matter); Armen A. Alchian, Private Property and the Relative Cost of Tenure, in THE PUBLIC STAKE IN UNION POWER (P. Bailey, ed., 1958) (arguing that the relative cost of tenure is lower at nonprofit than at for-profit institutions); Armen A. Alchian, Some Economics of Property Rights, 30 IL POLITICO 816 (1965) (examining property rights for risk bearing and incentive reasons, and the inefficiencies arising from common ownership).
28 Alchian, *Principles*, supra note 15, at 524. He adds, "[b]ut I don't regret having had the opportunity to express appreciation for the help Professor Haley gave me while I was a student at Stanford."
29 One surprise not worth highlighting was Alchian's e-mail concerning a paper that David Haddock and I had recently published, praising it for having successfully applied his theory of cost to explain analogous puzzles in demand theory. David D. Haddock & Fred S. McChesney, *Why Do Firms Contrive Shortages?: The Economics of Intentional Underpricing*, 32 ECON. INQUIRY 39, 39 (1994); e-mail from Armen Alchian to David Haddock & author (on file with author). I was excited; I would be included in his discussion of one of his three best articles! Bursting my bubble, Louis De Alessi suggested that I take this with a grain of salt. "Armen has a charming tendency to wax eloquent about the last paper he has read that he really likes." Armen agreed to have his points greatly shortened and placed in a footnote.
MAGNUS MAGISTER

curious what metal would be necessary for the forthcoming H-bomb, as it was being engineered and tested. The engineers and physicists would not tell the economists, of course, so "I told them I would find out." Which he did, by studying the stock prices of firms making the various possible bomb ingredients. One firm specializing in lithium had recently exhibited a remarkable run up in share price. Alchian wrote up his findings and conclusions in a memo circulated at RAND, The Stock Market Speaks, which he was immediately ordered to withdraw. As far as anyone knows, no copy survives. But for Armen's casual mention of the episode to me, no one would know it ever existed.

This was truly exciting. Well before the use of stock-market event studies became common, Armen had already figured it out—but was not including it in the summary of his achievements. Just as impressive, he was assuming that stock markets were efficient, long before Eugene Fama and others had propounded efficient-market hypotheses more formally. I called him to insist that his account go into his Principles, which it did, just as he had written about it to me. I never discerned any reason why he had to be prodded—except that this was Armen. The notion that one could conceive of and successfully employ the event-study methodology and the efficient-market hypothesis, yet make almost nothing of it, says much about the man.

I have recounted from a sample of one—myself—the evidence in favor of the hypothesis that Armen Alchian, in addition to his clear contributions to economic science, was an extraordinary expositor thereof who ensured that his contributions would be passed along to subsequent generations. But the sample size could be multiplied. Just to double the number of data points, consider Armen’s exceptional importance in the emergence of law and economics, beginning in the later 1960s. His influence on Henry Manne, and Manne’s economics and judges institutes multiplies the sample size considerably. And then there are the dozens of colleagues and graduates who acknowledge their debts to Armen Alchian.

At the end of the day, was the denial of Nobel status to Armen Alchian unjust? Yes, to many of us at least. But the issue is really of little consequence. More importantly, did non-Nobelism detract from his status among his peers—the only ones who could knowledgeably judge—or his own principal concerns? Almost certainly not. Axel Leijonhufvud spoke of what impressed his colleagues:

What always comes first to my mind in thinking about him is his personal lack of pretentiousness, lack of self-importance and pomposity. I learned from Armen to (I hope) take economics seriously, but not to take economists too seriously. Armen always had this toler-

---

30 It is fascinating that Alchian’s work validates the strong form of the efficient-market hypothesis, since it shows markets reacting to seemingly nonpublic information.
ant amusement at the overweening ambition and pretentiousness, and what the British call puffery, of economists....

It is appropriate to close on that note. To know Armen Alchian was to love him, and I was privileged to know him. Helping him write his Principles fortunately was not the end of our association. I would sometimes cross paths with him at a conference; occasionally he would write to congratulate me on something I had just published that struck his fancy.

But the episodes recounted here remain the most cherished memories. With our work on the Principles reaching an end, he wrote to me. "Best wishes and I hardly need say I appreciate all your interest and efforts." But the appreciation was all mine, for all those years.

31 Leijonhufvud, supra note 20, at 419.