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THE ART OF LAW & MACROECONOMICS

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Table of Contents

- I. Introduction
- II. The Absence of Law & Macroeconomics Explained
- III. The Legal Refraction of Macroeconomic Policy
 - A. The Juridification of Macroeconomic Policymaking
 - B. How Law Matters
 - 1. Outcome- and Procedure-Based Legitimation
 - 2. The Centrality of Administrative Law
 - 3. The Rejection of Decisionism in Constitutional Democracies
 - C. Legal Precepts
 - 1. Consistent Policies are Not Necessarily Rule-Based
 - 2. The Systemic Working of Legal Rules is Not Fully Predictable
 - 3. Legal Discourse Can Constrain Decision-Making
- IV. On the Nature of Law & Macroeconomics
 - A. Overview
 - B. A Threefold Taxonomy for Economics
 - C. The Art of Economics between Substance and Rhetoric
 - D. The Challenges of the Art of Law & Macro
- V. Conclusion

If assured knowledge is fragmentary and disconnected, if there are voids which must be filled to complete a system of knowledge, the manner and means of this filling is a question of elemental importance for insight into the nature of conduct. At the least, this filling of void spaces in knowledge [...] cannot be a matter of mere rational inference, for it is in conscious knowledge that the void spaces exist, and if their filling could be done by inference alone, that would be tantamount to the existence of sufficient knowledge.

George L. S. Shackle, *Epistemics & Economics*, 1972, p. 155

I. INTRODUCTION

The efforts to link legal and economic knowledge have historically been closely linked to the broader socioeconomic context. In a seminal study on the relationship between law and macroeconomics, Mark Kelman argued that the history of Law & Economics could be thought in terms of each mini-generation of scholars' ambitions.¹ In the 1930s and 1940s, in the context of economic depression and state activism, the first generation studied the misallocation of resources caused by noncompetitive pricing and focused mostly on antitrust.² Animated by economic recovery after the 1960s, the second generation expanded the breadth of economic analysis to core private law topics such as torts,³ property,⁴ and contracts,⁵ as well as to crime,⁶ procedure,⁷ and to some degree

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¹ Mark Kelman, *Could Lawyers Stop Recessions? Speculations on Law and Macroeconomics*, 45 *STAN. L. REV.* 1215, 1219 (1993).

² Seminal contributions include HENRY C. SIMONS, *ECONOMIC POLICY FOR A FREE SOCIETY* 47–49, 57–60 (1948); Ward S. Bowman, Jr., *Toward Less Monopoly*, 101 *U. PA. L. REV.* 577, 615–30 (1953); and Edward S. Mason, *Monopoly in Law and Economics*, 47 *YALE L.J.* 34, 45–49 (1937). See also FRANZ BOHM ET AL., *The Ordo Manifesto of 1936*, in *GERMANY'S SOCIAL MARKET ECONOMY: ORIGINS AND EVOLUTION* (Alan Peacock & Hans Willgerodt eds., 1989) (defending an “economic constitution” that would spouse a political decision about the economic life of the nation).

³ See Ronald Coase, *The Problem of Social Cost*, 3 *J.L. & Econ.* 1 (1960); Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 *Yale L.J.* 499 (1961).

constitutional law.⁸ Writing in 1993, Kelman could only timidly suggest—but rightly so—that as of the 1990s a third generation of legal economists would increasingly turn its attention to the organization and governance of productive ventures, particularly corporate structures and long-term contractual relationships.⁹ He was also correct in foreseeing that this third generation would try to shift the focus from static allocative efficiency to a study of the institutional and legal conditions for dynamic productive efficiency and growth.

Indeed, during the past two decades, Law & Economics became less parochial and more international. Common law pricing mechanisms lost prominence in the field and international development and innovation became central topics.¹⁰ An important driver of this shift was the attempt to provide a solid institutional framework for a post-Soviet, capitalist and globalized international economy.¹¹ Indeed, it was the failure of the initial economic reforms in former communist countries that paved the way to consider legal reform and institutional improvement as a developmental strategy.¹² After such a pivotal historical juncture, a concern with institutions—particularly in the form of new-institutional economics—gained standing in policy and academic circles.

In the world's current condition of economic turmoil, a discussion of the relationship between law and macroeconomics is timely. As I write in the aftermath of the 2007–08 financial crisis, neither the previously prevailing trend towards greater free market

⁴ See Harold Demsetz, *Toward a Theory of Property Rights*, 57 *Am. Econ. Rev.* 347 (1967); Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 *Harv. L. Rev.* 1089 (1972).

⁵ See Steven Cheung, *Transaction Costs, Risk Aversion, and the Choice of Contractual Arrangements*, 12 *J.L. & ECON.* 23 (1969); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 *J.L. & ECON.* 233 (1979).

⁶ See Gary Becker, *Crime and Punishment: An Economic Approach*, 76 *J. POL. ECON.* 169 (1968); Gordon Tullock, *An Economic Approach to Crime*, 50 *SOC. SCI. Q.* 59 (1969); Isaac Ehrlich, *Participation in Illegitimate Activities: A Theoretical and Empirical Investigation*, 81 *J. POL. ECON.* 521 (1973).

⁷ See William Landes, *An Economic Analysis of the Courts*, 14 *J.L. & ECON.* 61 (1971); Richard Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 *J. LEGAL STUD.* 399 (1973); John Gould, *The Economics of Legal Conflicts*, 2 *J. LEGAL STUD.* 279 (1973).

⁸ James Buchanan & Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (1962).

⁹ Kelman, *supra* note 1, at 1222. Representative works include Frank Easterbrook & Daniel Fischel, *The Economic Structure of Corporate Law* (1991); Henry Hansmann, *The Ownership of Enterprise* (1996); and Mark Roe, *Strong Managers, Weak Owners* (1994).

¹⁰ Kelman, *supra* note 1, at 1222.

¹¹ See, e.g., Richard A. Posner, *Creating a Legal Framework for Economic Development*, 13 *WORLD BANK RES. OBSERVER* 1 (1998); MARIA DAKOLIAS, *THE JUDICIAL SECTOR IN LATIN AMERICA AND THE CARIBBEAN: ELEMENTS OF REFORM* 50 (1996), available at http://www.wds.worldbank.org/external/default/WDSContentServer/WDS/IB/1996/06/01/000009265_3961214163938/Rendered/PDF/multi_page.pdf; Paul Rubin, *Growing a Legal System In the Post-Communist Economies*, 27 *CORNELL INT'L L.J.* 1 (1994).

¹² See Kenneth W. Dam, *The Law-Growth Nexus: The Rule of Law and Economic Development* (2006); Thomas Carothers, *Aiding Democracy Abroad: The Learning Curve* (1999); Ibrahim F. I. Shihata, *The World Bank in a Changing World: Selected Essays* (1991); Cheryl Gray, *Legal Process and Economic Development: A Case Study of Indonesia*, 19 *World Dev.* 763 (1991).

policies, nor the well-known anti-regulation bias of Law & Economics scholarship, can be taken for granted. The reasons for that are contextual as well as theoretical. To begin with, governments worldwide now increasingly seek to control their economies and preserve (or augment) their global influence.¹³ Ian Bremmer defined this phenomenon as a global turn in the direction of state-capitalism, that is, the system under which the state is the dominant economic player and uses markets primarily for political gain.¹⁴ With varying degrees in each country, the new scenario entails a quantum increase in regulation of several industries, an overall increase in government ownership of natural resources and finance (both domestically and overseas by means of sovereign wealth funds), and an increase in trade protectionist policies.¹⁵

Politics is inevitably intertwined with economic thinking and practice, a trait that is particularly clear in debates over macroeconomic policy. After all, macroeconomics is the branch of economics dedicated to no less than the understanding of aggregates that are politically salient such as levels of investment, employment, growth, inflation, consumption, and business-cycles. Of specific importance is the fact that the outbreak of the 2007 crisis is now often portrayed in policy circles as a consequence of lack of regulation and excessive trust on market mechanisms.¹⁶ Unsurprisingly, this set of events has now turned into an attack addressed at the intellectual foundations on which much of Law & Economics scholarship (as currently practiced) rests.

Of particular concern is the widely felt, although rarely explicitly stated, notion that the foundation of Law & Economics rests upon the theory of microfoundations of economics. The theory of microfoundations traces aggregate phenomena to the behavior and interactions of individuals.¹⁷ It posits the existence of a unified theory to explain the economy as a whole, and does so by subsuming macro into microeconomics.¹⁸ The central assumption is methodological individualism, that is, the view that social phenomena can be accurately explained by showing how they result from the intentional states that motivate the individual actors.¹⁹ With methodological individualism,

¹³ IAN BREMMER, *THE END OF THE FREE MARKET: WHO WINS THE WAR BETWEEN STATES AND CORPORATIONS*, 151–55 (2010).

¹⁴ *Id.* See also David Trubek et al., *Towards a New Law and Development: New State Activism in Brazil and the Challenge for Legal Institutions* (Univ. of Wis. Legal Studies Research Paper No. 1207, 2012); JOSEPH L. BOWER ET AL., *CAPITALISM AT RISK: RETHINKING THE ROLE OF BUSINESS* (2011); *Special Report, State Capitalism*, *THE ECONOMIST*, Jan. 21, 2012, at 54.

¹⁵ Bremmer, *supra* note 13.

¹⁶ Notably, see Alan Greenspan's congressional testimony on October 23, 2008. *The Financial Crisis and the Role of Federal Regulators: Hearing Before the Comm. on Oversight and Gov't Relations, 110th Cong. (2008)* (statement of Dr. Alan Greenspan, former chairman, Federal Reserve Board) (“[T]hose of us who have looked to the self-interest of lending institutions to protect shareholder's equity, myself especially, are in a state of shocked disbelief.”). For a more technical account, see Olivier Blanchard, *The Future of Macroeconomic Policy: Nine Tentative Conclusions*, IMFDIRECT (Mar. 13, 2011), <http://blog-imfdirect.imf.org/2011/03/13/future-of-macroeconomic-policy/>.

¹⁷ See Maarten Janssen, *Microfoundations*, *THE NEW PALGRAVE DICTIONARY OF ECONOMICS, SECOND EDITION* (2008), <http://www.tinbergen.nl/discussionpapers/06041.pdf>.

¹⁸ *Id.*

¹⁹ See generally Joseph Heath, *Methodological Individualism*, *THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY* (Nov. 16, 2010), <http://plato.stanford.edu/entries/methodological-individualism/>.

economic agents are assumed to rationally maximize their satisfaction not only in market settings, but in non-market interactions as well.

Law & Economics has so far been conceived as the science that studies efficient incentives for rational actors interacting in the sea of state-sponsored laws and regulations.²⁰ Its concern with efficiency in contracts, property, torts and organizations only makes practical sense because it carries the implicit assumption that macro-efficiency rests on micro-efficiency. That is, that the way to make the whole economy more efficient is by making each interaction among individuals and within organizations more efficient as well. There would be no good reason to seek a superior partial equilibrium in a specific micro-setting (a contractual relation, for example), if scholars believed that the aggregate (or macro) results would be an inferior equilibrium. One would never defend increasing some slices of the pie while at the same time imagining that in so doing the whole pie will ultimately become smaller.

The academic debate about the theory of economic microfoundations long predates the 2007 crisis,²¹ and in fact it has been a part of the critique to Law & Economics.²² The main objection to microfoundations is that “applications of general equilibrium theory [roughly, the idea that a set of prices exists that will result in optimality in all markets] do not follow from a consistent micro approach.”²³ Simply put, there is no “good theory of expectations formation above the level of individual agent,” so the aggregate effects of interactions in specific markets are uncertain.²⁴ As elegantly put by Colander et al., “the behavior of the aggregate need not correspond to the behavior of the components, nor can it generally be derived from a consideration of the latter alone.”²⁵ Other objections range over the economic meaningfulness of the idea of rationality²⁶ and, most importantly, on

²⁰ Thomas S. Ulen, *Law and Economics in the Future of Legal Scholarship, Education, and Practice*, 53 *REV. OF BUS. & ECON.* 218, 220 (2008) (“I think that the most lasting effect of the revolution wrought or being wrought by law and economics on legal scholarship is *methodological*: its importation into law of the scientific method of inquiry.”).

²¹ See David Colander, Overview to BEYOND MICROFOUNDATIONS (David Colander ed., 1996); Geoffrey Hodgson, Why the Problem of Reductionism in Biology Has Implications for Economics, 37 *WORLD FUTURES* 69 (1993); JOHN FOSTER, *EVOLUTIONARY MACROECONOMICS* (1987). For a survey of this literature, see Jeroen C.J.M. van den Bergh & John M. Gowdy, The Microfoundations of Macroeconomics: An Evolutionary Perspective, 27 *Cambridge J. Econ.* 64 (2003); E. Roy Weintraub, The Microfoundations of Macroeconomics: A Critical Survey, 15 *J. ECON. LITERATURE* 1 (1977).

²² See *Duncan Kennedy*, The Role of Law in Economic Thought: Essays on the Fetishism of Commodities, 34 *AM. U. L. REV.* 939, 963 (1985); *Duncan Kennedy*, Cost-Benefit Analysis of Entitlement Problems: A Critique, 33 *STAN. L. REV.* 387 (1981). See also *Ronald Dworkin*, Is Wealth a Value?, 9 *J. LEGAL STUD.* 191 (1980).

²³ Van den Bergh & Gowdy, *supra* note 21, at 66.

²⁴ *Id.*

²⁵ Colander et al., Beyond DSGE Models: Towards an Empirically-Based Macroeconomics, *The American Economic Review*, Vol. 98, No. 2, May, pp. 236-240 (2008), at 236-37 (“in a complex system aggregate behavior cannot be deduced from an analysis of individuals alone, [so] representative agent models fail to address the most basic questions of macroeconomics”).

²⁶ *Id.* (“the assumptions we make about individuals in microeconomics are based on introspection, not on any mass of coherent empirical evidence or even on any intuitive plausibility criteria. The only justification of the hyper-rational, self-interested agent typically used in standard macro models was that it

the fact that models that include realistic properties of behavior tend to have multiple equilibria.²⁷

As can be seen, the latest economic crisis did not inaugurate the critique against microfoundations; however, it created momentum against it.²⁸ Some of the latest critics argue that the assumption of methodological individualism (as well as its offspring, rational expectations theory) should be improved or made more realistic. Joseph Stiglitz, for example, recently suggested that we should try to find the “right” microfoundations.²⁹ Arguably, this can be done by improving current models with concepts and experiments from behavioral psychology.³⁰ Other criticisms are more fundamental. Akerlof and Shiller, for example, continuously argue that market agents systematically fall prey to herd behavior, and are in many instances distant from the model of rationality that currently characterizes most of current economic analysis.³¹ More radically, and in the spirit of revived Keynesianism, Katharina Pistor, a legal scholar, has recently presented arguments based on the premise that financial markets are deeply impaired by imperfect knowledge and liquidity constraints, and cannot be said to be “informationally” efficient in a meaningful sense.³²

In what may turn out to be a new intellectual wave, some economically inclined legal scholars³³ now openly claim to have become Keynesians—as did Richard Posner, the uber-representative of what once was “standard” Law & Economics.³⁴ The inspiration in John Maynard Keynes economics means, at a minimum, the acceptance that the risk of economic instability is ever-present, uncertainty plays a central role in that instability,

was consistent with the characterization used in micro theorizing. And even that justification is now disappearing with the rise of behavioral economics”).

²⁷ Phedon Nicolaides, *Limits to the Expansion of Neoclassical Economics*, 12 CAMBRIDGE J. ECON. 313 (1988); Sheila Dow, *Mainstream Economic Methodology*, 21 CAMBRIDGE J. ECON. 73 (1997).

²⁸ See Wim Meeusen, *Whither the Microeconomic Foundations of Macroeconomic Theory*, 54 BRUSSELS ECON. REV. 51 (2011) (discussing a series of challenges brought against the theory of microfoundations in the wake of the 2007-08 crisis).

²⁹ Joseph E. Stiglitz, *A Balanced Debate About Reforming Macroeconomics*, IMF DIRECT (Mar. 22, 2011), <http://blog-imfdirect.imf.org/2011/03/22/balanced-debate-about-reforming-macroeconomics/> (“Perhaps the major failing of some of the earlier models was that, while the attempt to incorporate microfoundations was laudable, it was important that they be the right micro-foundations”).

³⁰ See generally BEHAVIORAL LAW AND ECONOMICS (Cass Sunstein ed., 2000).

³¹ See, e.g., George A. Akerlof & Robert J. Shiller, *Animal Spirits: How Human Psychology Drives the Economy, and Why it Matters for Global Capitalism* (2009).

³² Katharina Pistor, *On the Theoretical Foundations for Regulating Financial Markets Or, What If It Is Not All about Information Costs?* (June 28, 2012) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2113675.

³³ By “economically inclined legal scholars” I mean those devoted, in the words of Eric Posner, to “law law and economics”, rather than “economics law and economics”. See Eric Posner, *The Future of Law and Economics: Essays by Ten Law School Scholars*, available at <http://www.law.uchicago.edu/alumni/magazine/fall11/lawandecon-future>.

³⁴ Richard Posner, *How I Became A Keynesian*, New Republic, Sept. 23, 2009, at 34. See generally Richard A. Posner, *The Failure Of Capitalism: The Crisis of '08 And The Descent Into Depression* (2009); Richard A. Posner, *The Crisis Of Capitalist Democracy* (2010). See also Yair Listokin, *Equity, Efficiency, and Stability: The Importance of Macroeconomics for Evaluating Income Tax Policy*, 29 Yale J. on Reg. 45 (2012).

and the belief that regulation offers prospects to reduce chances of instability.³⁵ Evidently, that does not mean simply that all legal scholars interested in economic methodology are Keynesians now. Richard Epstein for example has recently set himself to openly rejected Keynesianism,³⁶ and Ronald Gilson and Reinier Kraakman are now working to reinstate the credibility of the Efficient Capital Market Hypothesis³⁷—a close cousin of microfoundation theorization. In short, and expectably, on one hand there is currently a burgeoning debate about the methodology that will guide Law & Economics henceforth. And on the other hand, there is a discernible thematic convergence: many legal scholars have now been driven into studying the peculiarities of the financial industry, its connection with the business cycles and the systemic implications of its failure.³⁸

The lesson is as follows: while the precise intellectual legacy of the 2007 crisis remains unclear, the new political scenario will most likely cause legal scholars to turn their attention to topics where the macroeconomic dimension is particularly salient. Such topics include not only regulatory initiatives in financial markets, but most importantly (and depending on how the economic crisis unfolds henceforth) may also include foreign exchange, monetary and fiscal policies. In addition, and because of the acute distributional consequences of macroeconomic policies, legal scholars will most likely be increasingly drawn into considering their constitutionality, legality and legitimacy. In so doing, they will not be completely exempted from delving into macroeconomic reasoning. Yet to the extent that some macroeconomic reasoning is required, scholars will feel much lesser pressure to ground their conclusions in microfoundations.³⁹

³⁵ See Richard L. Gordon, *Law and Macroeconomics*, THE ONLINE ENCYCLOPEDIA OF LAW & ECONOMICS, 661, 668, 670 (1999), <http://encyclo.findlaw.com/0620book.pdf>.

³⁶ See, e.g., Richard Epstein, *Why I Will Never Be a Keynesian*, 33 HARV. J.L. & PUB. POL'Y 387 (2010).

³⁷ Ronald J. Gilson & Reinier Kraakman, Market Efficiency after the Financial Crisis: It's Still Information Costs (April 2012) (unpublished manuscript), available at <http://www.law.umn.edu/uploads/12/d7/12d77c902205da28b32a345e4497654e/CLEAN-EMCH-4-1-12-2-2-Kraakman.pdf>.

³⁸ See, e.g., Katharina Pistor, *supra* note 32; Steven L. Schwarcz, *Regulating Complexity in Financial Markets*, 87 WASH. U. L. REV. 211 (2010); Roberta Romano, For Diversity in the International Regulation of Financial Institutions: Rethinking the Basel Architecture (April 5, 2012) (unpublished manuscript), available at <http://www.nd.edu/~ndlaw/prog-law-economics/Romano.pdf>; Jeffrey Gordon, *Executive Compensation and Corporate Governance in Financial Firms: The Case for Convertible Equity-Based Pay* (Columbia Ctr. for Law and Econ. Studies and Eur. Corporate Governance Inst., Working Paper No. 373, 2010); Jeffrey N. Gordon & Christopher Muller, Confronting Financial Crisis: Dodd-Frank's Dangers and the Case for a Systemic Emergency Insurance Fund, 28 YALE J. ON REG. 151 (2011); John C. Coffee, Jr., *Systemic Risk After Dodd-Frank: Contingent Capital And The Need For Regulatory Strategies Beyond Oversight*, 111 COLUM. L. REV. 795 (2011); Jodie A. Kirshner, The Indian Anomaly: Rethinking Credit Rating Agency Regulation from the Perspective of Hyman Minsky (September 1, 2012) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2160857; and Erik F. Gerding, *Credit Derivatives, Leverage, and Financial Regulation's Missing Macroeconomic Dimension*, 8 *Berkeley Bus. L. J.* 29 (2011).

³⁹ Recent examples include Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 IOWA J. CORP. L. 265, (2012); Anastasia Nesvetailova, *The Crisis of Invented Money: Liquidity Illusion and the Global Credit Meltdown*, 11 THEORETICAL INQ. L. 125 (2010); Charles J. Whalen, *Rethinking Economics for a New Era of Financial Regulation: The Political Economy of Hyman Minsky*, 15 CHAP. L. REV. 149 (2011); Jose Gabilondo, *Dodd-Frank, Liability Structure, And Financial*

The rest of this article explores the under-theorized but increasingly important relationship between law and macroeconomics. It offers three contributions. Part II explains the absence of Law & Macroeconomics thus far. It argues that the absence of a clearly identifiable “mainstream” within the macroeconomic literature reduces the rhetorical appeal of legal arguments grounded in macroeconomics. Part III explains and exemplifies the way in which law and legal knowledge matter for macroeconomic regulation. It argues that legal knowledge is useful because macroeconomic regulation is constrained by the legal system, yet the notion of a legal system is broader than a mere collection of rules designed by technocrats. Part IV recuperates a conception of economics formulated in the late 19th Century by John Neville Keynes that draws a sharp distinction among the science, the ethics and the application of economics, and sets a framework where legal knowledge is of particular interest for macroeconomic policymaking. Part V concludes.

II. THE ABSENCE OF LAW & MACROECONOMICS EXPLAINED

When scholars refer to Law & Economics, they typically have in mind the relationship between law and micro—rather than macro—economics.⁴⁰ Microeconomics studies the actions of individual agents, such as firms and consumers, and how their behavior determines prices and quantities in certain markets. What makes the application of microeconomics to legal questions attractive is its theoretical robustness. In comparison with microeconomics, however, macroeconomics is not theoretically robust. This is the main explanation for why a field of Law & Macroeconomics has not flourished so far.

Microeconomics can be considered robust because the main difficulties it deals with lie not at the level of its theoretical foundations, but rather at the level of application.⁴¹ In employing microeconomic methodology to legal questions, a scholar can apply mainstream microeconomics, shorthand for accepted “truths”. She can thus take for

Instability Cycles: Neither A (Ponzi) Borrower Nor A Lender Be, 46 WAKE FOREST L. REV. 469 (2011); Kenneth G. Dau-Schmidt, *Keynes Was Right!*, 87 IND. L.J. 59 (2012).

⁴⁰ Kelman, *supra* note 1, at 1216; and Thomas S. Ulen, *The Lessons of Law and Economics*, 2 J. LEGAL ECON. 103, 105 (1992). For exceptions trying to integrate legal and macroeconomic reasoning, see John J. Donohue III & Peter Siegelman, *Law and Macroeconomics: Employment Discrimination Litigation Over The Business Cycle*, 66 S. CAL. L. REV. 709, 709 (1993); Jeremiah C. Humes, *Macroeconomic Analysis of the Law: The Missing Piece of the Law and Economics Puzzle*, 42 WASHBURN L.J. 957, 959 (2004); Douglas A. Kysar, *Sustainability, Distribution, and the Macroeconomic Analysis of Law*, 43 B.C. L. REV. 1, 5 (2001); Steven A. Ramirez, *The Law and Macroeconomics of the New Deal at 70*, 62 MD. L. REV. 515, 520–21 (2003). Nobel laureate Gary Becker has recently argued that some of the works by economists Daron Acemoglu and Andrei Shleifer, among others, can be thought of as part of the “emerging and exciting subfield of macro law and economics” as they analyze “the connections between legal systems and long-term rates of growth, the degree of economic inequality, aggregate investments, and other macroeconomic variables”. See Gary S. Becker & Richard A. Posner, *The Future of Law and Economics*, available at <http://www.law.uchicago.edu/alumni/magazine/fall11/lawandecon-future>. Becker is presumably referring to contributions such as DARON ACEMOGLU & JAMES ROBINSON, *WHY NATIONS FAIL: THE ORIGINS OF POWER, PROSPERITY, AND POVERTY* (2012), and ANDREI SHLEIFER, *THE FAILURE OF JUDGES AND THE RISE OF REGULATORS* (2012).

⁴¹ See Richard Posner, *The Problems of Jurisprudence* 140 (1990).

granted ideas that are largely corroborated by intuition, such as that demand curves slope downwards and supply curves slope upwards.⁴² She can also rely on the notion that individuals do what they deem to be best for themselves given their preferences;⁴³ that efficiency results from maximizing welfare or wealth; and most importantly, that legal rules create implicit prices and incentives.

Evidently, that does not mean that mainstream microeconomics is unquestionable on a theoretic level.⁴⁴ In particular, the application of this framework to legal questions has been the subject of an enduring debate. However, the existence of a mainstream within microeconomics signifies, firstly, that the theory can be set in the process of generating predictive models and testable hypotheses, especially after one adds transactions costs and behavioral psychology.⁴⁵ Secondly, it signifies that in a legal dispute an argument employing methodological individualism can command some level of persuasion, that is, it becomes a rhetorically relevant argument.⁴⁶ As so, the lesson typically taken by adamant of Law & Economics is that the foundational theory is solid; the main challenge is empirical.

To illustrate, consider the idea that breaches of contractual promises may sometimes be efficient,⁴⁷ which is arguably “the most important contribution (in terms of impact) of economic analysis to contract law.”⁴⁸ The basic issue presented to a legal economist is figuring out the legal doctrines that will induce individuals to breach contractual promises where this is efficient, and to fulfill promises where breaching is inefficient.⁴⁹ It is possible to come up with different ideas for what these doctrines should be simply by accepting that promisors and promisees respond to economic incentives in much the same

⁴² This is why, as put by Mark Kelman, “the economic subdisciplines that have dominated legal discourse [...] are readily explained, even if more sophisticated versions require mathematical skills lawyers infrequently possess.” See Kelman, *supra* note 1, at 1217.

⁴³ Or as Gary Becker puts it, “individuals maximize their utility from basic preferences that do not change rapidly over time.” See GARY S. BECKER, *A TREATISE ON THE FAMILY* ix (enlarged ed., 1981).

⁴⁴ See for example Geoffrey Hodgson, *Behind Methodological Individualism*, 10 *CAMBRIDGE J. ECON.* 3 (1986), at 211 (rejecting the “doctrine within which all explanations of social phenomena have to be couched in terms of statements about individuals” and also noting that the expression methodological individualism “carries [a pro-market] ideological charge”).

⁴⁵ Robert Cooter, *Maturing into Normal Science: The Effect of Empirical Legal Studies on Law and Economics*, 2011 *U. ILL. L. REV.* 1475 (2011) (arguing that empirical legal studies is the maturation of Law & Economics into the long-awaited science of law).

⁴⁶ Donald McCloskey, *The Rhetoric of Law and Economics*, 86 *MICH. L. REV.* 752 (1988).

⁴⁷ That is the original point made by Robert Birmingham according to which “[r]epudiation of obligations should be encouraged where the promisor is able to profit from his default after placing his promisee in as good a position as he would have occupied had performance been rendered.” See Robert Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 *RUTGERS L. REV.* 273, 284 (1970). The “theory” of efficient breach was named as such by Charles Goetz and Robert Scott. See Charles Goetz & Robert Scott, *Liquidated Damages, Penalties, and the Just Compensation Principle: A Theory of Efficient Breach*, 77 *COLUM. L. REV.* 554 (1977).

⁴⁸ Aristides N. Hatzis, *Rights and Obligations of Third Parties*, *ENCYCLOPEDIA OF LAW & ECONOMICS*, <http://encyclo.findlaw.com/4800book.pdf> (last visited Oct. 17, 2012).

⁴⁹ See, e.g., Eric Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 *YALE L. J.* 829 (2003) (concluding that law and economics fail to produce plausible theories of contract doctrines).

way that buyers and sellers respond to prices in the market. Solving the puzzle of which doctrine is best, however, hinges on empirical data that is either elusive or unavailable.

Unlike with micro, the difficulties of macroeconomic analysis lie at the level of foundational theory inasmuch as at the level of application.⁵⁰ Macroeconomics is the branch of economics that studies aggregate economic phenomena such as recessions, growth, unemployment, monetary stability, exchange rates, international trade, and finance, among others.⁵¹ While microeconomics has a readily identifiable mainstream, identifying mainstream macroeconomics is a daunting task. For some, mainstream macroeconomics can be equated to Keynesianism.⁵² This is basically the set of economic doctrines formulated by John Maynard Keynes in his classic, *The General Theory of Employment, Interest and Money*, published in 1936. But at closer look, these doctrines cannot be simply equated to mainstream. Several criticisms during the 20th century exposed fragilities and limitations of Keynes' theories and governments worldwide have pursued non-Keynesian policies in several occasions, and often for good reasons.⁵³

Evidently, mainstream economics is never a static set of ideas—both within micro and macroeconomics.⁵⁴ The distinction between what lies within or outside the economic “mainstream” tends to vary not only historically but also geographically. The point, however, is that the depth of disagreement is much greater within macro than within microeconomics. When a legal scholar decides to apply microeconomic methodology to analyze a problem, her audience can expect that she will assume marginalist decision-making and rational maximization, and that she will employ analytical concepts such as scarcity, partial equilibrium, incentives, efficiency, and so on. Conversely, the application of macroeconomic theory to legal problems inevitably raises an uncomfortable question: which macroeconomic view is to be employed?⁵⁵

⁵⁰ If anything, the disagreements over the microfoundations approach to macroeconomic theory should serve as a warning. See *supra* notes 21–27.

⁵¹ See for example Rudiger Dornbusch, et al., *Macroeconomics 3* (7th ed. 1998) (“Macroeconomics is concerned with the behavior of the economy as a whole – with booms and recessions, the economy’s total output of goods and services, the growth of output, the rates of inflation and unemployment, the balance of payments, and exchange rates”); and Olivier Blanchard, *Macroeconomics 1* (1997) (“Macroeconomics studies aggregate economic variables, such as production for the economy as a whole (aggregate output) or the average price of all goods (the aggregate price level). In contrast, microeconomics studies production and prices in specific markets”).

⁵² See Ramirez, *supra* note 40, at 555.

⁵³ Influential non-Keynesian theories include Milton Friedman’s life-cycle permanent income hypothesis, the Modigliani-Miller theorem, Friedman and Phelps’ natural rate of unemployment, Robert Lucas’ theorization over rational expectations in monetary policy, and Robert Barro’s theorization of Ricardian equivalence. See George A. Akerlof, *The Missing Motivation in Macroeconomics*, 97 AM. ECON. REV. 5 (2007).

⁵⁴ See, e.g., David Colander et al., *The Changing Face of Mainstream Economics*, 16 REV. OF POL. ECON. 485 (2004) (criticizing heterodox economists for failing to pay attention to ongoing developments within mainstream economic thinking).

⁵⁵ Kelman, *supra* note 1, at 1217.

To see why, consider a concrete example that I have examined in my studies of Brazilian foreign exchange regulation.⁵⁶ Exchange controls are regulations employed by governments to tax, limit or ban specific kinds of exchange transactions or cross-border remittances of funds. Since the 1930s, Brazil had federal laws establishing a system of exchange controls under which international flows of funds typically depended on previous and specific authorizations from the government for most transactions. However, in the beginning of the 1990s, a few ordinances enacted by Central Bank's governors replaced the authorizative system with a declaratory one.⁵⁷

The legality of such Central Bank ordinances became a contentious point. In the course of debates, public prosecutors filed lawsuits arguing that these ordinances contradicted a hierarchically superior federal law that mandated stringency of exchange controlling.⁵⁸ The ordinances should accordingly be deemed as illegal because a federal law—in Brazil like in any other Western-style constitutional democracy—can only be amended by another federal law, and not by mere ordinances enacted by a body of the federal government such as the Central Bank.

The fact is that these ordinances contradicted the spirit, but not the plain language, of the federal law at hand. In court, the Central Bank argued that its ordinances legitimately filled existing loopholes in the federal law.⁵⁹ In addition, the pragmatic argument offered in favor of the legality of these ordinances was that they were necessary for Brazil to attract higher foreign capital and investments. Greater economic openness and less exchange controls were accordingly portrayed as necessary attributes for Brazil to join the globalization boon.

The problem, however, is that there is no consensus amongst macroeconomists as to whether having foreign exchange controls in place is a desirable regulatory feature or not. Keynes had argued—and modern day Keynesians still sustain⁶⁰—that greater financial openness may cause macroeconomic problems, including inflation and unemployment.⁶¹ As so, in some cases exchange controls should be discretionarily used by monetary authorities to avoid excessive currency appreciation, block speculative attacks, or permit a reduction in base interest rates.⁶² Accordingly, macroeconomists of a Keynesian bent

⁵⁶ Bruno Salama, *Regulação Cambial entre a Ilegalidade e a Arbitrariedade: O Caso da Compensação Privada de Créditos Internacionais* [Foreign Exchange Regulation between Illegality and Arbitrariness: The Case of Private Setoff of International Credits], *REVISTA DE DIREITO BANCÁRIO E DO MERCADO DE CAPITAIS* No. 50 (2010), available at http://works.bepress.com/bruno_meyerhof_salama/42/.

⁵⁷ *Id.*

⁵⁸ Namely, Lei No. 4.131, de 3 de Setembro de 1962 (Braz.).

⁵⁹ Salama, *supra* note 56, at 172.

⁶⁰ See PAUL KRUGMAN, *THE RETURN OF DEPRESSION ECONOMICS AND THE CRISIS OF 2008* (2009); and Saving Asia: It's Time to Get Radical, *FORTUNE*, Sept. 7, 1998, at 74-80.

⁶¹ Thomas I. Palley, *Rethinking the Economics of Capital Mobility and Capital Controls* 13, (Political Econ. Research Inst., Univ. of Mass. at Amherst, Working Papers No. 193, 2009), available at http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_151-200/WP193.pdf.

⁶² *Id.* See also Kenneth S. Rogoff, *Rethinking Capital Controls: When Should We Keep an Open Mind?* *Finance & Development* 39 (4) (2002); Jonathan Ostry et al., *Capital Inflows: The Role of Controls*, *IMF*

stepped into the debate to offer the pragmatic argument that it was best to view the ordinances as illegal, so that the Central Bank's ability to tightly control cross border flows of capitals whenever necessary could be preserved.

Brazilian courts eventually held that these ordinances were legal,⁶³ but that is not my specific concern here. What I wish to highlight is that a macroeconomic analysis of law hinges on assumptions about the overarching workings of economic aggregates, yet such assumptions are themselves highly contentious. Again, the main point is that the theoretical foundations of macroeconomics are not robust and that every applied challenge quickly becomes a highly theoretical one. Macroeconomics therefore fails to offer legal scholars an external, "objective", criterion on which they can ground their conclusions. When a legal debate is conducted based on macroeconomic reasoning, the arguments tend to be no more convincing than when they hinge on traditional legal theories and doctrines. A debate opposing neoclassic vs. Keynesian macroeconomic reasoning is no more credible than one opposing natural law vs. legal positivism because no one really knows the answer. There are therefore almost no rhetorical advantages of adding macroeconomic reasoning to disputes about legal interpretation.

Again, the macroeconomic debates over foreign exchange controls provide a good illustration.⁶⁴ Although exchange controls are largely absent in the United States, they are still pervasive in emerging markets, making this an important question especially in the context of recent concerns over an international "currency war."⁶⁵ Today's macroeconomic debates over exchange controls are framed along the lines of two dichotomous perspectives which tend to be loosely referred to as "orthodoxy" and "heterodoxy".⁶⁶

Staff Position Note SPN/10/04, February 19, 2010; and Managing Capital Inflows: What Tools to Use? IMF Staff Position Note SDN/11/06, April 5, 2011.

⁶³ Salama, *supra* note 56, at 172.

⁶⁴ For a summary of the macroeconomics of exchange controls, see Bruno Salama, Foreign Exchange Controls and the Governance of State-Capitalism (May 26, 2011) (unpublished manuscript), *available at* <http://ssrn.com/abstract=1855031> (detailing an analysis of the macroeconomics of exchange controls).

⁶⁵ A "currency war" is a situation in international affairs in which countries compete against each other with a view to lower the exchange rate for their home currency, so as to boost the export-led growth. For a benign account about the prospects of a more serious currency war, see BARRY EICHENGREEN, *EXORBITANT PRIVILEGE: THE RISE AND FALL OF THE DOLLAR AND THE FUTURE OF THE INTERNATIONAL MONETARY SYSTEM* (2011); *Financial Shock and Awe The world's central banks are at war. What does that mean for the rest of us?* FOREIGN POLICY, Oct. 6, 2010; and *The Dollar Dilemma: The World's Top Currency Faces Competition*, FOREIGN AFFAIRS, Sep./Oct. 2009. For a pessimistic account, see JAMES RICKARDS, *CURRENCY WARS: THE MAKING OF THE NEXT GLOBAL CRISIS* (2011). See also *How to Stop a Currency War*, ECONOMIST, Oct. 16, 2010, at 13 (highlighting the risk of actual currency wars, but in fact downplaying it); Martin Wolf, Op-Ed., *Currencies clash in new age of beggar-my-neighbour*, FIN. TIMES (London), Sept. 29, 2010, at 15 (explaining currency wars and the intervention of China).

⁶⁶ Frederic S. Lee, *Heterodox Economics*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS, (2d. ed. 2008) (noting that words such as "orthodoxy" and "heterodoxy" are usually employed as umbrella terms to indicate, respectively, mainstream and non-mainstream economic thinking), *available at* http://www.dictionarofeconomics.com/article?id=pde2008_H000175.

Orthodoxy grounds a critique to the use of exchange controls mostly with a combination of two arguments. First, the neoclassical microeconomic efficiency argument posits that capital mobility increases national saving and investment levels, improves portfolio allocation, and increases trade and foreign direct investment.⁶⁷ Second, the public choice argument posits that capital mobility engenders a “race to the top” among countries, the reason being that national governments compete to improve governance with a view to attracting foreign capital and trade.⁶⁸ Balanced against that, there are two salient heterodox perspectives grounding a defense of exchange controls. First, Keynesian macroeconomics rejects the neoclassical view on the factors determining of exchange rates, interest rates, savings, and investment, and posits that in certain cases exchange controls may be necessary to contain imbalances created by international flows of capital.⁶⁹ Second, the market failure perspective deals with microeconomic “imperfections”, the solution to which is the enforcement of exchange controls.⁷⁰

In the spirit of the scientific debate, it is convenient to try to solve theoretical questions through empirical analyses. Unfortunately, as is common with most (if not all) macroeconomic questions, the debates over the overall desirability of exchange controls are empirically unsettled.⁷¹ Given the lack of empirical consensus, such debates tend to simply rely on different foundations.⁷² In this epistemic sense, macroeconomic views can be viewed as after all ideological: each view posits a different type of macroeconomic instrumentality and assumes—but cannot prove—different types of outcomes.

The existence of deep-seated divergences amongst different macroeconomic strands is evidently not limited to foreign exchange controls. It covers essentially every macroeconomic topic, from unemployment to international trade, taxation, and inflation, just to name a few.⁷³ Because each macroeconomic strand departs from a different epistemic ideology, their divergences over applicative questions are inevitably transformed into foundational ones. When transported into a legal dispute, these foundational disagreements tend to simply become second-class economic arguments. Legal certainty is lost and nothing gained in return. This is the main reason why Law & Economics continues to be based exclusively on micro, rather than macro, economics.

To sum up, if Law & Economics is the application of microeconomic theory to legal problems, then Law & Macroeconomics could conceivably be the application of macroeconomic theory to legal problems. Accordingly, Law & Macroeconomics would consist of discussions over the laws that promote, for example, economic growth,

⁶⁷ Palley, *supra* note 61, at 5.

⁶⁸ *Id.* at 9.

⁶⁹ *Id.* at 13–14.

⁷⁰ *Id.* at 17.

⁷¹ Salama, *supra* note 64.

⁷² See Barbara R. Bergmann, *The Current State of Economics: Needs Lots of Work*, 600 ANNALS AM. ACAD. POL. & SOC. SCI. 52, 58 (2005).

⁷³ See generally Snowdon et al., *A Modern Guide to Macroeconomics: An Introduction to Competing Schools of Thought* (1994).

monetary stability or greater employment.⁷⁴ The main problem of pursuing this path is that there is much less consensus about the workings of macroeconomy than there is about the workings of the specific markets (that is, the microeconomy). Essentially, every conclusion about a macroeconomic problem is highly questionable not only at the level of application, but also at a foundational, theoretical level. As a result, the kind of scientific project that characterizes Law & (Micro)economics is not readily replicable with Law & Macroeconomics.

In light of the above, the prevailing view is that a meaningful convergence between legal and macroeconomic knowledge must be put on hold until economists finally attain some agreement about how the macroeconomy functions. This will probably take a long time, but this article argues that there are alternative ways of thinking about the relationship between law and macroeconomics now.

III. THE LEGAL REFRACTION OF MACROECONOMIC POLICY

In a constitutional democracy, the implementation of macroeconomic policies typically begs the use of legal discourse and carries the risk of litigation. Consequently, the legal system can be conceived as a constraint (rather than simply an instrument) of policymaking. In this sense one can metaphorically speak of a legal “refraction” of macroeconomic policy. In physics, refraction is the change in direction of a wave due to a change in its medium. Just like a transmitted beam is bent away from the direction of the incident beam when traveling in the water, so does macroeconomic policy when instrumentalized by a system of law. Legal scholars can accordingly contribute to macroeconomic policy based on their understanding of the internal rationality and structure of the legal system. To articulate these ideas I will first clarify the role played by the juridification of macroeconomic policymaking, then move on to theoretical observations about the role of law as a structure of macroeconomic policy, and finally I offer three precepts for macroeconomic policymaking based on a general understanding of legal system in Western-style democracies.

A. The Juridification of Macroeconomic Policymaking

State law is an essential component of the institutional framework that constrains macroeconomic regulation, and this is not a trivial observation. Macroeconomic theory tends to assume that economic outcomes in different settings are so similar that localized institutional factors can be ignored for the purposes of generating predictive models. In fact, both interventionist and anti-interventionist economists have often been skeptical about institutions. The former attributed economic success to optimal bureaucratic management whereas the latter credited rational decisions of market agents given a

⁷⁴ This was in fact done by some legal scholars. See, e.g., Ramirez, *supra* note 40, at 520 (attempting to “place the law and macroeconomics of the New Deal in its proper historical perspective; that is, as a superior normative approach to legal issues relating to macroeconomic infrastructure”); Donohue III & Siegelman, *supra* note 40, at 710.

“technically-determined opportunity set.”⁷⁵ A meaningful contribution of legal knowledge to macroeconomic policymaking therefore requires a more detailed explanation of why law matters.

In today’s constitutional democracies, political battles are commonly fought in courts, and for two main reasons. Firstly, the regulatory state decentralized normative activity, and a justifiable concern with generating predictability and stability represented a call for the bureaucracy to formalize its policies in ordinances, communiqués, and other sorts of legal provisions. Policymaking accordingly became increasingly juridified, a phenomenon that only accelerated in recent times with increased globalization.⁷⁶ Secondly, in the regulatory state courts increasingly moved towards playing a more active role in shaping regulation—sometimes by enforcing constitutional rights, and sometimes through the judicial review of laws or regulations enacted by parliaments or by the bureaucracies.⁷⁷ Evidently, not every country is the same and not every macroeconomic policy falls equally under the spell of a judicial ruling. Yet it is possible to say that these developments brought law, lawyers, and legal thought to the forefront of macroeconomic regulatory debates.

The implications of the juridification of economic policies to macroeconomic theorization and policymaking are not well understood. Macroeconomists tend to view law as either a blackbox—simply too complicated to be modeled—or, more commonly, as a set of tools that can be conceived by specialists and then freely employed by bureaucracies in response to various economic challenges. There is little doubt that macroeconomic policymaking is constrained by politics. It is well known that national governments repeatedly fail to adopt efficiency enhancing reforms due to narrow interests and lobbies.⁷⁸ The problem, quite clearly, is that macroeconomic policies have not only efficiency consequences but distributional effects as well.⁷⁹ Therefore, macroeconomic policies end up largely captured by interest groups.⁸⁰

⁷⁵ Kelman, *supra* note 1, at 1218.

⁷⁶ Lars Chr. Blichner & Anders Molander, *What is Juridification?* 2–5 (Ctr. for European Studies, Univ. of Oslo, Working Paper No. 14, 2005) (delineating five dimensions of juridification, as follows: “First, constitutive juridification is a process where norms constitutive for a political order are established or changed to the effect of adding to the competencies of the legal system. Second, juridification is a process through which law comes to regulate an increasing number of different activities. Third, juridification is a process whereby conflicts increasingly are being solved by or with reference to law. Fourth, juridification is a process by which the legal system and the legal profession get more power as contrasted with formal authority. Finally, juridification as legal framing is the process by which people increasingly tend to think of themselves and others as legal subjects”).

⁷⁷ Tom Ginsburg, *The Global Spread of Constitutional Review*, in *THE OXFORD HANDBOOK OF LAW AND POLITICS* 81, 87–88 (Whittington et al., eds., 2008).

⁷⁸ See, e.g., Raquel Fernandez & Dani Rodrik, *Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty*, 81 *AM. ECON. REV.* 1146–55 (1991).

⁷⁹ See Laura Alfaro, *Capital Controls: A Political Economy Approach*, 12 *REV. INT’L ECON.* 571 (2004).

⁸⁰ J. Lawrence Broz & Jeffrey A. Frieden, *The Political Economy of Exchange Rates*, in *THE OXFORD HANDBOOK OF POLITICAL ECONOMY* 587, 591–96 (Barry R. Weingast & Donald A. Wittman, eds., 2006).

Aside from politics, however, juridification is itself another constraint for macroeconomic regulation. Juridification—again, the formalization of policies in laws and other legal provisions—refracts macroeconomic policies mainly because the concrete application of laws may differ from the original intention of those who created them. The prohibitions, permissions and other rules that make up macroeconomic policies are not ethereal or ineffable macroeconomic “tools,” but are legal provisions instead. Legal provisions give rise to several challenges traditionally studied by legal scholarship, the most evident of which is the problem of interpretation. Because laws are always interpreted in the context of a broader legal system, they are almost invariably plagued by some degree of indeterminacy. The problem of indeterminacy arises even where laws are never litigated.

B. How Law Matters

If laws are not simply technologies that can be freely employed by technocrats, what are they? The concept of law is one of the oldest concerns of legal theory and offering a response or even summarizing the literature is beyond the present scope. A specific focus on the relationship between law and macroeconomic, however, points out to three important tenets of a legal system. First, economic outcomes reinforce the legitimacy of the law, but this legitimacy also rests on observing certain procedures and respecting certain rights. Second, macroeconomic policy is most often put in place by means of administrative law, yet administrative law not only upholds an institutional design but also an ideology that shapes the interpretation of the law in concrete cases. And third, in a constitutional democracy macroeconomic regulation has to uphold certain traits that include, among others, judicial review. To illustrate, the German Supreme Court recently ruled on whether the German participation in a permanent bailout fund was constitutional.⁸¹ As put by the Los Angeles Times, German judges held that “Europe’s fate in their hands”.⁸² The lesson is unequivocal: macroeconomic policymaking constantly lives under the shade of invalidation by courts.

1. Outcome- and Procedure-Based Legitimation

⁸¹ In July 2011, the Eurozone member countries signed a treaty to establish a permanent stability mechanism known as the European Stability Mechanism (“ESM”). The ESM grants emergency loans and is expected to serve as a financial “firewall” against financial crises. Before entering in force, the treaty had to be ratified by at least ninety percent of member countries. Jared Curzan, *A Critical Linkage: The Role of German Constitutional Law in the European Economic Crisis and the Future of the Eurozone*, 35 *FORDHAM INT’L L.J.* 1543, 1564 (2012). The constitutionality of the ESM was questioned in court in several countries including Germany, its largest sponsor. In September 12, 2012, the German Supreme Court rejected an attempt to block the ratification of the ESM in Germany. However, it imposed conditions under which the German Parliament must vote before the country’s total exposure through the ESM is extended. See Graeme Wearden, *German Court Approves Bailout Fund, With Conditions - Eurozone Crisis*, *THE GUARDIAN BUSINESS BLOG* (Sept. 12, 2012), <http://www.guardian.co.uk/business/2012/sep/12/eurozone-crisis-german-court-bailout-fund>.

⁸² Henry Chu, *German judges may hold Europe’s fate in their hands*, *L.A. TIMES*, Sept. 11, 2012, available at <http://articles.latimes.com/2012/sep/11/world/la-fg-germany-court-20120911>.

In constitutional democracies, the legitimacy of macroeconomic regulation is based both on procedures and outcomes. The former aspect has to do with whether regulation is grounded, roughly, on the rule of law. The latter aspect has to do with the actual results that are perceived to have been attained by regulation. Law matters for macroeconomic regulation because it disciplines procedures and engenders outcomes. Clearly, regulation that does not abide by procedural requirements is constitutionally unacceptable in Western-style democracies. Yet regulation that does not conduce to desirable outcomes turns out to be not only economically, but also politically unpalatable.

This dual structure of legitimation is grounded in theoretical as well as practical considerations. Theoretically, it conjugates the concerns of democratic deliberation and power delegation. On the one hand, in a democracy regulation should ultimately be premised on public deliberation focused on the common good.⁸³ In a pluralistic society, however, finding the common good is thwarted by the existence of incompatible understandings of value.⁸⁴ Consequently, fair and preset procedures tend to become the basis of collective agreement; hence, the notion of procedural legitimation arises.⁸⁵ On the other hand, we are not left with a purely procedural view of democracy, including because some democratic collective choices are just too repulsive to be acceptable.⁸⁶ An additional point is that mass democracies are also systems of competition for political leadership where the citizenry authorizes certain leaders to pursue policies that are, in many ways, ultimately chosen by those leaders.⁸⁷ If public policy and regulation fail to advance the interests of the citizenry, then the citizenry has a good reason to reject not only such policies but their political champions as well.⁸⁸

Practically, the main problem posed by this dual structure of regulatory legitimation is that procedures and outcomes may trade-off with each other.⁸⁹ The idea that adherence to preset procedures improves outcomes is valid, if at all, in the long-run. To be sure, procedural legitimacy may reinforce public trust, enhance voluntary cooperation, and reduce free-riding, thus leading to outcome-legitimation.⁹⁰ However, none of that tends to happen in the short-term. Yet many of the pragmatic problems faced by political and

⁸³ Joshua Cohen, *Deliberation and Democratic Legitimacy*, in *DELIBERATIVE DEMOCRACY: ESSAYS ON REASON AND POLITICS* 67, 68-69 (James Bohman and William Rehg eds., 1997).

⁸⁴ Joshua Cohen, *Procedure and Substance in Deliberative Democracy*, in *DELIBERATIVE DEMOCRACY: ESSAYS ON REASON AND POLITICS* *supra* note 83, at 407-408.

⁸⁵ See JÜRGEN HABERMAS, *BETWEEN FACTS AND NORMS* 311-12 (William Rehg trans., 1996).

⁸⁶ See Cohen, *supra* note 84, at 408-409.

⁸⁷ Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* 269-83 (2003).

⁸⁸ *Id.*

⁸⁹ On the topic, see Mark Copelovitch, *Picking Up (and Rearranging) the Pieces: The Great Recession and the Politics of Global Financial Governance* 10-11 (work in progress, prepared for presentation at the "Politics in Time of Crisis II" Workshop, Ruprecht-KarlsUniversität Heidelberg, Heidelberg, Germany, December 3-4, 2010) (on file with author).

⁹⁰ See generally DOUGLASS C. NORTH, *INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE* (1990); DOUGLASS C. NORTH, *UNDERSTANDING THE PROCESS OF ECONOMIC CHANGE* (2005). See also Bruno Salama, *Sete Enigmas do Desenvolvimento em Douglass North [Seven Enigmas of Development in Douglass North]*, 2 *ECON. ANALYSIS L. REV.* 404 (2011) (Braz.).

bureaucratic elites such as unemployment or impoverishment are quite pressing and naturally convey a sense of urgency.

In addition, procedural legitimation tends to be costly and time consuming. The classical doctrine of procedural legitimation found in 18th century writers such as Montesquieu assumed the existence of a small government that infrequently intervened in the economy. Conversely, present-day regulatory states actively seek to manage macroeconomic indicators. Considerations of expediency justify large degrees of power delegation to the bureaucracy because, as put by Richard Posner, “you cannot have big government – the government that tries to do more than secure the night watchman state – with just courts and legislatures.”⁹¹ This is why modern democracies tend to entrust macroeconomic regulation to a relatively independent bureaucracy that is judged based on the perceived results that it “delivers”.⁹²

Here, notice the importance of the term “perceived”. The task of ordaining complex systems, such as financial systems, is a daunting one. For instance, along with Mises and Hayek, libertarians sustain that the market is a spontaneous order where unintended consequences are so pervasive as to render actual engineering of outcomes impossible.⁹³ Perhaps, but in the midst of crisis even adherents of strictly doctrinaire libertarian positions tend to become more tolerant toward remedial solutions that are believed to reestablish stability and prosperity. Just like there are “no atheists in foxholes”, there are basically no libertarians in financial crises.⁹⁴ In any case, if regulators are shrewd or lucky enough to capture the political laurels of a subsequent recovery—something that indeed can happen independently of their actual merits—they will be perceived as having acted wisely, and regulation will be perceived as having worked. The politicians that appointed such bureaucrats are likely to benefit from their success as well.

2. The Centrality of Administrative Law

In democracies, public law is the realm in which the two forms of macroeconomic legitimation become incarnated in arrangements that matter for practical purposes. The compromise between outcomes and procedures is most clearly visible within administrative law. Administrative law establishes islands of technocracy inside the state. It does so by setting technical competences for specialized bodies that are in charge of deploying their technical expertise over macroeconomic topics. At the same time,

⁹¹ Richard A. Posner, *The Rise and Fall of Administrative Law*, 72 CHI.-KENT L. REV. 953, 953 (1997).

⁹² See David Levi-Faur, *The Global Diffusion of Regulatory Capitalism*, 598 ANNALS AM. ACAD. POL. & SOC. SCI. 12, 13 (2005) (“Democratic governance is no longer about the delegation of authority to elected representative but a form of second-level indirect representative democracy - citizens elect representatives who control and supervise ‘experts’ who formulate and administer policies in an autonomous fashion from their regulatory bastions.”).

⁹³ See Ludwig Von Mises, *Economic calculation in the Socialist Commonwealth* (1990); available at <http://mises.org/pdf/econcalc.pdf>. Originally published in 1920); and F. A. HAYEK, *LAW, LEGISLATION AND LIBERTY, RULES AND ORDER* (1973), chapter 2.

⁹⁴ As sarcastically observed by Jeffrey Frankel, *Responding to Crises*, 27 CATO J. 165, 165 (2007).

administrative law also subjects these technical bodies to procedural constraints in two ways.

Firstly, administrative law embodies a certain institutional design. By institutional design, I mean the set of rules, standards, systems of checks and balances, and transparency requirements that constrain state officials. Some of these constraints have to do with foundational institutions of the society and are typically reflected or inspired in constitutional law. Examples include the right of judicial review or the extent of the powers of the executive branch. Other constraints, such as the independence of the central bank, the ability of the federal government to finance states, or the ability of the Central Bank to print money to finance the federal government, are narrower and are properly disciplined by infra-constitutional administrative law.

Secondly, administrative law upholds certain values that together create a legal ideology. As employed here, a legal ideology is an intellectual model that provides an overarching view about topics conventionally studied within legal theory and legal doctrine. In administrative law, common questions include the delineation of a frontier between questions of fact and questions of law, the circumscription of bureaucratic discretion, the criteria for judicial review, the extent to which there is a need for reasoned explanation in court decisions, among others. These overarching views, to borrow Tom Ginsburg's expression, serve to "regulate regulation".⁹⁵

To sum up, the debate over institutional design is centered on the explicit legal constraints that will govern the way in which the state intervenes in the economy. In turn, the debate about legal ideology has to do with the legal philosophy that inspires the interpretation of such constraints. Drawing the distinction between institutional design and legal ideology is important to highlight that law refracts macroeconomic policymaking not only because it sets explicit incentives, but also because law incarnates a "worldview" that is interwoven with moral and ethical judgments about the fairness of the way in which legal and regulatory questions should be decided.⁹⁶

3. The Rejection of Decisionism in Constitutional Democracies

The concepts of "legalism" and "decisionism" designate two basic and opposing legal ideologies within administrative law. The backbone of legalism is the principle of legality, and its practical implication is the upholding of legal formalism. Administrative decision-making is thus framed as the enforcement of general rules that apply to individual cases. The conformity of the bureaucratic enforcement with the legal mandate is the yardstick to measure the legality of a decision. Since rulemaking is viewed as

⁹⁵ Tom Ginsburg, *The Judicialization of Administrative Governance: Causes, Consequences and Limits*, in ADMINISTRATIVE LAW AND GOVERNANCE IN ASIA: COMPARATIVE PERSPECTIVES 1, 1 (Tom Ginsburg & Albert Chen eds., 2009).

⁹⁶ See Dani Rodrik, *Institutions for High-Quality Growth: What They Are and How to Acquire Them* 4 (Nat'l Bureau of Econ. Research, Working Paper No. 7540, 2000) ("[the legislator] needs to ensure that she provides her subjects with the right mix of 'ideology' (a belief system) and threat of violence to forestall rebellion from below"), available at <http://www.nber.org/papers/w7540>.

separate from rule enforcing, state officials are expected to refrain from altering the legal situation retrospectively by discretionary departures from the established law. In addition, state laws are expected to be general in character, ascertainable, prospective, public, and relatively stable.⁹⁷

The legal ideology diametrically opposing legalism is decisionism. Its distinctive trait is the acceptance that state actions may lie beyond the threat of legal enforcement.⁹⁸ Decisionism thus fits comfortably within what legal philosopher William Scheurman termed the “jurisprudence of lawlessness.”⁹⁹ This strand of jurisprudence explores fundamental critiques to legalism and legal formalism.¹⁰⁰ The attack revolves around the alleged indeterminacy of positive law. The indeterminacy thesis is the contention that legal materials are “empty vessels” into which judges and bureaucrats can engage in political and social ruling.¹⁰¹ Under the most radical versions of the indeterminacy thesis, legal materials permit practically any conceivable solution to a legal question at hand.¹⁰² If this is so, then legal enforcement is inevitably willful and strictly political. As the argument goes, the notion of legalism is meaningless, if not deleterious. As can be seen, the rejection of legalism rests less on principle-based reasons (such as unfairness), and more on pragmatic ones (ineffectiveness, for instance).

Carl Schmitt, the paradigmatic illiberal scholar from the early 20th century, offered the most thorough defense of decisionism. In his classic libel against legalism, Schmitt defined liberalism as a form of “political romanticism”¹⁰³ and legal formalism as a “childish fiction”.¹⁰⁴ By implication, Schmitt argued that norm-based legitimacy for bureaucratic decision-making was implausible. The implications of decisionism for present-day administrative law is that decision-makers ought to derive their political legitimacy not from laws but instead from broad sociological notions such as tradition (religious or otherwise), protection of revolutionary goals (e.g. economic growth or stability), or collective values (however defined or interpreted).

Yet a critique to formalist and legalism jurisprudence needs not discredit liberalism altogether, as did Schmitt. As noticed by Judith Shklar, it is “one thing to favor the ideal

⁹⁷ See LON L. FULLER, *THE MORALITY OF LAW* 146 (Yale Univ. Press rev. ed. 1969). See also JOSEPH RAZ, 214-219 *THE AUTHORITY OF LAW*, 1979. For a review of the literature on the rule of law, see BRIAN Z. TAMANAHA, *ON THE RULE OF LAW* (2004).

⁹⁸ Katharina Pistor & Chenggang Xu, *Governing Emerging Stock Markets: Legal vs Administrative Governance*, 13 *CORP. GOVERNANCE: AN INT’L REV.* 5 (2005).

⁹⁹ WILLIAM E. SCHEURMAN, *CARL SCHMITT: THE END OF LAW* 15–175 (1999). This is not to be confused with Thomas J. Kernan's 1906 address, *The Jurisprudence of Lawlessness*. While the former presents a philosophical discussion of the limits of law and jurisprudence in a liberal society, the latter contains a catalogue of the circumstances in which juries rendered acquittals in accordance with the so-called “unwritten law.” See Thomas J. Kernan, 14 *Am. Law* 433, 452-456 (1906).

¹⁰⁰ SCHEURMAN, *supra* note 99, at 2.

¹⁰¹ *Id.* at 7–8.

¹⁰² The classic statement of this argument can be found in Duncan Kennedy, *Form and Substance in Private Law Adjudication*, in *CRITICAL LEGAL STUDIES* 36 (Allan C. Hutchinson ed., 1989).

¹⁰³ CARL SCHMITT, *POLITICAL ROMANTICISM* (Guy Oakes trans., The MIT Press 1986) (1919).

¹⁰⁴ See Stanley L. Paulson, *The Theory of Public Law in Germany 1914–1945*, 25 *OXFORD J. LEGAL STUD.* 525, 537 n.73 (2005).

of a *Rechtsstaat* [roughly, rule of law] above all ideological and religious pressures, and quite another to insist upon the conceptual necessity of treating law and morals as totally distinct entities.”¹⁰⁵ In that spirit, the predominant legal ideology in modern-day democracies is neither legalism nor decisionism, but constitutionalism instead. The core ideas of constitutionalism are that government must be legally limited in its powers, that its legitimacy depends on the observance of such limitations, and that such limitations are both law-based as well as value-based.¹⁰⁶

Constitutionalism manifests itself most clearly through judicial review. This is the doctrine and institutional practice under which actions of state officials and politicians are subject to assessment and possible invalidation by independent courts. Because of this characteristic, constitutionalism does not totally dispense with legalism, because most often judicial review is justified as the enforcement of written laws. On the other hand, constitutionalism rests in constant friction with the enduring practice of decisionism that endures due to the existence of “black holes” in administrative law. These black holes are, in the words of Adrian Vermeule “domains in which statutes, judicial decisions and institutional practice either explicitly or implicitly exempt the executive from legal constraints.”¹⁰⁷

Macroeconomic theory pays virtually no attention to legal ideology. The problem is not so much that it ignores legal ideology, but rather that legal ideology is simply naturalized. Typically, there is a mechanical association between a specific type of institutional design and a specific type of legal ideology, which is thus assumed to be “natural,” and thus not problematic. First, free market designs are implicitly expected to be premised on legalism, that is, roughly, to be governed by rules. Second, interventionist policies are expected to rely on decisionism, that is, to be premised on bureaucratic actions that lie beyond the threat of legal enforcement. The automatic association between “passive deregulatory” policymaking and rules on one side, and “centralized activism” and political discretion on the other, is a definitive trait of macroeconomic thinking.¹⁰⁸

This naturalized association, however, is flawed. Democratic regulatory states purport to uphold constitutionalism alongside with economic intervention. The legitimacy of macroeconomic regulation in these countries depends not only on outcomes, but on democratic procedures as well. As so, macroeconomic regulation must adapt to the normatively cogent tenets of constitutionalism.

C. Legal Precepts for Macroeconomic Policymaking

¹⁰⁵ Judith N. Shklar, *Legalism: Law, Morals and Political Trials* 43 (1986).

¹⁰⁶ *Constitutionalism*, THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY, <http://plato.stanford.edu/entries/constitutionalism> (last edited Sept. 11, 2012).

¹⁰⁷ Adrian Vermeule, *Our Schmittian Administrative Law*, 122 HARV. L. REV. 1095, 1096 (2009). See also Johan Steyn, *Guantanamo Bay: The Legal Black Hole*, 53 INT'L & COMP. L.Q. 1, 1 (2004); DAVID DYZENHAUS, *THE CONSTITUTION OF LAW* 3 (2006).

¹⁰⁸ Kelman, *supra* note 1, at 1218 (contrasting “passive deregulatory” policymaking and “centralized activism”).

In the paragraphs that follow, I explain how knowledge about basic aspects legal theorization and judicial practice can illuminate macroeconomic policymaking.

1. Consistent Policies are Not Necessarily Rule-Based

The argument that clear and stable rules are necessary for economic prosperity has now become almost a truism. The famous Weberian lesson is that definite rules serve to stabilize expectations and award the predictability necessary for market coordination.¹⁰⁹ Yet the economic value of predictability trades off with the necessity to reform the legal system so as to eliminate archaic, misconceived, unfair, or distortive laws. Because of that, law generally, and administrative law in particular, is always caught between the past and the future. On one hand, law is necessary to preserve the social order and avoid violence.¹¹⁰ On the other hand, law is an instrument of transformation, and in some cases it is transformation itself.¹¹¹

Finding a balance between permanency and transiency is also a problem for macroeconomists. It manifests itself most clearly in the course discussions over optimal versus consistent policy.¹¹² An optimal policy is one that maximizes the social welfare function from a certain point of time into the indefinite future. A consistent policy maximizes the social welfare function, yet remains invariant overtime.

In a seminal article that eventually rendered its authors a Nobel Prize in economics, Finn Kydland and Edward Prescott argued that a consistent monetary policy is superior to an optimal monetary policy.¹¹³ The structure of Kydland and Prescott's argument was: first, to equate consistent policy with a policy based on clear and stable rules, then, to equate optimal policy with bureaucratic discretion, and finally, to explain why the former policies are better than the latter.¹¹⁴ Having done that, they concluded their article as follows:

¹⁰⁹ MAX WEBER, *ECONOMY AND SOCIETY* 337 (Guenther Roth & Claus Wittich eds., 1978) ("The universal predominance of the market consociation requires [...] a legal system the functioning of which is *calculable* in accordance with rational rules").

¹¹⁰ DOUGLASS C. NORTH ET AL., *15 VIOLENCE AND SOCIAL ORDERS: A CONCEPTUAL FRAMEWORK FOR INTERPRETING RECORDED HUMAN HISTORY* (2009).

¹¹¹ Hannah Arendt, *On Revolution* 8 (1963).

¹¹² David Colander, *The Lost Art of Economics: Essays on Economics and the Economics Profession* 63–64 (2001).

¹¹³ Finn Kydland & Edward Prescott, *Rules Rather than Discretion: The Inconsistency of Optimal Plans*, 85 J. POL. ECON. 473 (1977).

¹¹⁴ In his discussion of the art of monetary policy, David Colander offers an excellent metaphor to illustrate Kydland and Prescott's point:

[Suppose there is] a child who wants ice cream and will scream incessantly if he or she does not get it. Let us say that the optimal policy is to give in. That might not be a reasonable policy. The consistent policy is to establish a rule from which it is impossible to deviate: No ice cream unless you eat your vegetables. Knowing that his or her parents cannot deviate from that rule, any rational child (and many-real world children) will modify his or her behavior, since the unmodified behavior will not produce ice cream and will make everyone worse off. The rule gets parents what they want and it involves less screaming, but this

“If we are not to attempt to select policy optimally, how should it be selected? Our answer is, as Lucas (1976) proposed, that economic theory be used to evaluate alternative policy rules and that one with good operating characteristics be selected. In a democratic society, it is probably preferable that selected rules be simple and easily understood, so it is obvious when a policymaker deviates from the policy. There could be institutional arrangements which make it a difficult and time-consuming process to change the policy rules in all but emergency situations. One possible institutional arrangement is for Congress to legislate monetary and fiscal policy rules and these rules to become effective only after a 2-year delay. This would make discretionary policy all but impossible.”¹¹⁵

Clearly, this argument can be traced to a long pedigree that views rules as superior to discretion. This view is in agreement with the monetarist tradition espoused by Milton Friedman and earlier by Henry Simmons according to which “an enterprise system cannot function effectively in the face of extreme uncertainty as to the action of monetary authorities or, for that matter, as to monetary legislation.”¹¹⁶ This view is also in agreement with the liberal tradition that strongly prefers the rule of law over the “rule of men.”¹¹⁷ Moreover, and to the extent that it embodies the idea that market players can bargain and reach efficient outcomes when they operate within a system of stable and predictable rules, the Kydland and Prescott model can also be said to be in agreement with the Coase Theorem.

The main problem, however, is that the description of the way in which constitutional and administrative laws could render discretionary policy “impossible” idealizes law.¹¹⁸ It assumes that law is a kind of technology—expressed under the mysterious rubric of “institutional arrangements”—that can be inserted in proper places to achieve specific ends. For that to be true, one must assume that laws can be applied individually and mechanically (or “formalistically”) to concrete cases simply by subsuming a certain set of facts into the abstract rules. In concrete cases, however, the application of law does not follow this pattern.

To see why, consider that legal provisions that formalize macroeconomic regulation are plagued by the problem of legal indeterminacy. This problem can be summarized as follows: if the application of a rule to a concrete case calls for deliberation about its meaning, then the rule can no longer be said to be a guide for action in the way that

rule can only be implemented by limiting parents’ discretion: they cannot give in, because they have made it impossible to do so.

See COLANDER, *supra* note 112, at 64.

¹¹⁵ Kydland & Prescott, *supra* note 113, at 487.

¹¹⁶ *See* Henry C. Simmons, *Rules Versus Authorities in Monetary Policy*, 44 J. POL. ECON. 1, 3 (1936). *See also* MILTON FRIEDMAN, *A PROGRAM FOR MONETARY STABILITY* (1960).

¹¹⁷ *See, e.g.*, Richard A. Posner, Hayek, Law, and Cognition, 1 NYU J. L. & Liberty 147, 153 (2005).

¹¹⁸ *See* José R. Rodriguez, The Persistence of Formalism: Towards a Situated Critique beyond the Classic Separation of Powers, 3 L. & DEV. J. 39, 47 (2010).

macroeconomic models require. In fact, decades of legal theorization during the 20th century have shown that it is quite difficult to come across cases where there is only one possible interpretation of a legal text for a concrete problem at hand.¹¹⁹

An intuitive answer to the problem of legal indeterminacy is to try to draft narrow rules that are as precise as possible. That would arguably reduce the room for discretion on the part of the bureaucrat or judge applying the rule. This strategy, however, may not work as intended. Experience shows that as the regulated phenomena become more complex, principles may deliver more consistency than rules.¹²⁰ The iterative pursuit of precision in single rules may increase the imprecision of a complex system of rules.¹²¹ Where the legal system is excessively detailed, it is almost always possible to find a rule that grounds any intended decision. This process of “rule seeking” may actually increase discretion rather than limit it.¹²² The implication is that consistent policies, monetary or otherwise, are not necessarily rule-based.

2. The Systemic Working of Legal Rules is Not Fully Predictable

The actual workings of a rule within a legal system may be different from the regulators’ original expectations. Laws and institutions created in different historical settings cohabitate the legal system and create a regulatory framework that is inherently unstable. It is an illusion to imagine that it is possible to reconstruct a regulatory edifice from scratch.¹²³ It is also an illusion to imagine that it is possible to prevent political actors from trying to influence the way in which the legal system will be interpreted and enforced in concrete cases.¹²⁴

Let me illustrate this point with a recent regulatory controversy that took place in the United States. With a view to avoid systemic risk and to avoid a “credit crunch” (that is, a reduction in the overall availability of credit), during the 2007–08 financial crisis the Federal Reserve set up eleven programs with which it lent or put up collateral to financial firms facing liquidity constraints.¹²⁵ However, it did not publicly disclose the names or amounts for each transaction, and perhaps for a good reason: the receipt of financial aid or liquidity loans tends to stigmatize the recipient banks because of the negative signal

¹¹⁹ See, e.g., Fuller, *supra* note 97; Hans Kelsen, *Pure Theory of Law* (Max Knight trans., 1970); Duncan Kennedy, *Legal Formalism*, in *The International Encyclopedia of the Social and Behavioral Sciences* 8634–38 (2001).

¹²⁰ John Braithwaite, *Rules and Principles: A Theory of Legal Certainty*, 27 *AUSTL. J. LEGAL PHIL.* 47 (2002).

¹²¹ *Id.* See also JULIA BLACK, *RULES AND REGULATORS* (1997); Julia Black, *Talking About Regulation*, *PUB. L.* 77 (1998).

¹²² José Rodrigo Rodriguez, *Segurança Jurídica e Estratégias Legislativas: Restauração e Reforma* (Direito GV Working Paper No. 64, 2011) (Braz.).

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ Mark Pittman, *Court Orders Fed to Disclose Emergency Bank Loans (Update2)*, *BLOOMBERG* (Aug. 25, 2009), available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a7CC61ZsieV4>.

that is created in the market.¹²⁶ In fact, since 1914 it has been the Federal Reserve's policy not to disclose the names of the recipient banks.

Recently, however, the Fed was forced to change this policy. It did so against its will, and not because of a specific policy or law designed for that purpose, but instead because of a court decision. Bloomberg News sued the Fed under the Freedom of Information Act.¹²⁷ Signed into law by Lyndon B. Johnson in 1966, the Freedom of Information Act is a federal law that allows for the full or partial disclosure of previously unreleased information and documents controlled by the United States Government. Although originally it was not intended to cover rediscount and other operations of financial "rescue", Bloomberg's complaint eventually prevailed after a two-year court battle.

The lesson is the problem of unwanted legal consequences is an additional impairment to a rule-based system. Unwanted legal consequences spring not only from the well-known (but often forgotten) limitations of human cognitive capacities, but also from the fact that market players react strategically to regulation (a process sometimes referred to a "regulatory dialectic").¹²⁸ They are also related to the feedback mechanisms that exist among the economic, political and legal spheres.¹²⁹ And finally, as illustrated by the above example, unwanted consequences can result simply from the unpredictable workings of a complex legal system within a constitutional democracy.

3. Legal Discourse Can Constrain Decision-Making

The above discussion showed that increasing the precision of rules is not necessarily the best way to achieve consistent policymaking. The reason is complex phenomena may require principles instead. A related point is that legal certainty may not be obtainable exclusively based on a superior combination of rules and principles, but on legal discourse instead. Legal discourse is commonly portrayed exclusively in a negative light; as is well-known, even lawyers frequently refer to legal discourse as a means to pervert regulation through rule-seeking or otherwise. However, legal discourse can be used to solidify and make public the rationales that underlie regulation, thus engendering legal certainty.

To see why, consider, firstly, that the juridification of policymaking begs the use of legal discourse. Even where disagreement exists over the exact interpretation of a rule, disputes cannot be carried out exclusively in terms of interests and power.¹³⁰ The offer of

¹²⁶ Charles Goodhart, *Liquidity Management*, 2009, available at www.kc.frb.org/publicat/sympos/2009/papers/Goodhart.09.11.09.pdf (paper prepared for the 2009 Federal Reserve Bank of Kansas Symposium entitled "Financial Stability & Macroeconomic Policy").

¹²⁷ 5 U.S.C. § 551 (2006).

¹²⁸ See Edward Kane, *Accelerating Inflation, Technological Innovation, and the Decreasing Effectiveness of Banking Regulation*, 36 J. OF FIN. 355 (1981).

¹²⁹ See, e.g., Caroline M. Fohlin, *Economic, Political, and Legal Factors in Financial System Development: International Patterns in Historical Perspective* (Social Science Working Paper No. 1089, 2000), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=267674.

¹³⁰ For a similar point in the context of WTO disputes, see Daniel Benoliel & Bruno Salama, *Towards an Intellectual Property Bargaining Theory: The Post-WTO Era*, 32 U. PA. J. INT'L L. 265, 266 (2010).

reasons for decision serves the purpose of clarifying to market players (and in some cases to the citizenry in general) the rationales behind regulation. With that, difficult cases can be resolved in a fashion that is consistent with proper regulatory goals, and a greater degree of uniformity can be attained. At the same time, the presentation or motivations in the application of regulation preserves the legal ideology according to which difficult cases should be decided based on the best argument available, and serves as a weapon against the perils of decisionism.¹³¹

Secondly, in modern-day democracies giving reasons to decision-making is particularly important because the basic political framework is no longer that of a classical, or “pure”, separation of powers.¹³² A pure separation of powers assumes that the establishment and maintenance of political liberty requires that the government be divided into three branches, the legislature, the executive, and the judiciary.¹³³ To each of these three branches there is a corresponding identifiable function of government, and each branch is confined to the exercise of its own function.¹³⁴ Under a system of pure separation of powers, judges would mechanically (or “formalistically”) apply the law. The assumption is the political discussion has been resolved in the parliament.¹³⁵

In today’s constitutional democracies, however, it is common to find increasingly active courts that sway regulation and public policy in rather unexpected ways. The question, then, is how to constrain judges so that they do not act arbitrarily. One of the answers is the system of institutional checks and balances. For instance, the parliament can create a law that has the practical effect of overruling case law. A less obvious answer is that discourse can also be used for that end. The lesson is that it is possible to combine principled regulation with proceedings for their application that restrict the interpretative possibilities of the judges and regulators applying the law to concrete cases.¹³⁶

IV. ON THE NATURE OF LAW & MACROECONOMICS

Having considered the way in which legal knowledge matters for macroeconomic policymaking, a question arises about the nature of this relationship. In view of the widespread diffusion of Law & Economics literature, we are now used to thinking about the relation between law and economics as based on the dichotomy positive / normative analysis. That is, legal scholarship that draws on economic methods is either considering a description of how legal incentives affect the world (the positive dimension) or issues of applied ethics and justice (the normative dimension). This section argues that Law & Macroeconomics as conceived herein is more adequately framed as an art—a practice concerned with applied matters—than as a science. It does so by recuperating and

¹³¹ Klaus Günther, *Teoria da argumentação no Direito e na Moral: Justificação e Aplicação* (2004) (Braz.).

¹³² See Rodriguez, *supra* note 118.

¹³³ M. J. C. Vile, *Constitutionalism and the Separation of Powers* 14 (2nd ed. 1998).

¹³⁴ *Id.*

¹³⁵ See Rodriguez, *supra* note 118, at 52

¹³⁶ See Rodriguez, *supra* note 122.

explaining John Neville Keynes' most useful (but unwarrantedly forgotten) distinction among positive, normative, and the art of economics.

A. Overview

John Neville Keynes (1852–1949) is the English economist who outlived by three years his much more famous son, John Maynard Keynes (1883–1946). Neville Keynes most enduring contribution to economics is a treatise named *The Scope and Method of Political Economy*.¹³⁷ Originally published in 1891 and revised thereafter, this was the first systematic appraisal of economic method in English language. Neville Keynes wrote it in reaction to a controversy over the epistemological character and method of economics that was central to economic thinking in his time—and in fact, one that haunts the economic profession until today.¹³⁸ The controversy is related to whether economics is a scientific endeavor that establishes hypotheses based on the deduction of assumed truths about the world (such as that men rationally maximize utility), or whether economics is an examination of the workings of institutions considered in a specific historical setting (such as the impacts of a specific belief system on economic performance).

In the late 19th century, Neville Keynes framed this controversy as the clash between what he perceived as the two dominant schools of economic thought, the English and the German Schools of economics.¹³⁹ The English School was represented by remarkable figures such as John S. Mill, John E. Cairnes, Nassau W. Senior and Walter Bagehot.¹⁴⁰ It posited that economics was a value neutral science that used a deductive method to identify economic uniformities.¹⁴¹ Scientific deduction was made possible by the discovery of “simple and indisputable facts of human nature – as for example that in their economic dealings men are influenced by the desire for wealth – taken in connexion with the physical properties of the soil, and man’s physiological constitution.”¹⁴²

¹³⁷ John Neville Keynes, *The Scope and Method of Political Economy* 22 (4th ed. 1917) [hereinafter Neville Keynes, *Political Economy*].

¹³⁸ In Continental Europe, this controversy later became known as the “Methodenstreit”. During the late 1880s and early 1890s, it opposed the continental legatees of the English School, namely the Austrian School of Economics (led by Carl Menger), against the proponents of the German Historical School, led by Gustav von Schmoller. *See, e.g., id.* at 17, 120, 171.

¹³⁹ *Id.* at 16 (“The two schools, thus broadly distinguished, are sometimes spoken of as the English and the German respectively. These designations have the merit of brevity [...] They must not, however be interpreted too literally. In particular, it fails to assign a sufficiently important place to the mass of historical and statistical material that the labor of English economists has provided [...]. Again, the so-called German doctrines, whatever may have been their origin, are no longer the peculiar possession of any one country.”).

¹⁴⁰ Neville Keynes references the following books: John Stuart Mill, *Principles of Political Economy with some of their Applications to Social Philosophy* (7th ed., 1909); John Elliot Cairnes, *The Character and Logical Method of Political Economy* (1875); Nassau W. Senior, *Political Economy* (3d ed., 1854); Walter Bagehot, *Economic Studies* (1880). Neville Keynes, *Political Economy*, *supra* note 137.

¹⁴¹ Neville Keynes, *Political Economy*, *supra* note 137, at 12.

¹⁴² *Id.*

While the English School purported to be deductive and abstract, the German School of economics purported to be ethical and realistic. The German School is also known as the Historical School of Economics, since its most prominent members held that history was the main source of knowledge about economic issues. Its proponents believed that economics was culture-specific and therefore not generalizable over time and space. As explained by Neville Keynes, “moderates” such as Wilhelm G. F. Roscher and Adolph Wagner searched for a compromise between induction and deduction.¹⁴³ However, “radicals” such as the notorious Gustav von Schmoller would “practically identify political economy and economic history, or at any rate resolve political economy into the philosophy of economic history.”¹⁴⁴

Despite its internal divisions, the German School (particularly of the strand championed by Schmoller) challenged two core ideas of the English School.¹⁴⁵ First, it rejected the possibility of drawing a clear line between the positive and the normative inquiry; that is, between what “is” and what “ought to be.”¹⁴⁶ Rather than discovering “truths” about reality, the German School thought the scope of the economist that of weighing and comparing the moral merits of the motives that prompt economic activity.¹⁴⁷ It is in this sense that the German School considered itself ethical, rather than scientific. In particular, an ethical task of the economist was “to set forth an ideal of economic development having in view the intellectual and moral, as well as the merely material, life.”¹⁴⁸

Second, the German School rejected a priori thinking about economic matters. It distrusted theories not derived from historical experience, and emphasized empirical and historical analysis over logic and mathematics. It also sustained that the economy could not be understood other than in close connection with other branches of social science.¹⁴⁹ As so, instead of deducing implications based on the model of the “economic man,” economists should first appeal to specific observation, and only then seek generalizations. Hence, the focus of economic research should lie with actual men who are “moved by diverse motives, and influenced by the actual conditions of the age and society in which they live.”¹⁵⁰

The introduction to a book by Vilfredo Pareto, one of the most famous espousers of the axiomatic-deductive economic methodology that characterized the English (and later, the Austrian) School, contains a narrative that illustrates the undertones of the methodological controversy at hand:

¹⁴³ *Id.* at 19. Other members of the German School whose work is mentioned or discussed by Neville Keynes include Bruno Hildebrand, Karl G. A. Knies, and Adolph Wagner.

¹⁴⁴ *Id.* at 18, 19.

¹⁴⁵ *Id.* at 19 (also noticing that noticing that “we must not exaggerate the opposition between what may be called the classical English school and the new school”).

¹⁴⁶ *Id.* at 17.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.* at 17.

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

“Giving a lecture before a convention of scientists at Geneva, Pareto was interrupted from the audience by a patronizing call from Gustav von Schmoller, an economist of the then German Strassburg [sic]. “But are there laws in economics?” Schmoller had no personal acquaintance with Pareto at the time. After the lecture Pareto recognized the heckler on the street and sidled up to him in his shabby clothes and in guise of a beggar: “Please, sir, can you direct me to a restaurant where one can eat for nothing?” “Not where you can eat for nothing, my good man,” the German replied, “but there is a place where you can eat for very little!” “So, there *are* laws in economics!” laughed Pareto as he turned away.”¹⁵¹

B. A Threefold Taxonomy for Economics

Neville Keynes sought to establish middle-grounds between the English abstractionism and the Germanic historicism. He wanted to retain the advantages of the deductive thinking that characterized the former, without running into the shortcomings pointed out by the latter. To accomplish that, he proposed that economics should be viewed as partly a positive science concerned with finding truths about how the world works, partly an ethical inquiry, and partly an art concerned with practical precepts for action. What Neville Keynes did, therefore, was to posit the existence of a third dimension—the “art” of economics—which should be added to the two standard ones (positive and normative economics).¹⁵²

Neville Keynes argued that the positive dimension of economics is properly scientific. Its goal is to formulate models about the economic world, that is, to understand the “order of economic phenomena, their coexistences or sequences, under existing or assumed conditions.”¹⁵³ The normative dimension is concerned with the “standard by reference to which the social worth of economic activities and conditions may be judged.”¹⁵⁴ At the same time, however, Neville Keynes argued that concrete problems facing policymakers are neither properly scientific nor normative.

Concrete economic challenges cannot be solved exclusively through economic considerations. Rather, they require input from other political and social sources. Moreover, the solution to practical problems cannot be viewed exclusively as an exercise in applied ethics. As a result, dealing with practical problems is an art, the art of “investigation of economic rules, i.e., the determination of maxims or precepts by

¹⁵¹ Ulen, *supra* note 20, at 255 (citing VILFREDO PARETO, *THE MIND AND SOCIETY: A TREATISE ON GENERAL SOCIOLOGY* xviii (Arthur Livingston ed., 1935)). Ulen's article also argues that “in the modern legal academy, law and economics is playing the role of Pareto and traditional doctrinal scholars are playing the role of Schmoller.”

¹⁵² NEVILLE KEYNES, *POLITICAL ECONOMY*, *supra* note 137, at 21 (“The distinction here indicated is indeed threefold rather than two-fold as is usually implied.”).

¹⁵³ *Id.* at 21.

¹⁵⁴ *Id.*

obedience to which given ends may best be attained.”¹⁵⁵ In fact, as argued in this article, this practical or applied side of policymaking is exactly where legal thought and macroeconomics can fruitfully converge.

Neville Keynes’ offers two examples that distinctively illustrate his threefold economic taxonomy. He considers, firstly, the phenomenon of payment of interests.¹⁵⁶ A first question is why interest is paid at all, and what determines the rate that is paid. This is a positive investigation, a question for the science of economics. Secondly, there is a question about what should be a fair interest rate, a normative debate and a question for what Neville Keynes calls the “ethics of political economy.”¹⁵⁷ Thirdly, there is the practical debate about whether the state should interfere in private arrangements over the payment of interest, and if so, what means should be employed so that the standard that is normatively desired can be attained, at least approximately.¹⁵⁸ The formulation of economic precepts of that kind is an object of the “art of political economy.”

The other example presented by Neville Keynes concerns taxation.¹⁵⁹ The positive inquiry revolves around topics such as the existence of taxation itself and the influence of different forms of taxation on relative values. These are scientific questions about what “is.”¹⁶⁰ They are different, for instance, from inquiries about what the ideal forms of taxation “ought to be.”¹⁶¹ They are also different from discussions over applied problems, for instance, that of finding the adequate taxation scheme in a specific place and time. To exemplify, says Neville Keynes, achieving “equality of taxation” may require a system of progressive taxation or the judicious combination of direct and indirect taxation.¹⁶² This is the art of finding the specific rules or precepts that will best permit achieving the desired end.

In positing such a threefold division of economics, Neville Keynes selectively appropriates some ideas from the English and of other ideas from the German School. From the English School, Neville Keynes retains the notion that economics can be a scientific endeavor. He agrees with the distinction between the discovery of economic principles on one side, and their application on the other. In so doing, Neville Keynes accepts that it is possible to explain economic phenomena without passing a judgment on their moral worth or setting up an aim for economic progress. That is, it is possible to search for economic laws that exist independently both of the observer’s ethical values and of his concerns with concrete policy challenges.¹⁶³

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* at 22.

¹⁵⁸ *Id.* at 22, 32–33.

¹⁵⁹ *Id.* at 21.

¹⁶⁰ *Id.* at 22.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.*

At the same time, in positing that the science of economics should be distinguished from the art of economics, Neville Keynes rejected the British School's assumption that the application of positive economic science to concrete problems was itself scientific. For in concrete instances, the application of abstract and value-neutral theorization about economics required making allowances for other considerations ignored in the scientific pursuit.¹⁶⁴ He sustained that "a universally recognized fact [is] that but few practical problems admit of complete solution on economic grounds alone."¹⁶⁵

Neville Keynes also makes a selective appropriation of contributions of the German School. He conceded that Schmoller and others were correct in stressing the importance of history to economic thinking. A recognition that history matters means that economic deduction is contingent on the values that men frame for themselves in each place and each time. Nonetheless, Neville Keynes rejected the German School's insistence that economic description and prescription were inevitably linked. He argued instead that the formulation of ethical prescriptions about the economy logically presupposes the existence of theory of how the economy works.¹⁶⁶

In particular, said Neville Keynes, it is not possible to decide upon whether it is morally right that the state intervene in markets—for instance, capping interest rates or making taxation progressive—without having a theory about what the results will be.¹⁶⁷ To illustrate, he noticed that "industrial and financial policy can be rightly directed, only if based upon [the theoretical knowledge that science affords]; and whether we seek to construct social ideals, or to decide upon adequate steps towards their attainment, an indispensable preliminary is a study of the economic consequences likely to result from varying economic conditions."¹⁶⁸ Neville Keynes asserted that, without such an estimation of consequences, practical economic questions paradoxically end up solved without reference to their ethical aspects.¹⁶⁹

Neville Keynes, an Englishman himself, seems to have found the inspiration for opening concessions to the German School in the work of Adam Smith. Neville Keynes viewed Smith as a man whose economic thinking had the virtue of being free from methodological "excess."¹⁷⁰ As argued by Neville Keynes, Adam Smith had rejected neither a priori reasoning (typical of the English School) nor a posteriori reasoning (typical of the German School).¹⁷¹ Rather, Smith accepted a plurality of methods insofar as he perceived them to assist him in investigating the phenomena of wealth.¹⁷² Because of that, Smith's "authority" had been claimed by both the English and the German

¹⁶⁴ *Id.* at 24 (arguing that in seeking to be scientific the English School became moral).

¹⁶⁵ *Id.* at 30.

¹⁶⁶ *Id.* at 23.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 29.

¹⁶⁹ *Id.* at 24.

¹⁷⁰ *Id.* at 11.

¹⁷¹ *Id.*

¹⁷² *Id.*

Schools.¹⁷³ Smith, says Neville Keynes, “believed in a ‘natural’ order of events, which might be deduced a priori from general considerations, but he constantly checked his results by appeals to the actual course of history.”¹⁷⁴ Thus, it can be said that the art of economics conceived by Neville Keynes was very much in this Smithian spirit of methodological compromise.

C. The Art of Economics between Substance and Rhetoric

Today, recuperating the category of art of economics is critical to thinking in a constructive way about several challenges, including the governance of state intervention and the resurgence of state capitalism worldwide. I will later demonstrate the way in which legal knowledge plays out with the art of macroeconomics in connection with certain modern-day challenges. But to build such arguments I should first address some objections to Neville Keynes’ threefold taxonomy of economics.

As an initial consideration, the importance of discussing economics methodology is itself contentious. Law & Economics scholars, in particular, often take pride in claiming that they “do” Law & Economics, rather than simply talk “about” it. Unlike in most fields of human activity, where prudence is the greatest virtue, in academia hubris is more often an asset than a liability. Symptomatically, it seems that this attitude of relative disdain for methodological questions has been useful in helping legal economists formulate numerous insightful observations within several fields, particularly those pertaining to private law (notably contracts, property law, and torts). Yet I see no good reason for discarding a methodological question *tout court* simply because it fails the test of immediate applicability. Scholars are paid by their universities to teach, think, and write; and immediate applicability is ultimately the task of policymakers. In Law & Economics, a fascination with immediate applicability might transform insightful scholars (including legal scholars) into the proverbial “slave of some defunct economist.”¹⁷⁵ In this sense, recuperating the notion of economics as partly an art helps, rather than harms, scientific research.

¹⁷³ *Id.* (“It has been said of [Adam Smith] that he first raised political economy to the dignity of a deductive science. But he has also been regarded as the founder of the historical-method in political economy.”)

¹⁷⁴ *Id.* On this methodologically dualist character of Smith’s contribution, see Samuel Gregg, *Smith Versus Keynes: Economics and Political Economy in The Post-Crisis Era*, 33 HARV. J. L. & PUB. POL’Y 443, 459–63 (2010). See also E. G. WEST, ADAM SMITH: THE MAN AND HIS WORKS 20 (1976) (emphasizing Smith’s concern with the effects of legal, institutional and general environmental conditions on human progress).

¹⁷⁵ JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY 383 (1935) (“The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas.”).

A more solid objection to Neville Keynes' threefold taxonomy is that it barely resisted the test of time, if at all. The positive/normative dichotomy is now entrenched in the economics profession and academia. A decisive step in that direction was the publication of Milton Friedman's influential essay, *The Methodology of Positive Economics* (1953). It is an interesting and often unnoticed fact that the very first words of Friedman in such an essay are quotes of Neville Keynes, as follows:

"In his admirable book on The Scope and Method of Political Economy, John Neville Keynes distinguishes among 'a positive science . . . a body of systematized knowledge concerning what is; a normative or regulative science ... a body of systematized knowledge discussing criteria of what ought to be . . . ; an art ... a system of rules for the attainment of a given end'; comments that "confusion between them is common and has been the source of many mischievous errors"; and urges the importance of "recognizing a distinct positive science of political economy'."¹⁷⁶

Commenting on Friedman's essay, David Colander observes that "what is particularly ironic about losing the art of economics is that it was lost while in plain sight."¹⁷⁷ Indeed, Milton Friedman's essay focuses on the distinction between positive and normative economics, yet at no point does it deny the existence of the art economics. On the contrary, in restating a point earlier had been made by Neville Keynes, Friedman expressly referenced the art of economics in that same famous article, as follows:

"Normative economics and the art of economics, on the other hand, cannot be independent of positive economics. Any policy conclusion necessarily rests on a prediction about the consequences of doing one thing rather than another, a prediction that must be based – implicitly or explicitly - on positive economics."¹⁷⁸

To be true, Neville Keynes himself at times displayed an ambiguous attitude towards the category of economic art.¹⁷⁹ He repeatedly pointed out that the frontiers between the English and the German Schools were much stronger on the formal statements of their proponents about methodology, than on substance of the concrete works of the best economists of either School.¹⁸⁰ Naturally, Neville Keynes noticed the difference in the relative importance that authors in each School attached to different aspects of their works.¹⁸¹ And perhaps more tellingly, Neville Keynes noticed that there was a difference in the attitude of each School towards the economic doctrine of *laissez faire* and also toward government intervention. (Expectably, in comparison to the German School, the

¹⁷⁶ Milton Friedman, *The Methodology of Positive Economics*, in *ESSAYS IN POSITIVE ECONOMICS* 3, 3 (1953).

¹⁷⁷ COLANDER, *supra* note 112, at 19.

¹⁷⁸ FRIEDMAN, *supra* note 116, at 5.

¹⁷⁹ Neville Keynes, *Political Economy*, *supra* note 137, at 31.

¹⁸⁰ *Id.* at 11. For a restatement of this point in modern economic writing, see DEIRDRE MCCLOSKEY, *THE RHETORIC OF ECONOMICS* (1986).

¹⁸¹ Neville Keynes, *Political Economy*, *supra* note 137, at 11.

English School was more sympathetic to *laissez faire* and less to government intervention).¹⁸² But when analyzing concrete challenges, the difference between the two Schools was “strictly speaking one of degree only.”¹⁸³

Yet upholding the art of economics, said Neville Keynes, is important mainly because it engenders “clearness of thought.”¹⁸⁴ Firstly, it justifies that a positive investigation of economic phenomena be pursued independent of immediate and practical applicability. Granted, the study of economic regularities is not an end in itself.¹⁸⁵ But scientific expediency mandates that a scientific study be carried out without the specific objective of solving a specific practical question, or accommodating a specific ethical view.¹⁸⁶ For positive economics is an abstract thinking about abstract problems, and immediate relevance should not be a concern of the positive scientist. To illustrate, as put by David Colander, if theoretical physics were required to maintain policy relevance, Einstein’s thought experiments would have been seen as a waste of time.¹⁸⁷

Secondly, the category of economic art legitimates the creation of special departments of political and social philosophy that deal with practical questions in which economic considerations are important.¹⁸⁸ As Neville Keynes puts it, the term art “has the special merit that it does not suggest a definite body of principles with scientifically demarcated limits”. If solving practical regulatory challenges required only economic inputs, then the scientific endeavor would be coincidental with the applied one. Once the complexity of reality is carefully considered, the argument that applied policy concerns can be reduced to economics becomes so unreasonable that only an academic would dare consider it.¹⁸⁹

Thirdly, having a branch of economics that is concerned with applied questions frees economists to delve deeper into what economic goals are appropriate. Neville Keynes argues that the recognition that economic regularities exist does not mean that moral considerations are irrelevant for the economy. On the contrary, “neither economic activities nor any other class of human activities can rightly be made independent of moral laws.”¹⁹⁰ But one thing is to study the potential influence exerted by economic ideals on economic outcomes, and quite another is to discuss the objective validity of such ideals in themselves.¹⁹¹

¹⁸² *Id.* at 18.

¹⁸³ *Id.* at 20.

¹⁸⁴ *Id.* at 31.

¹⁸⁵ *Id.* at 26.

¹⁸⁶ *Id.*

¹⁸⁷ COLANDER, *supra* note 112, at 21.

¹⁸⁸ Neville Keynes, Political Economy, *supra* note 137, at 31.

¹⁸⁹ For a similar point, see Robert Cooter, *Law and the Imperialism of Economics: An Introduction to the Economic Analysis of Law and a Review of the Major Books*, 29 UCLA L. REV. 1260, 1266 (1982) (“the claim that law can be reduced to economics is too preposterous for anyone but an academic to contemplate.”).

¹⁹⁰ Neville Keynes, Political Economy, *supra* note 137, at 24.

¹⁹¹ *Id.* at 25.

In his book, *The Lost Art of Economics* (1991), David Colander discusses additional reasons for upholding the category of economic art: helping policymaking,¹⁹² improving economics teaching,¹⁹³ and releasing economists from “artiphobia”.¹⁹⁴ Colander’s reasoning is persuasive enough but the nature of economics teaching or of economics as such are not my main concerns here. Rather, my point is demonstrating where and how the art of economics and legal thinking converge.

D. The Challenges of the Art of Law & Macro

Neville Keynes was correct in arguing that in concrete policy questions “account must also be taken of ethical, social, and political considerations that lie outside the sphere of political economy regarded as a science.”¹⁹⁵ Given that law is a social phenomenon, Neville Keynes’ reference to “social considerations” can be interpreted as including law. On the other hand, the fact that law is not individually singled out from other social considerations suggests that he understood that law and legal knowledge were of no special concern or relevance. In many ways, Neville Keynes’ disregard for law and legal knowledge is understandable. Writing in the Victorian Era, he was immersed in a political system of conservative liberalism. He did not witness the ascendance of constitutional rights in public discourse or the rise of the regulatory state. He enjoyed times of judicial restraint on the part of courts and of gradual political reform carried out by the parliament. Conversely, we live in a completely different setting because courts (and thus, lawyers as well) have moved from the periphery to the center of the political debate.

Evidently, no one denies that most macroeconomic policies are “legal” in the limited sense that state officials with authority execute them.¹⁹⁶ As such, law is considered merely the instrument of macroeconomic regulation. This, however, is incorrect. Macroeconomic policies are not simply instrumentalized with law; they are also refracted through law. The implication is that macroeconomic policy objectives—the channeling of savings to productive investment, the increase in exportation, the generation of jobs and growth, the increase in tax revenues, the control of inflation, among many others—are not automatic and also depend upon legal structures, rules and reasoning.¹⁹⁷

The refraction of macroeconomic regulation through law carries a momentous implication. It means that macroeconomic policy questions cannot be discussed, as is common, based simply on their assumed impacts on efficiency and economic growth. Rather, an examination of legal structures in each setting is useful to understand the

¹⁹² COLANDER, *supra* note 112, at 69.

¹⁹³ *Id.*

¹⁹⁴ *Id.* at 124.

¹⁹⁵ Neville Keynes, *Political Economy*, *supra* note 137, at 30.

¹⁹⁶ Kelman, *supra* note 1, at 1216–17.

¹⁹⁷ For a similar point, see Tamara Lothian, *Rethinking Finance Through Law: A Theoretical Perspective* (Columbia Law School, Working Paper No. 412, 2011). *See also* Tamara Lothian & Roberto Mangabeira Unger, *Crisis, Slump, Superstition and Recovery Thinking and Acting Beyond Vulgar Keynesianism* (Columbia Law & Econ. Working Paper No. 394, 2011).

concrete possibilities of proposed macroeconomic interventions. Evidently, that does not mean that macroeconomic questions should (or even could) be simply recast as legal ones. However, it means that legal knowledge can improve macroeconomic regulation.

In particular, for applied (as opposed to merely theoretical) macroeconomic questions, legal knowledge will increasingly matter in two important, albeit often conflicting, ways. On the one hand, legal knowledge is necessary to formulate doctrinal concepts geared toward expediency and efficiency, as is intrinsic to macroeconomic intervention. On the other hand, legal scholars can contribute to macroeconomic regulation by rejecting decisionism. Decisionism stands for uncontrolled power: it has historically served to justify a wide spectrum of authoritarian regimes. The defense of the legal ideology of constitutionalism is ever more important as countries swing into state-capitalism, because the defense of due process and of legal formalism can serve as a political weapon against the well-known risk of state-capitalism transforming into tyranny. Ultimately, this is the essence of the Art of Law & Macroeconomics.

V. CONCLUSION

Scholars typically portray developments in their fields as resulting from internal advancements, with newer theories and concepts displacing old ones based on the canons of the field's inner program. Law & Economics—roughly, the academic field at the confluence of the “ocean currents” of legal and economic thought—¹⁹⁸ is no exception. Its ambition to function as a hard science means that every development can be attributed to a novel insight of an “intellectual entrepreneur”¹⁹⁹ into an aspect of legal theory and practice.²⁰⁰ Yet the efforts to link legal and economic knowledge can also be traced to the broader socioeconomic context in which scholars operate, and the 2007–08 financial crisis is a case in point. The magnitude and political relevance of the crisis drew many economically inclined legal scholars to study banks and the financial industry, something that they were previously reluctant or uninterested in doing. Such scholars have accordingly now been exposed to concepts typically dealt with within macro (rather than micro) economics. As a result, a field that had previously been exclusively the realm of law and microeconomics may now incorporate topics of macroeconomics as well.

¹⁹⁸ Robert Cooter, *Justice at the Confluence of Law and Economics*, 1 Social Justice Research 67 (1987) (“As a boy I camped on a sandbar off the Caroline coast at the confluence of two ocean currents that made the waters rough but fertile. As an economist in a law school, I am at the confluence of two intellectual traditions”).

¹⁹⁹ See Larry E. Ribstein, Henry Manne: Intellectual Entrepreneur (February 18, 2007) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1094904. See generally David E. Pozen, We Are All Entrepreneurs Now, 43 Wake Forest L. Rev. 283 (2008).

²⁰⁰ See generally Thomas S. Ulen, Very Like a Whale: Inaugural Lecture for the Alumni Distinguished Professor of Law (Oct. 15, 1997), <http://igpa.uillinois.edu/system/files/WP62-whale.pdf>; and Ian Ayres, Very Like A Law Professor: An Essay In Honor Of Tom Ulen 2011 U. Ill. L. Rev. 1767 (2011).

This article demonstrated that legal scholars can give a meaningful (even if perhaps modest) contribution to macroeconomic regulation. They can do that by offering legal precepts—directions to policymakers—that are based on the premise that macroeconomic policies are part of a system of legal rules, principles and institutions. Indeed, effective macroeconomic intervention requires not only an understanding of individuals, but of the structure of their interactions as well.²⁰¹ Since in a constitutional democracy this structure is largely established by the law, legal scholars can contribute to macroeconomic policy based on their understanding of the internal rationality and structure of the legal system. In so doing, legal scholars will not be contributing to the science, but instead to the art economics.

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²⁰¹ David Colander et al., *supra* note 25. *See also* Thomas Schelling, *Micromotives and Macrobehavior* (1978) (showing that macrobehavior can depart from what the individual units are trying to accomplish); and Peter Howitt, *Coordination Issues in Long-Run Growth*, in *Handbook of Computational Economics: Agent-Based Computational Economics* (Leigh Tesfatsion & Kenneth Judd eds., 2006).