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The Art of Law & Macroeconomics
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Abstract

In the world’s current condition of macroeconomic turmoil, a justifiable question arises: what is the contribution that legal scholars, as opposed to economists, can make to macroeconomic regulation? Since mainstream Law & Economics scholarship adapts much more easily to micro (rather than macro) economics, an alternative paradigm is needed. I propose that legal scholars explore the Art of Law & Macroeconomics, a concept that links legal knowledge and the art of economics. Legal scholars are therefore expected to offer policy advice based on their understanding of the internal rationality and structure of the legal system.
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Introduction

Law & Economics scholars typically aspire to practice science.¹ Yet, when it comes to dealing with macroeconomic topics, the objective of these scholars should rather be the contribution to an art. Part I explains the proposed concept of the Art of Law & Macroeconomics. Part II contrasts the suggested approach with mainstream Law & Economics. Part III analyzes the related work of John Neville Keynes. Part IV establishes a conceptual framework for the Art of Law & Macroeconomics and offers legal precepts for macroeconomic policymaking. A brief conclusion follows.

I. Towards a New Paradigm for Law & Macroeconomics

A. On Legal Knowledge and the Art of Economics

The Art of Law & Macroeconomics links legal knowledge and the art of economics. At the outset, two semantic clarifications are in order. First, by “legal knowledge” I do not refer to the mechanical memorization of rules, but instead, to the set of cultural competences that professional lawyers develop in law schools, such as interpretation and litigation.² The distinctive trait of legal knowledge is to reflect upon the legal system primarily from within. That is, to focus on the workings of laws in a given system of rules, principles, and legal institutions.

Second, the “art” of economics is a concept adopted by John Neville Keynes (1852-1949), the English economist who outlived by three years his more famous son, John Maynard Keynes (1883-1946).³ Neville Keynes divided economics into three branches: positive, normative, and art. Positive economics is the scientific study of how the economy works; normative economics is the ethical study of how the economy should work; and the art of economics is concerned with the formulation of precepts for policy advice.⁴ In other words, positive economics is concerned with finding economic uniformities that determine the actual workings of the economy; normative economics is a branch of applied ethics that deals with value judgments and ideals; and the art of

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¹ Thomas S. Ulen, Law and Economics in the Future of Legal Scholarship, Education, and Practice, 53 Rev. of Business and 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.”)
economics is economic knowledge applied to concrete (as opposed to conceptual) problems.

Legal scholars can contribute to macroeconomic research and practice by exploring connections between legal knowledge and the art of economics. In his book, *The Lost Art of Economics* (1991), David Colander’s defines the art of economics as the application of the knowledge learned in positive economics to achieve the goals determined in normative economics.\(^5\) I accordingly propose that the Art of Law & Macroeconomics be defined as the application of legal knowledge to complement the pursuit of the goals determined in normative macroeconomics.

This definition of the Art of Law & Macroeconomics is premised on two theoretical assumptions. The first is that institutions matter for macroeconomic outcomes. For lawyers, this proposition tends to sound obvious; for macroeconomists, it does not. Most of macroeconomic theory assumes 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; the latter, to rational decisions of market agents given a technically-determined opportunity set.\(^6\) This article is instead based on the idea that non-economic institutional constraints shape macroeconomic outcomes.

The second building block of my definition of the Art of Law & Macroeconomics is that state law is an essential component of the institutional framework that constrains macroeconomic regulation. This observation may again seem evident, yet, it is not. No one denies that most macroeconomic policies are “legal” in the limited sense that state officials with authority execute them.\(^7\) But typically law is viewed as plainly plastic, malleable, and manageable. As such, law is considered merely an instrument of macroeconomic regulation – a point I reject. I argue that macroeconomic policies are not simply instrumentalized with law, but are also refracted through law.

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.\(^8\) Rather, an examination of legal structure in each setting is useful to understand the concrete possibilities of proposed macroeconomic interventions. Evidently, that does not mean that macroeconomic questions should be recast as legal ones. However, it means that legal knowledge can improve macroeconomic regulation. Ultimately, this is the essence of the Art of Law & Macroeconomics.


\(^7\) Kelman, *supra* note 6, at 1216-1217.

B. Scholarship in Historical Context

In a seminal study about the relationship between law and macroeconomics, Mark Kelman argued that the history of Law & Economics can be thought in terms of each mini-generation of scholars’ ambitions.9 As Kelman explains, in the 1930s and 1940s the first generation studied the misallocation of resources caused by noncompetitive pricing, and focused mostly on antitrust.10 As of the 1960s, the second generation departed from Richard Posner’s argument that Common Law was efficient and used transactions cost theorization to analyze private law topics such as contracts, property, and torts.

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 of productive ventures, particularly corporate structures and long-term contractual relationships.11 He was also correct in foreseeing that the third generation of scholars 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.12

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. The main driver of this shift was the attempt to provide a solid institutional framework for a post-Soviet, capitalist and globalized international economy. 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 macroeconomic developmental strategy.13 After such a pivotal historical juncture, a concern with institutions – particularly in the form of new-institutional economics – gained standing in macroeconomic policy and academic circles.

At the same time, in the aftermath of the Soviet collapse macroeconomic regulation became increasingly more juridicized. By juridicization, I mean regulation grounded in legislation, ordinances, and other kinds of legal provisions of national and international law rather than sheer discretion. Juridicization can be considered a direct reaction to globalization, in two ways: Globalization accelerated efforts toward the establishment of a framework for stable international economic relations. Evidently, attempts to establish international law were more successful in some areas (e.g. trade and intellectual property)14 than in others (notably, monetary coordination).15 In addition, in competition

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9 Kelman, supra note 6, at 1219.
11 Kelman, supra note 6, at 1222.
12 Id.
14 See generally Daniel Benoliel and Bruno Salama, Towards an Intellectual Property Bargaining Theory: The Post-WTO Era, 32 U. PA. J. INTL L. 265 (2010); and Bruno Salama and Daniel Benoliel,
for investments, trade and technology; governments worldwide sought to align their policies with the prevailing liberal credo of institutionalization, functional division of power, and rule of law.\textsuperscript{16}

The juridicization of macroeconomic regulation, while irregular across different sectors and countries, carried at least two noteworthy implications. First, lawyers became increasingly involved with macroeconomic regulation, as they were more frequently summoned to perform their conventional jobs of writing detailed regulation, litigating, interpreting, and challenging statutes in court. Second, the actions of the state officials that implement macroeconomic policies became more frequently challenged, both in national courts and in international fora such as the World Trade Organization.

Now, as I write in the aftermath of the 2007-08 financial crisis, the prevailing trend towards greater free market policies can no longer be taken for granted. On the contrary, governments worldwide increasingly seek to control their economies to augment their global influence.\textsuperscript{17} Ian Bremmer defined this phenomenon as a global turn toward state-capitalism – the system under which the state is the dominant economic player and uses markets primarily for political gain.\textsuperscript{18} The strengthening of state capitalism entails various consequences: 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.\textsuperscript{19} As recently put by Jeffrey Garten, this is the “ill wind” that blows.\textsuperscript{20}

The kind of Law & Economics that prevailed thus far is likely to be affected by the reemergence of state-capitalism. As scholars grapple with challenges related to state intervention, bureaucratic discretion, state planning, and administrative law will increasingly be a focus of concern. Perhaps, this new wave of Law & Economics will build on Law & Development scholarship – yet with an increasing concentration on policy challenges typical to developed (rather than only in developing) countries.\textsuperscript{21} Or perhaps, as I argue here, the relationship between law and macroeconomics will be considered as an art rather than as a science.

C. The Tension between Interventionism and Constitutionalism

Currently, an important driving force for change within Law & Economics scholarship is the inevitable tension that exists between economic interventionism and constitutionalism. This relationship is abrasive since interventionism tends to emphasize governance premised on judgments of convenience rather than rules. As such, it flirts

\begin{thebibliography}{99}
\bibitem{16} See Salama, \textit{supra note} 8, at 19.
\bibitem{17} See Salama, \textit{supra note} 8 at 37.
\bibitem{19} \textit{Id.}
\bibitem{20} \textit{Id.}
\bibitem{21} Jeffrey Garten, How to Live with the Reality of State Capitalism, Fin Times 17 (Jan 15,2008).
\bibitem{22} For an example of that, see Ronald J. Gilson & Curtis J. Milhaupt, Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism, 60 Stan. L. Rev. 1345.
\end{thebibliography}
with a legal ideology – decisionism – that clashes with constitutionalism. Within decisionism, the exercise of power and authority by the state is premised on unchecked discretion. Decisionism, thus, challenges the liberal ideology that underlies constitutionalism, namely that state actions and state officials should be accountable based on the rule of law. The reemergence of debates over decisionism implies, in addition, that ideological debates are back – and therefore, the positivist vision of solving applied macroeconomic challenges based solely on economic analysis may have to be dismissed.

Indeed, a venerable liberal tradition places considerable hope on the promise of rule of law and democratic accountability of state officials. A salient problem for economic intervention by the state, however, is that there are trade-offs between accountability and efficiency. Expediency, systemic risks, regulatory strategy, protection of public savings and other political and economic concerns justify large degrees of power delegation to bureaucrats. In theory, empowered regulators can be held accountable ex post.

In practice, however, ex post accountability tends not to be effective since investigations of regulators typically become deeply politicized. In addition, government officials are often entrusted with mandates to implement laws with no meaningful guidance – so the ensuing debates about whether they fulfilled or breached the law end up having greater political than legal density. As a result, even in developed democracies macroeconomic regulation often becomes fairly opaque, in two senses: first, the degree of democratic accountability at any point in time is difficult to measure; second, the effects of democratization on the quality of regulation are difficult to measure as well.

Here, there is a noteworthy implication for the Art of Law & Macroeconomics. 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. This highlights a pragmatic attitude on the part of legal scholars standard to Law & Economics. 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.

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23 Including the system defended by the father of the concept of decisionism, Carl Schmitt, a Nazi scholar. See William Scheurman, Carl Schmitt: The End of Law (1999).
II. The Limits of Macroeconomic Analysis of Law

A. Why Scholarship in Law & Macro Cannot Be Like Law & Micro

When legal scholars refer to Law & Economics, they typically have in mind the relationship between law and micro – rather than macro – economics. 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 not the scope of microeconomics, but rather its theoretical robustness. Microeconomics can be considered robust because the main difficulties it deals with lie not at the level of its theoretical foundations, but rather in its application. In comparison with microeconomics, however, macroeconomics is not theoretically robust. This is the main explanation for why Law & Macroeconomics has not flourished so far.

When a legal scholar sets herself to apply microeconomic methodology to legal questions, she can legitimately pay little attention to theoretical economic questions. She can limit herself to applying mainstream microeconomics, shorthand for accepted truths. She can thus take for granted ideas that are largely corroborated by intuition, such as that demand curves slope downwards and supply curves slope upwards. She can also rely on the notion that individuals do what they deem to be best for them given their preferences; that efficiency results from maximizing society’s welfare or wealth; that the expected consequences matter for evaluating the morality of human actions; and most importantly, that legal rules create implicit prices, that is, incentives. In applying this theoretical framework, the main difficulty is measuring the concrete effects of laws and regulations. In short: the foundational theory is relatively solid; the basic challenge is empirical.

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. Unlike with micro, the difficulties of macroeconomics lie at the level of foundational theory inasmuch as at the level of application. In particular, identifying mainstream macroeconomics is most often a daunting task. For some, mainstream economics can be equated to Keynesianism. Keynesianism is basically the set of economic doctrines formulated by John Maynard Keynes in his classic *The General Theory of Employment, Interest and Money*, published

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28 See Kelman, supra note 6.

29 See Ramirez, supra note 25.
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.30

Evidently, mainstream economics is never a static set of ideas – an observation that is true both within micro and macroeconomics.31 The distinction between what lies within or outside the economic “mainstream” tends to vary not only historically but also geographically.32 The point I am making, however, is that such variation is much greater within macro than within microeconomics. When a legal scholar decides to apply microeconomic methodology to analyze a problem, her audience can promptly expect that she will assume marginalist decision-making and rational maximization, and that she will employ analytical concepts such as scarcity, equilibrium, incentives, efficiency, and so on. However, the application of macroeconomic theory to legal problems inevitably raises an uncomfortable question: which macroeconomic view is to be employed?33

Let me illustrate the difficulty posed by such a question with a concrete example that I have examined in my studies of Brazilian foreign exchange regulation.34 In the mid-1990s, the Brazilian government decided to reduce the stringency of the country’s foreign exchange controls. 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 established a system of exchange controls under which international flows of funds typically depended on previous and specific authorizations from the government. But in the beginning of the 1990s, a few ordinances enacted by Central Bank’s governors changed replaced the authorizative system with a declaratory one.35 Some public prosecutors, however, questioned the legality such ordinances in court. They argued, firstly, that these ordinances contradicted a hierarchically higher federal law that mandated stringency of exchange controlling.36 Secondly, they held that such federal law could not be amended by Central Bank ordinances, but only by another law coming from the Parliament.

From a legal perspective, the question about the legality of such ordinances was difficult: such ordinances contradicted the spirit, but not the plain meaning, of the federal law at hand. As so, there were good technical grounds to argue both in favor and

32 See Part III infra.
33 Kelman, supra note 6, at 1217.
34 Bruno Salama, Regulação Cambial entre a Ilegalidade e a Arbitrariedade: O Caso da Compensação Privada de Créditos Internacionais, Revista de Direito Bancário e do Mercado de Capitais No. 50 (2010).
35 Id.
36 Namely, Federal Law No. 4,131 of 1962.
against their legality. In the course of public debates, some economists as well as economically minded lawyers defended the legality of the Central Bank ordinances with a consequentialist argument. They claimed that an additional reason why the ordinances should be viewed as legal was that they were necessary for Brazil to attract higher foreign invests. Greater economic openness and less exchange controls, they reasoned, was a necessary attribute 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 neo-Keynesians still sustain – that greater financial openness may cause macroeconomic problems, including inflation and unemployment. As so, having exchange controls may be discretionarily used by monetary authorities to avoid excessive currency appreciation, to block speculative attacks, or to permit a reduction in base interest rates. Accordingly, macroeconomists of a Keynesian bent stepped into the public debate to sustain that it was best to view the ordinances at hand as illegal. The reason was the Central Bank’s ability to tightly control cross borderer flows of capitals should be preserved.

Brazilian courts eventually held that the ordinances were legal, 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 the macroeconomy, yet such overarching 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.

B. Intermezzo: Why Economics Matters for Law? The Law & Econ View

Both the fields of law and economics deal with problems of coordination, stability and efficiency in society. But the formation of complementary lines of analysis and research is not simple because their methodologies differ sharply. While law is exclusively verbal, economics is also mathematical; while law is markedly interpretative, economics is markedly empirical; while law ultimately aspires to be fair, economics ultimately aspires to be scientific; and while the yardstick of economic analysis is cost and benefit, the yardstick of legal analysis is legality. These methodological differences have historically rendered the intellectual dialogue between legal and economic scholars quite turbulent and often destructive.

38 Thomas I. Palley, Rethinking the Economics of Capital Mobility and Capital Controls, Working Papers wp193, Political Economy Research Institute, University of Massachusetts at Amherst (2009), at 13.
39 Id.
In recent decades, however, such a dialogue became more fertile. From the works of figures such as Ronald Coase, Richard Posner, Guido Calabresi, Henry Manne and Robert Cooter, among many others, the discipline of Law & Economics found common grounds and operated in the confluence of these two admirable traditions. Law & Economics assumes the existence of two analytical dimensions, one normative (or prescriptive) and the other positive (or descriptive). The most fundamental idea of normative Law & Economics is that the waste of resources is, at the very least, something undesirable. There is, therefore, something intuitive in pairing efficiency (which entails the lack of waste) justice. This proposition comes in two flavors, firstly as an ethical foundation to law and secondly as a complement to pragmatic thinking about law.

Wealth maximization as an ethical foundation for Law is a radical philosophical theory. Richard Posner formulated it in a series of articles from the second half of the 1970s. Subsequently, in 1983, he consolidated these writings in a book with the suggestive title of The Economics of Justice. Unsurprisingly, Posner’s thesis was highly controversial and generated furious reaction from various corners. Criticism exposed a number of deficiencies of Posner’s thesis, leading him to afterwards revise his position. In Problems of Jurisprudence (1990), Posner abandoned his defense of maximization of wealth as an ethical foundation of law, and came to defend wealth maximization in a more limited way that frames it as a version of legal pragmatism.

In “converting” himself to legal pragmatism, Richard Posner gave new shape to the notion that efficiency can be useful to law. He dismissed the notion that efficiency could be a sufficient operating criterion for evaluating issues pertaining to law, as well as the notion that efficiency – or wealth maximization, Posner uses both expressions interchangeably – should always outweigh other societal values. From a pragmatic perspective, law is fundamentally an instrument for the construction of social ends. Posner rejected the idea that the law is founded on permanent principles or that it could be practiced exclusively through its logical manipulation. He postulated instead that the meaning of legal categories is social, not immanent, and that human accomplishments should be assessed relative to the circumstances and also evaluated by their consequences. This led Richard Posner to a rejection of all fundamental criteria that could in an absolute form guide the normativity of law, including the criteria of efficiency.

In the end, the enduring normative message of Law & Economics – which is much in the historical pragmatic spirit of American legal scholarship of Holmes and others – is that the pursuit of justice through legal practice can benefit from a consequentialist discussion of incentives, costs and benefits. For the adamant of Law & Economics scholarship, such a discussion can be illuminated with the use of positive Law & Economics. Positive Law & Economics purports to apply a “scientific method” to legal problems. This means that analyses are carried out in two steps. First, the analyst formulates a logical hypothesis that is based on an abstract theory. For example, an increase in the probability of detection by the police will decrease the number of theft. Second, she gathers data to test the hypothesis empirically. Ideally, such data comes in the form of an econometric analysis. In practice, it often comes in the form of anecdotal evidence (including court precedents), questionnaires, experiments, historical accounts, and so forth.

Ultimately, positive Law & Economics invariably departs from a simple premise, namely that microeconomics is useful in the analysis of law. Robert Cooter notes that this premise has several versions, three of which are particularly important: the reductionist version, the explicative version, and the predictive version. The reductionist version suggests that law can be reduced to economics and that the traditional legal categories (such as subjective rights, fault, negligence, etc.) can be replaced by economic categories. The explicative version posits that economics can provide an explicative theory of the structure of legal rules. The predictive version suggests that economics can be used to predict the consequences of different legal rules and interpretations. To do any or all of that, positive Law & Economics employs Transaction Cost Theory, Agent Theory, Public Choice Theory, and Game Theory. In addition, theorists may complement their analyses with other cognitive sciences, particularly behavioral psychology and (tentatively) neuroscience.

Consider, for instance, the idea that some breaches of contractual promises are efficient. 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. Scholars may come up with different theories for what these doctrines should be, but in principle to do that they need only accept that promisors respond to economic incentives in much the same way that buyers and sellers respond to prices in the market. 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.”

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49 Ulen, supra note 1, at 226.
52 Kelman, supra note 6, at 1217.
Again, this means that Law & Economics uses microeconomic theory to discuss legal and policy questions where the difficulty lies not at the level of the foundations, but of application.\(^{53}\)

C. The Macroeconomics of Exchange Controls: An Illustration

If Law & (Micro)Economics is the application of microeconomic theory to legal problems, then by analogy Law & (Macro)Economics could conceivably be the application of macroeconomic theory to legal problems. Accordingly, Law & Macroeconomics would consist of discussions over the laws that promote e.g. economic growth, monetary stability or greater employment.\(^{54}\) 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 microeconomy. Essentially, every conclusion about a macroeconomic problem is highly questionable not only at the level of application, but of foundational theory as well. As a result, the kind of scientific project that characterizes Law & (Micro)Economics is not replicable with macroeconomic topics.

To illustrate, let us consider again the macroeconomic debates about foreign exchange controls.\(^{55}\) Should governments employ them? 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 a “currency war”.\(^{56}\)

Today’s macroeconomic debates over exchange controls are framed along the lines of two dichotomous perspectives which can be loosely referred to as orthodoxy and heterodoxy. Orthodoxy grounds a defense of capital mobility 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. 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. 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. Second, the market failure perspective deals with microeconomic “imperfections”, the solution to which is the enforcement of exchange controls.

\(^{53}\) See Richard Posner, supra note 26, at 140.

\(^{54}\) This was in fact done by some legal scholars. See e.g. Ramirez, supra note 25, at 515 (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 25, at 710.

\(^{55}\) For a detailed analysis of the macroeconomics of exchange controls, See Salama, supra note 8.

\(^{56}\) 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. See How to Stop a Currency War, The Economist (October 16, 2010), at 13 (highlighting the risk of actual currency wars, but in fact downplaying it); and Martin Wolf, Currencies clash in new age of beggar-my-neighbor, Financial Times (September 28, 2010).
In the spirit of pragmatism, a common attitude within economists is to try to solve theoretical questions through empirical analyses. Unfortunately, as is common in macroeconomics, the debates over exchange controls are empirically unsettled.\textsuperscript{57} Given the lack of empirical consensus, debates over capital mobility tend to rely on different foundations.\textsuperscript{58} In this epistemic sense, macroeconomic views can be viewed as being after all ideological: each view puts forth a different type of macroeconomic instrumentality and assumes (but cannot prove) different types of outcomes. In addition, the appearance of a myriad of macroeconomic views is symptomatic of the fact that disputes over fundamental conditions of social life have migrated from arenas of political philosophy to specialized professions, including law and macroeconomics.\textsuperscript{59}

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, or inflation, just to name a few. Because each macroeconomic strand departs from a different epistemic ideology, their divergences over applicable questions are inevitably transformed into foundational ones. This is the main reason why Law & Economics continues to be based exclusively on micro, rather than macro, economics. Symptomatically, in the sixth edition of his celebrated Economic Analysis of Law, Richard Posner’ argues that “macroeconomic performance, that is output, production, unemployment, and inflation, are ‘mysterious macroeconomic phenomena’”.\textsuperscript{60}

To sum up, the prevailing view is that Law & Macroeconomics must be put on hold until we finally reach a point where macroeconomists attain some agreement about how the macroeconomy works. This will most certainly take a very long time, but my argument in this article is that there are alternative ways of thinking about the relationship between law and macroeconomics as of now. In particular, I will emphasize the usefulness of Neville Keynes’ distinction between positive economics, normative economics, and the art of economics, as follows.

III. The Distinction between the Art and Science of Economics

A. Neville Keynes’ Take on Deduction and Induction

Neville Keynes’ most enduring contribution to economics is a treatise named The Scope and Method of Political Economy. Published in 1891, 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 at that time – and in fact, one that haunts economists until today.\textsuperscript{61} The controversy is related to whether economics is a scientific endeavor that

\textsuperscript{57} Salama, supra note 8, at 5.


\textsuperscript{59} Roberto M. Unger, What Should Legal Analysis Become 1 (1996); Free Trade Reimagined: The World Division of Labor and the Method of Economic (2010).


\textsuperscript{61} 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
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 – Confucian values or protestant ethics, for instance – 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. The English School was represented by remarkable figures such as John S. Mill, John E. Cairnes, Nassau W. Senior and Walter Bagehot. It posited that economics was a value neutral science that used a deductive method to identify economic uniformities. 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”.

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. 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”.

School of Economics (led by Carl Menger), against the proponents of the German Historical School, led by Gustav von Schmoller. Writing in 1891, it seems that Neville Keynes could acknowledge such Continental debates (See e.g. Neville Keynes, Political Economy, supra note 4, at 17, 120, 171) but not discuss them in detail.

62 Neville Keynes, Political Economy, supra note 4, 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”.)


64 Neville Keynes, Political Economy, supra note 4, at 12.

65 Id.

66 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.

67 Id., at 18, 19.
Despite its internal divisions, the German School (particularly of the strand championed by Schmoller) challenged two core ideas of the English School. 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”. 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. 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.”

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. 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 for generalizations. Hence, the focus of economic research should lie on actual men who are “moved by diverse motives, and influenced by the actual conditions of the age and society in which they live”.

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:

“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.”

68 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”).
69 Id., at 17.
70 Id.
71 Id.
72 Id.
73 Vilfredo Pareto, The Mind and Society: A Treatise on General Sociology xviii (Arthur Livingston ed., 1935), cited in Ulen, supra note 1, at 255 (which 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.”)
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 do 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).

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”. The normative dimension is concerned with the “standard by reference to which the social worth of economic activities and conditions may be judged”. At the same time, however, Neville Keynes argued that concrete problems faced by policymakers are neither properly scientific nor normative. On one hand, concrete economic challenges cannot be solved exclusively through economic considerations. Rather, they require inputs from other political and social sources. On the other hand, the solution to practical problems cannot be viewed exclusively as an exercise in applied ethics. As so, dealing with practical problems is an art, the art of “investigation of economic rules, i.e., the determination of maxims or precepts by obedience to which given ends may best be attained”. As I will argue later in this article, this practical 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. 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”. 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. The formulation of economic precepts of that kind is an object of the “art of political economy”.

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74 Neville Keynes, Political Economy, supra note 4, at 21 (“The distinction here indicated is indeed threefold rather than two-fold as is usually implied”).
75 Id. at 21.
76 Id.
77 Id.
78 Id.
79 Id., at 22.
80 Id., at 22, 32-33.
The other example presented by Neville Keynes concerns taxation. 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”. They are different, for instance, from inquiries about what the ideal forms of taxation “ought to be”. 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. This is the art of finding the specific rules, or precepts, that will permit as best as possible achieving the desired end.

In positing such a threefold division of economics, Neville Keynes is in reality making a selective appropriation of 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. As so, 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.

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. He sustained that “a universally recognized fact [is] that but few practical problems admit of complete solution on economic grounds alone.”

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. However, Neville Keynes rejected the German School’s insistence that economic description and prescription were inevitably linked was however viewed as untenable. He argued instead that the formulation of ethical prescriptions about the economy logically presupposes the existence of theory of how the economy works.

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

81 Id., at 21.
82 Id., at 22.
83 Id.
84 Id.
85 Id.
86 Id., at 24 (arguing that in seeking to be scientific the English School became moral).
87 Id., at 30.
88 Id., at 23.
taxation progressive – without having a theory about what the results will be.\textsuperscript{89} 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.”\textsuperscript{890} In fact, said Neville Keynes, without such an estimation of consequences practical economic questions paradoxically end up solved without reference to their ethical aspects.\textsuperscript{91}

Neville Keynes, and 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”.\textsuperscript{92} 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).\textsuperscript{93} Rather, Smith accepted a plurality of methods insofar as he perceived them to assist him in investigating the phenomena of wealth.\textsuperscript{94} Because of that, Smith’s “authority” had been claimed by both the English and the German Schools.\textsuperscript{95} 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.”\textsuperscript{96} As so, 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.

For starters, 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 often the greatest virtue, in academia hubris is more often an asset than a liability. Symptomatically, it seems that this attitude of relative disdain for

\textsuperscript{89} Id.
\textsuperscript{90} Id., at 29.
\textsuperscript{91} Id., at 24.
\textsuperscript{92} Id., at 11.
\textsuperscript{93} Id.
\textsuperscript{94} Id.
\textsuperscript{95} 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”).
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 into the proverbial “slave of some defunct economist”. In this sense, recuperating the notion of economics as partly an art helps, rather than harms, scientific research.

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’.”

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”. 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.”

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97 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”).


To be true, Neville Keynes himself at times displayed an ambiguous attitude towards the category of economic art. 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. Naturally, Neville Keynes noticed the difference in the relative importance that authors in each School attached to different aspects of their works. 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 English School was more sympathetic to *laissez faire* and less to government intervention.) But when analyzing concrete challenges, the difference between the two Schools was “strictly speaking one of degree only.”

Yet upholding the art of economics, said Neville Keynes, is important mainly because it engenders “clearness of thought”. 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. 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. 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.

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. 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.

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100 Neville Keynes, Political Economy, supra note 4, at 31.
101 Id., at 11. For a restatement of this point in modern economic writing, see Deirdre McCloskey, The Rhetoric of Economics (1986).
102 Neville Keynes, Political Economy, supra note 4, at 11.
103 Id., at 18.
104 Id., at 20.
105 Id., at 31.
106 Id., at 26.
107 Id.
108 Colander, supra note 5, at 21.
109 Neville Keynes, Political Economy, supra note 4, at 31.
110 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 Law Review 1258, 1266 (1982) (“the claim that law can be reduced to economics is too preposterous for anyone but an academic to contemplate”).

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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.”\textsuperscript{111} 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.\textsuperscript{112}

In his book, \textit{The Lost Art of Economics} (1991), David Colander discusses additional reasons for upholding the category of economic art: helping policymaking,\textsuperscript{113} improving economics teaching,\textsuperscript{114} and releasing economists from “artiphobia”.\textsuperscript{115} 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, as follows.

IV. The Refraction of Macroeconomic Regulation through Law

A. Overview

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.”\textsuperscript{116} Given that law is a social phenomenon, Neville Keynes’ reference to “social considerations” can be interpreted to include 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 English parliament. We, however, live in a completely different setting.

In today’s constitutional democracies, political battles are commonly fought outside parliaments, 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 juridicized, a phenomenon that only accelerated in recent times with the advent of globalization. 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 the regulations

\textsuperscript{111} Neville Keynes, Political Economy, supra note 4, at 24.
\textsuperscript{112} Id., at 25.
\textsuperscript{113} Colander, supra note 5, at 69.
\textsuperscript{114} Id.
\textsuperscript{115} Id., at 124.
\textsuperscript{116} Neville Keynes, Political Economy, supra note 4, at 30.
enacted by the bureaucracy. All of that brought law, lawyers, and legal thought to the forefront of regulation debates.

The implications of the juridicization of economic policies to macroeconomic theorization 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 economic challenges of various sorts. Evidently, there is little doubt that macroeconomic policymaking is refracted through politics. As is well known, national governments will repeatedly fail to adopt reforms deemed to be efficiency enhancing due to narrow interests and lobbies.\(^{117}\) The problem, quite clearly, is that macroeconomic policies have not only efficiency consequences but distributional effects as well.\(^{118}\) Therefore, macroeconomic policies end up largely captured interest groups.\(^{119}\)

Aside from politics, juridicization is itself another constraint for macroeconomic regulation. Juridicization – 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 relative indetermination. The problem of indeterminacy arises even where laws are never litigated.

B. How Law Matters for Macroeconomic Regulation

1. Outcome- and Procedure-Based Legitimation of Macroeconomic Regulation

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. On one hand, regulation that does not abide by procedural requirements is normatively unacceptable; or the other hand, regulation that does not conduce to desirable outcomes is politically unpalatable.

The reasons for that are theoretical as well as practical. Theoretically, this dual structure of legitimation conjugates the concerns of democratic deliberation and power delegation. On one hand, in a democracy regulation is premised on public deliberation focused on


In a pluralistic society, however, finding the common good is thwarted by the existence of incompatible understandings of value. As so, fair and preset procedures tend to become the basis of collective agreement; hence, the notion of procedural legitimation. On the other hand, we are not left with a purely procedural view of democracy. Mass democracies are systems of competition for political leadership where the citizenry authorizes leaders to pursue policies that are, in many ways, ultimately chosen by those leaders. If public policy and regulation fails to advance the individuals interests, then that citizenry has a good reason to reject it.

Practically, the main problem posed by this dual structure of regulatory legitimation is that procedural and outcome legitimation may trade-off with each other. Firstly, the degree of procedural legitimacy may affect people’s perceptions and values. Simply put, procedural legitimacy may reinforce public trust, enhance voluntary cooperation, and reduce free-riding. Secondly, 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 the macroeconomy. 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.” This is why in modern democracies macroeconomic regulation is often entrusted to a relatively independent bureaucracy that is judged based on the results that are (rightly or wrongly) perceived to be “delivered” by it.

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 Hayek, libertarians tend to believe that the market is a spontaneous order where unintended...

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121 Id., at 408.
123 See Cohen, supra note 120.
125 Cohen, supra note 120.
127 See Douglass North, Institutions, Institutional Change and Economic Performance (1990), and Understanding the Process of Economic Change (2005). See also Bruno Salama, Sete enigmas do desenvolvimento em Douglass North, in Desenvolvimento e estado de direito (Oscar Vilhena Vieira, org.), São Paulo, Saraiva (2011), at ...  
129 See David Levi-Faur, The Global Diffusion of Regulatory Capitalism, Work in Progress, available at http://poli.haifa.ac.il/~levi/levifaur-framework.pdf (“Democratic governance is no longer about the delegation of authority to elected representatives 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”).
consequences are so pervasive as to render actual engineering of outcomes impossible. Perhaps, but in the midst of crisis even adherents of strictly doctrinaire positions tend to become more tolerant toward remedial solutions that are believed to reestablish stability. If regulators are shrewd or lucky enough to capture the political laurels of a subsequent financial recovery – what 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. Administrative Law as the Basis of Macroeconomic Regulation

In democracies, public law is the realm in which the two forms of macroeconomic legitimation become incarnated in practical arrangements. The compromise between outcomes and procedures is most clearly visible within administrative law. On one hand, 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. On the other hand, administrative law also subjects these technical bodies to procedural constraints, and 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”.131

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

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policymaking not only because it sets explicit incentives, but also because law incarnates a “world view” that is interwoven with moral and ethical judgements about the fairness of the way in which legal and regulatory questions should be decided.132

3. The Normative 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 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.133

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.134 Decisionism thus fits comfortably within what legal philosopher William Scheuerman termed the “jurisprudence of lawlessness”.135 This strand of jurisprudence explores fundamental critiques to legalism and legal formalism.136 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.137 Under the most radical versions of the indeterminacy thesis, legal materials permit practically any conceivable solution to a legal question at hand.138 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 (e.g. unfairness), and more on pragmatic ones (ineffectiveness).

132 See Dani Rodrik, Institutions for High-Quality Growth: What They Are and How to Acquire Them (“[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.”) NBER Working Paper 7540, available at http://www.nber.org/papers/w7540, p. 4.
136 Scheurman, supra note 135, at 2.
137 Id., at 7-8.
138 The classic statement of this argument can be found in Duncan Kennedy, Form and Substance in private Law Adjudication, Essays on Critical Legal Studies, 1986.
Carl Schmitt, a Nazi scholar from the early 20th century, offered the most thorough defense of decisionism. In his classic libel against legalism, Schmitt defined liberalism as a “political romanticism” and legal formalism as a “childish fiction”. 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 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”. 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.

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.”

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 unproblematic. 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

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“centralized activism” and political discretion on the other, is a definitive trait of macroeconomic thinking.¹⁴³

This naturalized association is however flawed.¹⁴⁴ 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 has to adapt to the normatively cogent tenets of constitutionalism.

C. Legal Precepts for the Art of Macroeconomic Regulation

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.¹⁴⁵ 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;¹⁴⁶ on the other hand, law is an instrument of transformation, and in some cases (such as a constitutional revolution) it is transformation itself.¹⁴⁷

Finding a balance between permanency and transiency is also a macroeconomic problem. It manifests itself in particular in the course of macroeconomic discussions over optimal versus consistent policy.¹⁴⁸ 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 it is invariant overtime.

In a seminal article that 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.¹⁴⁹ Kydland and Prescott’s argument can be traced to a long pedigree that views laws as superior to discretion. For starters it is consistent with a 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

¹⁴³ Kelman, supra note 6, at 1218 (contrasting “passive deregulatory” policymaking and “centralized activism”).
¹⁴⁴ See Salama, supra note 8, at 11.
¹⁴⁸ Colander, supra note 5, at 63-64.
Furthermore, the argument is consistent with the liberal tradition of rule of law rather than rule of men, according to which economic life should be based on rules that at once constrain the state and are enforced by the state. Moreover, 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 consistent with the Coase Theorem.

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. Having done that, they concluded their article as follows:

“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.”

The main problem here is that the description of the way in which constitutional and administrative laws could render discretionary policy “impossible” idealizes law. 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 individually and mechanically (or “formalistically”) applied 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.


152 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 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 5, at 64.

153 Kydland & Prescott, supra note 149, at 487.

To see why, consider, firstly, 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 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.155

An intuitive answer to the problem of legal indeterminacy is to try to draft narrow rules that are as narrow and 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.156 The iterative pursuit of precision in single rules may increase the imprecision of a complex system of rules.157 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.158 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 live together within the same legal system and create a regulatory framework in constant change. It is an illusion to imagine that it is possible to reconstruct a regulatory edifice from scratch, except perhaps through armed revolution.159 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.160

Let me illustrate this point with a recent regulatory controversy that took place in the United States. 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.161 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 that is created in

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155 Lon Fuller; Hans Kelsen, Pure Theory of Law; Duncan Kennedy, “Legal Formalism”, in The International Encyclopedia of the Social and Behavioral Sciences (2001); etc.
157 Id. See also Julia Black, Rules and Regulators (1997); and Talking about Regulation Spring Public Law 77 (1998).
159 Id.
160 Id.
the market. 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, the news company, sued the Fed under the Freedom of Information Act. 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”). They are also related to the feedback mechanisms that exist among the economic, political and legal spheres. 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 juridicization 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. The offer of 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

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166 For a similar point in the context of WTO disputes, See Benoliel & Salama, supra note 15, at [266].
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.167

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.168 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.169 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.170 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.171

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 as to avoid that they, themselves, act arbitrarily. Evidently, one of the answers is that there should be 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.172

Conclusion

In his well-known masterpiece, On War, Carl von Clausewitz, the notable Prussian military theorist of the early 19th Century, famously declared that “war is nothing more than the continuation of politics by other means”. Like war, it is common to think of law as just another aspect of politics. Once we accept that both law and economics are specific enough to be considered separately from politics, we will understand that scholarship in each field can offer independent contributions to macroeconomic policymaking.

This article suggested that one way of integrating these dimensions of macroeconomic regulation is by drawing on Neville Keynes’ contribution that views applied economics as an art. Accordingly, the Art of Law & Macroeconomics faces the following challenges. First, sustaining and justifying the relevance of institutional analysis for macroeconomic inquiry and policymaking. Second, identifying macroeconomic topics requiring lawyers’ expertise. And third, building a conceptual framework for an

168 See Rodriguez, supra note 158.
170 Id.
171 See Rodriguez, supra note 154, at 52
172 See Rodriguez, supra note 158.
interdisciplinary analysis where relevant points of contention revolve around the “internal” perspective of law.

Finally, we should acknowledge that Neville Keynes does not completely solve the problem of explaining how the precepts for policymaking could exist beyond propositions grounded in science. In fact, in a sense, he only makes the puzzle more complicated. He warns readers that the art of economics should not try to determine a comprehensive solution to practical problems, because such solution would by necessity be non-economic in its character. 173 Yet he does not say exactly how to integrate noneconomic considerations into economic problems. Maybe this is the ineffable character of art that so much bothers economists but captivates lawyers.

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173 Neville Keynes, Political Economy, supra note at 30.