The Constitutive Function of Law in the Economy

A Primer

Drawing from legal realism, a fundamental premise of Law and Political Economy (LPE) scholarship is that law is constitutive of the economy. This means that law is not merely an external regulatory force on otherwise "natural" and "neutral" markets. Rather, it is an intrinsic part of the creation of markets in the first place. The reason is that artificial, deliberate, and ultimately political legal structures (e.g., legal permissions, legal prohibitions, and legal entitlements backed up by public power) determine the allocation of resources within the economy and significantly shape the bargaining power of different actors. Following that line of thought, the right to property itself is also understood as a product of state power rather than a natural right that the state only secondarily safeguards.

The fundament of markets – and the analytical heart of mainstream economic thought – is the notion of voluntary market exchanges. The voluntariness of market transactions is key for the liberal defense of markets as both freedom- and utility-enhancing. For example, a sale of a particular good enables, in principle, both the buyer and the seller to exercise their freedom by engaging in the transaction and to maximize their personal utilities by acquiring the desired good or getting the desired price for it, respectively. What is the place of law in this transaction? Suggesting that the law is external to the transaction would mean that we could imagine the sale taking place without the legal framework set in place. On the contrary, constitutive theories of law propose that the transaction cannot be imagined without certain legal priors. This is because the law defines the fundamental rights of each party to a transaction, bestowing different capabilities on each party. This shapes the alternatives available to them and defines in which ways each party is permitted to 'coerce' the other in the course of negotiation. For example, legal priors shape the coercive powers of the different parties in different ways: whether (and to what extent) private property is recognized in natural resources, which institutionalizes scarcity; whether the seller may ask for any price for the good; whether the owner is forced to allow some uses of the property by virtue of its public value (e.g., easements etc.); whether there is a duty to assistance; whether – in the context of labour – the employee may engage in collective bargaining, whether the right to strike is allowed, whether there is a set minimum wage, etc. Even the market value of commodities is not independent of law, as acts of valuation rest upon legal priors: Prices depend on disposable income, which is determined by the initial allocation of entitlements, while legal entitlements also pattern bargaining power (i.e., an employer may offer different salaries depending on whether employees have the right to bargain collectively). Overall, contract terms should not be reduced to expressions of free will but rather be understood as determined by each party's ability to coerce each other's compliance by withholding goods or services from exchange and by the relative ability to hold out for more acceptable terms.

The famous legal theorist Robert Hale offers an illustrative example on how property rights as state-backed, legal entitlements grant coercive power and challenge the perception of "voluntariness" of transactions. A person, says Hale, has to eat to survive. While there is no

law against eating in the abstract, there is a law which forbids her to eat any of the food which actually exists in the community – the law of property. Of course, she could try to produce her own food. Again, there is no law to prevent her from doing so in the abstract. But there is a law which forbids her to cultivate any particular piece of land unless she happens to be an owner. This again is the law of property. This means that, ultimately, she has to work to survive. In the process, not only does she relinquish the right to remain idle but also abandons any claim of title in the products that she produced, accepting as recompense whatever wage the employer consents to pay. The owner's freedom to exclusively enjoy the fruits of productive resources inevitably entails that non-owners have a legal duty to refrain from accessing these fruits and can only do so at the discretion of the owner – which forces them into wage work. For Robert Hale, "it is the law that coerces into wage-work under penalty of starvation". Transactions may, then, be voluntary, but voluntary only under the very confined framework of state-backed private coercion instituted by law.

The prevalence of private coercion also means when the government intervenes in private market relations to curb the use of certain private bargaining power, it does not inject coercion for the first time into those relations; it merely changes the relative distribution of coercive power. In a recently attempted reform in the field of housing, the city of Berlin attempted to set a rent cap. Immediately, this raised critiques against limitations of the right to property, considering the restriction of the owner's freedom to ask for *any* price. However, the right to ask for *any* price is not a natural by-product of property but only a deliberate legal construct – in this case, a rule of permission. Allowing owners to ask for any price for rentals is indeed a deliberate, conscious decision, and only one possible way to define the right to property. This points to the futility of resolving conflicts on the basis of abstract notions of 'freedom'. Would this be the freedom of the property owner to impose their terms? Or the freedom of the renter to have access to affordable housing? LPE scholarship points to how such choices are ultimately political, involving the conscious decision to tolerate some forms of coercion but not others. Hence a significant finding of this way of conceiving the law-economy nexus is that the categorization of types of activity as being 'private' – and, therefore, as being matters with which, in line with liberal values of freedom, individual citizens should be left to negotiate in the market place and in the realm of civil society – is often a misnomer. The state and other political entities at the supranational level are already playing a coercive role in these contexts. Consequently, LPE scholarship suggests the need for a pervasive re-thinking of the foundational categories into which law, as an academic discipline and as a legal practice, is traditionally divided.

Building on this analysis about the background function of law, another key insight of LPE scholarship is that phenomena and events in the economy and in society that tend to be framed as natural, or inevitable, or unforeseeable, or simply the product of market 'forces' – for example, competitive labour dynamics, inequality, the global financial crisis, or inflation – are in fact predictable outcomes of legally empowered political choices by states and powerful market actors. Therefore, academic research in the tradition of LPE can, by taking both an interdisciplinary and intra-legal approach to studying markets and the economy as a whole, challenge the dominance of economics, and neoclassical economics in particular, as being 'the' discipline that has the monopoly on explaining how markets actually work. Importantly, this

reframing points to alternative ways of responding to problems within markets. For example, rather than introducing new regulations that curb the permissions of financial actors who are engaging in problematic activity in a specific market, it might be more effective to turn to the broader legal tapestry that *enables* that market activity to take place in the first place. As opposed to entering into the 'cat and mouse' dynamic of regulation – a dynamic that often sees market actors innovate to circumnavigate new regulations – it could be more productive to make adjustments in the contract law, tax laws, bankruptcy laws, or provisions of international private law that enable financial actors to engage in the harmful activity in the first place. Part of the problem that research in the tradition of Law and Political Economy helps to expose is that market actors 'get ahead of the law' in spaces such as technology, banking and investment because they are able to use a set of core legal modules, including property rights, trust law, contract laws, corporate laws, and others to characterise their wealth, property, and capital differently to evade regulation, and 'code' it to ensure that it continues to give a return. This dynamic has been described at length in a book- *The Code of Capital: How the Law Creates Wealth and Inequality* - authored by a scholar aligned with the LPE movement, Katarina Pistor.

So, what might an LPE approach, and a focus on the constitutive role of law in particular, mean for strategic litigation initiatives? We very much want to leave the space open at the Workshop for the introduction of new and different ideas about what the 'constitutive' role of law is, and about what its significance might be for strategic litigation. For this reason, we do not want to take much space here in setting out our ideas on these dynamics. However, in the spirit of getting things going, a few questions and ideas that we have are as follows:

Perhaps the challenge that LPE scholarship presents to the traditional division between 'private' and 'public' - as descriptors of activity and as legal fields – could be mobilized to *recharacterize the nature of actors and/or actions* of corporations, financial institutions, and governments for the purposes of litigation? Could an illustration of how the constitutive role of law is relevant to the carrying out of harmful activities thereby implicate or trigger the legal responsibilities of *a wider field of actors* who could be pursued in the courts? Might the focus on constitutive role of law assist with the development of *new argumentative patterns* that could extend the reach of current laws to cover the actions of specific respondents and defendants? Could the intra-legal dimension of LPE research, which exposes how particular actions are legally enabled through a nexus of different legal regimes, lead to actions being pursued under *new routes*? For example, instead of pursuing an action for negligence under tort law, might an action under contract law, or under constitutional law, or a judicial review of a government tax policy offer a more promising avenue for redress? Could the focus on the constitutive role of law function as a factor for case selection, focusing on the potential distributive and power-conferring effects of legal change that extend *beyond remedies* for victims? Could LPE as a scholarly movement play a role in *changing the expert consensus* or public discourse around a given legal claim, thereby placing indirect pressure on judges or decision makers in ways that might be advantageous to litigants?