

Bargaining with Giants and Immortals:

Can Law Fix the Laws of Capitalism?

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I. Introduction

In recent times, there has been renewed interest in the distributive effects of the seemingly “neutral” ground rules of private law. Ground rules such as property, contracts, torts, trust, and inheritance are central for the generation and distribution of wealth in modern capitalist societies. Recently, however, the nexus between private law, capitalism, the generation and distribution of wealth has been subject to new scrutiny in legal theorizing. Until recently, one might distinguish three phases of legal-economic theorizing about these issues:

First, there was the classic and neoclassic consensus about the creation of wealth through markets as modeled by thinkers ranging from Adam Smith and David Ricardo to the Chicago school. Their main tenet is that the market leads to efficient allocation of goods through the equilibrium principle. This view implies that distribution is better left to the state via the system of public law, i.e., in particular, ex-post taxation. The classical and neoclassical view of the market as a neutral and natural generator of social wealth which is only disturbed but not furthered by state regulation is mirrored in the classic formalist understanding of private law. According to this view, usually associated with 19th-century formalism and the Lochner era, the ground rules of private law provide a politically neutral framework that enables market transactions among equals. Bargaining power or distributive issues, again, play no role here.

This view changed drastically under the influence of the social and realist private law schools, which began to develop in Europe and the United States around the early 1900s, above all in the 1920s.¹ While it is perhaps overly simplistic to present the move to “the social” as a paradigm shift in legal thought (given that 19th-century legal thought wasn’t so “formalist” after all), this was nevertheless a major innovation. In particular, the Realists offered tools to revert the classic thinking about private law. The most cogent reading of this reversal might still be Robert L. Hale’s account of contract not as an exercise in private autonomy and voluntary bargaining, but instead as coercion in the shadow of the law. Thus, power re-entered the picture of private law: Whereas the exercise of bargaining power

¹ France: Duguit, Demogue; Germany: Jhering, the Free Law School, Kantorowicz, Ehrlich; USA: Legal Realism, in particular Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 Pol. Sc. Qu. 470 (1923).

had previously been bracketed off and excluded from the picture by the formalist reading of contractual freedom among formally equal parties, it now came back in the form of bargaining power to challenge the idea of free contracting. On this basis, progressive private law thought was able to reconceptualize large parts of classical private law under the new paradigm of unequal bargaining power. This was the birth, *inter alia*, of consumer protection, labor law, and equal opportunity law, all understood as adding a “materialized” layer of “the social” to private law.²

However, this was still not a convincing picture of the theory or underlying mechanics of private law. Most notably, distributive or paternalist regulations of private law relationships in some cases failed to reach their goal, or, as Duncan Kennedy puts it, “hurt the people they were trying to help”.³ Economics was back in the picture together with law and economics as well as the renewed question of how the institutions or ground rules of private law are interconnected with economics. How does private law shape market transactions? Should it interfere with the distribution of assets reached by the operation of the market mechanism? The new, post-Realist and post-CLS consensus of economic private law theory acknowledges or even presupposes that private law is, of course, not politically or distributively neutral. On the contrary, there is a wide consensus that wealth is distributed along the lines predetermined by the assignment of entitlements carved into the form of private property and contract. The main point of the post-CLS consensus of law and economics, however, is that the main issue is not about distribution, but rather about wealth maximization: It may be the case that capitalism leads to relative inequality among citizens or classes within a population. But what first and foremost needs to be recognized is that the capitalist market economy creates unprecedented wealth for entire strata of global and national populations who had never before been in the position to participate in the global distribution of assets at all. More simply put: wealth has to be generated and, in the best-case scenario, maximized before there is anything to distribute at all. Thus, efficiency is generally regarded as being prior to – as a political-social goal – equality. In private law theory, this post-CLS neoclassical law and economics consensus translates into a triad of tenets: First, private law should focus on fostering efficiency through enabling market transactions. According to the Coase theorem, it makes no sense for private law to aspire to distributive justice by means of asset reallocation; irrespective of the initial endowment of entitlements, the market mechanism will lead to an efficient asset allocation. This neoclassic law and economics view of private law is further backed up by two corollaries: Second, the law should step in and correct inefficient allocative decisions when market failures occur in the form of externalities that cannot be priced through the market. Third, due to the focus on efficient markets and again strongly based on Coasean thinking, transaction costs as the costs of the market

² In Germany, Wieacker’s account provides a classic reading of this development (including the well-known problems of this tale of transformation, e.g., the “materialist” tendency of Nazi law): WIEACKER, *PRIVATRECHTSGESCHICHTE DER NEUZEIT*, 3d ed. 2016. In the USA, CLS took up the Realist strands, see, in particular, Duncan Kennedy’s work.

³ Duncan Kennedy, *Law Distributes I: Ricardo Marx CLS*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3813439.

exchange play an important role in private law theorizing. Private law institutions are generally assessed under the paradigm of whether hierarchical command (“the firm”) costs less than market contracting. While this, again, does not naturalize markets, it does provide a strong reason for focusing the law on enabling and enhancing markets wherever possible and wherever there is no problem of externalities.⁴

This is where things stand right now. And again, the voices of a new chorus for “Putting Distribution First”⁵ cannot be overheard. There is renewed interest in both how and why the ground rules of private law shape and create inequality. In “The Code of Capital,” Katharina Pistor has argued that capitalists, aided by sophisticated lawyers in a process stretching over centuries, have used the ground rules of property, contract, collateral, bankruptcy, and corporations to turn certain assets – but not others – into capital. Through legal coding, assets become tools for the accumulation of wealth – but only for capital holders: “Capitalism, it turns out, is more than just the exchange of goods in a market economy; it is a market economy in which some assets are placed on legal steroids.”⁶ Moreover, the “market fundamentalist” – or the viewpoint of a private law theory centering on the neoclassical triad of premises described above – has been challenged for unduly narrowing and distorting the potential of the law in shaping social institutions and, ultimately, the world we live in. Why, it was asked, must antitrust law be narrowed to an efficiency-oriented approach favoring the vertical concentration of power in large firms on the merits of its blind spot of transaction cost economics, but which, at the same time, restrains cooperation between small businesses? Why is intellectual property law skewed toward empowering rights involving information as a public good while simultaneously neglecting the protection of data commons and consumers? Finally, why does environmental law try to tackle the hazards of climate change by, again, using the tools of capitalist markets, such as carbon taxes and pollution rights, instead of caring about investments in public infrastructure, thereby simply replacing one evil with another?⁷

The following paper aims to assess the merits of the recent return to distributional issues in private law theorizing. It questions whether the claim that the underlying “broadened” view of economic theory – “law and political economy” – contradicts the neoclassical view of private law sketched out above can still be maintained and whether these novel theories provide a sound basis for a critique of the laws of capitalism. My argument will proceed in four parts. First, I will outline how the ground rules of private law contribute to the generation of capital and in what sense there is a “law of capitalism”. This part owes much to Katharina Pistor’s comprehensive treatment of these issues. Part three will pose the question whether the novel arguments in favor of distribution are warranted from a

⁴ See Britton-Purdy/Singh Grewal/Kapczynski/Rahman, *Building a Law-and-Political-Economy-Framework: Beyond the Twentieth-Century Synthesis*, 129 YALE L.J. 1784 (2020) for a comprehensive treatment of this “twentieth-century synthesis” of law and economics.

⁵ Robert C. Hockett, *Putting Distribution First*, 18 THEORETICAL INQUIRIES IN LAW 157 (2017).

⁶ KATHARINA PISTOR, *THE CODE OF CAPITAL*, 2019, 11.

⁷ Britton-Purdy et al, 129 YALE L.J. 1784 (2020).

standpoint of private law theory. Part four will dig deeper into the economic issues at stake and reframe the question why distribution through the means of private law seems more often than not to “hurt the people it is trying to help” and thus notoriously appears dubious from the viewpoint of the neoclassical economic consensus. On this basis, part five will reassess the proposals for using law as a political tool to fix the laws of capitalism. The final part suggests or rather asks where to head next.

II. Is there a Law of Capitalism?

What is the law of capitalism and how does it interact with the economics of markets? Does capital (capitalism, the market principle) precede law? Or does capital (capitalism, the market principle), quite to the contrary, presuppose and depend on law as its means of creation and operation? If the latter, is there something like a genuine “Law of Capitalism”?

1. Law as the Code of Capital

Katharina Pistor has prominently raised these questions in her recent work,⁸ and I will limit the following sketch to a rough framework which only traces the main lines of argument. The main line of argument is this: It is easy to see that the global economic functioning of capitalism squarely relies on the nationally coded legal ground rules of private law, notably property, contracts, collateral, bankruptcy, and corporations. Markets are not natural and neither are the national tools of private law that help shape their function and outcomes. Moreover, the age-long global working of capitalism would not have been possible without the fine-honing of the said tools through generations of sophisticated lawyers whose task it is to “invent” ever-new legal forms of legally coded capital. What, then, is capital? Pistor agrees with economic thinkers since Karl Marx that what makes an object capital is something more than just its value. It needs to undergo a transformation which makes it valuable in a specific, capitalist sense. This transformation, as Pistor argues, is more than what Marxists call “commodification.”⁹ What turns assets into capital is, instead, a legal coding procedure: Capital is “a legal quality that helps create and protect wealth.”¹⁰ The four specific legal attributes that create capital’s properties via the means of private law are as follows: priority, durability, convertibility, and universality.¹¹ Priority rights serve to rank claims and privileges over weaker titles and thus serve as an ace in bankruptcy procedures. Durability extends priority claims in time and thus expands the life span of assets against competing claimants, creating vested rights over centuries. Universality not only ensures that priority and durability can be held against the parties who agreed to them, but against anyone. Finally, convertibility gives asset owners a guarantee to convert their assets into state money when they can no longer find private takers.

⁸ PISTOR, THE CODE OF CAPITAL; ID., THE LAWS OF CAPITALISM, 2022 (citation tentative, draft version).

⁹ *Infra*.

¹⁰ PISTOR, THE CODE OF CAPITAL, 12.

¹¹ PISTOR, THE CODE OF CAPITAL, 13-15.

From all of this, Pistor concludes that “the legal code confers attributes that greatly enhance the prospects of some assets and their respective owners to amass wealth, relative to others – an exorbitant privilege.” Her final conclusion, however, is anything but obvious. A “privilege” denotes a feudal right, conferred at will by a feudal lord upon a subject and “privileging” the latter vis-à-vis his equals. This is not how the coding of modern capital works, and it is a non-sequitur to equalize the modern, capitalist-style inequality with feudal status relationships. While it is certainly true that private law tools can be used for generating the effects Pistor describes – and are actually deliberately used towards those goals with the effect of centuries of greatly increased global welfare, as the neoclassical defenders of capitalism would argue – it does not follow that these properties turn the ground rules of private law into a genuine law of capitalism in the sense that it is inherently tilted towards excluding large factions of the society from participating in social welfare, or, even stronger, that they provide a built-in principle of privileging a few at the expense of the many in the same way as feudal privileges did. There is a fundamental conceptual difference between the unilateral power structure of feudal society, in which private power and feudal privilege were one, and the bilateral power structure of modern society that is vested in the democratically controlled state, in which private power is decentralized and detached from political power. It is, of course, possible to criticize this modern arrangement as “bourgeois ideology” along the lines of Marx.¹² But does this make private law into a genuine law of capital? Does this bracket off the regulatory possibilities of public law, or, indeed, lead to a necessary conceptual divide between the private and the public? Does all of this turn the nationally vested arrangements of national private law into a neo-feudal law? I cannot see how any of these arguments could be made. Every single one of them could and actually have been refuted. On this plane, there is no genuine law of capital. Instead, equality among private law subjects is real, valuable, and something the legal universe has never seen prior to the rise of modern capitalism.

Equality among private law subjects is real, especially in one specific respect. The freedom to “invent” new brands of capitalism, or to turn new asset classes into capital, is not a weakness; instead, it is a major strength of private law regimes. This freedom is the direct effect of freedom of contract. That freedom of contract is not channeled into a given set of contract types – but instead leaves it open to private parties to invent new, unforeseen types resulting in new classes of capital – is one of the reasons for the enormous wealth-creating potential of capitalist systems. To offer just one such example: Digital capitalism wouldn’t even have been possible (with all its pros and cons) if it weren’t for the self-innovatory potential of private law. In the same vein, capitalist approaches to solving problems of climate change might turn out to be much more powerful than anticipated today (the question only being how much more of the ecosystem has to be destroyed before this effect kicks in). And what about the argument that cutting-edge coding techniques are only practiced by the most sophisticated lawyers and are not open to all? Well, law is a market. Not everyone can buy the luxury product. But legal innovations, as opposed to technical innovations, are not coded in terms of

¹² *Infra.*

intellectual property. Seen in this way, the law market is actually a large commons of ideas. Ideas spread. Small businesses use legal tech. Without capitalism, there is no legal tech for everyone.

2. The Legal Fetish of Capitalism

Does all of this mean that there is no law of capitalism after all? Not quite. In her most recent work, Pistor digs even deeper and focuses on the question of how global capitalism manages to evade legal governance. As an answer, she offers a triad of – again – specifically legally coded features of global capitalism: private rights as non-reciprocal individual entitlements, legal arbitrage, and decentralized access to legal coercion.¹³ But once more, this reading of legal coding as the essence of capitalism poses the question as to whether there is anything like a law of capitalism. At this point, Pistor comes up with the admirable idea of posing the following question to its opponents: What does socialist legal theory have to say about capitalist law? The two main antagonistic positions can be quickly sketched out: The “positivist” strand, derived from Hans Kelsen, the Vienna School, and turned in the socialist direction by the Austro-Communist Karl Renner, still provocatively mirror the “bourgeois” position that the form of law does not determine the content. After all, this was the main insight promoted by Kelsenian positivism, i.e., there is something to be gained from a “pure” theory of law devoid of content, be it capitalist, socialist, etc. Thus, there is no specific law of capitalism. The form of law “as such” is “neutral”: “Law does not create, and certainly does not dictate social conditions. It is strictly neutral so that the same law can be used for different purposes.”¹⁴ According to Renner, there is, in particular, no difference between “capitalist” and “socialist” property.

From an orthodox Marxist standpoint, this obviously could not be the final word on the matter. For historical materialism, law is part of the “superstructure” that is determined by the “basis” of the relations of production, which, in turn, are determined by the ownership of the means of production. The root of the production relation lies in the power relation between the capitalist owner class, which is exploiting the proletariat by the extraction of surplus value, and the exploited class of the latter. Law has no independent function outside of this power relation. According to Marxist economic theory, law is part of the “bourgeois ideology,” and it will disappear as soon as the revolution of the proletariat has taken place and the capitalist owner class has been expelled from its exploitative power status.

One might note that these antagonistic approaches come to remarkably similar conclusions: According to the positivists, the legal form is neutral and independent of the economic power relation at its base. According to the Marxists, law is just an epiphenomenon of the economic base and will disappear with it. Neither approach seems to capture the formative role of the law in the creation of the capitalist economy. But just what is this formative role, and just where is the power vested in the law, which then translates into the power relations of capitalism? At this point, Pistor refers to an interesting parallel between two further fundamental legal thinkers, namely, Max Weber and the most

¹³ PISTOR, THE LAWS OF CAPITALISM, 2022, 6 (citation tentative, draft version).

¹⁴ PISTOR, THE LAWS OF CAPITALISM, 2022, 25 (citation tentative, draft version).

sophisticated theorist of socialist law, Evgeny Pashukanis. Both agree that the legal form is not neutral but has a specific impact on the development and shape of capitalism. In Weber's sociological account, "the law co-evolves with power relations, but also shapes them."¹⁵ Capitalist law in the forms of modern private law is a genuine product of European legal modernity, developed since the Middle Ages and explicitly not created with a view on enhancing capitalist rationality or efficiency, but rather emerged from the pluralism of legal orders, forms, and practices of medieval European market places. Pashukanis, however, disagrees with all the latter points. His account of capitalist law is perhaps the most sophisticated, at least the most challenging: As opposed to Weber, he makes a clear distinction between the form and the substance of the law. As in the orthodox Marxist account, he believes in the disappearance of bourgeois law as soon as the revolution of the proletariat has taken place. He does not think, however, that law has no influence on the underlying power relationships. In fact, his critique of bourgeois law along the lines of Marx's critique of the "fetishism of commodities" is highly sophisticated and well worth thinking about in modern capitalism: Pashukanis extends Marx's famous critique to the legal form.¹⁶ He argues that capitalist law is an inherent part of capitalism in that it shares its commodified form. The legal form itself becomes a marketable asset in capitalism, in the same way as assets become capital through the process of "commodification."

This brings us back to the question just what capital is. The Marxist answer is: Assets are turned into capital through commodification, i.e., through the widespread social practice that defines them as marketable goods. This does not change them physically, nor does it require a legal act. Rather, it is a social practice accompanied by a shift of viewpoint: Commodified goods are regarded in terms of their exchange value rather than their use value. The difference between both (leaving aside the obsolete labor theory of value) accounts for the possibility of the capitalist to extract surplus value out of their production and distribution through markets. The critique of the fetishism of commodities means that the bourgeois ideology fetishizes, i.e., essentializes the exchange value in commodified goods and thus creates an entire social order around an excess production of commodities. An example of this would be: The use value of gold (at least for the ordinary citizen) is small. The exchange value, however, is very high. The capitalist economic order fetishizes the latter and thus creates an entire industry around the production and the market exchange of gold in various forms, regardless of its use value. Buyers determine the price. It is important to understand that the fetishism of commodities is not a mere "sham." Rather, the attachment of a specific exchange value to goods on markets is real and will not simply disappear because a society suddenly realizes that it has invested too much social wealth in luxury housing, cars, jewelry, clothing, yachts etc. etc. The fetishism of commodities creates a fetish, but a fetish demands a persistent and always a shared social practice. According to Pashukanis, the same critique is pertinent with respect to the capitalist form of law: First, the form of law itself can be understood as commodified, i.e., as a marketable asset with an exchange value as opposed to a use

¹⁵ PISTOR, THE LAWS OF CAPITALISM, 2022, 28 (citation tentative, draft version).

¹⁶ KARL MARX, DAS KAPITAL. KRITIK DER POLITISCHEN ÖKONOMIE, vol. I, 1867.

value. Second and more profoundly, it is possible to level the same fetishism of commodities critique that applies to capitalist assets at the form of capitalist law. This means that law is a commodity. It is generated and sold on markets. It has a market price which does not, and notably not for all buyer groups, reflect its use value. The market price of law is not a matter of epistemic truth or normative right, but rather a function of the power relation between capitalist buyers of law and their caterers in law firms and law schools. And the resulting law, i.e., the private rights that form the capitalist legal structure, has a fetishized structure. We, the capitalist citizens, essentialize the marketable value of a property right, of a contract right, etc. and forget about the use value of the capitalized asset. In other words, private rights get their bite out of attaching legally corroborated exchange value to marketable assets. This, if there is anything like that at all, is the function of capitalist law. This also means that the law is never neutral vis-à-vis the economy. It has a major function in creating and shaping capitalist institutions. It is a fetish that endows the legal structure of capitalism with legitimacy. However, this means that the “magic” of the law is real and actually *conveys* legitimacy to the institutions it creates.

III. How to Criticize the Law of Capitalism?

A conclusion from the preceding part is the following: The insight of legal institutionalism is correct that understanding capitalism and markets requires understanding the constitutive function of law in their creation. There is, in other words, no natural or neutral market or economic process that is not profoundly influenced and shaped by the law. This insight implies not only that neoclassical economic theory is wrong in downplaying or neglecting the role of the law in the creation of markets, but that the same also holds true for Marxist economics, which arrives at the same fallacy from the opposite side.

1. Inequality: Economics

How, then, should one criticize the ground rules of private law that enable capitalism and indeed, as Pistor puts it, create a structure where some assets, but not others, are put “on legal steroids”? Is it a useful critique to claim, as Pistor does, that capitalism and the legal code of capital create “inequality” and thus “injustice”? Which inequality, which injustice precisely, and from what point of view? Measuring inequality always requires a comparative judgment: Inequality of whom compared to whom? Inequality of what compared to what? One reading of Pistor’s critique of the code of capital is straightforwardly economic, focusing on quantitative comparisons of wealth. But then, again, which kind of wealth? Global wealth? National wealth? Individual wealth? Wealth according to income percentiles? Wealth as compared between capitalists and the unentitled?

Let us start with income percentiles. In “The Code of Capital”, Pistor opens her argument by referring to the so called “elephant curve,” also known as Lakner-Milanovic graph or global growth incidence curve, which looks like an elephant’s head and illustrates the unequal distribution of income growth

for individuals belonging to different income groups worldwide.¹⁷ The original graph refers to the global change in income growth that occurred from 1988 to 2008. It shows that the global top 1% income earners experienced around 60% increase in income, whereas the income of the global middle class increased even more, that is, 70% to 80%. Apart from the world's 10% poorest, the only other global income group that did not experience substantial income gains above 10% (but no losses, either) during the said period is located between the 75th and 90th income percentile. This group contains the lower-income strata in the advanced market economies. Seen globally, it comprises an upper middle class with an income way above global average. Seen nationally within Western economies, however, it contains, as Pistor states, "the squeezed bottom 90 percent." From this, Pistor infers that "thirty years later, we are not celebrating prosperity for all, but instead are debating whether we have already, or not quite, reached levels of inequality that were last seen before the French Revolution, and this in countries that call themselves democracies, with their commitment to self-government based on majoritarian, not elite, rule."¹⁸

But is this conclusion sound? It is true that there is a group in advanced market economies that has not equally profited from the neoliberal globalization of markets since the 1980s. This group has witnessed a relative growth in income inequality vis-à-vis the national top 5% or 1% of incomes. The political consequences may indeed be linked to growing dissatisfaction with democratic government in the Western economies, so they have to be addressed there. But what about the enormous and unprecedented increase of wealth within the global middle classes, which comprise millions of families in economies in the Global South? The Lakner-Milanovich graph explicitly does not merit the conclusion that only the top earners worldwide have gained in the past 30 years. Rather, it supposes exactly the opposite conclusion: that global capitalism was an enormous success story in opening new wealth opportunities to the majority of people worldwide. What the lower income classes within the Western democracies have experienced is the effect of globalization and the rise of a new global middle class that has gained, while the old Western middle and lower classes have lost relative (not absolute!) wealth in worldwide comparison.

Again, the question remains: inequality measured by which measure? Another way to approach the question is to look at national wealth and to ask whether specific arrangements of capitalism, notably such that contain vested rights and long-term entitlements, contribute to national wealth, and what happens if they do not. In his reaction to Pistor's work, the German law and economics pioneer Hans-Bernd Schäfer chose this approach to challenge the thesis of growing inequality through capitalism. He argued that an analysis of inequality caused by the legal coding of capital remains incomplete as long as it only highlights income inequalities without taking into account the increased productivity of social wealth the innovation in capital may or may not have. Thus, Schäfer distinguishes three very different

¹⁷ Christoph Lakner/Branko Milanovic, *Global Income Distribution. From the Fall of the Berlin Wall to the Great Recession*, <https://openknowledge.worldbank.org/handle/10986/16935>, 31 (2013).

¹⁸ PISTOR, THE CODE OF CAPITAL, 2.

groups of effects that the coding of assets as capital may have on social wealth: (I) Wealth-destructive: The purpose of the coding of capital may be only to insulate or even redistribute private wealth from the bottom to the top in an oligarchic society, while overall social wealth in that society is not increased or even reduced. (II) Wealth-neutral: The coding of capital may have the effect of producing overall social wealth, but only at the cost of large damages or losses for large groups in the population (i.e., the Kaldor-Hicks criterion of efficiency is met). (III) Wealth-generating: Finally, the coding of a new class of capital may cause great overall social wealth and no or only negligible damage, even though it may increase relative income inequality between the groups of capital holders and the unentitled (i.e., the coding of this particular asset as a property right is Pareto efficient).¹⁹ Schaefer's argument is that it is not possible to assess the normative legitimacy of inequalities caused by the unequal distribution of entitlements coded as capital unless one also takes into account the very divergent potential for social welfare they cause. Schäfer agrees with Pistor that private rights which fall into category (I) should be banned by national legislation (unless they cause a revolution or civil war and will disappear anyway). Another corollary of Schäfer's argument is that not all property rights are efficient. The crucial point for political decision makers is to find out which are and which are not and to regulate potential private law entitlements accordingly. Generally, however, Schäfer shares the point of Lakner/Milanovic that capitalism based on private entitlements has proved to be an unprecedented success story for generating both public *and* private wealth over the past centuries. There is, in other words, no tradeoff between efficiency and equality, at least not on this level of argument. In sum, Schäfer criticizes Pistor's argument for its "lack of interest in the productive properties of the ground rules of private law."

2. Inequality: Methodology

Notwithstanding, Pistor insists on the individual wealth of capital holders versus the unentitled as the relevant point of comparison. She sees an unbridgeable gap between individual and social wealth and argues that "capital is coded through private law in regimes of property and contract. This coding has created a multinational monster of corporate injustice which cannot be controlled by national legislators any more. Gross injustice by private law institutions cannot be justified." Thus, in her view, the microeconomic perspective of wealth generated by capital versus wealth foregone by those without endowment remains the most salient point for a critique of private law. Can this choice of standpoint be justified on methodological grounds?

One way is to take a neo-Marxist approach towards a critique of private rights. Marx's classic critique can be outlined as follows: Private rights, especially property rights, are granted in the form of egalitarian basic freedoms through the democratic constitutions of the enlightenment age. But again, this is part of the bourgeois ideology: In fact, private rights preserve the feudal system with all its inequalities, most notably regarding private wealth and private power, under the surface of citizen's equal rights. The modern society successfully isolates private power structures from political

¹⁹ Hans-Bernd Schäfer, *Nationalreichtum und private Armut durch Zivilrecht?*, 85 RABELSZ 854, 862 (2021).

governance through democratic government. The ideological move in this reconstruction of the private versus the public as normatively separated is, again, the fact that modern democratic government explicitly depends on equal participation of all citizens, and, moreover, grants all citizens equal rights, including equal “freedom” of property. That these rights/freedoms (Hohfeld!) exist on paper only but not in the private-power-laden reality of capitalism, makes them part of the bourgeois ideology.²⁰ Since Marx, this argument has been often repeated, most recently by the German philosopher Christoph Menke, whose work Pistor draws on.²¹

Yet, as seen above, that private rights are part of an ideology or even a fetish, as Pashukanis put it, precisely does not mean that they are a mere sham. Put differently, the modern divide between the public and the private does not simply disappear by stating that private rights serve factual inequality under the veil of constitutional equality. Thus, it is not possible to argue that private inequality *directly* challenges or contradicts democratic rule. Pistor’s argument that capitalism equals feudalism in its potential to create income inequalities may be correct (or not), but from this it does *not* follow that “the feudal calculus stands in direct opposition to the aspiration of democratic polities for which law is the primary tool of collective self-governance.”²² Democratic governments in Western market economies have chosen – with some variations – to follow capitalist economic policies precisely through majoritarian self-determination in order to participate socially in the wealth generated by a decentralized, private capitalist economy. If a society chose not to pursue that path any further, it could choose to change its system into socialist economics. I will show below why it is very hard to see any “middle ground” between the two systems.

Another methodological approach towards challenging the priority of efficiency in assessing the inequality generated by capitalism is through stating that there is also no methodological middle ground between the viewpoint of neoclassic economics, on the one hand (which is focused on efficiency/wealth maximization, market failures/externalities, and transaction costs), and the novel view of “law and political economics” (which puts “distribution first”), on the other. Here, we enter the field of epistemology, indeed the philosophy of science: It is not impossible that two different methodological approaches towards explaining the same phenomenon reach different, and indeed, incompatible results. It is also not the case that either is refuted by the other as long as they produce coherent results within their respective realms. Falsification of a scientific paradigm demands more than just the existence of competing paradigms. In this case, however, more is at stake: Two methodological fragments of the economic discourse lead to incompatible explanations of the same

²⁰ KARL MARX, ON THE JEWISH QUESTION, 1844: “The liberty of egoistic man and the recognition of this liberty, however, is rather the recognition of the unrestrained movement of the spiritual and material elements which form the content of his life. Hence, man was not freed from religion, he received religious freedom. He was not freed from property, he received freedom to own property. He was not freed from the egoism of business, he received freedom to engage in business.” (Translation from the German original.)

²¹ CHRISTOPH MENKE, KRITIK DER RECHTE, 2015.

²² PISTOR, THE CODE OF CAPITAL.

empirical phenomenon by partially bracketing the respective view of the opposite approach. In such a case, shouldn't there be an aim of reconciliation or at least acknowledgment of the blind spots of each theory, lest one arrive at empty results by its circular application to just the convenient facts? In the end, shouldn't the more powerful theory govern, unless one arrives at a reconciliation? In the case at hand, this means indeed, along the lines of Schäfer, that there is no meaningful talk about inequalities generated by private law, unless one also takes into account the massive increase of public wealth generated by capitalist practices in the forms of private law. Or, conversely, public wealth is useless if it doesn't in the end benefit private individuals. Private and public wealth are inseparable – the one doesn't exist without the other.

IV. Why Exactly does Capitalism create Inequality?

In what has been said up to now, one recurring theme was the impossibility of a middle ground: between capitalism and socialism, capitalist and socialist law, public wealth and private equality, theoretical focus on efficiency and theoretical focus on distribution. Why is that so? Why is capitalism a make-or-break issue? This part will look more deeply into this question. I will develop the argument that legal institutions are indeed necessary to build the coded framework of capitalism. Yet, even if legal coding is a necessary reason, it is not a sufficient reason to explain the exploitative mechanism of capitalism. Understanding that mechanism makes it necessary to restate the question: Why does capitalism create inequality among private actors in the first place? I will show that this is not just because the legal code endows assets with properties like priority, durability, convertibility, and universality. It takes more than just this to make capital exploitative. It takes the market mechanism and the question who is in the position to hold out in the bargaining situation that is necessary to generate the cooperative surplus germane to every market transaction. The answer is: The capital holder is always – 100% – in that position.

1. Ricardo/Marx: The Winner Takes It All

Understanding this point brings us back to classic economic reasoning, namely, to the work of David Ricardo and Karl Marx. Their very similar views on the distribution of the cooperative surplus in markets transaction was recently restated by Duncan Kennedy.²³ Ricardo developed his argument in form of a stylized model of landlords who own the land and rent it out to farmers. Straightforwardly, the landlords are capitalists in this model. They do not do anything besides owning the land, renting it out to the farmers, and collecting the rent. There is a market between landlords and farmers regarding the better or worse quality of farmland. Not all pieces of land are of the same quality. Some are more fertile than others. Higher fertility means that a given farmer will be able to produce the same amount of wheat for lower cost than on less fertile land. On less fertile land, the cost of production per unit will be higher, while the selling price for wheat is equal for all farmers and all types of lands.

²³ Duncan Kennedy, *Law Distributes I: Ricardo Marx CLS*, *supra*.

Ricardo's important, if counter-intuitive, point is this: All the farmers get the same return on their capital investment regardless of whether their production cost per unit is high or low. The farmers who rent good land are not better off than the farmers who rent bad land, notwithstanding that their cost of production per unit is lower. All the extra profit the farmers make on good land will go to the landlord as rent, given that the demand for wheat regulates the market price and thus the number of potential farmers competing for farms. The higher the price of wheat due to increased demand, the more potential farmers, the more profitable land of any quality, the more competition for the good land, the more pressure to farm the good land for the standard profit which equals that of the bad land. In effect, all the surplus goes to the landlord due to his ability to hold out. To be sure, the landlord can only reap the benefit of his capital as long as it produces marketable goods. If the market price of wheat declines or demand for wheat ceases altogether, property in the land is useless. The market between landlords and farmers is a true Haeian bargaining situation: The farmers know they will be "exploited" because the landlords take all the surplus value. They contract nonetheless because they have to earn an income. Note that the farmers are not consumers. They are entrepreneurs who choose farming as a profession because it offers an average rate of profit above subsistence (if that condition is not fulfilled, farming will stop altogether). At the same time, the landlords have no other choice than to rent out their land. If the land is of bad quality and the price of wheat is low, farming might not be profitable and they will not find a farmer at all. On the other hand, the owners of good land will have plenty of farmers to choose from and control prices. The winner takes it all.²⁴

Marx's theory of profit makes a surprisingly similar point. In Marx's theory, the capitalists are the owners of the means of production. They hire workers to produce commodities which are sold on markets for prices determined by competition with other producers and other commodities (again leaving aside the labor theory of value). The difference between the market price and the cost of production is profit, which – again – goes to the capitalist in full. In an argument similar to Ricardo's, Marx argues that the competition among workers will drive wages down to subsistence level, and – again parallel to Ricardo – regardless of how much "surplus" a given worker creates. The point is, again, that all workers, whether good or bad, have to contract with the capitalist in order to gain their subsistence, whereas the capitalist can hold out as long as the commodity he produces is in demand. Kennedy concludes that "for both Ricardo and Marx, it is 'mere ownership' that permits appropriation of all the surplus."²⁵

But what is it exactly that gives "mere ownership" the "almost metaphysical" quality of the capitalist being able to hold out against the unentitled counterpart and extract all the surplus from the bargain? Why has the counterpart *no bargaining power at all* – given that the farm or the factory will not run without farmers or workers? Kennedy continues his argument by challenging the idea that the *abstract* concept of property alone is sufficient to explain this quality of – again – capital. Once more, the

²⁴ Kennedy, *Law Distributes I: Ricardo Marx CLS*, 3-12.

²⁵ Kennedy, *Law Distributes I: Ricardo Marx CLS*, 12-17, at 16.

question is: What makes capital capital? For both, Ricardo and Marx, it is not property alone, but the property has to have a special, indeed “metaphysical” quality, which is something along the lines of “fertility” or “productivity.” If we have an asset, we can code it into a property right with Pistor’s four features of priority, durability, convertibility, and universality. What makes it capital, however, is that it is a property right that is productive or “fertile.” Only if that is the case do Pistor’s four qualities, especially durability, forge an asset into a source of wealth of superhuman reach, especially over time. Human imagination can create rights that, by far, surpass the physical reach or lifespan of human beings. When these rights are attached to sources of productivity, “fetishized” by the market, they create the possibility for the owner to hold out quasi forever. It is like bargaining with a giant, or with an immortal being. They can hold out forever, and you can’t: You’re only human. You have to eat today and tomorrow. In brief: It is not only the durable property right that makes the capital capital. It is the human inventiveness that turns a durable property right into an immortal source of “surplus” production. Capitalism is not a monster. It is a god.

Can there be a successful socialist revolution? The Marxist utopia was to keep the means of production, i.e., the fertile durable assets of capitalism, in place and just change the relations of production by expropriating the capitalists and turning the means of production over to the proletariat. Why didn’t this work, historically? My intuition is: because it is precisely the entrepreneurial potential of capitalism – the potential to invent new “fertile” assets – plus the part of the story I’ve omitted – the difference between un-improving and improving/entrepreneurial landlords and factory owners – that keeps the expansive cycle of capitalism running (with all ups and downs).

2. Efficient Taxation

It should be added that Ricardo’s model provides a systematic reason why taxation of capital (and not private law regulation of bargaining or rent control) is indeed the choice solution to address the problem of unequal distribution of wealth in the society: A tax imposed on the landlords cannot be passed along to farmers who already work on subsistence levels, lest their farms go out of business. This applies to landlords with good and bad qualities of land alike, because all surplus is already taken by the landlords. The landlords with the good land will have to “eat” the tax and leave rent where it is, while the tax imposed on the landlords with the marginal land will have to be small and nominal, so that the same result is achieved and land is left in cultivation. In effect, the tax has no efficiency cost.²⁶

V. Fixing Inequality through Law?

Several insights can be taken away from the previous part: There is no capitalism without law, but there is more to capitalism than law. Arguing that there is a law of capitalism, that it creates inequality, and that it should and actually can be fixed by law, is a strong claim, but the economic law of capitalism might yet be stronger. Nonetheless, let us see what law can do about fixing the laws of capitalism.

²⁶ Kennedy, *Law Distributes I: Ricardo Marx CLS*, 12.

1. Incremental Roll-back?

Pistor makes a strong point for law as the right weapon to roll back the worst evils of capitalism. She rebuts the obvious objection that a law which provides the most valuable tools for the operation of capitalism might not be in the best position to dismantle its own effects: “The fact that capital cannot rule without law does not imply the reverse, namely that law could not be used to protect other interests on par with capital. One could, for example, harness the code and its modules to empower others who have experienced the empire of law mostly from below.”²⁷ As we will see, however, this aim poses a conceptual problem which leads back to the question whether there is something like a genuine law of capital: Endowing the disenfranchised with the tools of private right will reproduce and actually reinforce the system instead of breaking with it. In fact, the utopian proposals of Marxist and neo-Marxist (Christoph Menke) thinking about private right have always emphasized that just extending the tools of capitalism to the disenfranchised is not enough to reach a new system where rights as vessels of private power and means of domination no longer play a role. Instead, Marx and Menke both envisioned a new form of right that transcends the insight/outside, private/public dualisms and creates a new commonality. In any case: No one has ever seen the advent of such utopian rights, so they are no viable path to choose.

Two other roads out of capitalist-generated inequality seem obvious, but Pistor does not take them. One straightforwardly leads to socialism. The other is the classical and neoclassical solution of after-the-fact-redistribution through taxation of capital holders. Surprisingly, taxation plays only a small role in Pistor’s scheme of reforming capitalism even though many of the problems she addresses (tax evasion of multinationals) are genuine problems of international tax law. Instead, Pistor proposes an array of “roll-back strategies”²⁸ of the level of national legislation which aim at cutting back the legal privileges of capitalism including the freedom to invent new forms of capital. Specifically, she argues that choice of law should be made more difficult, that states should cut back on arbitration, that externalities caused by capitalism should be internalized, that traditional limitations on coding capital should be resurrected, that new mechanisms should be invented to give voice to those who suffer most in capitalist crises, and that democracies should join forces in fighting the global excesses of capitalism. “For democracy to prevail in capitalist systems, polities must regain control over law, the only tool they have to govern themselves, and this must include the modules of the code of capital. At the very least, they must roll back the many privileges capital has come to enjoy over and above the modules of the code of capital.”²⁹

All those points are well taken. None are new, however, and there are none which have not been tried before or are actually in place already. Some also seem to miss their target. For instance, it is not clear why arbitration is a specific problem in a worldwide legal order where national state courts are

²⁷ PISTOR, THE CODE OF CAPITAL, 229.

²⁸ PISTOR, THE CODE OF CAPITAL, 229.

²⁹ PISTOR, THE CODE OF CAPITAL, 224.

currently rediscovered as a forum for environmental and human rights claims. When it comes to limitations on coding capital, Pistor mentions speculative contracts or wagers. But how to regulate them – globally? The traditional limitation was that wagers were not enforceable in a court of law. But wouldn't reinstating that limitation exactly mean to reopen the door to an extra-state private law designed by private rule-making and privately-governed arbitration? In my view, Pistor overstates the regulatory power of the law if it is burdened with the task of solving the – legally generated and democratically elected – problems of Western capitalism. Again, the laws of capitalism, economically speaking, might be stronger than the law, legally speaking: What already strikes me is the idea that there could be something like a “roll-back” of capitalist modes; an idea fundamentally opposed to all we know about capital's expansive logic. The logic of capitalism is highly innovative, not, however, regarding its own roll-back or reversal or shrinking; at least to date. Perhaps climate change and shrinking global resources will teach capitalism how to shrink innovatively one day. The law might provide valuable nudges to that end, but it will not do the innovative work required.

2. Bargaining Power and “Palliative Redistribution”

Another path how to proceed has been proposed by Duncan Kennedy.³⁰ Kennedy challenges the Ricardo/Marx insight that there is never real bargaining in capitalism because bargaining power always rests 100% on the side of the capital owners. Kennedy argues that this very formalist neoclassical reading of the absolute power of property rights does not match reality. In reality, bargaining power reappears because the ground rules of property and contract are far too complex and too ambiguous to determine the outcome of a bargain. In reality, the bargaining power of landlords vis-à-vis farmers will vary greatly, not only according to quality of farmers, but also and more importantly according to the specific setup of ground rules designed to protect the landlord's property. There, Kennedy argues, it may make an enormous difference whether judicial remedy is available at all, who controls it, whether it is farmer-friendly or landlord-friendly, etc. Kennedy thus proposes to reintroduce the notion of bargaining power into the legal analysis and critique of capitalism. He argues that it is possible to use the factual contingency of property and contract regimes to implement policies of “palliative redistribution” wherever there are pockets of capitalist profit that can be attacked in favor of the losing side of the bargain without “hurting the people one is trying to help,” e.g., where there is no danger that costs are passed to the unentitled side. Kennedy consciously argues in favor of the selective injustice this modus operandi might cause for some holders of capital vis-à-vis others. In his view, it is not a legitimate objection of capital holders that only some, but not others, are attacked by claims of the unentitled. How this argument and counter-argument plays out in practice can be studied at the recent court cases in climate liability, which are directed “arbitrarily” against single defendants out of the entire group of CO₂-emitting companies (e.g., the Shell corporation).³¹

³⁰ Kennedy, *Law Distributes I: Ricardo Marx CLS*, 29-41.

³¹ Rechtbank Den Haag, Judgment of 26 May 2021, C/09/571932, *Vereiniging Milieudéfensie et al. ./.* Royal Dutch Shell PLC.

Kennedy calls this “palliative redistribution” because it does not change the big picture of capitalist distribution of surplus, which still goes close to 100% to capitalists. Kennedy, however, argues that it is better to pursue a strategy of incremental palliative redistribution than to do nothing at all. Again, the counter-argument would be: This is a rather meager outcome that comes close to a capitulation in front of the power structure of capitalism. Again, the chilling insight is: There is no middle ground. There is no legal method to reach an even pattern of equal bargaining power of say 50%/50% or even 70%/30% in all capitalist bargains. It is rather close to 99%/1% or at best 90%/10%, even if there are some cases where the balance tips in favor of the unentitled; and one may indeed use legal tools to enhance their possibilities as often as possible without much effect on that result. Remember – it is *palliative*. It doesn’t change the system. It only takes away some of the pain and possibly causes new pain elsewhere.

VI. What next?

Where are we heading next? How to proceed with the benefits and ailments of capitalism depends on what we as (Western) societies want, but also, as always in capitalism, on what we can afford. Pistor argues that if we do not act in order to restrain the excesses of global capitalism, we will end up either in violent disruption or in further erosion of the law’s legitimacy as a means for social ordering.³² The latter point strikes me as paradox: There has never been more law and regulation than today, and there is no indication of its decreasing legitimacy – quite on the contrary, given that law is more important than ever as a regulating tool for the complex relations of global capitalism. Will climate change finally make an end to its insatiable expansion? Again, capitalism, for the longest part of its history, has proved to be innovative enough to transform itself to new fields when challenged with scarce resources in the old ones. Is the challenge of climate change fully novel compared to past capitalist crises? This point is hard to argue because, again, the effects of climate change on different parts of the world and on different groups of global populations are strongly disproportionate. Rather than halting the further expansion of global capitalism, climate change instead seems to increase the gross inequality of global income distribution even more. Unfair enough, it is the Global South that suffers most. Or is it? Look again at the Lakner-Milanovic graph. In the end, it is not clear who loses and who wins. It might be a good idea to follow the advice given in the joke reported by Pistor of the two farmers in Ireland who met somewhere in the hills of Donegal and one asked the other for the best way to Dublin: “Don’t start from here!”³³ Our situation, however, is rather the opposite: We are in the middle of Dublin, sitting comfortably amidst capitalist wealth. Now we are asked to pick a spot, whichever, in the hills of Donegal where we are supposed to go – we don’t know the target, only that there will be no hot water there. Are we prepared to go?

³² PISTOR, THE CODE OF CAPITAL, 234.

³³ PISTOR, THE CODE OF CAPITAL, 233.