Economics for progressive international lawyers: a review essay

Robert Howse*

Dani Rodrik, *Economics Rules: The Rights and Wrongs of the Dismal Science* (Norton, 2015).

Joseph Stiglitz, *The Euro: How a Common Currency Threatens the Future of Europe* (Norton, 2016).

Thomas Piketty, *Capital in the Twenty-First Century*, trans. Arthur Goldhammer (Harvard UP, 2014).

ECONOMIC COUNTER-EXPERTISE

Expertise in economics is something few progressive international lawyers possess. Yet this expertise is routinely applied against efforts to reimagine an international legal order with a more equitable distribution of the gains and losses of globalisation, with a visible measure of social and economic justice, and with hope for empowering the disempowered. If countries don't sacrifice their regulatory autonomy under investment treaties, we are told that they will not access the foreign investment needed for development; if we don't tolerate sweatshops, displacement of indigenous peoples, and environmental degradation, the growth needed to reduce poverty will not happen; if indebted, poor countries don't repay their debt in full (despite devastating social consequences), they will never regain access to the capital markets. Austerity (often hitting the least advantaged first and hardest) is needed to push down wages, make exports competitive, restore financial market and investor confidence, and bring about a return to growth.

As David Kennedy suggests, '[e]xpert rule mobilizes knowledge as power. The knowledge part combines common-sense assumptions about the world

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that may be neither conscious nor open to debate with technical and more broadly ideological material that is often disputed'.[1] There is now a counter-expertise of economics, which broadly supports many progressive critiques of neoliberal, or Washington Consensus globalisation. And this counter-expertise comes at the highest academic level in the economics profession. What is the nature of this counter-expertise and how does it relate to the reconceptualisation of the international legal economic order by scholars of international economic law? Is the counter-expertise largely a combination of conventional economic thinking with different ideological orientation, emancipated from the entrenched institutional interests that affect economic thinking in places like the International Monetary Fund (IMF) or the World Bank, or the US Treasury? Or is there an alternative imaginary of economic behaviour and its relationship to legal and political structures?

The three authors reviewed here are central sources of what I am calling 'counter-expertise'. Thomas Piketty, Dani Rodrik and Joseph Stiglitz are all academic economists of the first order who have, at the same time, been active as public intellectuals over the past two decades, insistently questioning the orthodoxies of globalisation characteristic of the knowledge elites in the international economic institutions and the policy experts closely networked with them, whether in Washington, Geneva, Brussels, or London. (One could easily add Jeffrey Sachs to the list.) I offer in this review essay the perspective of an international legal scholar, literate but untrained in economics, to provide a sense of how the ideas of these thinkers have affected my own thinking about globalisation and the law.

When I began as a scholar of international economic law, the predominant normative orientation of the discipline could be described in the following terms: the law is an instrument that serves rational international economic policy; rational policy is about efficiency; efficiency leads to growth; efficiency requires open markets, with strong protections for property and contractual rights and disciplines on government intervention. Questions of justice or redistribution should remain 'elsewhere': they do not belong to international economic law. Whatever the immediate human costs of open markets, the growth they produce will provide the resources needed for justice and redistribution, which will be undertaken by domestic governments, perhaps with the support of aid agencies in the case of developing countries. Having a greater interest in political and economic ideas, and their history, than the prior generation of international economic lawyers, I was aware, more or less from the start, of the gross simplification of theory and narrowing of vision in 'rational' international economic policy taken as received

1 D Kennedy, *A World of Struggle: How Power, Law, and Expertise Shape Global Political Economy* (Princeton UP, 2016) 7.

wisdom among the lawyers. One did not have to read many pages in Keynes, or Mill, or even Adam Smith to see that. Yet I myself lacked the theoretical and methodological tools needed to engage in a reconstruction of international economic policy. I could engage in a certain internal type of critique, for example, of the inconsistency, or dogmatism, of the attempt to exclude environmental considerations from international economic policy. Or I could revert to an alternative normative idiom, such as that of 'human rights', although this lacked legitimacy in the policy world, and could seem indifferent to actual social outcomes. What I really needed were allies among economists—allies sensitive to politics as well as economics, who are not indifferent to justice, and who view law not simply as 'government intervention' but also in terms of the default rules that set the transaction costs of bargaining and thus often structurally determine the possibilities for different economic and social outcomes. The three economists whose work is discussed below are among such allies.

RETHINKING THE 'LAW AND ECONOMICS' OF INEQUALITY

Piketty's *Capital* articulated questions of inequality and distribution as matters of central interest and importance to economic analysis. Already in an early work, *The Price of Inequal*ity, Stiglitz had powerfully questioned the notion that policy economics could comfortably focus on growth, while bracketing or excluding considerations of inequality. But Piketty's work, with its Marx-inspired title, provides a deeper critical analysis of the capitalist system as such: Piketty marshals an enormous array of data, from the 19th century (and earlier) to the present, cumulatively showing a tendency for capital to increase at a greater pace than economic growth. The gains from productive economic activity increasingly go to those who hold capital or wealth and earn returns on it rather than to workers who earn wages. Being a rentier pays off as well or better than being an entrepreneur. Piketty compares the L'Oréal heiress Liliane Bettencourt to Bill Gates. Even though Bettencourt never worked in her life she grew her fortune as fast as Gates, the archetypal innovator-entrepreneur.

Piketty does not offer a normative theory of equality. He presumes in a common-sense manner that to some degree the legitimacy, and viability, of liberal capitalism must depend on it not giving rise to endlessly greater inequality. And so his key policy prescription is a global tax on capital (this is quite different from a 'Tobin' tax on financial and foreign exchange transactions, aiming to constrain speculation). The tax would have to be global, because financial globalisation gives capital unprecedented opportunities to escape the reach of any one jurisdiction. And it would need to be accompanied by financial transparency where all banking information was automatically shared with all fiscal authorities. Piketty explicitly presents the proposal as 'utopian'—it would require a 'very high level' of international cooperation, 'doubtless unrealistic in the medium-term'.[2] The idea is that every individual would be taxed on the present market-value of all their assets, regardless of location in the world. Presumably this would require agreement on the applicable taxing jurisdiction, whether, as in the case of the US, citizenship, or, as in the case of most other countries, residence. Piketty recommends the automatic exchange of information concerning financial and other assets between jurisdictions to make the system effective: the taxing jurisdiction would have a full picture of each individual's holdings.[3]

Piketty is confident that other aspects of globalisation do not contribute to inequality, and he proposes as a selling point of his tax on capital that it would preserve economic openness and globalisation.[4] He offers a gradualist version of his utopian proposition, presupposing regional cooperation to accelerate the existing trend to fight against tax haven practices and increase the transparency of financial institutions. Short of a global tax, Piketty is persuasive that much more can be done in these directions. The LuxLeaks and Panama Papers episodes have recently focused public attention on these issues.

A global tax on capitalism would provide a comprehensive conceptual response to capitalism's tendency to reproduce and even intensify inequality. The practical obstacles to its implementation are no doubt insuperable at present. But is Piketty right to consider it utopian? In a series of papers that are pitched, in part, as a response to Piketty's book,[5] Stiglitz has questioned whether Piketty has in fact identified a 'law' or general truth, about capitalism from his empirical work—i.e. that inequality is produced by gains to capital outstripping the general rate of growth in the economy. In a similar vein, Stiglitz raises doubts about the notion that a corresponding taxation of capital in general would improve matters.

According to Stiglitz, it is necessary to have a more precise, textured account of why certain forms of capital or wealth generate returns in excess of the general rate of economic growth. Stiglitz conjectures that some kinds of assets, like

2 T Piketty, *Capital in the Twenty-First Century*, trans. A Goldhammer (Harvard UP, 2014) 515-16.

3 Ibid 518. See also T Piketty, 'Technical Appendix of the Book "Capital in the Twenty-First Century"' March 2014, available at http://piketty.pse.ens.fr/files/capital21c/en/Piketty2014TechnicalAppendix.pdf (last visited 2 February 2017) 56-62.

4 However, Piketty does accept with Stiglitz (and Rodrik) that contrary to the predominant outlook until recently in the IMF, for example, capital controls can be a legitimate means of addressing or averting a financial crisis. In the Asian financial crisis of the late 1990s, Malaysia defied the IMF orthodoxy of the time and imposed capital controls with apparent success in stabilising its financial system. By the time of the 2007-2011 financial crisis, the Fund itself had reconsidered the orthodoxy, and indeed capital controls were actually part of its prescription for Iceland's banking crisis in 2008.

5 J Stiglitz, 'New Theoretical Perspectives on the Distribution of Income and Wealth among Individuals', Parts I-V, National Bureau of Economic Research Working Papers 21189-93, May 2015.

land, particularly in urban areas, or intellectual property, attract *rents*. So do businesses with monopolistic or oligopolistic characteristics. If this is so, a more varied or differentiated policy response may be required, as opposed to taxing capital generally. This could include an emphasis on the strengthening of anti-trust norms and enforcement, and limiting intellectual property rights. It could also include a tax on land. Stiglitz further observes that land, unlike human capital (labour) or capital goods (like machinery), is a positional good that can be used as collateral. When the value of land goes up, the owner has increased access to credit that can be used to earn more returns. Stiglitz notes that there are many policies that advantage capitalists over workers: capital gains are taxed at a lower rate than wages in many jurisdictions, low interest rates benefit less-risk-averse investors while they disadvantage workers trying to protect their savings, who might be more inclined to invest in, for example, government bonds.[6]

Stiglitz and Piketty both question the positive economic effects of foreign investment. Stiglitz notes that the rent-yielding, positional-goods features of land are an inducement to foreign investors to buy up land in, for example, developing countries. He suggests that this has, in a number of cases, exacerbated inequality; it has a tendency to enrich already-wealthy local elites. Piketty points out that those developing countries that depend on domestic capital formation and investment to boost productivity and enhance human capital have done better than those that rely on massive infusions of foreign investment. He notes that none of the Asian countries that has experienced dramatic growth was financed by foreign capital for physical infrastructure or improvements in education, training, and scientific and technical knowledge. In sum, foreign investment and—even less—borrowing on global financial markets are not a substitute for wise domestic policy choices, and cannot overcome the domestic pathologies of political economy (the resource curse would be one example). Indeed foreign capital could exacerbate these problems.[7]

To get ahead of myself slightly, the relationship of foreign investment to growth and development is a major question for Rodrik too. He observes: 'neither investment nor growth rose in the developing countries that opened themselves up to foreign finance. The lack of a positive trend . . . suggested that the constraints to growth in many of these countries lay elsewhere. Firms failed to invest not because they were shut out of finance, but because (for a variety of reasons) they did not foresee high returns'.[8] For Rodrik, the policy and market

6 Ibid.

7 There is evidence, for instance, that where a state suffers from weak rule of law, protecting one constituency, foreign investors, from the impact of weak rule of law can reduce pressures for more general governance reforms. See T Ginsburg, 'International Substitutes for Domestic Institutions' 25 *International Review of Law and Economics* (2015) 107.

8 D Rodrik, *Economics Rules: The Rights and Wrongs of the Dismal Science* (Norton, 2015) 167.

failures that hobble development vary from country to country and don't permit analysis or prescription from a single economic model. The implication is that empirical work, especially case studies examining what has worked or not worked in a particular context, is crucial to economic policy insight, but also that international economic law should be flexible, not locking in particular policy approaches or general prescriptions. But power and influence are gained for economic experts by being able to offer general formulae and prescriptions such as 'free trade is good', or 'eliminating restrictions on movement of capital is good'.

CONTEXT OVER ECONOMIC DOGMA

Understanding the challenges of individual countries requires expertise that is not just economic, but also legal, political, and so forth. The empirical inquiries undertaken by Rodrik and his colleagues, which are summarised in *Economics Rules*, have shown that activist industrial policies, including subsidies, have often been a key and successful part of development strategies, but only in some countries. Where there is generalised corruption and incompetence in government these will be as dysfunctional as other policies. But the discipline of the global market will certainly not solve corruption and incompetence. Rodrik writes:

> Advocates of the Washington Consensus—whether in its original or expanded versions—presented it as good economics. For them, the policies reflected what sound economics teaches: Free markets and competition enable the efficient allocation of scarce resources . . . . As the importance of institutions sank in, because of the poor response of many economies to Washington Consensus policies, reform efforts expanded in their direction. But it is one thing to slash import tariffs or remove ceilings on interest rates—two common enough approaches—and quite another to install, on short order, institutions that advanced economies acquired over decades, if not centuries.[9]

For Rodrik, then, the failure of the Washington Consensus to produce the promised growth and development in many countries, and the models of economic growth on which it was premised (the gains from liberalising trade, investment, and capital flows), do not represent an indictment of contemporary economics or even its preference for market solutions. Instead, they suggest that such a preference operates often as a bias, rather than as a sound rule of thumb, and shows an unwillingness to consider alternative models even where standard

9 Ibid 160-61.

tools of economic analysis would identify limits to market ordering, or the lack of the kinds of economic, legal or political institutions presumed by 'first best' models. The recent trend towards empirical analysis as a prerequisite of normative or conceptual economic argument suggests to Rodrik a promising opportunity to check the dogmatism or ideology that can often distort policy prescriptions and the choice of economic model for analysing any particular problem. The issue identified by Rodrik is that all economic models depend on assumptions of various kinds about the real world. The validity of those assumptions will differ from context to context so policy economics is really the art of matching economic models to real world contexts. Rodrik's point here is well supported. Already a range of empirical studies has undermined the neoliberal prescription that developing countries in particular should enter into Bilateral Investment Treaties (BITs) in order to incentivise foreign investment (which as noted above, has already been shown not to have been part of the most successful growth stories in developing countries). These studies taken together show that entering into BITs has not, in general, led to increased flows of foreign direct investment (FDI) for the countries in question. It may remain a blind article of faith of the professional elite associated with investor–state dispute settlement (ISDS) that BITs and ISDS somehow matter to investors, but intelligent discussions of the investment regime today, whether at the Organisation for Economic Co-operation and Development (OECD) or the United Nations Conference on Trade and Development (UNCTAD), almost always take into account the lack of evidence of any convincing positive effect on FDI flows.[10]

GREEK TRAGEDY

Greece's sovereign debt crisis is at the heart of Stiglitz's book *The Euro*. The widespread hardship imposed on Greece's people and the punitive nature of the conditions for a bailout, particularly those insisted on by Germany, is, of course, a well-known story. Still, among financial journalists and many policy economists in Europe and elsewhere, the narrative—incorrect as it turns out—persists of Greece as an irresponsible profligate, engaged in unjustified public spending, unwilling and unable to tackle cronyism and corruption. That image might have some validity with respect to some previous governments, but because Syriza is a party of the left (created from, among others, former communists), the neoliberal-oriented policy elite has often operated from a

10 See, for an overview of the relevant studies, C Bellak, 'Economic Impact of Investment Agreements', Department of Economics Working Paper 200, Vienna University of Economics and Business, August 2015.

presumption that Greece's leaders are inured to economic market rationality and will only respond to being beaten with a stick. The great merit of Stiglitz's work is to show that while economic irrationality abounded in the Greek crisis, this was less a matter of Syriza's policies than in the austerity ideology and absurd conditionalities imposed on Greece, as well as the inadequate framework of monetary integration within which Greece became trapped. Stiglitz writes: 'why in the midst of Greece's unemployment, with youth unemployment peaking above 60 percent, was the Troika talking about how old milk can still be called fresh, or how bread should be sold?'[11] In order to justify to German and other Eurozone taxpayers a bailout for Greece, it had to be shown that the country was being put under strict tutelage and engaging in sacrifice. The bureaucrats were let loose, whether at the IMF or Brussels, to imagine everything that might be wrong with governance and policy in Greece, based on their neoliberal rulebooks, but with little direct experience of the country itself.

AUSTERITY AS FALSE ECONOMIC CONSCIOUSNESS

As Stiglitz explains, the economic construct upon which 'austerity' was based is 'internal devaluation'. Under this view, if a country's imports exceed exports, such that it is forced to borrow to finance the difference, the standard corrective mechanism of currency devaluation—which is unavailable in a currency union like the Euro—can be replaced by austerity policies, whereby the government is discouraged or prevented by fiscal restraints from stimulating the economy and reducing unemployment. High unemployment will drive down wages eventually as workers are desperate to accept even poorly-paying jobs. Lower wages will then mean lower prices, and lower prices will make the country's exports competitive, to the point where imports and exports are balanced. In other words, adjustment through misery.

Stiglitz gives a cogent explanation as to why this did not work in the case of Greece and elsewhere in the Eurozone (and why it should not have been expected to work). Growth in exports was disappointing while, on the other hand, decreases in GDP were much larger than predicted. Why? As more and more firms and households were brought to the brink of bankruptcy, 'inevitably they cut back spending on *everything*. The cutbacks on imports were one reason the trade balance was improved; the cutbacks in domestically-produced goods is one reason that GDP declined so much'.[12] Secondly, 'as the banks were weakened as a result of defaults and bankruptcies, money could easily move out of

11 J Stiglitz, *The Euro: How a Common Currency Threatens the Future of Europe* (Norton, 2016) 225.

12 Ibid 99.

the banks in the weak countries to those in the strong *within the eurozone*. This in turn would lead to further decreases in lending and further decreases in GDP'.[13] Thirdly, dramatically in the case of Greece, slashing wages did not result in a corresponding decrease in prices and boom in exports. Given declining domestic demand especially, firms had few options to build up their balance sheets except to maintain prices. Furthermore, heightened bankruptcy risk meant that potential foreign buyers 'shied away, worried that when the time came for delivery, the companies would be unable to do so'.[14] Finally, 'the increase in risk meant that firms were less willing to undertake investments or even increase employment *at any interest rate*'.[15]

Was the adoption of this—as it transpired—disastrous internal devaluation an inevitable consequence of the Euro? According to Stiglitz, yes and no. Given the large differences among the economies within the Eurozone, it was likely that they would face different economic shocks at different times. Given that the normal tools of adjusting exchange rates and interest rates were not available within the currency and monetary union, and given that fiscal stimulus was also constrained by the required budgetary targets, to be successful at managing economic crises, the Eurozone would have required *social solidar*ity among its members: a willingness to share the burden of a crisis in one or several countries through commonly financed investments in afflicted countries and through backing their social safety nets through the adjustment process. Stiglitz is, fundamentally, not a Eurosceptic. His preference is clearly political integration in Europe in the direction of social solidarity to sustain economic integration, including through a currency union, and with the commitment of a community to facilitate a response to a crisis in any given Member State through redistribution and other support for counter-cyclical policies. But Stiglitz argues that, apart from the enthusiastic idealism that deepening interdependence would bring forth stronger political bounds, there were few reasons to believe, at the time of the Euro creation, that it could achieve such integration. Instead, what accompanied the Euro was not solidarity funding, but a central bank determining interest rates on the basis of particular (German central bankers') conceptions of monetary policy (albeit imperfectly) and budgetary targets that limited the Keynesian fiscal proclivities of the Eurozone members. From the perspective of Germany, which predictably established itself as a kind of hegemon in the Eurozone, each country should live within the disciplines. Where that proved difficult, the country would have to pay for its own sins, as it were. Stiglitz does not oppose the Euro or indeed

13 Ibid 100.

14 Ibid 101.

15 Ibid.

the EU on the ground of economic nationalism. On the contrary, under different conditions, a first best world would be a Europe that is integrated both economically and politically.

But could the perceived necessity of not letting the Euro collapse push Europe in the direction of solidarity given the evident truth that austerity has not worked? There is some evidence of solidarity in the willingness of the European Central Bank (ECB) to support the European bond market and in the creation of the European Stability Mechanism (ESM). Yet these measures seem most of all directed to protecting the interests of large financial institutions. The ESM has carried with it all the irrational conditionalities that Stiglitz criticises in the case of Greece. Europe's leaders seem comfortable with solidarity when it is a matter of protecting bankers, but have no qualms about imposing untold costs on workers in countries in crisis.

CONCLUSION

In the current political and intellectual environment in North America and Europe, it has become quite fashionable to speak of a quarrel between populism and expertise. As scholars who often see ourselves as experts of one sort or another, this kind of posited dichotomy invites us to align ourselves against the 'people'. Indeed if we start travelling down the road of 'alternative facts' or 'science' as merely someone's (self-interested) opinion, we not only betray our own vocation but may also help legitimate the worst kinds of political irrationality. In the case of progressive international economic law scholars, it could, on the other hand, seem tempting simply to reject or debunk economic orthodoxy as the thinly disguised ideology behind the global capitalist class. This might liberate us to make whatever arguments we like about the demands of justice, and to judge and confront the law and institutions on that basis. My own approach has been to learn whatever I can from economics (while at the same time maintaining a certain critical distance from the kinds of economics that morphs into orthodox policy prescriptions). Partly, this is from a sense of humility. While straightforward rejectionism might seem easy, understanding the world seems crucial for putting law and justice into practice and I admit I don't have the intellectual tools to provide a comprehensive alternative to the methods and constructs of contemporary academic economics (which, of course, encompass game theory and cognitive psychology) in understanding the phenomena in question. And if there is some structural bias or fundamental orientation in contemporary economics that is intrinsically skewed towards neoliberalism or against a progressive agenda, I haven't found it. The work of the three economists reviewed here suggests that, in fact, it may not exist.