EDITORIAL

- *Prof. (Dr.) Ranita Nagar*[*]

It gives us immense pleasure to present the inaugural issue of the GNLU Journal of Law and Economics, a publication that we hope will provide its readers with high-quality empirical research inputs on law and economics.

We, at the Centre for Law and Economics, Gujarat National Law University, are immensely proud and optimistic about the idea of a Journal, dedicated to developing and fostering academic literature on the vast and ever dynamic field of Law & Economics.

The GNLU Journal of Law & Economics (GJLE) is a bi-annual review published digitally by Gujarat National Law University (GNLU). The journal is online and open access and edited by students, with the aim to foster the open-access culture in academia and also to encourage research, writing and discourse in the field of law and economics. The journal is an official publication of the GNLU Centre for Law & Economics.

The academic community has contributed enormously to the study of law and economics in India. It has stimulated the development of a literature on this subject which is impressive by any standards and is slowly coming at the forefront of policy and judicial thinking.Its magnitude and detail can be best assessed by looking at some of the answers the discipline provides, to problems in policy-making and legal frameworks. Charged with the objective of providing a novel insight into how economic rationales could help in the formulation of effective policy frameworks to deal with socio-legal problems, the interdisciplinary subject of law and economics has helped lawyers and policy-makers to better understand legal rules.

The promise and relevance of the subject in the Indian legal scenario motivated us at GNLU to develop a forum for discussion and debate in the field of law & economics, and to undertake academic research and study to suggest improvements in various laws, bills and government policies. It was boosted by the budding ambition of our University to explore various avenues of multi-disciplinary empirical studies in law and provide comprehensive, credible and innovative points of discourse. In 2010, The Centre for Law & Economics (CLE) was established with the aim of familiarizing all stakeholders with the role that Law & Economics plays in improving the efficiencyof laws. Apart from offering the subject of 'Introduction to Law and Economics' as part of its regular curriculum wherein students are introduced to the analysis of

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Tort Law, Contract Law, Property Law, Intellectual Property Rights using tools of microeconomics, various research activities, conferences, workshops, competitions, seminars and capacity building sessions are organized by the Centre to provide a common intellectual ground for law & economics.

The Centre values rigorous work in the discipline and aims to promote awareness of and research in the field. It carries out courses and conferences for scholars, practitioners and students apart from publications on the economic analysis of contemporary legal issues. It aims to produce quality prescriptions for legislators, regulators and government departments and provide clear explanations and guidance to businesses and ordinary citizen alike. Some of the research activities being undertaken by the Centre presently include issues relating to the regulatory framework overlooking the depollution of River Ganga, causes of delay in the adjudication of cheque-bounce cases and the implications of the recognized Right to Privacy on the Aadhaar Project.

With the objective of fostering greater research into economic analysis of laws in India, the Centre has published books and compilations on the economic analysis of various facets of the law, ranging from an introduction of the basic models of economic analysis of law to the specialized areas of the constitutional law, commercial laws, torts, personal laws, crime and environmental laws. Over time, the scope of the publications has been concentrated to provide for profound academic literature. Notably, the book "Law & Economics: Breaking New Grounds" was aimed to educate and spread awareness on the interdisciplinary subject of Law & Economics among technocrats, scientists, social engineers, professionals and policymakers, which will build-up a rational society. I'm happy to note that this book was the outcome of the First International Conference on Law & Economics, 2015, held at GNLU. Currently, students of the Centre are working on a compilation of articles on assessing judicial reforms for the Indian courts, through the lens of economics and empiricism.

The activities and research tasks of the Centre are now focused towards developing a comprehensive "Indian school of thought for law and economics". The need for such thought arises due to special and unique considerations of Indian law-making and law enforcement. The existing literature arising from American, German and other schools of thought have to be reworked, rethought and redeveloped for the multitudinous considerations existing in our country. To provide for solutions fit for the time, age and place, such innovation and flexibility is the need of the hour.

These pursuits are encouraged by the motivations received from the Indian legal and regulatory institutions for the usage of economic tools in law-making. The Hon'ble Supreme Court has recognized the need for economic analysis when they're interpreting the law. In the recent Right to Privacy judgement, Justice D.Y. Chandrachud cited the works of Richard Posner on Privacy, causing a great appreciation of law and economics literature. Institutions of policy-making and review like the NITI Aayog have set up a 'Behavioural Lab" to use tools of behavioural economics when dealing with policies. Furthermore, the Law Commission has been already using empirical tools to recommend legal developments. The Government has been encouraging of these developments and has made available of data accessible. Websites like mygov.in and ecourts.gov.in have helped the academic community to access data in a manner like never before.

Such developments arise from the need to provide scientific and efficient solutions to present day solutions. Recent developments in aspects like the Aadhaar Project, data protection, cyber-crime protection, corporate insolvency, etc have emphasised the need for scientific interventions. Present issues require usage of multi-disciplinary approaches to provide relevant answers.

The Contributions

The Inaugural Issue of the Journal comprises of nine articles, which have been collected across several countries. The articles present literature on various facets of law, ranging from Criminal law to Labour Law and Environmental Law to Corporate Law, with a special focus on developing Indian Jurisprudence. This is in sync with the aim of the Journal to present and foster writings on varied facets of law and economic analyses on a single platform, with the eventual objective to impact Indian policy-making and developing an 'Indian School of Thought' for law and economics.

Our edition beings with Nathanael Kos'Isaka's "**Fiscal Capacity and Stabilization Function within the Eurozone: A Matter of Uncertainty**". The future of the Eurozone is one of the most contemporary issues of today's globalized world. Many argue that the economic instability within the Euro area can be linked to the absence of a Centralized Stabilization Mechanism. To solve this problem, many areproposing the introduction of a "Eurozone budget". In this Article, Kos'Isaka argues that the proposed solution can be characterized by the uncertainty about the reality of the economic problem and the need to put in place

a euro-area budget, on the one hand, anduncertainty about the legal and institutional aspects of the solution, onthe other hand.

In "**The purpose of the corporation and corporate social responsibility**", Gabriel Eduardo Messina&Lisandro A. Hadad review the growing social responsibilities of the corporate sector. Breaking away from the study of Corporate Social Responsibility from the point of view of the administrative theory or corporate management, the authors make a point for Corporations to contribute tosocial welfare as a significant role of corporate law in modern day. In order to enhance the debate, they study the socialrolegiven to companies and the possible conflict that can be revealed betweenshareholders and stakeholders, in terms of incentives and profits. Further, the authors argue that the search for shareholder wealth maximization constitutes the best option for companies organized around acorporate structure, to contribute to the progress of social welfare.

"**The United States is Out, India is in: Some Costs and Benefits on The United States'Withdrawal from the Paris Agreement on Climate Change**" is a ground-breaking work from Prof.Carolina Arlota wherein she reviews the most significant setback to the global concentrated movement against climate change: U.S.' withdrawal from the Paris Agreement, which will come into effect in 2020. Studying the controversial decision from a law and economic perspective, Prof.Arlota focuses on the advantages and disadvantages for the United States and argues that the withdrawal is not aligned with cost-benefit analysis grounded on the normative use of economics. The case is supported by the factoring of moral principles, such as precautionary principleandintra-and-inter-generational equity. As a lesson from the episode, Prof.Arlota also economically reviews a few challenges to international governance and bargaining between states: such as the incentives of involved parties to free-ride, the absence of a mechanism to engage in top-down bargaining and difficulties to bargain in the face of cognitive uncertainty about the feasibility of achieving policy outcomes, such as lowering carbonemissions. The author contrasts the United States example with paradigmatic Indian case, as Indiarecently moved from being a reluctant signatory to an active member of the Accord.

The fifth piece in the issue is "**Corporate Law & Economics of Limited Liability: A perspective overview**" by Lucas F. Bento. In this essay, the author offers a strong economic reasoning to the rise of Limited Liability Partnerships (LLPs), being one of the most path-breaking innovations in corporate management. Apart from studying the economic and legal reasons and the incentives of the corporate bodies and shareholders to engage in such a corporate design, the analysis offers fresh inputs from

Behavioural economics and Social Development Economics by the mutual trust dilemma. The essay concludes with questions and challenges that are intrinsically linked with the growth of LLPs, with the idea to foster further research.

"**Towards Precise Norms for Land Acquisition in Developing Countries**" is an essay by the renowned Prof.(Dr.) Hans-Bernd Schäfer in which he offers a fresh perspective on the debate between precise legal rules versus broad andinformation-intensive legal standards for land acquisition. Delving into the law relating to land acquisition, with a special focus on developing countries, he links the presence of clear and precise rules to the economic and political development of countries. In his characteristic style of argumentation with empirical studies, he analyses the new-age meaning and relevance of the concept of 'Eminent Domain' and argues in favour of clear and precise rulesregulating eminent domain power, to prevent misuse and abuse by Governments in the name of development.

We then come to the third essay of the issue:Prof.Jaivir Singh's "**Frustrating or Perhaps Supportive of Economic Activity? A Law and Economics Take on Labour Law in India**", which presents a fresh foundational base for labour law reforms in present day India. Much of the debate surrounding labour reform, along with attempts to simplify and consolidate labour laws, has been concerned with viewing laws as an impediment to efficiency. Prof. Singh argues that this monochromatic understanding is antithetic to the law and economics literature (particularly, the Coasian framework) which explain how laws can combat inefficiencies, depending on the presence of transaction costs. Drawing from the Incomplete Contracts literaturepioneered by Grossman, Hart, and Moore in the 90s, Prof. Singh highlights a set of transaction costs which are sought to be lowered by existing Labour laws in India. He argues that such an analysis highlights the role of labour laws in correcting certain market failures and thereby, enhancing efficient productive activity rather than stifling efficiency.

The Economic Approach to Crime and Punishment developed by Gary Becker in the late 70s now serves as an unassailable core for law and economics of Criminal studies. The trade-off between probabilityand severity of punishment views detection probability and fines as perfect substitutes, with the underlying assumption being that Courts are willing to exercise judicial power to enforce maximum fines. In his essay "**Optimal Magnitude and Probability of Fines when Courts Dislike Punishment**", NunoGaroupareconsiders the high fine-low probability result by Becker. He establishes that in presence of courts who dislike punishment, the optimal policyinvolves lower sanctions and develops an economic

model to factor the discrepancy in the assumption. This model is complemented with policy implications and corrections.

The concluding essay of the Issue delves into the foundational aspects of law and economics. In "**Interdisciplinarity in law: Its necessity andchallenges**", Prof. Regis Lenneau delves into the 'scientific' model of law and how that has been remodelled and developed by the plethora of interdisciplinary approaches, one of which is the approach of using economic approaches in the study of law. Prof.Lenneau's inquisitive approach draws from the historical beginning of law and interdisciplinary studies and leads to present day significance of using interdisciplinary approaches, rather than viewing legal studies as a monochromatic science. The challenges surrounding the widespread usage of interdisciplinary approaches are also studied to chart the growing complexity in the field.

The final write-up in the inuguralissue is a **book review** of John F. Pfaff'sLocked In: *The True Causes of Mass Incarceration and How to Achieve RealReform* and Patrick *Sharkey's Uneasy Peace: The Great Crime Decline, the Renewal of City Life, and the Next War on Violence*. Writing in his inimitable style, Prof. Thomas Ulen reviews the remarkable decline in the crime rate in the United States since the 90s and the many lessons that Criminal Justice policy-makers can deduce from its economic study. Connecting the "great crime decline" with the high imprisonment rates in the U.S., Prof.Ulen reviews Prof. Pfaff's account of why there hasbeen such heavy use of incarceration as a crime-deterring strategy in the United States. He then turns to a discussion of Prof. Sharkey's account of the importantrelationship between the level of crime and societal well-being. The points noted in the analysis have massive significance appeal to those who are curious whycrime rates fluctuate, what are its effect on societal well-being, and what tools the United States used to combat crime increases and whether thosetools are effective.

Acknowledgement

It is for the first time in the country that a concentrated effort is being undertaken to develop and propagate academic inquisition into the field of law and economics. This endeavour of ours has been supported by many enthusiasts, without whom this Issue would not have seen the light of day.

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Professor of Law for their continued support. The Board of Advisors of the Journal have been a constant source of encouragement and inspiration; our collective gratitude is due to them also.

Finally, my special thanks to the faculty and of course the student editorial board of the Journal for bringing out such a thought provoking and intellectually challenging issue.

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FISCAL CAPACITY AND STABILIZATION FUNCTION WITHIN THE EUROZONE: A MATTER OF UNCERTAINTY

- *Nathanael Kos'isaka*[*]

I. INTRODUCTION

The Economic and Monetary Union (EMU) is based on an asymmetry: On one hand, there is the monetary dimension which falls within the exclusive competence of the European Central Bank (ECB), on the other hand, there are the economic and budgetary domains which fall within the competence of the Member States.[1]

There is, therefore, no centralization of the fiscal pillar within the euro area. Budgetary policies have remained national. This has resulted in a system of coexistence between a single monetary policy pursued by the ECB and budgetary policies conducted by the Member States. This institutional architecture had an economic impact: by limiting fiscal integration, it did not organize the existence of a stabilization function at a centralized level. There was no budget for the euro area. Indeed, macroeconomic stabilization is one of the tasks traditionally pursued by a federal budget.[2]However, it must be understood that this organization of things was not the result of chance.

This "organic dispersion"[3]which characterizes that the economic pillar of the EMU is the result of a deliberate choice made by the Member States, as soon as the euro was created, in order to reconcile on the one hand their wish to benefit from the advantages which one can draw from a single currency and, secondly, their desire to preserve their sovereignty.

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[1] Treaty on the functioning of European Union, 1957, art. 120 and 122, Acts of European Union, 1957 (Italy).
[2]RICHARD A. MUSGRAVE and PEGGY B. MUSGRAVE,PUBLIC FINANCE IN THEORY AND PRACTICE (McGraw Hill, 1989).
[3]FRANCESCO MARTUCCI, L'ORDRE ÉCONOMIQUE ET MONÉTAIRE DE LA COMMUNAUTÉ EUROPÉENNE 273 (Bruylant 2015).

At the time it was made, this choice was not, in the eyes of its promoters, meaningless. This architecture was supposed to be viable, despite the lack of centralization at the budget level. There was a rationality to the system, as it existed before the crisis.[4]On the one hand, there was the (ECB), which was supposed to absorb the shocks affecting the entire zone by acting on interest rates. On the other hand, there were national fiscal policies that managed specific shocks. Such a configuration could not pose any problems as long as public finances were healthy. But the arrangement from Maastricht has failed, and can be seen both before and after the crisis. Before the crisis, the Stability and Growth Pact could not eliminate sovereign debt risks. The advent of the sovereign debt crisis demonstrates this. During the crisis, the ECB's monetary easing instruments proved their limit, while the Member States had to tighten their fiscal policies.

Thus, the occurrence of the crisis has made some doubt the ability of the system, based on the maintenance of almost exclusive member states' competences in budgetary policies, even when those policies are coordinated to ensure the prevention of shocks that may affect the countries of the Eurozone. As a result, a debate is now taking place on how to make the euro area more resilient. This debate mainly focuses on the macroeconomic stabilization function within the euro area. For some, the euro area is facing an economic problem: namely, the absence of a centralized stabilization mechanism, which would be a gap in the euro area. To solve this problem, many are proposing the introduction of a Eurozone budget. However, we note that this debate is characterized by uncertainty about the reality of this economic problem, on the one hand, and uncertainty about the legal and institutional aspects of the solution proposed to this problem, on the other hand. This paper will be articulated around these two aspects.

II. UNCERTAINTY ON THE ISSUE

The first uncertainty is about the need put in place a budgetary capacity to ensure a stabilization function in the Eurozone. The question of necessity arises mainly from the economic point of

[4]Agnès Bénassy-Quéré ,Xavier Ragot and Guntram Wolff, *Quelle union budgétaire pour la zone euro,* 29 LES NOTES DU CONSEIL D'ANALYSE ÉCONOMIQUE 1, 1-12 (2016).

view. While it seems that a large part of the scientific community is leaning towards a positive response, arguments in the opposite direction are also invoked. As a result, two opposing points of view manifest the uncertainty in this matter.

On one side, there is the position of those who believe that the establishment of a fiscal capacity for the euro area is necessary, or at least, desirable. The 2008 financial crisis and the sovereign crisis of 2010 are presented as having shown that the EMU is likely to suffer and succumb to external shocks. Starting from this point, several factors have been put forward to explain this situation and thus justify the setting up of a stabilization mechanism. Most of these factors are based on a view of EMU as incomplete. This lacuna is deduced from Mundell's theory of optimal currency areas.[5]Through this theory, Mundell wanted to determine the conditions in which it would be relevant for regions to adopt a common currency. On the basis of this, the fact that EMU is not an optimal economic zone has been put forward. EMU was not an optimal currency area not only in view of the traditional criteria initially identified by Mundell but, furthermore, it was not so in the light of the other criteria developed as a result of Mundell's work. Indeed, among the works that succeeded those of Mundell, some put forward the need for a fiscal integration.[6]This fiscal integration itself implies a central budget for the monetary zone. From this perspective, a currency area cannot be optimal in the absence of a centralized stabilization mechanism. From this point of view, in the lack of a central budget, national fiscal policies, even when coordinated, are insufficient to ensure an adequate macroeconomic stabilization of the euro area. It thus follows from this argumentation the idea of an incompleteness of the euro area that should, therefore, be filled. Some writers have not hesitated to compare the Eurozone to a house without a roof.[7]The specificity of the euro area in relation to the federal countries[8]was also put forward: if these areas do not even fulfill the classic criteria of the optimal currency area, they

[5]Robert A. Mundell, *A Theory of Optimum Currency Areas*, 51 AMERICAN ECONOMIC REVIEW 657, 657-665 (1961).
[6]JAMES INGRAM, REGIONAL PAYMENTS MECHANISMS: THE CASE OF PUERTO RICO, (University of North Carolina Press 1962); Peter Kennen, *The Theory of Optimum Currency Areas: An Eclectic View, in* MONETARY PROBLEMS OF THE INTERNATIONAL ECONOMY, (Richard A. Mundell and Alexander A. Swoboda 1969); James Ingram, *How: The Optimum Currency Problem, in* MONETARY PROBLEMS OF THE INTERNATIONAL ECONOMY, (Richard A. Mundell and Alexander A. Swoboda 1969) and Emmanuel Farhi and Ivan Werning, *Fiscal Unions*, 107(12) AMERICAN ECONOMIC REVIEW 3788, 3788-3834 (2017).
[7]Paul de Grauwe, *Design Failures in the Eurozone: Can they be fixed?,* LSE 'EUROPE IN QUESTION' DISCUSSION PAPER SERIES 1, 1-32 (2013).
[8]INTERNATIONAL MONETARY FUND, *Toward a fiscal union for a Euro Area*, pg. 15 (September 2013).

nevertheless have one thing in common that distinguishes them from the Eurozone is that they have a central budget responsible for managing asymmetric shocks.[9]In countries as different as the United States, Australia[10]or India[11], there are macroeconomic instruments that are supposed to cushion the effects of the business cycle.

On the other hand, there are those who argue that there is no need to put in place a fiscal capacity. In addition to criticisms and doubts about the relevance of using the theory of optimal currency areas to explain the inadequacies of EMU[12], this position is based on several arguments that can be grouped into three categories. Firstly, there is a questioning of the external nature of the shocks affecting the countries of the euro area. So there are experts stating that "an external shock is often a great deal less than ' external ' than the term implies, with shocks being caused by insufficient supervision by member states, delayed reforms, missed growth opportunities, and letting debt rise unsustainable levels."[13]The idea is that the shocks are in fact due to the inadequacies of the Member States in respect of their commitments. If states fail to cope with the crisis, it is because they do not have room to act. This situation results from non-compliance with the rules of the Stability and Growth Pact. If the rules and principles of the Stability and Growth Pact had been respected, then the states concerned could have better cushioned their shock. From this point of view, it is not the exclusively decentralized nature of stabilization that poses a problem. On the contrary, in order to make the EMU more resilient, the stabilization and internal damping mechanisms of the member states should be strengthened. It is not necessary to change the architecture EMU. Second, there is the same effect, those who believe that the difficulties facing the EMU are not the fact of its institutional architecture. These difficulties are in fact linked to the lack of mobility of the factors of production. It is then a question of taking targeted measures on

[9]GEROGE ANDERSON, FISCAL FEDERALISM COMPARATIVE AN INTRODUCTION (Oxford University Press 2009); FRANCE GIUSEPPE FERRARI, FEDEALISIMO, E SISTEMA FISCAL E AUTONOMIE: MODELLI GIURIDICI COMPARATI (Donzelli 2010).
[10]Miranda Stewart, *Australia*, *in* TAX ASPECTS OF FISCAL FEDERALISM: A COMPARATIVE ANALYSIS 137, 137-180 (Gianluigi Bizioli & Claudio Sacchetto 1 ed. 2011).
[11]Ashutosh Varshney, *How has Indian Federalism Done?,* 1(1) STUDIES IN INDIAN POLITICS 43, 43-63 (2013).
[12]Ivo Maes, *Optimum Currency Area Theory and European Monetary Integration,* 37(2) TIJDSHRIFT VOOR ECONOMIE EN MANAGEMENT 137, 137-152 (1992) ; EUROPEAN PARLIAMENT,*Adjustment to asymmetric Shocks,* 1-75 (September 1998).
[13]Adrian Schout, *The EMU does not have any flaws. A Critique of the European Commission's Reflection Paper on the Deepening of the EMU,* CLINGENDAEL- NETHERLANDS INSTITUTE OF INTERNATIONAL RELATIONS (June 12, 2018, 9:02 P.M.), https://www.clingendael.org/publication/emu-does-not-have-any-flaws.

this dimension rather than reforming the architecture of the Monetary Union. Finally, another trend challenges the need for a fiscal union.[14]The crisis has led to a number of reforms. One of the most important is the establishment of the banking union, and the strengthening of budgetary surveillance, notably through the implementation of the European Semester. These mechanisms, whose purpose is to prevent systemic risks from the banking sector and, for the other, to prevent macroeconomic imbalances, have suggested that it would no longer be necessary to introduce stabilization tool at the level of the euro area. The idea being that risk reduction would somehow replace its sharing. In other words, a banking sector better monitored and more solid, and a level of public and private debt and stockings reduce the need for a fiscal stabilization tool. In the same vein, an increasingly popular opinion is to argue that, instead of trying to establish a fiscal capacity, Europe should pursue a more pragmatic solution, which is to "complete the banking union" and transform the existing European Stability Mechanism (ESM) into a European Monetary Fund (EMF).[15]

On the political scene, the desirability of setting up a stabilization tool is also debated. The uncertainty is manifested here too by the presence of two opposite positions. The principle of the organization of a centralized stabilization in the euro area enjoys political support in the European Union. If the question of fiscal integration is a long-standing concern in the European Union[16],the first time the budget capacity phrase is used in an official document of the EU is in the Van Rompuy report prepared by the Chairman of the Council and published in 2012. In this report, it is explicitly stated that the strengthening of fiscal discipline is not sufficient and that fiscal capacity should be developed. This idea of a fiscal capacity attached to the EMU was also mentioned and supported, both by the Commission[17]and the European Parliament[18]as well as some Head of

[14]ANSGAR BELKE AND DANIEL GROS, BANKING UNION AS A SHOCK ABSORBER: LESSONS FOR THE EUROZONE FROM THE US (Rowman and Littlefield International 2015).
[15]Andre Sapir and Dirk Schoenmaker, *We need a European Monetary Fund, but how should it work?*, BRUEGEL (June 17, 2018, 9:20 P.M.), http://bruegel.org/2017/05/we-need-a-european-monetary-fund-but-how-should-it-work.
[16]This concern can be found in the Werner report of 1970 or the MacDougall report of 1977, in which it was stated that a budget of 5-7% of Community GDP would have been sufficient to ensure the stabilization function of the federal state budgets. However, the idea of adding to the Economic and Monetary Union a fiscal capacity is fairly recent, even though the Delors Report of 1989 was already approaching that idea.
[17]PRESIDENT OF EUROPEAN COMMISSION, *Completing Europe's EMU* (June 2015).
[18]EUROPEAN PARLIAMENT, *Towards a genuine EMU,* pg. 7 (November 2012).

States.[19]However, a certain number of States, mainly in northern Europe, have expressed some skepticism at the idea of a stabilization mechanism. This is how the Dutch Prime Minister declared that "we've come a long way, and the EU has shown that it can take action when it has to. But we're not sufficiently prepared for another crisis. And yes, I know that a currency union needs stabilization mechanisms at times of crisis. But if the 19 Eurozone countries were to put their own budgets and national debts in order that would probably be stabilization enough. That, too, is simply an existing agreement under the Stability and Growth Pact". More recently, in June 2018, several European countries, including the Netherlands, reiterated their opposition to a euro area budget. In their view, the need for such a mechanism does not arise. What is needed is a stronger performance on national structural and fiscal policies in line with common rules. In other words, the lack of a centralized stabilization mechanism is not the fundamental problem of the euro area.

If an uncertainty weighs on the economic necessity justifying the setting up of a budget for the euro area, uncertainty also weighs on the legal and institutional conditions for carrying out such an approach.

III. UNCERTAINTY ON THE SOLUTION

This uncertainty can be seen across three aspects of the fiscal capacity: its establishment conditions, its revenues and its expenditures.

Amending the Treaties is not an easy task, especially for a subject as delicate as the establishment of a fiscal capacity for the Eurozone. And that is where the first source of uncertainty lies. Indeed, for certain forms of fiscal capacity, it will be necessary to amend the Treaties. It should be noted now that the discussions on a fiscal capacity are also about the form it will take. Various proposals have been made. This fiscal capacity could be a full-fledged budget, an insurance-type tool against output gaps or an unemployment insurance scheme, etc. These different forms do not have the

[19]Both Emmanuel Macron and Angela Merkel showed their support for a euro area budget during their meeting of June 19, 2018.

same legal implications. In the case of an unemployment insurance scheme, for instance, it will be necessary to amend the Treaties.

Other sources of uncertainties in establishing a fiscal capacity for the euro area can be illustrated through the European Commission's president proposal.[20]This proposal argues in favor of a fiscal capacity for the Eurozone financed by a line on the European Union's budget. The first problem arises from the need to find a legal basis in the treaties enabling the establishment of such a capacity for the Eurozone. It should be noted that the implementation of any expenditure appearing in the Union budget requires, according to Article 310 (3) TFEU, the prior adoption of a legal act corresponding to this expenditure. The legal basis will depend on the type of fiscal capacity that one wishes to put in place (a rainy day fund scheme, an unemployment reinsurance scheme, an investment Protection scheme, etc.). Two issues need to be addressed in setting up this capacity.[21]Firstly, because of the principle of conferral, the scope of action of the fiscal capacity will be limited by the scope of the corresponding legal basis. Secondly, the establishment of this capacity will require the involvement of representatives from all EU Member States. This requirement poses apparent difficulties. However, while there are ways to avoid the involvement of representatives of all Member States, including limiting participation in the decision-making process to the Eurozone Member States only, these means have a limited reach. Although it would be interesting to consider the establishment of a fiscal capacity through Article 136 TFEU, this article only concerns the coordination and the surveillance of national budgets. It is not clear that this article can then serve as a legal basis for establishing fiscal capacity for the euro area states. It might also be envisaged to go through the enhanced cooperation procedure. But here again, there is no certainty about the use of Article 20 as the legal basis for the establishment of the fiscal capacity.

[20]Jean-Claude Juncker, State of the Union Address to the European Parliament, Strasbourg, 13 September 2017.
[21]Richard Crowe, *Is a separate Eurozone Budget a good idea?,* ADEMU- A DYNAMIC MONETARY AND ECONOMIC UNION (June 11, 2018, 7:35 P.M.), http://ademu-project.eu/wp-content/uploads/2018/06/120-Is-a-separate-eurozone-budget-a-good-idea.pdf.

About expenditure, it is clear that the choice of spending is an essential issue in the implementation of the fiscal capacity. Indeed, the fiscal capacity must make expenditures. That's how it carries out its tasks. But the expenditure aspect of the capacity carries two major issues.

The first question is the function of this fiscal capacity: should it be limited to the stabilization function, which is its primary function, or should it be extended to the other functions traditionally assumed by a budget, such as the financing of public goods?[22]It is indeed possible to imagine that this capacity would finance certain public goods at the level of the Eurozone, whether in terms of environment, infrastructure or health. In this case, it is necessary to ask whether it is possible to imagine public goods that would only benefit the members of the Eurozone. In this aspect, the Eurozone would be exposed to a free rider problem: non-euro area countries will be the free riders. Such a situation will most likely reinforce the reluctance of some countries to finance goods from which all Member States will benefit. But this question of the financing of public goods by the budget of the euro area involves another aspect: the problem of a two-tier European Union. Indeed, financing public goods for the countries of the Eurozone is tantamount to erecting this zone into a real subsystem.[23]

This remark leads us to the second issue arising from the extension of the functions of the euro area budget. If the fiscal capacity must finance public goods, bodies able to make choices and to define priorities should be established. In other words, the Eurozone should be granted some form of institutional autonomy. It will be necessary to have an entity entrusted with the task to define how the funds should be spent. The institutionalization of the Eurogroup is one the way to

[22]Jean Pisani-Ferry, Erkki Vihriälä, and Guntram Wolff, *Options for a Euro-area Fiscal capacity,* 1 BRUEGEL POLICY CONTRIBUTION 1, 1-14 (2013); Eulalia Rubio, *Budget de la zone euro: trois fonctions, trois instruments*, 567 REVUE DE L'UNION EUROPÉENNE 214, 214-217 (2013) and STÉPHANIE HENNETTE, THOMAS PIKETTY, GUILLAUME SACRISTE, AND ANTOINE VAUCHEZ, POUR UN TRAITÉ DE DÉMOCRATISATION DE LA ZONE EURO (T-DEM), (Éditions du Seuil 2017).

[23]But perhaps the euro zone is already a subsystem. A hypothesis can be made that through the ESM, there is already a public good only financed for the members of the Eurozone, it is the financial stability. In addition, the Member States of this zone have already accepted a loss of sovereignty superior to that of the other Member States.

tackle this issue.[24]Aside from the uncertainties and obstacles related to expenditures, there are those related to the revenues of the fiscal capacity.

How will the euro area budget be financed? There are many possibilities. But these different possibilities are not without problems. These include what has been called the problem of asymmetry and the issue of unanimity.[25]

The first possibility is to make Member States finance the capacity. It is the idea of a Eurozone budget that would be funded by a line in the budget of the European Union. This solution nevertheless raises a problem of asymmetry. In accordance with the budgetary principle of universality, the funding devoted to the fiscal capacity will come from the common pot, to which all Member States contribute. As a result, the problem posed by asymmetry will manifest itself on two levels. Firstly, there are differences in size, wealth and economic performance between Member States. As it may have emerged from the statements of some European political figures, the establishment of a European budget should not devote a Union of transfer, with payments made by rich Member States in favor of poor Member States. The differences in size between Member States coupled with the particular nature of the European construction appear to be obstacles to the establishment of a fiscal capacity since it will be easy for some Member States to feel exploited by others. Secondly, the problem of asymmetry will also be manifested by the fact that States that are not members of the Euro Zone will be reluctant to finance a capacity that will only benefit the members of that zone. The logic of equalization, which is found in some federal states, is less well understood within the framework of the European Union.

Another solution would be to ensure that the fiscal capacity has its own resources. This can be achieved by raising a new tax.[26]But is it possible for a tax to be created at the European level? For

[24]Furthermore, the gradual evolution of the role of the Eurogroup since the 2008 crisis can be seen as the first step toward a movement that will lead to the recognition of this entity as a formal body of the European Union. On this point See Louise Fromont, 'L'Eurogroupe, le coté obscur de la gouvernance économique', *Revue du droit de l'Union européenne*, no. 4 (2017), pp. 195-221.

[25]See Federico Fabbrini, *Economic Governance In Europe. Competitive Paradoxes and Constitutional Challenges* (Oxford: Oxford University Press, 2016), pp. 154-179.

some, the combination of Articles 311 and 113 TFEU allows such an approach. Beyond the legal controversy on this point[27]if we admit that this is possible, we soon find ourselves in front of another obstacle. These two articles operate on the basis of unanimity. And this unanimity constitutes in itself an impediment to the financing and, therefore, the establishment of fiscal capacity. It will be complicated to get the agreement of all the Member States. To overcome this difficulty, one could consider going through the method of enhanced cooperation, but the saga of the tax on financial transactions shows the limits of this scheme.

Even if the obstacle of unanimity is overcome, there will remain another problem: the democratic legitimacy of the capacity. The lack of democratic legitimacy manifests itself through the marginal place occupied by the European Parliament in all this architecture. If a tax is established under the Eurozone to finance the fiscal capacity, would this not be a breach of the principle of consent to tax, and its equivalent in other countries, when it's known that the European Parliament has only advisory powers in tax matters. Some may argue that it will be the sign of a lack of representation. One way to solve this issue would be to devote a parliament of the Eurozone. But in that case, it will then be necessary to amend the treaties.

A solution to this problem could be that only the euro area Member States would finance the euro area's fiscal capacity. In this case, the euro area Member States could contribute to the fiscal capacity through derogation from the principle of universality found in Article 21 of the Financial Regulation. It's the method of external assigned revenue. This method allows Member States to contribute additional amounts to specific actions of the Union. This circumvents article 314 TFEU.[28] Member States will directly allocate the funds to a particular expense on a voluntary basis. Thanks to this method, Member States will be able to finance the capacity by making an agreement between them in which they commit themselves to pay predetermined amounts to the fiscal

[26]Daniel Gross, *Eurobonds: Wrong solution for legal, political, and economic reasons*, VOX CEPR POLICY PORTAL (June 15, 2018, 9:45 P.M.), https://voxeu.org/article/eurobonds-are-wrong-solution.

[27]Edoardo Traversa & Alexandre Maitrot de la Motte, *Le fédéralisme économique et la fiscalité dans l'Union européenne*, *in* L'UNION EUROPÉENE ET LE FEDERALISM ÉCONOMIQUE 343, 343-380 (Stéphane de La Rosa, Francesco Martucci & Edouard Dubout 2015).

[28]The budgetary procedure of article 314 implies the participation of the representatives of all Member States.

capacity. However, this solution presents two difficulties. On the one hand, this mechanism leaves little power to the Commission, which cannot effectively compel Member States to respect their commitments. On the other hand, since this mechanism is based on direct payments by Member States, it brings out the link between financial transfers between Members States and fiscal capacity. Once again, the problem of asymmetry will arise: the wealthiest states of the EMU will be reluctant to finance the least wealthy ones.

IV. CONCLUSION

The uncertainties surrounding the establishment of a budgetary capacity for the Eurozone constitute one of the significant challenges of the reform of the EMU. We have seen that these uncertainties concerned both the need to develop a fiscal dimension for the euro area and the legal conditions for carrying out such a project. In any case, the establishment of this capacity will only come at the cost of many efforts, which makes the realization of such a scenario unlikely, without making it impossible, in the near future. Regarding these developments, alternative solutions are increasingly being discussed, such as strengthening the banking union. Are these solutions likely to resolve the difficulties facing the euro area? Only time will tell. But what is certain is that as long as there is uncertainty about the best way to make the euro area more resilient, its future will also remain uncertain.

THE PURPOSE OF THE CORPORATIONS AND CORPORATE SOCIAL RESPONSIBILITY

- *Gabriel Eduardo Messina & Lisandro A. Hadad*

I. INTRODUCTION

"…there is one and only one social responsibility of business
–to use its resources and engage in activities designed to increase its profits
so long as it stays within the rules of the game…"[1]

Over the last decades there has been an exponential increase in the responsibilities expected to be conferred on corporations.

Corporate Social Responsibility (CSR) is an approach that breaks through more and more in the academic debates and in the sphere of public policies,[2] to the point of being considered the stance of the majority[3]. Therefore, the current essay will articulate the social role, given to companies and the possible conflict that can be revealed between shareholders and stakeholders.[4]

[1] Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, The New York Times Magazine (Oct. 8, 2015), http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html.

[2] Timothy M. Devinney, Joachim Schwalbach, Cynthia A. Williams, At a macro level, whether the corporate governance system generally is oriented towards shareholders alone, or towards a broader stakeholder group, will have implications for firms' relationships with societal institutions and sense of social obligations, *Corporate Social Responsibility and Corporate Governance: Comparative Perspectives*, Corporate Governance: An International Review, 21(5) 413 (2013).

[3] María Celia Marsili, El rol social de la empresa está fuera de discusión, habiéndose delineado doctrinariamente y en documentos de organismos internacionales su contenido, *La Responsabilidad Social de la Empresa y el Derecho Societario*, XII Congreso Argentino de Derecho Societario VIII Congreso Iberoamericano de Derecho Societario y de la Empresa 606 (Buenos Aires, 2013).

[4] Caspar Rose, The literature dealing with the seeming conflict between shareholders and other stakeholders is large. The contributions reflect different methodological approaches ranging from financial economics over political science to management theory, *Stakeholder Orientation vs. Shareholder Value— A Matter of Contractual Failures*, European Journal of Law and Economics, 18 78 (2004).

The alluded task will depend to a large extent, on what is understood as the purpose of the corporation or corporate interest and CSR,[5] so that some conceptual clarifications are required.

As a management technique, CSR does not need to be examined by legal science. However when a normative role is assigned, that is to say, when corporations *are supposed* to assume certain responsibilities linked to CSR to achieve an indefinite social-interest goal, which is its purpose, this perspective gets significant importance to corporate law. CSR is frequently disregarded by jurists, due to the rooted habit of attempting to epitomize law without any contact with economics, administration or finance matters, to name a few.

In other words, it is usual that CSR is studied only from the point of view of the administrative theory or corporate management. Nevertheless, the current article intends to warn against possible consequences that this conception may have for corporate law.

If it is accepted that one of the objectives of the law, in this case corporate law, could be to contribute to the development of social welfare, the debate is generated about the means or the way to reach that goal. Giving our opinion in advance, we consider that the search for shareholders' wealth maximization[6] constitutes the best option for companies, organized around a corporate structure, to contribute to the progress of social welfare[7]. Beyond the difficulty to empirically contrast the previous statement, the intention is to provide theoretical arguments that may serve as foundation[8].

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[5] Ronald Bénabou, Jean Tirole, Corporate social responsibility (CSR) is somewhat of a "catch-all" phrase for an array of different concepts, *Individual and Corporate Social Responsibility* Economica, 77 12 (2010). In same way, Forest L. Reinhardt, Robert N. Stavins, Richard H. K. Vietor, *Corporate Social Responsibility Through an Economic Lens*. Fondazione Eni Enrico Mattei Note di Lavoro 84.2008 -NBER Working Paper No. 13989, 1.

[6] Reiner Kraakman, Bernard Black, Corporate law, we believe, should have the same principal goal in developed and emerging economies succinctly stated, to provide governance rules that maximize the value of corporate enterprises to investors, *A Self-Enforcing Model of Corporate Law,* "Foundations of corporate law" Second Edition, Roberta Romano, editor 725 (2012).

[7] John Armour, Henry Hansmann, Reinier Kraakman, What is Corporate Law? *The Anatomy of Corporate Law. A Comparative and Funtional Approach*, Oxford University Press, Second Edition 29. Diego Duprat, "Responsabilidad social de la empresa". La Ley, 1 (2009).

[8] Steve Letza, Xiuping Sun, James Kirkbride, Different perspectives in theory result in different diagnoses of and solutions to the problems of corporate governance practice, *Shareholding Versus Stakeholding: a critical review of corporate governance*, Corporate Governance: An International Review, 12, 242, (2004).

Lastly, it should be pointed out that Corporate Social Responsibility (CSR) has been studied several times from a macro or public policy perspective, which indicates that the debate about this subject is also about the role of the corporation within society[9].

II. CORPORATE SOCIAL RESPONSIBILITY, THE STAKEHOLDER DOCTRINE AND CORPORATIVE PHILANTHROPY

"Do corporations have any responsibilities beyond trying
to maximize stockholder value, adhere to contracts, implicit as well as explicit,
and obey the laws of the different countries where they operate?
My answer is "no""[10]

Entrepreneur Social Responsibility[11] and Corporate Social Responsibility are currently ordinary terms that are used in economic, political, social and media circles, which present, however, a not rigorous conceptual basis.[12] To a large extent, the discussion on social responsibility is focused on corporations, so I will omit private businessmen.[13]

[9] Antonio Argandoña, Heidi Von Weltzien Hoivik, When we define CSR, we are implicitly defining the whole set of interrelated responsibilities and roles in society: CSR is not only business ethics, but also social ethics and even political ethics…. *Corporate Social Responsibility: One Size Does Not Fit All. Collecting Evidence from Europe*, 89, Issue 3 suplement, Journal of Business Ethics, 229-230.

[10] Gary Becker, *Do Corporations Have a Social Responsibility Beyond Stockholder Value?* (May 10, 2016), http://www.becker-posner-blog.com/2005/07/do-corporations-have-a-social-responsibility-beyond-stockholder-value-becker.html.

[11] Isaac Halperín, "Las sociedades comerciales son generalmente empresas comerciales; pero no es forzoso que así sea dado que los conceptos de sociedad y empresa no se identifican". Sociedades Anónimas. Examen crítico del decreto-ley 19.550. Ediciones DePalma. Buenos Aires, 22 (1974).

[12] Pablo De Andrés Alonso, Valentín Azofra Palenzuela, "El enfoque multistakeholder de la responsabilidad social corporativa: De la ambigüedad conceptual a la coacción y al intervencionismo". Revue Sciences de Gestion – Management Science – Ciencias de Gestión, No. 66, 6, (2008).

[13] Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, The New York Times Magazine, (Oct. 8, 2015), http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html.

As noted, one of the first challenges found by diverse authors who develop this concept is to specify a definition of CSR.[14] In spite of difficulties, a definition must be attempted. Therefore, in this paper, the definition of the so called "Green Book", produced by the European Commission, which considers corporate social responsibility as companies' voluntary integration of social and environmental concerns into their commercial deals and their connections with their interlocutors is adopted. [15]

Voluntarism[16] seems to be a factor that the different definitions have in common so that the adoption of CSR policies implies the acceptance of corporate liabilities beyond legal requirements[17] or as a result of institutional demands imposed by certain corporate governance systems.

Also, there is a close relationship between CSR and the doctrine of *stakeholderism*[18] or *stakeholder*[19]; and *even though these terms cannot be seen as synonyms*, they may incarnate the same risk: to distort the firm`s goal.[20]The same situation occurs with the so called corporative philanthropy.[21]

The stakeholder theory is usually presented as a meeting proposal between management theory and business ethics aimed to legitimize a corporative governance model, supposedly pluralist, socially responsible and targeted at wealth maximization of every stakeholder.[22]

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[14] Lawrence E Mitchell, CSR remains ill-defined, if defined at all, and proliferating precatory pronouncements are no better than the paper on which they are written, *The board as a path toward corporate social responsibility*. Doreen McBarnet, Aurora Voiculescu, and Tom Campbell, *The new corporate accountability: corporate social responsibility and the law*, Cambridge University Press, 279, (2007).

[15] 7, (may 09, 2016) http://www.europarl.europa.eu/meetdocs/committees/deve/20020122/com(2001)366_es.pdf.

[16] Efraín H. Richard, "La responsabilidad social corporativa va más allá del cumplimiento de las leyes y las normas, dando por supuesto el respeto y su estricto cumplimiento". "Utilidad inmediata de la doctrina de responsabilidad social empresaria". MJ-DOC-4729-AR | MJD4729.

[17] "Lo cual significa que la responsabilidad social comienza cuando termina el derecho". BOUR, Enrique. "Responsabilidad social de la empresa análisis del concepto". Estudios Económicos Volumen XXIX, Nº 59 (N.S.), Julio - Diciembre de 2012. Departamento de Economía, Universidad Nacional del Sur, 10.

[18] Richard Marens, *We Don't Need You Anymore: Corporate Social Responsibilities, Executive Class Interests, and Solving Mizruchi and Hirschman's Paradox*, 35 No. 4, Seattle University Law Review, 1221-1222 (2012).

[19] Antonio Argandoña, Heidi Von Weltzien Hoivik, In practice, then, CSR will be the result of a dialog between the firm and its stakeholders about the obligations of the first and the expectations of the second, *Corporate Social Responsibility: One Size Does Not Fit All*, Collecting Evidence from Europe, 89, Issue 3 suplement, Journal of Business Ethics, 225 (2009).

[20] Caspar Rose, The concept of a firm's social responsibility is closely related to the stakeholder theory i.e. whether management should subordinate profit maximization to other goals, *Stakeholder Orientation vs. Shareholder Value— A Matter of Contractual Failures*, 18 Issue 1, European Journal of Law and Economics, 93 (2004).

[21] Luisa Montuschi, "… tres aspectos en los cuales la RSE asume un papel preponderante. El primero corresponde a la tradicional filantropía corporativa, que manifiesta preocupación por el bienestar de los miembros de la corporación", "La responsabilidad social de las empresas: la brecha entre los principios y las acciones". Academia Nacional de Ciencias Ecónomicas 15-16 (Jan 01, 2016) http://www.anceargentina.org/site/trabajos/LA%20RESPONSABILIDAD%20SOCIAL%20DE%20LAS%20EMPRESAS%20f.pdf.

Even though a precise definition of *stakeholder* is not available, this concept can be understood as inclusive of every individual and group, affected by the activities of the organization,[23] as well as individuals that are vital for the survival and success of the undertaking.[24]
It has been maintained that along with the shareholder maximization aim (of value or wealth), the ethic horizon[25] must not be overlooked.

Even though these are well-meaning, the previous statements can only be interpreted as expressions of desire. Firstly, due to the fact no one can aspire for companies (or people) to behave in a non-ethical way.[26] Secondly, these terms are neither contradictory nor in need of clarification. Shareholders' wealth maximization does not imply that the company behave in a dishonest manner (or rather managers' dishonest behaviour). There seems to be a tendency, maybe unintentional, to consider wealth maximization as detrimental, so that it is necessary to clarify that it must be achieved within ethical and legal boundaries. Every organization has a purpose,[27] and

[22] Pablo De Andrés Alonso, Valentín Azofra Palenzuela, "El enfoque multistakeholder de la responsabilidad social corporativa: De la ambigüedad conceptual a la coacción y al intervencionismo". Revue Sciences de Gestion – Management Science – Ciencias de Gestión (ISSN:1634-7056), No. 66, 9 (2008).
[23] Geoffrey P. Lantos, "… stakeholders can be envisioned as existing at four levels. First, is the systemic¬¬/macroenvironmental general/environment level – largersocietal factors, incluiding the entire business system, plus society at large […]. The second… microenviroment/operating task/enivoroment, consisting of exchange relationship partners (such us suppliers and distributors), plus competitors, customers, the local community, and the financial community […]. A third level of stakeholder is within the business organization, notably superiors, subordinates and other employees and labor unions. The final level of stakeholder I significant others of business decision makers, such as peers, family, friends, etc." The boundaries of strategic corporate social responsibility, 18 No. 7, The Journal of Consumer Marketing, 604-605 (2001).

[24] Pablo De Andrés Alonso, Valentín Azofra Palenzuela, "…en el sentido originario del término, los stakeholders se identificaron con aquellos sin los cuales una organización no podría sobrevivir, es decir, "aquellos en quienes la organización tiene un interés (stake)". "El enfoque multistakeholder de la responsabilidad social corporativa: De la ambigüedad conceptual a la coacción y al intervencionismo". Revue Sciences de Gestion – Management Science – Ciencias de Gestión (ISSN:1634-7056), No. 66, 8 (2008).
[25] Mariano Gagliardo, La meta y aspiración a la "maximización del valor de la acción" tiene que estar acompañada de una restauración de la confianza si aspiramos a superar nuestras crisis recurrentes. Para ello, también resulta ineludible, un trasfondo humanístico y ético que defina a la gestión societaria y empresarial, permitiendo, asimismo, armonizar la eficiencia con un obrar de los administradores transparente y responsable, *Maximización del valor de la acción*, MJ-DOC-3017-AR | MJD3017.
[26] Without going into digressions about what is considered "ethical behaviour".
[27] Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function,* 14 No. 3, Journal of Applied Corporate Finance, 8 (2001).

their activity will be directed at that goal in the optimal way;[28] and if the goal is an economic benefit, wealth maximization will be the activity guiding lighthouse. Therefore, we are not ashamed to state that it is not harmful for the corporation "to make money within the law" if that is the reason why the corporation was created.

III. CORPORATION APTITUDE FOR PRACTICING CSR

"To view pollution, or investment in South Africa,
or other difficult moral and social questions
as governance is to miss the point."[29]

The chance that a company is able to conduct CSR actions is directly related to the debate on the corporation's purpose,[30] and the proper conceptualization and differentiation between company, artificial person and enterprise. In this way, it will be essential to make a few assessments of corporate interest, the organization's purpose or objective function, and the compliance with the contracts and the law.

The corporate-interest institute has been profusely addressed in corporate literature. Nonetheless, its representation and delimitation still arouses controversy, to the point that it is considered one of the most evanescent concepts that the doctrine[31] has to face.

It should be mentioned that this topic is not expected to be developed in a few lines; and only some aspects that have been kept in mind to substantiate the conclusions, are noted.

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[28] Ricardo F. Crespo, Maximización y auto-interés no significan necesariamente lo mismo, pues el segundo de los términos es más acotado, *Alcances y limitaciones de la noción de maximización económica*, Anales de la Academia Nacional de Ciencias Morales y Políticas. Tomo XXXVIII, 104 (2011).

[29] Frank Easterbrook, Daniel Fischel, The economic structure of corporate law, Harvard University Press. ISBN 0-674-23539-8, 39.

[30] Eric B. Rasmusen, *The proper goal of a corporation is an old question in corporate law, most commonly discussed in connection of "social responsibility",* The goals of the corporation under shareholder primacy: just profit— or social responsibility and religious exercise too? Page 6. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2365135.

[31] Rafael Mariano Manovil, Grupos de Sociedades en el Derecho Comparado, Ed. Abeledo Perrot, Bs. As., 571 (1998). In same way, Horacio P. Fargosi, Releyendo el art. 248 de la Ley de Sociedades Comerciales, MJ-DOC-940-AR | MJD940.

In honour of brevity, corporate interest denying theories[32] are disregarded, because the objective of this study would be thoroughly exceeded. It is only pointed out that although the main denying positions are based on the fact that accepting the existence of corporate interest implies "subjectivism", since the idea of interest always refers to an attitude typical of men,[33] necessarily related to their natural reality[34]. It is estimated, on the contrary, that social interest is a category with objective existence, deduced from the incorporation agreement,[35] and whose concept is sufficiently clear, forming a control method over discretionary decisions of the political body or the managers, and a protection boundary for those defeated in that decision.[36]

However, if we expect to take the analysis further, it will be necessary to question about this matter from a theoretical point of view. In this way, in order to analyse a business-company's ability to practice CSR, we must inquire into corporations´ purposes, that is to say, what is the reason why people create this organizations.

It should be taken into account that the problem of corporate interest is related to the incorporation agreement, which gives birth to the legal entity. Around a legal entity, other figures, called stakeholders move. They participate in the company activity without belonging to it, but related to it by means of the agreement and the law.[37]

[32] Within the authors, we can quote Colombres and Roimiser.
[33] Efraín Hugo Richard, Orlando Manuel Muiño,"El término "interés de la sociedad" […] ha recibido algunas censuras por implicar un subjetivismo -interés- de las personas jurídicas, elemento subjetivo que sólo puede encontrarse en las personas físicas", "Derecho Societario". Editorial Astrea. Buenos Aires, 75 (2000).
[34] Carlos A. Molina Sandoval, El difícil contorno del interés social, MJ-DOC-1713-AR | MJD1713.
[35] Germán González Cocorda, Tomás Capdevila, El interés social y el interés contrario del accionista. Recensión del artículo 248 según la jurisprudencia. XI Congreso Argentino de Derecho Societario. VII Congreso Iberoamericano de derecho societario y de la empresa. Fundación para la investigación y el desarrollo de las Ciencias Jurídicas. Tomo II. Buenos Aires 275 (2010).
[36] Jesús Alfaro Aguila-Real, *Interés social, cumplimiento normativo y responsabilidad social corporativa*, http://almacendederecho.org/interes-social-cumplimiento-normativo-y-responsabilidad-social-corporativa/.
[37] Jesús Alfaro Aguila-Real, ob. cit.

Focused on the purpose of the corporation, people may have multiple objectives to become a member and they will choose the most convenient channel or method to achieve their purposes.[38] The legislator, having in mind the aforesaid, regulated different ways of association. In this way, non-profit organizations seem to be in compliance with activities, by which the members´ wealth increase is not the ultimate goal. A proof of that turns out to be the tax benefits that these institutions enjoy: since they are aimed at social good activities, the government encourages their creation by tax-relief. However, there is no obstacle to activities aimed at social good accomplished by a corporation: people within their scope of liberty, are able to join together and can agree to create a corporation targeted at social good or not aimed at distributing profit among their members (or any sort of percentage). Equally, the founders of these companies are able to appoint other people to manage the created artificial person and the role of these managers will be to maximize profit for the members (who elected them for that task).

Through the legal-instrument company, the shareholder attempts to satisfy his individual interest. This interest, as a shareholder, is an indirect interest; obtained as a reflection; it must be achieved through the fulfilment of the corporation´s purpose or corporate interest.
Since there are several specifically-legislated legal structures, orientated to social good, which are not for profit, and that enjoy tax-benefits; it is very difficult to imagine that people who create a corporation, have a different goal than to maximize the return on their investments.[39]

Hence, the *managers will have to try to optimize utility – either economic or not – and in absence of explicit orientation it will have to be understood as shareholders' wealth maximization.*[40]

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[38] Eric B. Rasmusen, *If shareholders wish to use the corporation solely to earn money, fine. But if, as is not only often but usually the case in a closely held corporation, the shareholders have other goals, those are legitimate too*, The goals of the corporation under shareholder primacy: just profit— or social responsibility and religious exercise too?, 39, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2365135.
[39] Jesús Alfaro Águila-Real, "…considerada como contrato, el objetivo de la sociedad debe ser el que las partes hayan establecido en el mismo y, presuntivamente, es decir, salvo que los socios digan otra cosa en los estatutos, maximizar la rentabilidad de las inversiones realizadas por los socios (arts. 1665 CC y 116 ss. y 133 C de c, en particular) o, lo que es lo mismo, maximizar el valor de la empresa a largo plazo".. "El interés social y los deberes de lealtad de los administradores", AFDVAM 213 (2016). Although I share the first postulate with the author, I allow myself to doubt that it is assimilable to the maximization of the value of the company in the long term. Hence the use of the formula - somewhat vague - "maximization of wealth.
[40] David L. Engel, "One cannot persuasively claim to have found an extra-profit goal that society wants corporations to pursue, unless one can offer at least a plausible explanation of why the legislatura did not long ago enactliability rules, regulations, or other measures, to implement the goal in question quite independently of any management practice of social responsibility". *An Approach to Corporate Social Responsibility*, 32, No. 1, Stanford Law Review, 36 (1979).

Based on the assertion that the legal personality of an entity is a technical resource that the legislator may adopt or not, according to rules of coexistence or legislative policies, that is to say, it is a simplified system of legal relationships and the legislator has the power to make legal rules that recognise it as a different allocation centre, by means of social actions or contractual relationships functionally externalised,[41] the corporation turns out to be an instrument of which the shareholders make use of to achieve their common purpose.

On the basis of this contractual concept of a company, the risk the shareholders are willing to share (for the developing of an activity applied to the production or exchange of goods and services) becomes the purpose of the contract.[42]

At this point, it is possible to point out one of the main characteristics of the analysed institute: corporate interest is the common denominator of the legal interest of the shareholders in the company.

It is also worth mentioning that corporate interest may or may not agree with the majority interest, disagreeing with the dogmatic trend that identifies both ideas. The majority principle is useful as an organizational criterion of the shareholders, in case there is disagreement about the decision to make, in order to respond better to corporate interest, that is to say, the referred principle is based on decisions made by a majority, acting in pursuit of corporate interest, not personal interests, not in accord with the former. In case the will of the shareholders comes into conflict, the matter is initially decided by the majority, though bounded by the incorporation agreement purpose.

[41] Gabriela Calcaterra, Personalidad, empresa y contrato de sociedad, VIII Congreso Argentino de Derecho Societario. IV Congreso Iberoamericano de Derecho Societario y de la Empresa. Tomo I. 91.

[42] Horacio P. Fargosi, "aquel interés común derivado del riesgo y de la vocación de soportar las pérdidas y de participar de las utilidades, fundamento de la igual calidad de derechos, forma parte de la causa-fin de la sociedad", "Releyendo el art. 248 de la Ley de Sociedades Comerciales". MJ-DOC-940-AR | MJD940.

In conclusion, corporate interest may be understood as the common interest of every shareholder, which functions as common surety, protecting the essence of company's purpose and the bond between the former and the latter.[43]

IV. DUTIES OF MANAGERS AND SHAREHOLDERS FOR WEALTH MAXIMIZATION

"When one person exercises authority that affects another wealth, interests may diverge."[44]

Motivations that bring people to go into business and develop an activity as a group go beyond this analysis. Nonetheless, it must be noted that every organization has a purpose and, as a consequence, a governance system that allows for decision making.[45] In this sense the two basic options are consent or authority.

Authority appears frequently in those structures where there is significant asymmetry of information or where members have opposing interests. Once the authority system is established, its counterpart is to be held accountable for their actions (*accountability*).[46]

Corporate governance practices, either in the area of management or control, have a direct implication for the survival of organizations, since individuals or agents who make important decisions may not bear a substantial share of the wealth their decisions[47] generate; a frequent situation within the board of directors.[48]

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[43] Rafael Mariano Manovil, Grupos de Sociedades en el Derecho Comparado, Ed. Abeledo Perrot, Bs. As., 574 1(998).
[44] Frank Easterbrook, Daniel Fischel, *The economic structure of corporate law*, Harvard University Press. ISBN 0-674-23539-8, 91.
[45] Robert Cooter, Hans-Bernd Schäfer, The structure of offices and roles in an organization makes its individual members capable of corporate action. Its members coordinate their behavior to pursue common goals, as with a football team, symphony, orchestra, church, army, partnership, or corporation, *Solomon's Knot. How Law Can End the Poverty of Nations*, Princenton University Press, New Jersey, 12 (2012).
[46] Stephen Bainbridge, The New Corporate Governance in Theory and Practice, Oxford University Press, New York, First Edition, 3.
[47] Eugene F. Fama, Michael C. Jensen, "… we are concerned with the survival of organizations in which important decision agents do not bear a substantial share of the wealth effects of their decisions", *Separation of Ownership and Control*, 26 No. 2, Journal of Law and Economics, Corporations and Private Property: A Conference Sponsored by the Hoover Institution, 301, (1983), http://links.jstor.org/sici?sici=00222186%28198306%2926%3A2%3C301%3ASOOAC%3E2.0.CO%3B2-A. http://links.jstor.org/sici?sici=00222186%28198306%2926%3A2%3C301%3ASOOAC%3E2.0.CO%3B2-A.
[48] Eugene F. Fama, Michale C. Jensen, *Id.*

Corporate governance traditionally has proposed control systems[49] that include establishing plans, policies, procedures, standards and codes,[50] among others, based additionally on instruments of incentive or compulsion directed towards reducing uncertainty and diminishing the cost of transaction.

Nevertheless, to restrict the possibility of individual election within circles characterized by uncertainty, dynamism and complexity, complicates the development of conditions aimed at facilitating innovation, quick and flexible reaction and, in general, proper decision making; key factors for the survival of organizations. As a consequence, it can be stated that the greater the responsibility to account for their actions, the less productive the authority-based decisions will be. At some point, authority and accountability are irreconcilable.[51]

Having in mind that agents are rational, but to a limited extent, contracts will be incomplete due to the fact that it will be impossible to foresee every contingency or future situation.[52] Facing this fact, corporate law states a series of mechanisms to solve this issue, among which behaviour standards are outlined. The solution just mentioned is based on the special incorporation agreement characteristic, which turns it into an incomplete sample, since no restriction can be specified about a necessarily indefinite act of decision-making delegation.[53]

[49] Martín E. Paolantonio, "Los mecanismos de control pueden tener origen legal, contractual en sentido estricto, o seguirse de la existencia de un mercado de control societario que limite la posibilidad de un comportamiento oportunista por parte de los administradores societarios". "Retribución de los directores y análisis económico del derecho: reflexiones sobre el caso de las sociedades abiertas" en "Revista de Derecho Privado y Comunitario". No. 21. Derecho y Economía. Rubinzal – Culzoni Editores. Santa Fe, 297-298 (1999).

[50] Enrique Pelaez, "Por medio de los principios contenidos en estos Códigos de Gobierno Corporativo se intentó disminuir uno de los principales problemas que enfrenta el accionariado disperso de las grandes corporaciones que consiste en la disociación entre la propiedad y control que provoca importantes problemas de agencia, difíciles de resolver".. "Informe sobre el código de gobierno corporativo". XI Congreso argentino de societario: VII Congreso iberoamericano de derecho societario y de la empresa. 1ª ed. Buenos Aires: Fundación para la Investigación y Desarrollo, 2010. ISBN 978-987-23848-3-8. Mar del Plata. 19, 20 21 y 22 de Octubre de 2010. Tomo III. Page 440.

[51] Stephen Bainbridge, *The New Corporate Governance in Theory and Practice*, *supra* note 46.

[52] Frank Easterbrook, Daniel Fischel, *The economic structure of corporate law*, *supra* note 44.

[53] Martín E. Paolantonio, "El análisis económico del derecho y la estructura societaria" en "Análisis económico del Derecho". Kluger, Viviana (compiladora). Editorial Heliasta. Buenos Aires, 220 (2006).

Managers´ duties are introduced as the tool developed by the legal system to complete the unspecified terms within the agreements subscribed by the shareholders.

Disregarding the legal system requirements, the following question may be considered: why managers must direct their activities *only* at shareholders? In this sense, the first answer resides in the position of residual beneficiary that members of a company occupy. The fact that members receive the flow of residual funds of the corporation reveals an interest alignment, since they are among the most affected by the results of the company activity. However, this reason alone could be unsatisfactory.[54]

Another frequent argument is the one that suggests that - "*no servant can serve the interests of several masters"*- related to managers being unable to serve the shareholders along with another group with different or opposed interests.

In front of the previous statement, it could be argued that within a public limited company there might exist different types of shares that confer different rights to their holders.[55] This way, even if the aspiration is shareholders´ primacy, since they have dissimilar interests, we would be in the same position as that of running the company´ activities in aid of all the stakeholders. In spite of the different rights attributable to the different types of shares, it cannot be forgotten that they share a characteristic that distinguish them from third party strangers to the company: the choice of participating in profit and loss. The common interests in participating in the company outcomes make managers direct their activity in aid of the shareholders.

Assuming the existence of freedom of contract (legal as much as factual), agents sign agreements – either loans, employment or supply contracts, etc- with the company because they are expecting to improve their current situation – by means of return of the lent money, plus interests or salary,

[54] Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties* (1991), Yale Law School Faculty Scholarship. Paper 1713. 31. http://digitalcommons.law.yale.edu/fss_papers/1713.

[55] The Argentine law admits for certain types of companies (not very used by the way) the need for different types of partners. For example, in "comandita simple" company and in the capital and industrial compay, capital and industrial partners. In both cases, each member category is granted diferent rights and obligations.

salary payment, supplies, etc-. As we will see later, each contracting party must accept the risk structure inherent to their voluntary relationship[56] with the firm.

In other words, it could be considered that shareholders are the ones who appreciate[57] the "tool" of managers´ fiduciary duties the most, and as a consenquence they decide to invest by subscribing for shares and not by means of another legal structure.

Even in relation to corporative philanthropy, and assuming the existence of a market for altruism,[58] managers (as agents)[59] will have to attempt to satisfy shareholders` main interests,[60] in the best way.[61] Although it is considered that corporations could be more productive than government and non-profit organizations, to conduct altruistic activities (though the reason for this productivity should be examined), it must be kept in mind that the analogy between individuals (natural person) and companies (artificial person) fails when discussing social-interest goods supply. While human beings are versatile and have different interests, corporations are incorporated with a well-defined purpose, which do not mainly include a direct contribution to general interest.[62]

[56] Special mention will be made of those who are involuntarily related to society: for example, the community where the company operates does not sign a contract but it will be the task of public representatives to safeguard their interests.
[57] Jonathan R. Macey, Corporate Social Responsibility: A Law & Economics Perspective, 17 Issue 2, Chapman Law Review, 333.
[58] Todd Henderson, Anup Malani, *Corporate Philanthropy and the Market for Altruism,* http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=8004&context=journal_articles.
[59] Eric Posner, *Agency Models in Law and Economics,* http://www.law.uchicago.edu/files/files/92.EAP.Agency.pdf. Frank Easterbrook, Daniel Fischel, The economic structure of corporate law, Harvard University Press. ISBN 0-674-23539-8. Stephen Ross, The Economic Theory of Agency: The Principal's Problem 63 Issue 2 American Economic Review, 134 (1973). Michael C Jensen, Clifford W. Smith Jr, *Stockholders, manager and creditor interests: Applications of agency theory*, 2. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=173461, among many others.
[60] John Buchanan, Dominic Heesang Chai, Simon Deakin, Viewing shareholders as 'principals' and managers as their 'agents' is not synonymous with the idea and practice of 'shareholder primacy', but it is linked to it, *Agency Theory in Practice: a Qualitative Study of Hedge Fund Activism in Japan,* Corporate Governance: An International Review, 22(4), D'Angelo Law Library, Chicago University, 299 (2014).
[61] Richard Marens, The existence of an agency relationship between partners and administrators is not peaceful doctrine: "Historically and legally, agency theory was not an accurate account of how corporations were expected to be run", *We Don't Need You Anymore: Corporate Social Responsibilities, Executive Class Interests, and Solving Mizruchi and Hirschman's Paradox*, 35 No. 4, Seattle University Law Review, 1218 (2012).
[62] Geoffrey P. Lantos, The boundaries of strategic corporate social responsibility, 18 No. 7, The Journal of Consumer Marketing, 609 (2001).

In this way, *managers, in the course of their duties, must direct their behaviour towards social interest*[63], *which presumably, will result in shareholdes'r wealth maximization.*[64]

When disguised as CSR, it is intended to protect interests of people who are strangers to the incorporation agreement. By doing this, not only are we unreasonably forcing this idea of corporate interest,[65] but also, we would be failing to provide the managers with a unique task,[66] and as a consequence, they would be prevented from maximizing this function, with multiple objectives[67] (in many occasions opposed).[68] Even though alternative models have been developed, using the game theory,[69] it cannot be stated that the mentioned deficiency has been overcomed.

The above-said does not imply the disclaiming of the needs of those interested in the firm.[70] The attention required by many stakeholders is a result of corporate logic itself: it is inconceivable to any organization that competes on the market, to disregard consumers, employees, creditors, suppliers, community, etc.[71] However, all the attention granted, must not nullify the aim of the

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[63] Francisco Junyent Bas, El interés social: directiva central de responsabilidad de los administradores societarios. IX Congreso Argentino de Derecho Societario V Congreso Iberoamericano de Derecho Societario y de la Empresa, San Miguel de Tucumán, 429, (2004).

[64] Douglas G. Baird, Todd Henderson, Purpose not shared by many: "An example of an almost-right principle that has distorted much of the thinking about corporate law in recent decades is the oft-repeated maxim that directors of a corporation owe a fiduciary duty to the shareholders", Other's people money, 60 Issue 5, Standford Law Review, 1309.

[65] Diego Duprat, "Responsabilidad social de la empresa". La Ley, 1 (2009).

[66] Michael C. Jensen, "…stakeholder theory should not be viewed as a legitímate contender to value maximization because it fails to provide a complete specification of the corporate purpose or objective function", *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 No. 3, Journal of Applied Corporate Finance, 9 (2001).

[67] Id. 10-11, "It is logically impossible to maximize in more than one dimension at the same time unless the dimensions are what are known as "monotonic transformations" of one another".

[68] Luisa Montuschi, "Pero en el nuevo contexto definido por la RSE ese objetivo deberá ser compatibilizado con otras demandas dirigidas a la empresa", *La responsabilidad social de las empresas: la brecha entre los principios y las acciones*, Academia Nacional de Ciencias Económicas, 30. (2008) (Jan 14, 2016) http://www.anceargentina.org/site/trabajos/LA%20RESPONSABILIDAD%20SOCIAL%20DE%20LAS%20EMPRESAS%20f.pdf.

[69] Lorenzo Sacconi, "..the objective function of the firm is univocally defined not as the maximisation of shareholder value, but as the maximisation of the Nash bargaining product of the stakeholders' utilities within a symmetrical payoff space, after having set the negative externality on other non-cooperating stakeholders at a minimum. This objective function is perfectly calculable as the Pareto efficient allocation of payoffs that maximizes the egalitarian distribution".. *The Economics of Corporate Social Responsibility*, EconomEtica, No. 39, 31 (2012).

[70] Michael Porter, Mark Kramer, The mutual dependence of corporations and society implies that both businees deciscions and social policies must follow the principle of shared value. That is, choices must benefit both sides, *Strategy and Society: The link between competitive advantage and corporate social responsibility*, Harvard Business Review, 5 (2006).

[71] Alejandro Miller, "…entendemos que la sociedad mercantil debe prestar atención a los intereses de los "stakeholders" dado que los mismos finalmente repercutirán -en el largo plazo- favorable o desfavorablemente a la creación de valor económico de la sociedad mercantil".. "Los nuevos paradigmas en el Hacer de las Sociedades Comerciales". MJ-DOC-5113-AR | MJD5113.

organization pursued by its members.[72] Both employees[73] and creditors invest in the company (either their time or resources), have expectations and interests at stake, and yet each and every one of them must endure the risk structure they have accepted as a consequence of their relationship with the firm[74] and they can count on legal protection as well as contractual basis they deem appropriate.

Nonetheless, it could be argued that due to the previous assumptions about the limited rationality of the agents, agreements between stakeholders and the corporation are also incomplete. However, it is important to remember that the relationship between every stakeholder and the corporation will be different, showing each and every one of them their own distinctive features. Hence, potential conflicts in each relationship must be identified in addition to the management mechanisms in accordance with the business characteristics, among which the agreement and *gap filling protection* of different laws are mentioned. In other words, it would be *mutatis mutandis* applicable the so called Tinbergen Rule[75]: for each goal it will be necessary at least an instrument to attempt to reach it – and it must turn out to be linearly independent-.[76]

The expansion of managers´ duties does not seem to be the appropriate tool to protect the interests of people strange to the incorporation agreement: not only because just one tool to reach

[72] Gary Becker, In many other situations, apparent conflicts between maximizing stockholder value and social goals disappear on closer examination. A corporation may give money to local charities, play up its contributions to the environment, and do other things that appear to reduce shareholder value because that sufficiently improves the government regulations that affect their profitability, *Do Corporations Have a Social Responsibility Beyond Stockholder Value?* (May 10, 2016), http://www.becker-posner-blog.com/2005/07/do-corporations-have-a-social-responsibility-beyond-stockholder-value-becker.html.

[73] Jonathan R Macey, Taking steps to improve worker morale is good for workers and good for shareholders, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, (1991). Yale Law School Faculty Scholarship Paper 1713, 35, http://digitalcommons.law.yale.edu/fss_papers/1713.

[74] Frank Easterbrook, Daniel Fischel, The economic structure of corporate law, Harvard University Press. ISBN 0-674-23539-8, 37.

[75] Jeffrey Schas, Felipe Larraín, "Tinbergen delineó cuidadosamente los pasos cruciales para la formulación de políticas óptimas. Primero, las autoridades deben especificar las metas de la política económica, usualmente en términos de una función de bienestar social, que la autoridad está tratando de maximizar, Basadas en la función de bienestar social, las autoridades identifican los objetivos que quieren alcanzar. Segundo, las autoridades deben especificar los instrumentos de política que se dispone para alcanzar los objetivos. Tercero, las autoridades deben tener un modelo de de la economía que conecte los instrumentos con los objetivos, para así poder escoger el valor óptimo de los instrumentos de política" "Macroeconomía en la economía Global". Pearson Educación. México, 586 (1995).

[76] Jeffrey Schas, Felipe Larraín, "Si en una economía de estructura lineal las autoridades tienen N objetivos, estos objetivos se pueden alcanzar siempre que existan al menos N instrumentos de política que sean linealmente independientes entre sí", "Macroeconomía en la economía Global", Pearson Educación, México, 588 (1995).

several goals would be tried, but also because the sought goals depend on each other and are even opposed.[77]

Lastly, it seems illogical that CSR emerges with a greater deal of energy next to financial scandals of the last decade. In the first place, it should be explained that many of the aforesaid facts, were contrary to ethics, as well as illegal. There is also a contradiction in thinking that disloyal managers would not have committed a crime having as a goal profit maximization of all the stakeholders. That the disloyal manager would stop acting selfishly when faced with a change of the activity guiding-goal is a paradox.

Ultimately, the problem is not that managers attempt to satisfy too many interests[78] simultaneously, but that this perspective has the potential to allow them to serve their own interests,[79] finding it difficult,[80] not to say impossible, to assess the business management.[81]

V. ARTICULATION OF THE CORPORATION PURPOSE AND SOCIAL RESPONSIBILITY

"…the profit motive is compromised in both word and deed.
It now shares its royal throne with a multitude of noncommercial
motives that aspires to loftier and more satisfying values."[82]

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[77] Jesús Alfaro Águila-Real, "En este sentido, indicar a los administradores que han de proteger «armónicamente» los intereses de todos los grupos interesados en la empresa no proporciona ningún criterio para ponderar tales intereses y atribuir, por tanto, un mayor o menor peso a cada uno de ellos, por lo que los administradores quedan sin directivas de conducta claras". "El interés social y los deberes de lealtad de los administradores", AFDVAM 20, 214 (2016).

[78] Guillermo E Ragazzi, "La responsabilidad social empresaria (moda, mito un nuevo paradigma de gestión)". XI Congreso argentino de societario: VII Congreso iberoamericano de derecho societario y de la empresa. 1ª ed. Buenos Aires: Fundación para la Investigación y Desarrollo, 509 (2010).

[79] Jonathan R Macey, An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties (1991), Yale Law School Faculty Scholarship. Paper 1713, 36. http://digitalcommons.law.yale.edu/fss_papers/1713.

[80] Caspar Rose, "Recognizing this implies that the notion of a broad duty of loyalty for management is simply misleading due to problems of verifiability and the fact that no servant can serve the interests of several masters", *Stakeholder Orientation vs. Shareholder Value— A Matter of Contractual Failures*, 18 Issue 1, 86-87 (2004).

[81] Pablo De Andrés Alonso, Valentín Azofra Palenzuela, "…los teóricos del enfoque stakeholders cuentan con el apoyo activo de muchos managers que quieren liberar su poder de decisión de las limitaciones que le imponen el criterio de la búsqueda del valor y su aplicación por los mercados de capitales", "El enfoque multistakeholder de la responsabilidad social corporativa: De la ambigüedad conceptual a la coacción y al intervencionismo". Revue Sciences de Gestion – Management Science – Ciencias de Gestión (ISSN:1634-7056), No. 66, 12 (2008).

[82] Theodore Levitt, The Dangers of Social Responsibility, Harvard Business Review, 42 (1958).

As it has been anticipated, the task of articulating corporate goals and CSR[83] depends to a large extent, on how each of these concepts is understood.

Based on the previous explanation, the following ways of adopting CSR are recognized: *additional, strategic* (instrumental), *constitutive*,[84] among others.[85]

From the first perspective, CSR is considered a policy of product differentiation[86] which, in addition to standard offer, attempts to satisfy an altruist preference of the consumer (for an additional cost).[87] Maybe, the ones that bear corporate-activity costs are not consumers, but employees by accepting lower salaries for working in companies compatible with altruist preferences, or creditors or any other investor through minor rates or returns. It is evident that CSR is not free of charge: an agent related to the Company bears the costs, which could be compensated or not, with the profit obtained from social actions carried out by the corporation. That is to say, the preference of an agent who signs an agreement with a company that adopts CRS actions is not different from any other preference that stimulates the contractual bond.[88] As long as it is the will of an agent to pay his counterparty an amount that has exceeded the cost of the offered service or good, the agreement will probably be reached.

[83] Eric B Rasmusen, *The proper goal of a corporation is an old question in corporate law, most commonly discussed in connection of "social responsibility",* The goals of the corporation under shareholder primacy: just profit— or social responsibility and religious exercise too? Page 6. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2365135.

[84] Lorenzo Sacconi, The Economics of Corporate Social Responsibility, EconomEtica, No. 39, 7 (2012).

[85] Geoffrey P Lantos, For example, Lantos distinguishes three kinds of CSR: ethical, altruistic and strategic: "… there appear to be three mutually exclusive types of CSR based on the nature (required vs optional) and purpose (for stakeholders' good, the firm's good , or both): ethical CSR, altruistic CSR, and strategic CSR", The boundaries of strategic corporate social responsibility, 18 No. 7, The Journal of Consumer Marketing, 605 (2001).

[86] Michael C Jensen, Clifford W. Smith Jr., Competition among organizational forms occurs in numerous dimensions, not only in their pricing and other marketing policies but also, for example, in their investment, financing, compensation, dividend, leasing, insurance, and accounting policies, *Stockholders, manager and creditor interests: Applications of agency theory*, Page 4, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=173461 06-04-2015.

[87] "…la RSE es también una actividad estratégica adicional en la competencia comercial". BOUR, Enrique. "Responsabilidad social de la empresa análisis del concepto". Estudios Económicos Volumen XXIX, No. 59 (N.S.), Departamento de Economía, Universidad Nacional del Sur, 24 (2012).

[88] Robert T Miller, The Coasean Dissolution of Corporate Social Responsibility, 17 No. 2, Chapman Law Review, 383.

We do not disregard that the shareholder is an investor, and as such, he should be willing to assume lower profit. However, this decision may not be his to make; instead it is made by the corporate managers,[89] when the investment has already been made.

From the instrumental perspective, CSR is considered a present strategy within the main corporation activities, but still functional to the traditional goal of profit maximization. Many authors, traditionally identified with the social responsibility movement, could be grouped within this view. They state that CRS actions must not be tested for the respectability of its cause, but for the opportunity to create "shared value" – a benefit for the society and valuable for the business-.[90] In this context, *companies take advantage of the expectations CSR creates in order to obtain competitive advantages.*

Backtracking to the taxonomy outlined at the beginning, we note that both additional and instrumental versions are absolutely compatible with the common interest presumably pursued by the Company[91] and with Friedman`s neoclassical view about purpose of the corporation.[92]
It is not the same with the constitutive view[93]: where CSR is raised to *corporative governance model,* and the corporate goal is the common profit of every relevant stakeholder. The criticism expressed when expounding managers' inability to maximize more than one goal simultaneously, is applicable

[89] Gary Becker, "I am bothered only when managers, founders, or others in control of corporations that behave in a "socially responsible" manner try to pass the cost of behaving in this way on to others rather than bearing the costs themselves", *Do Corporations Have a Social Responsibility Beyond Stockholder Value?*, (May 10, 2016), http://www.becker-posner-blog.com/2005/07/do-corporations-have-a-social-responsibility-beyond-stockholder-value-becker.html.

[90] Michael Porter, Mark Kramer, Strategy and Society: The link between competitive advantage and corporate social responsibility, Harvard Business Review, 6 (2006).

[91] Frank Easterbrook, Daniel Fischel, For most firms the expectation is that the residual risk bearers have contracted for a promise to maximiza long-turn profits of the firm which in turn maximizes the value of their stock, *The economic structure of corporate law*, Harvard University Press, 36.

[92] Markus Kitzmueller, Jay Shimshack, A key insight within economics is that CSR is not necessarily incompatible with profit maximization, at least for a subset of firms within a separating equilibrium. While CSR to satisfy manager preferences may constitute moral hazard, CSR to satisfy nonclassical preferences of investors, employees, and consumers does not. Similarly, CSR to influence outcomes driven by public and private politics may be consistent with shareholder wealth maximization, *Economic Perspectives on Corporate Social Responsibility,* Journal of Economic Literature, 52 (2012), http:www.aeaweb.org/articles.php?doi=10.1257/jel.50.1.51.

[93] Geoffrey P Lantos, "Unlike strategic CSR, where it is belivied that money put into good works will yield a return on investment for the business, with altruistic CSR this is not motive…", The boundaries of strategic corporate social responsibility, 18, The Journal of Consumer Marketing, Nº 7, 609 (2001).

to this case. Nonetheless, it will imply sacrificing profits in the social interest,[94] which was not established by the shareholders. Managers will be in charge of evaluating social needs and they will arrange the firm's resources accordingly. Brushing aside that it is a pluralistic society, what it is considered socially responsible is constantly being re-evaluated.[95]

As a consequence, CSR as a *voluntary process* adopted by the managers, *which implies a sacrifice for the shareholders is unacceptable, since it is incompatible with the corporate objective.*

Together with the significant extension of managers' duties,[96] something that distorts the decision-making mechanism,[97] there is the risk of diluting the main objective of the company. To impose a different responsibility, either social, political or of any other type, will mean a restriction to the property of the shareholders,[98] having the "same effect than a tax imposed to the owners."[99]
In the most radical versions, managers, far from being agents of their principals (the shareholders), become public servants,[100] a kind of judges, who must establish a certain balance[101] between

[94] Forest L Reinhardt, Robert N Stavins, Richard H. K. Vietor, Of course, questions regarding sacrificing profits in the social interest apply beyond the environmental sphere, *Corporate Social Responsibility Through an Economic Lens*, Fondazione Eni Enrico Mattei Note di Lavoro 84.2008 -NBER Working Paper No.13989, 1.
[95] David L Engel, "…it is far from clear that all the values and attitude implicitly affirmed by a process of corporate voluntarism would be desirable", *An Approach to Corporate Social Responsibility*, 32 No. 1, Stanford Law Review, 29 (1979).
[96] Raúl A Etcheverry, Eugenio Xavier De Mello, "Las "Empresas B". Posibilidad de su regulación mediante cambios en el derecho societario". XII Congreso Argentino de Derecho Societario VIII Congreso Iberoamericano de Derecho Societario y de la Empresa, Buenos Aires, 580 (2013).
[97] Norman Barry, "… it would also completely overturn customary methods of decision making in a company and might well make capitalist enterprise imposible", The Stakeholder Concept of Corporate Control Is Illogical and Impractical, 4 No. 4, The Independent Review, 542.
[98] Elaine Sternberg, The Stakeholder Concept: A Mistaken Doctrine, Issue No. 4, Foundation for Business Responsibilities, 31 (1999).
[99] Enrique Bour, Responsabilidad social de la empresa análisis del concepto, Estudios Económicos Volumen XXIX, Nº 59 (N.S.), (2012). Departamento de Economía, Universidad Nacional del Sur. Page 23. En un sentido similar puede citarse: "But if he does this, he is in effect imposing taxes, on the one hand, and deciding how the tax proceeds shall be spent, on the other". Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, The New York Times Magazine, (Oct. 8, 2015), http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html.
[100] Jonathan R Macey, "Creating such a duty transforms the top managers of public companies from private businessmen into unelected and unaccountable public servants", *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, Yale Law School Faculty Scholarship Paper 1713 42 (1991), http://digitalcommons.law.yale.edu/fss_papers/1713.
[101] Geoffrey P Lantos, "Social responsibility is balancing act: business must balance economic performance, ethical performance, and social performance, and the balance must be achieved among various stakeholders", *The boundaries of strategic corporate social responsibility*, 18 No. 7, The Journal of Consumer Marketing, 601 (2001).

contradictory interests of every *stakeholder,*[102] and the implicit faculty for redistributing the profit obtained from the company activities.[103]

Furthermore, it must be analysed whether a company that sacrifices profit (in absence of explicit orientation), would have a chance of surviving on the market.[104] In order to accomplish this task it must be analysed under what conditions a company is able to operate having a different goal from shareholders profit maximization.[105]

According to economic theory, if the corporation operates on a competitive market, its inefficiency (or the implementation of CSR without the result of greater economic benefits) brings adverse consequences and it would probably be expelled from the market.

Instead, existing imperfect competition or state intervention, the profit-maximization goal will not be a requirement for the company survival, and the application of the principle could mean a reduction of social welfare.[106]

Under these circumstances, it is useful to examine whether the correct solution is to adopt CSR paradigm (or stakeholder theory) or to reduce the market imperfections or externalities by means of governmental measures or any other methods considered appropriate.

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[102] Margaret Blair, Lynn A Stout, "Rather, the directors are trustees for the corporation itself—mediating hierarchs whose job is to balance team members' competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together", *A Team Production Theory of Corporate Law*, 85, No. 2, Virginia Law Review, 280-281, (1999).

[103] Stephen M Bainbridge, In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green, 50, Issue 4, Washington & Lee Law Review, 1433 (1993).

[104] George W Dent, There is also evidence that increased "corporate social responsibility" reduces shareholder wealth, Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance, 44 No. 5, Houston Law Review, 1223 (2008).

[105] Forest L Reinhardt, Robert N Stavins, Richard H. K. Vietor, "… the relationship between socially responsable activities and profitability may be best characterized as some firms will generate long-term profits from some socially responsible activities some of the time (Reinhardt 2000)", Corporate Social Responsibility Through an Economic Lens, Fondazione Eni Enrico Mattei Note di Lavoro 84.2008 -NBER Working Paper No. 13989, 14. It would even be very difficult to affirm that there is a causal relationship in those cases in which a better performance of firms with CSR policies is demonstrated over those that do not. See Geoffrey P Lantos, The boundaries of strategic corporate social responsibility, 18 No. 7, The Journal of Consumer Marketing, 620 (2001).

[106] Mark J Roe, Maximizing shareholder wealth where competition is weak, therefore, could plausibly reduce production, raise prices, and lower national wealth, especially if managers when unconstrained value production, sales, and expansion over shareholder profits, The shareholder wealth maximization norm and industrial organization, Harvard Law and Economics Discussion Paper, 16. En sentido similar podemos encontrar: "To be sure, there are circumstances when the value-maximizing criterion does not maximize social welfare—notably, when there are monopolies or "externalities." Michael C Jensen, Value Maximization, *Stakeholder Theory, and the Corporate Objective Function*, 14 No. 3, Journal of Applied Corporate Finance, 11 (2011).

In the same way, it is possible to ask if corporate managers are the best qualified to represent the interests of consumers, creditors, employees and the community as a whole. The answer seems to be in the negative: corporate managers do not appear to have the training (or skills) to fulfill such a task.[107] At any rate, in this study, it was taken for granted that managers are designated by shareholders in order to achieve a different goal.

As regards legitimisation, it must be mentioned that the selection of these public servants has not been completed in a democratic way: surely, by a majority of shareholders, however, not by general public, who will be the receiver of social benefits,[108] after having democratically selected their own rulers from whom they expect a proper behaviour.

Another query on constitutive CSR application revolves around what would happen if it turns into a habitual behaviour. That is to say, if corporations are expected to solve public-interest situations, either, based on efficiency[109]or on the delay in providing solutions by the state. What would be the consequences of generalizing this principle and try to maximize it?

Also, in terms of social welfare, it must be kept in mind that in order to achieve the goal of shareholder value-maximizing, efficiency and innovation will try to be increased, which will have a positive impact on economy, either by means of greater incomes for shareholders, better salaries, or lower prices for consumers.[110]

[107] David L Engel, "…it is persuasively argued that corporate managements, at least as now structured are altogether ill-suited to the job of distributing society's riches", *An Approach to Corporate Social Responsibility*, 32 No. 1, Stanford Law Review, 30 (1979).
[108] Ernest Dale, If managers really begin to function in this way, all the various parties at interest, and the general public, may well begin to ask for a voice in selecting them. It is contrary to all democratic tradition for constituents to have no say in the selection of their representatives and no way of calling them to account, Management Must be Made Accountable, Harv. Bus. Rev., 49 (1960). Richard Marens, *We Don't Need You Anymore: Corporate Social Responsibilities, Executive Class Interests, and Solving Mizruchi and Hirschman's Paradox*, 35 No. 4, Seattle University Law Review, 1218 (2012).
[109] David P Baron, Firms may be more efficient in the provision of social good than are the organizations to which personal gifts are made. Corporate giving, however, may go to causes opposed by shareholders, in which case personal giving, which can be targeted to selected social causes, may be preferred, Corporate Social Responsibility and Social Entrepreneurship, No. 1916, Stanford Graduete School of Business Research paper, 30.
[110] George W Dent, Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance, 44 No. 5, Houston Law Review, 1271 (2008). En un mismo sentido podemos citar: "…maximizing profits for equity investors

Lastly, the degree of decentralization of ESR (Entrepreneur Social Responsibility), carried out by each firm, will be a serious issue in the achievement of social interests since no mechanism of coordination of activities is outlined.[111]

VI. CONCLUSION

Corporations are neither responsible for all the world's problems, nor do they have the resources to solve them all[112]

In this study it was attempted to articulate CSR perspective with the possible conflict that could appear between shareholders and stakeholders, advising about the risks of adopting those versions described as extreme.

Corporate efficiency is not achieved by altering the corporation intrinsic functioning, but allowing it for creating value for its shareholders and growing economically.[113] The state must assume regulatory and control roles in compliance with the law of their concern, in order to protect those groups in need, or to stimulate certain behaviours to the detriment of others, to move forward towards social welfare.

The truth is, the application of CSR in many opportunities, boosts a cost that seems to be assumed by the shareholders, through a decision of the managers they selected themselves. A question that must be asked is, what would happen in case, during the management-body authority-designation

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assits the other "constituencies" automatically". Frank Easterbrook, Daniel Fischel, The economic structure of corporate law, Harvard University Press, 38.

111 "Un punto no menor del argumento es el grado de conocimiento y coordinación de los empresarios para cumplir con las supuestas RSE. Descentralización de las decisiones y RSE son objetivos incompatibles entre sí". Enrique Bour, Responsabilidad social de la empresa análisis del concepto, Estudios Económicos, Departamento de Economía, Universidad Nacional del Sur, Volumen XXIX, No. 59 (N.S.), 23 (2012).

112 Michael Porter, Mark Kramer, Strategy and Society: The link between competitive advantage and corporate social responsibility, Harvard Business Review, 13 (2006).

113 Diego Duprat, Responsabilidad social de la empresa, La Ley, 15-5-2009.

meeting, managers anticipated their CSR plan or their future philanthropic actions using someone else´s money? Would they still be selected by the capital owners?

Corporate interest distortion, unlimited extension of managers´ duties (with the consequent difficulty for management assessment)[114] and, in conclusion, the alteration of the role of the company on the market[115] must be the limits upon using Corparate Social Responsibility perspective.

[114] Ronald Bénabou, Jean Tirole, It may also weaken managerial accountability by creating multiple objectives and performance criteria; at the extreme, too many missions amount to no mission at all, Individual and Corporate Social Responsibility, 77 No. 305, Economica, 15 (2010).

[115] Robert Cooter, Hans-Bernd Schäfer, "… a market for organizations keeps them focused in making money, so owned organizations play the central role in economic life. In contrast, unowned organizations that focus on goals other than making money play the central role in government, religion and social life.", Solomon's Knot. How Law Can End the Poverty of Nations, Princenton University Press, New Jersey, 125 (2012).

COST & BENEFIT ANALYSIS OF THE UNITED STATES' WITHDRAWAL FROM THE PARIS AGREEMENT

- *Carolina Arlota*[*]

I. INTRODUCTION

What are the benefits and costs associated with the United States withdrawing from the Paris Agreement on climate change? This note approaches this question focusing on the advantages and disadvantages for the United States while considering its global impact and the moral dimensions involved. This work is unique, because it considers this United States' controversial decision from this law and economics perspective. This note also advances our understanding about membership in the Paris Accord, as it compares the United States' withdrawal with the engagement of India.

Scientific consensus relates climate change to global warming, which has among its human-induced causes the accumulation of greenhouse gases (GHG) in the atmosphere.[1]The United Nations Framework Convention on Climate Change (UNFCCC), an international agreement signed at the Rio Earth Summit 92 and which entered into force in 1994, aimed at the stabilization of greenhouse gas emissions.[2] In 2015, the Twenty First Conference of Parties of the United Nations Framework Convention on Climate Change enacted the Paris Agreement.[3] This Accord aims at containing the rising of the global average temperature to well below 2C

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[1]For an overview about the Paris Accord: Izzet Ari and Ramazan Sari, *Differentiation of Developed and Developing Countries for the Paris Agreement,* 18 ENERGY STRATEGY REVIEWS 175, 175-176 (2017).

[2]The full text of the United Nations Framework Convention on Climate Change (UNFCCC),https://unfccc.int/resource/docs/convkp/conveng.pdf

[3]The scientific consensus regarding the existence of climate change and necessity of mitigation was a relevant part of discussion at the UNFCCC. JOHN HOUGHTON, SCIENCE AND INTERNATIONAL ENVIRONMENTAL POLICY: THE INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE (Cambridge University Press 2009);RICHARD REVESZ, PHILIPPE SANDS and RICHARD STEWART, *in* ENVIRONMENTAL LAW, THE ECONOMY AND SUSTAINABLE DEVELOPMENT 355-357 (Cambridge University Press 2001).

above pre-industrial levels, while advancing efforts to cap the temperature increase to 1.5 C above pre-industrial levels.[4] The United States has been actively involved in the negotiation and approval of the Paris Agreement, with former President Obama calling it a tribute to American leadership.[5]

In June 2017, President Trump announced that the United States would be "getting out" of the Paris Climate Accord.[6] Former President Obama wasted no time, and fiercely defended the Agreement.[7] The United States' withdrawal, which will only be effective in 2020,[8] has been a contentious topic even before its official announcement by President Trump, due to the goals of the Paris Agreement, namely, to reduce greenhouse gases in the atmosphere. Despite the general scientific consensus referred above, some U.S. politicians remain skeptical about the existence of global warming itself.[9] Notwithstanding this skepticism, CEOs of major U.S. companies[10] and

[4]Article 2 of the Paris Accord determines: (1). This Agreement, in enhancing the implementation of the Convention, including its objective, aims to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty, including by: (a) Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change. The full text of the Paris Accord can be found at: https://unfccc.int/sites/default/files/english_paris_agreement.pdf.

[5]The White House, Office of the Press Secretary, Statement by the President on the Paris Climate Agreement (Dec. 12, 2015), available at: https://obamawhitehouse.archives.gov/the-press-office/2015/12/12/us-leadership-and-historic-paris-agreement-combat-climate-change. It is noteworthy that U.S. leadership during the Obama years used soft power, with the installation, in 2008, of air quality monitors in the U.S. embassy in Beijing and tweeting about the data. Hence, for the first time in China there was public available information about the levels of dangerous pollutants and they were tweeting about it. See: David Roberts, *How the U.S. Embassy Tweeted to Clear Beijing's Air,* Wired Opinion (Jun. 3, 2015).

[6]Donald Trump, Statement by President Trump on the Paris Climate Accord (Jun. 01st, 2017), available at: https://www.whitehouse.gov/briefings-statements/statement-president-trump-paris-climate-accord/.

[7]Philip Rucker and Jenna Johnson, Trump Announces U.S. will leave Paris Climate Deal, Sparking Criticism at Home and Abroad , The Washington Post, Sept. 5, 2017, also stressing that Rex Tillerson, the U.S. Secretary of State at the time, was against the withdrawing: https://www.washingtonpost.com/politics/trump-to-announce-us-will-exit-paris-climate-deal/2017/06/01/fbcb0196-46da-11e7-bcde-.

[8]In accordance with the timeframe determined by Article 28 of the Paris Accord, *supra* note 4.

[9]President Trump, in a Tweeter dating from November 06, 2012, called climate change a "hoax" invented by China to undermine the competitiveness of U.S. manufacturing. The tweet is available on line at the following link: https://twitter.com/realDonaldTrump/status/265895292191248385.

[10]Some of the major U.S. companies are active in trying to revert the effect of the U.S. withdrawal: Richard Luscombe, Top U.S. firms including Walmart and Ford oppose Trump on Climate Change (Dec. 1, 2017); https://www.theguardian.com/environment/2017/dec/01/trump-climate-change-paris-withdrawal-ford-walmart jobs?utm_campaign=SocialFlow&utm_source=Twitter&utm_medium=AP_Politics.

members of both political parties have criticized the withdrawal.[11] European leaders strongly condemned President Trumps' decision.[12]

Adding to the controversy is the nature of climate change itself as a collective problem. This is the case, because the benefits of carbon abatement cannot be restricted to those who contributed to it; nor will climate change affect only those who contribute to create it. Following this line of reasoning, the involved parties have incentives to free ride.[13] Climate change governance, thus, is notoriously difficult. The challenges are exacerbated because of the division of powers in the international system, with top-down bargaining not being a realistic course of action.[14] In addition, cognitive uncertainty about the feasibility of achieving policy outcomes, such as lowering carbon emissions, at acceptable costs contribute to increase difficulty when bargaining.[15]

In light of the above, this note contends that the United States' withdrawal from the Paris Accord is not aligned with cost-benefit analysis grounded on the normative use of economics.[16] Hence, this note builds on the notion of cost-benefit analysis being used to improve the environment,[17] while also considering wealth maximization. In this vein, the normative utility of cost-benefit analysis is present, by clarifying governments' choices, making those more transparent as it aims to isolate government's decisions from interest-group politics.[18]

[11]Rucker and Johnson, *supra* note 2.
[12]In a joint statement, German Chancellor Angela Merkel, Italian Prime Minister Paolo Gentiloni and French President Macron firmly rebutted President Trump's intention to renegotiate the Paris agreement, stating the following: "We deem the momentum generated in Paris in December 2015 irreversible, and we firmly believe that the Paris agreement cannot be renegotiated, since it is a vital instrument for our planet, societies and economies." This joint statement is available at: https://www.theguardian.com/environment/2017/jun/01/trump-withdraw-paris-climate-deal-world-leaders-react.

[13]MICHAEL J. TREBILCOCK, DEALING WITH LOSERS: THE POLITICAL ECONOMY OF POLICY TRANSITION 120 (Oxford University Press 2014).
[14]Charles F. Sabel and David G.Victor, *Governing Global Problems Under Uncertainty: Making Bottom-up Climate Policy Work*, 144 Climate Change, 15, 18 (2017).
[15]*Id.*
[16]Cost-benefit analysis as a regulatory tool has different meanings ranging from the normative use of economics to criterion of wealth maximization when evaluating a particular policy: RICHARD A. POSNER, ECONOMICS ANALYSIS OF LAW402-403 (2007).
[17]RICHARD R. REVESZ, AND MICHAEL LIVERMORE, RETAKING RATIONALITY: HOW COST-BENEFIT ANALYSIS CAN BETTER PROTECT THE ENVIRONMENT AND OUR HEALTH (2008).
[18]Posner, *supra* note 16, at 402-403.

Focusing on assessing the benefits and costs of the policy choice of withdrawing, this research clarifies how President's Trump choice abruptly departs from the previous administration with regard to reasoned regulatory action. It also illustrates how the withdrawal is unlikely to produce winners in the medium and long runs. U.S. enterprises, consumers and citizens, generally, will have to coop with a polluted environment by coal industries longer than needed, and without getting benefits for themselves. This note briefly contrasts the United States position with the paradigmatic Indian case, as India pledged to significantly reduce its emissions in accordance with the targets of its 2016 ratification of the Paris Accord.[19] The comparison is meaningful, because India is the fourth country in absolute number of emissions, with the United States being the second.[20]

This note is organized as follows: Part I examines a few considerations on why the United States' withdrawal is not maximizing the overall wellbeing of its population, focusing on the cost considerations associated with it. Part II contends that moral considerations should be also factor in this analysis. It also addresses two specific climate change principles which are based on moral concepts: the precautionary principle, and intra-and-inter-generational equity. This note concludes that the United States' withdrawal of the Paris Accord is costly on traditional considerations and when moral considerations are factored in. It also contrasts the United States example with India, a country which moved from reluctant signatory to active member of the Accord.[21]

[19]Kumar Sambhav Shrivastava, India Ratifies Paris Climate Treaty, Hindustan Times (Oct 3, 2016), and available at: htttps://www.hindustantimes.com/india-news/what-signing-the-paris-climate-change-treaty-means-for-india/story-RsDH1IAohQNEqRxb426YbM.html.

[20]*Id.*

[21]For an overview of India's journey from reluctant signatory of the Paris Agreement to its embracement: Ben Westscott, Reluctant Signatory India Takes Moral High-Ground on Paris Climate Deal: CNN (Jun. 2,2017), and available at: https://www.cnn.com/2017/06/02/asia/india-paris-agreement-trump/index.html.

II. SOME CONSIDERATIONS ON THE COSTS ASSOCIATED WITH THE UNITED STATES' WITHDRAWAL FROM THE PARIS AGREEMENT

This article is grounded on the general law economic assumption – and particular cost-benefit analysis' tenet – that regulation should aim at achieving the overall well-being rather than economical efficiency.[22]Importantly, cost-benefit analysis, as a technique, is not mandatory to all administration policies, because it carries its own costs.[23] Regarding international treaties, cost-benefit analysis method is often deemed as not mandatory, due to the explicit exception for foreign affairs.[24] It is noteworthy that the goal of this note is not to discuss the existence of the Paris Agreement itself, but to assess the extent that the current administration made a reasoned decision.[25]

Unregulated competitive markets can generate excessive amounts of air and water pollution, wastes, hazardous materials and other forms of environmental degradation.[26] These market failures tend to be significantly more serious than those addressed by economic regulation, justifying strong regulatory measures.[27]

From a regulatory perspective, administrative action needs to be reasoned.The consideration of costs being informative of the decision, however, is a nuanced claim that has been argued

[22]MATTHEW D. ADLER & ERIC A. POSNER, NEW FOUNDATIONS OF COST-BENEFIT ANALYSIS (2006), at 25.
[23]At the federal level, cost-benefit analysis, as a technique, is traditionally required in all polices that are classified, for instance, as significant regulatory action according to section 3, f, of the Executive Order 12866, of September 30, 1993, Federal Register Vol. 58, N. 190. This provision defines significant regulatory action as one that has an annual effect on the economy of $100 million or more. This provision was supplemented by Section 1(b) of the Executive Order 13563: *The White House Press Release on the Executive Order 13563: Improving regulation and Regulatory Review* (January 18, 2011), available at: https://obamawhitehouse.archives.gov/the-press-office/2011/01/18/executive-order-13563-improving-regulation-and-regulatory-review.
[24]§4, a , of the Executive Order 13771: *Presidential Executive Order on Reducing Regulation and Controlling Regulatory Costs* (January 30, 2017), available at: https://www.whitehouse.gov/presidential-actions/presidential-executive-order-reducing-regulation-controlling-regulatory-costs/.
[25]The White House, Office of the Press Secretary, Statement by the President on the Paris Climate Agreement (Dec. 12, 2015), *supra* note 5.
[26]Richard Stewart, Economic Incentives for Environmental Protection: Opportunities and Obstacles, *in* Environmental Law, the Economy and Sustainable Development, ed. Richard Revesz, Philippe Sands and Richard Stewart, Cambridge (2001), at 172.
[27]*Id.*

theoretically and in context outside the international arena.[28] In this line of reasoning, deregulation, namely, the choice of removing regulations which are in place in a particular market needs to be reasoned. This reasoning does not need to be exhaustive, but it has to inform the administrative action, generally. Stating it differently, where regulatory norms exist, the administration is required to justify the need for extinguishing those previous rules. The rationale is that those same rules, which the new admiration is aiming to abolish, were deemed necessary by the previous administration.[29]

In a decision involving environmental and administrative law, *Michigan v. EPA,* the United States Supreme Court determined that cost consideration is required not only by the statutory scheme at bar, but by principles of administrative law.[30]After *Michigan,* administrative regulatory action is only authorized if costs are considered, and remarkably: "no regulation is appropriate if it does significantly more harm than good."[31]Extrapolating this quote for presidential action, this note argues that the assessment of advantages and disadvantages of a particular deregulation (or regulation) is necessary, despite being in the international field.

On a related note,[32] cost is a relational concept, namely, it is not abstractly defined. Hence, the administration needs to determine whose interest are made a cost to whom in reasoned decision-making.[33]

In light of the above, this note looked at the actual costs of the withdrawal from the Paris Agreement. It turns out, however, that the economical impact of President Trump's withdrawal on the economy, on the environment and on the U.S. society, more generally, is difficult to

[28]Daniel Hamel, Jonathan Masur and Eric Posner, How Antonin Scalia's Ghost Could Block Donald Trump's Wall, *The New York Times* (Jan. 25, 2017).
[29]*Id.*
[30]Michigan v. EPA, 135 S. Ct. 2699 (2015), at 2707-2708.
[31]Justice Scalia, writing for the majority in *Michigan v. EPA, supra* note 18, at 2707.
[32]Arguing that the decision of the United States Supreme Court failed to consider cost as a relational concept (thus not clearly distinguishing cost determination and cost quantification,) which ultimately led to unduly extension of judicial review of administrative action: Daniele Bertolini and Carolina Arlota, *Michigan v. EPA: Cost/Rationality Nexus Clarified*, 29 FOURD. ENV. L. REV. 125, 155 (2017).
[33]For the explanation of cost as a relational concept: WARREN J. SAMUELS, STEVEN J. MEDEMA & A. ALLAN SCHMID, THE ECONOMY AS A PROCESS OF VALUATION (1997).

estimate, because of the multitude of factors involved,[34] particularly in light of the non-reasoned approach that the federal administration is leading in many areas. For instance, if a trade war with China continues, emission may be reduced, whereas if the President actually succeeds in making U.S. economy expanding 5%, or 6% emissions will likely increase.[35]

Another factor contributing to the difficulties on assessing President Trump's decision is the fact that several states of the U.S., led by California and New York, are setting their own limits regarding greenhouse gases.[36] In this scenario, the costs of the withdrawal are particularly difficult to estimate. As it happens with climate change, there is no consensus to when and in what amount such costs will precisely occur.[37]

The precise reasons why President Trump decided to withdraw from the Paris Agreement are unclear. He justified his decision based on economic motivation, such as protecting U.S. economy, particularly U.S. jobs. Alternative motivations abound, as his campaign counted with substantial contributions from oil tycoons.[38] This is quite problematic, considering that President Obama clearly judged that the agreement benefitted the United States, "with more jobs and economic growth driven by low-carbon investment."[39] His understanding was also in tuned with the European Union policy regarding climate change. After all, Europe is concerned with this

[34]Following President Trump's withdrawal of the Paris Agreement, some German interest groups on automobiles expressed concerns about the competitiveness of their product in relation to those produced in the United States. *See:* Edward Taylor, *German Carmakers Fear Losing Competitive Edge After U.S. Paris Exit*, Reuters (2017), available at: https://www.reuters.com/article/us-usa-climatechange-german-carmakers-idUSKBN18T1Q0.

[35]Kate Larsen *et al.*, *Taking Stock 2017: Trump's Regulatory Rollback Begin*, The Rhodium Group (March 27, 2017): https://rhg.com/research/trumps-regulatory-rollback-begins/.

[36]Thirty four U.S. states have committed, so far, to reduce global warming impact despite President Trump's withdrawal. See: Chelsea Harvey, *Trump's Domestic War on Climate Action Has Propelled States into Battle,* Project Earth (Apr. 07, 2017), and available at: https://projectearth.us/trumps-domestic-war-on-climate-action-has-propelled-sta-17964231238.

[37]ERIC POSNER AND ALAN O. SYKES, ECONOMIC FOUNDATIONS OF INTERNATIONAL LAW 230 (2013).

[38]Linking President Trump, the Vice-President Mike Pence and the chief of the Environmental Protection Agency – EPA, to oil tycoons Koch brothers: Jane Mayer, *In the Withdrawal from the Paris Climate Agreement, the Koch Brothers' Campaign becomes Overt,* The New Yorker (Jun. 05, 2017).

[39]The White House, Office of the Press Secretary, Statement by the President on the Paris Climate Agreement (Dec. 12, 2015), *supra* note 5.

topic as well as with technology, because it understands that to remain competitive, it needs to be in the forefront of science and renewable energy.[40]

President Trump mentioned, in his decision-announcement speech, that the United States "will withdraw from the Paris Climate Accord but begins negotiations to reenter either the Paris Accord or a really entirely new transaction on terms that are fair to the United States, its business, its workers, its people, its tax payers."[41] The President further stated that the agreement "disadvantages the United States to the exclusive benefit of other countries," while emphasizing that U.S. taxpayers would have to absorb the costs of lower wages, lost jobs, closed factories and a diminished economy.[42] Importantly, the data cited by President Trump belongs to a discredited study.[43]

Economists were fast in rebut the arguments exposed by President Trump in his announcement of the withdrawal. Those experts contend that rescinding the Paris Agreement will actually aggravate the problem, because jobs which might be preserved by the President's decision, such as those in coal and oil and gas industries, will not be created in other renewable-energy industries.[44] Increasing the costs of the new presidential policy is the fact that jobs under clean energy industries will also attract more investment, in a virtuous circle. Should the U.S. remain investing in traditional non-clean energy, the country will also have to cope with the consequences of climate change itself.

[40]Miranda Schreurs, *The European Union and the Paris Climate Agreement: Moving Forward without the United States*, 15 Chinese Journal of Population Resources and Environment, 192 (2017).
[41]Donald Trump, Statement by President Trump on the Paris Climate Accord (Jun. 01st, 2017), available at: https://www.whitehouse.gov/briefings-statements/statement-president-trump-paris-climate-accord/
Importantly, European leaders denied that there will be such renegotiation. On this point, *supra* note 12.
[42]*Id.*
[43]President Trump referred to the study made by NERA Economic Consulting. Among the main flaws of the study is the fact that only the costs of compliance with the Paris Accord were factored in; no benefits were considered. See: Jon Greenberg, *Fact-checking Donald Trump's statement withdrawing from the Paris climate agreement*, Politifact (Jun. 1, 2017), available at: http:///truth-o-meter/article/2017/jun/01/fact-checking-donald-trumps-statement-withdrawing-/
[44]Rolf Färe, Shawna Grosskopf, Carl A. Pasurka, and Ronald J. Shadbegian."Environmental Regulatory Rigidity and Employment in the Electric Power Sector." In *Does Regulation Kill Jobs?*, University of Pennsylvania Press (Coglianese Cary, Finkel Adam M., and Carrigan Christophereds), 89-108, (2013).

Importantly, it has been argued that the Paris Agreement does not cost net jobs, because coal jobs are in sharply decline while renewable energy is the principal job creator in the energy field.[45] Clean energy enabled the Obama administration to lower greenhouse gas emissions to 1994 levels, while managing to create 11.3 million jobs.[46]

It is noteworthy that the Paris Agreement, which has the support of significant economical actors, such as Exxon Mobil, Walmart, Apple, Shell, General Electric, aims at curbing the effects of global warming thus reducing uncertainty.[47] Any uncertainty, of course, makes business decisions more complex. In an open letter to President Trump, more than thirty U.S. CEOs urged him to remain in the Paris Agreement.[48] Modernization, competitiveness, predictability were among the core justifications alluded in the letter.[49] In this context, a withdrawal may signal that United States companies have lost government support and regulatory certainty.[50]

In its official communication, the U.S. State Department stated that the country's withdrawal of the Paris Agreement, and emphasized that the United States will remain working to reduce its emissions.[51] The text sounded contradictory, because it implies that the Paris Agreement was not in the benefit of U.S. workers, companies and taxpayers, generally.[52] The communication stressed that the United States supports a balanced approach to climate policy, and this equilibrium reconciles lowering emissions with economic growth and energy security.[53]Economic growth and

[45]Peter Haas, *Parxit, the United States, and the World*, 15 Chinese Journal of Population, Resources, and the Environment (2017), 186, at 188.
[46]Gina McCarthy, *If Trump Dumps the Paris Accord, China will Rule the Energy Future,* Foreign Policy (May 31, 2017).
[47]Paul Wisman, *Analysts: Leaving Climate Deal likely wouldn't add U.S. jobs,* AP News (Jun. 01, 2017),https://apnews.com/f89a55b6fcd0428eab02a6f41b24776b/Analysts:-Leaving-climate-deal-likely-wouldn't-add-US-jobs?utm_campaign=SocialFlow&utm_source=Twitter&utm_medium=AP_Politics
[48]The B Team, *CEOS of Major U.S. Companies Urge Trump to Stay in Paris: Mr. President we are writing to express our strong support for the U.S. remaining in the Paris Climate Agreement* (May 10, 20017), and available at: http://www.bteam.org/announcements/30-major-ceos-call-on-trump-stay-in-paris/
[49]*Id.*
[50]Luke Kempt , *Better Out than In*, 7 Nature Climate Change, 458 (2017) at 459, where the author explains that the United States had pledged to contribute US$3 billion, albeit having paid US$1billion so far.
[51]U.S. Department of State, *Communication Regarding the Intent to Withdraw from the Paris Agreement*, (August 7, 2017), available at: https://www.state.gov/r/pa/prs/ps/2017/08/273050.htm
[52]*Id.* The communication states the following: "As the President indicated in his June 1 announcement and subsequently, he is open to re-engaging in the Paris Agreement if the United States can identify terms that are more favorable to it, its businesses, its workers, its people, and its taxpayers."
[53]*Id.*

preserving the environment are not necessarily exclusionary goals, as the UNFCC treaty exemplifies.[54]

On a related point, international treaties aiming at curbing the effects of climate change need to include developing nations. The challenge is that government in those countries face increasing pressure to achieve economic prosperity, frequently at the expense of the environment.[55] More recently, the unlikely progress on renewable energy has displaced the once dominant assumption that economic growth and increasing greenhouse gas emissions must be tied.[56] India is a great example in its transition from a reluctant member in the Paris Agreement to a vocal member in checking the compliance of developed countries, in particular, with their Paris' targets.[57]

The prospects for compliance with the Paris Agreement with the U.S. withdrawal remain unsettled. It is perceived as undermining the legitimacy of the agreement and jeopardizing the effectiveness of climate change governance.[58] It may be that countries will decide to join and comply more effectively with the voluntary nature with the agreement. Or countries may decline to be bound to their targets. The India's ratification of the Paris Accord, despite the potential withdrawing of the United States, provides evidence of the first alternative.

In addition, commentators have argued that the U.S. withdrawal means more than relinquishment of its leadership, as it will ultimately enable China to become the leading player in the energy sector.[59] Experts differ about the weight of the United States' exit. Some have even argued that it might have a positive side.[60] The majority contends, however, that leadership is crucial to expand

[54] *Supra* notes 2 and 3.
[55] For a discussion about conflicting policy choices: Andrew Watson Samaan, *Enforcement of International Environmental Treaties: At Analysis*, 5 Fordham Environmental Law Review 261, 272 (2011).
[56] Brian Deese, *Paris isn't Burning: Why the Climate Agreement Will Survive Trump*, Foreign Affairs (Jul. 2017), available at: https://www.foreignaffairs.com/articles/2017-05-22/paris-isnt-burning
[57] Westscott, Reluctant Signatory India Takes Moral High-Ground on Paris Climate Deal, *supra* note 21.
[58] Zhang Hai-Bin *et al.*, *U.S. Withdrawal from the Paris Agreement: Reasons, impacts, and China's response*, 8 Advances in Climate Change Research 220 (2017), at 222.
[59] Gina McCarthy, *If Trump Dumps the Paris Accord, China will Rule the Energy Future,* Foreign Policy (May 31, 2017).
[60] Kempt , *Better Out than In*, *supra* note 50, at 460.

cooperation beyond Paris, because this Agreement was designed to be very flexible and accommodating of new challenges, including the U.S. withdrawal.[61]

The current U.S. policy sends a terrible precedent for the other nations. It may also contribute to discredit general U.S. climate change negotiation, because it is not the first time that the U.S, withdraws from an international agreement.[62] Hence, it may disturb the process of global climate cooperation.[63] An effective mechanism to foster compliance with international treaties is negative publicity.[64] If negative reputation has been used to pressure countries to comply with international instruments, generally, it may also be the case the U.S. will be subject to this negative repercussion.

The United States' decision also contributes to potential anti-U.S. sentiments, due to the potential free-riding of the United States over signatory nations. With the withdrawal, the United States gain more emission space and reduces mitigation costs while "squeezing other countries emission space and raising their mitigation costs."[65] As addressed earlier, the United States, under President Trump, aims at free-riding. This aim, of course, has significant consequences.

On a related note, the United States' rescission will significantly undermine the financial contribution to climate change. The Paris Agreement establishes a new system for the responsibilities of developed and developing countries, but the treaty does not define which countries belong to the former or to the latter.[66] Article 4 of the Paris Agreement determines that developed counties should remain leading the way through absolute emission reduction targets, developing countries should reduce their emissions in accordance with different national

[61]David G.Victor, *Order from Chaos: America exits the Climate Stage*, Brookings Institution (Jun. 01, 2017), at: https://www.brookings.edu/blog/order-from-chaos/2017/06/01/america-exits-the-climate-stage/

[62]In 2001, before the Kyoto Protocol entered into force, the U.S. withdrew, based on a Senate resolution arguing that the principle of differentiated responsibilities was not in the U.S. domestic interest: Delali Benjamin K. Dovie and Shuaib Lwasa, *Correlating negotiation hotspot issues, Paris Climate Agreement and the international climate policy regime*, 77 Environmental Science and Policy 1 (2017), at 2. On that occasion, European governments opted for expanding the Protocol.

[63]Hai-Bin *et al.*, *supra* note 58, at 223.

[64]Andrew Watson Samaan, *Enforcement of International Environmental Treaties: At Analysis*, 5 Fordham Environmental Law Review (2011), 261, at 274.

[65]Hai-Bin *et al.*, *supra* note 58, at 222.

[66]Izzet Ari and Ramazan Sari, *Differentiation of Developed and Developing Countries for the Paris Agreement,* 18 Energy Strategy Reviews 175 (2017), at 175.

circumstances.[67] Because of the collective action nature of climate change itself, as addressed in the introduction, all counties – not only the United States – will be affected by its withdrawal.

Under the principle of common but differentiated responsibility, developed countries provide climate financing to less developed countries.[68]In his speech, President Trump stressed that the United States would also cease any contribution for the Green Climate Fund.[69] Importantly, the United States contribution is critical for the Accord, as many developing countries have made their national determined contribution and conditional targets upon securing public funding from developed countries.[70]The uncertainty involving specific scientific effects of climate change abound. Nevertheless, there is a high likelihood that developing nations will suffer more climate change inflicted harms than those of the developed world.[71] Developed countries not only have more resources, they are also located in the north hemisphere, where temperatures are temperate.[72]

The scenario above is also potentially dire if one were to consider that President Trump's decision may cost the world a window of opportunity when it comes to climate change mitigation especially with research showing that the ten years after the agreement were crucial for achieving the targets.[73]

The President stressed that China and India would be allowed to build additional coal plants while the U.S. could not increase its emissions.[74] This is not technically accurate. According to the Paris Agreement, all countries are obligated to establish a target and to report and assess their progress towards such target within two years after signing; and later every five years. President

[67]According to article 4, item 4, of the United Nations Framework Convention on Climate Change: conference of the Parties (Paris, December 12, 2015), available on line at: https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf
[68]Hai-Bin *et al.*, *supra* note 58, at 222.
[69]Donald Trump, Statement by President Trump on the Paris Climate Accord (Jun. 01st, 2017), available at: https://www.whitehouse.gov/briefings-statements/statement-president-trump-paris-climate-accord/
[70]Kempt , *Better Out than in, supra* note 50, at 458.
[71]ERIC POSNER AND ALAN O. SYKES, ECONOMIC FOUNDATIONS OF INTERNATIONAL LAW (2013), at 231-232, where the authors remark that Russia will gain with climate change.
[72]*Id.*
[73]Hai-Bin *et al.*, *supra* note 58, at 223.
[74]Donald Trump, Statement by President Trump on the Paris Climate Accord (Jun. 01st, 2017), available at: ttps://www.whitehouse.gov/briefings-statements/statement-president-trump-paris-climate-accord/

Trump mentioned that the Agreement was an intrusion in the United States' sovereignty and that over time it will only have higher targets, and that United States needed to "unlocking the restrictions on America's abundant energy reserves."[75]

The Paris Agreement encourages countries to review their targets, under the assumption that countries will become more ambitious over time, despite not imposing sanctions.[76] On that note, countries now see the benefits of adopting clean energy industries and thus will likely increase their targets in order to profit from sound clean energy policies.[77] India, itself, is a paradigmatic example.[78]This, however, will not be the United States experience should the withdrawing remains the final decision.

A relevant point regarding countries' review of their targets refers to external monitoring. Countries review their own targets (and overall progress) and those of other members, with global and national civil society as well as public opinion scrutinizing them.[79] Despite emissions by country being quite different, "the inclusivity of the agreement motivates each country to scrutinize the performance of others. When participation rates in social dilemmas are very high or very low, both stigma and honor are maximized for deviant behavior."[80]

Another consideration referring to reputation is the damage caused to United States leadership. The withdrawal from the Paris Accord could turn the United States into a climate pariah, providing an unprecedented opportunity to China or the European Union to boost their international reputations and soft power.[81]

The United States withdrawal reasoning also departs from the understanding that international treaties aiming at curbing the effects of climate change need to include developing nations. And,

[75]Donald Trump, Statement by President Trump on the Paris Climate Accord (Jun. 01st, 2017), available at: https://www.whitehouse.gov/briefings-statements/statement-president-trump-paris-climate-accord/
[76]Hai-Bin *et al.*, *supra* note 58, at 223.
[77]*Id.*
[78]Annie Gowen and Simon Denyer, As U.S. Backs Away from Climate Pledges, India and China Step Up, Washington Post (Jun.1, 2017).
[79]Jennifer Jacquet and Dale Jamieson, Soft but Significant Power in the Paris Agreement, 6 Nature Climate Change, 643 (2016) at 644.
[80]*Id.,* at 645.
[81]Kempt , *supra* note 50, at 460.

in order to do so, they may have different targets for developed and developing countries. The challenge is that government in developing countries face increasing pressure to achieve economic prosperity, frequently at the expense of the environment.[82] In this sense, the India's ratification of the Paris Agreement shows that the country is not perpetuating this stereotype. Importantly, it shows that the country is attentive to the benefits of renewable energy for their economy. After all, the unlikely progress on renewable energy has displaced the once dominant assumption that economic growth and increasing greenhouse gas emissions must be proportional.[83]

Considering all the factors above, this note argues that the United States withdrawing from the Paris Agreement on Climate Change has more disadvantages then advantages for the United States in the medium and long runs, to the extent that limited benefits that might be achieved immediately will be for the coal-industry. Even if it is the case, as examined earlier, it will be for a short period of time. Because a corollary of the economic analysis of law is the comparison with additional policy choices, including not regulating or not modifying the status quo,[84] President Trump's decision does not promote well-being of U.S. citizens. Moreover, it reduces the country's influence in the international arena, which take several years to recover, and may itself prove detrimental to immediate trade considerations, for instance.

III. MORAL DIMENSIONS WHICH SHALL BE FACTORED IN THE ANALYSIS

This section resorts to the theoretical framework of cost-benefit analysis focusing on its moral dimension to assess the impact of the United States' withdrawal. The previous sections of this note demonstrated that traditional cost-benefit analysis validly concludes that the withdrawal did not maximize overall well-being of Americans nor of global citizens. This section contends that even if it were not the case, i.e., even when economic factors do not lead to a clear answer, the moral

[82]For a discussion about conflicting policy choices: Andrew Watson Samaan, *Enforcement of International Environmental Treaties: At Analysis*, 5 Fordham Environmental Law Review 261, 272 (2011).
[83]Deese, *supra* note 56.
[84]DAVID L. WEIMER AND AIDAN R. VINING, POLICY ANALYSIS: CONCEPTS AND PRACTICE 404 (2017).

aspect of a given policy shall also be factored. Hence, this research is aligned with the modern trend which argues that cost-benefit analysis shall not be blind-folded to moral considerations.[85]

In this context, moral considerations should be a part of cost-benefit analysis and may justify the enactment of a particular policy when the benefits do not outweigh the costs, because there are non-monetized factors involved.[86] There may also be non-quantifiable features in a particular time.[87] It has been argued that moral considerations may justify the enactment of environmental, safety or health regulations in cases where the immediate benefits measured under cost-benefit analysis do not outweigh the costs.[88] As Professor Steven Kelman emphasizes:

"Precisely because we fail, for whatever reasons, to give life-saving the value in everyday personal decisions that we in some general terms believe we should give it, we may wish our social decisions to provide us the occasion to display the reverence for life that we espouse but do not always show. By this view, people do not have fixed unambiguous "preferences" to which they give expression through private activities and which therefore should be given expression in public decisions. Rather, they may have what they themselves regard as "higher" and "lower" preferences. The latter may come to the fore in private decisions, but people may want the former to come to the fore in public decisions. They may sometimes display racial prejudice, but support antidiscrimination laws. They may buy a certain product after seeing a seductive ad, but be skeptical enough of advertising to want the government to keep a close eye on it. In such cases, the use of private behavior to impute the values that should be entered for public decisions, as is done by using willingness to pay in private transactions, commits grievous offense against a view of the behavior of the citizen that is deeply engrained in our democratic tradition. It is a view that

[85]References are made to:Steven Kelman, *Cost-Benefit Analysis: An Ethical Critique*, 5 REGULATION 33, 40 (1981); Martha Nussbaum, *The Costs of Tragedy: Some Moral Limits of Cost-Benefit Analysis*, 29 J. LEGAL STUD. 1005, 1035 (2000).
[86]Kelman, *supra* note 85, at 33.
[87]Emphasizing that surveys of self-reported well-being are relevant and produce helpful information, despite not being possible to "map" the regulatory impact in well-being scales: Cass R. Sunstein, *Cost-Benefit Analysis, Who's Your Daddy?*, 7 J. BENEFIT COST. ANAL. 107, 107-120 (2016).
[88]Kelman, *supra* note 85, at 33.

denudes politics of any independent role in society, reducing it to a mechanistic, mimicking recalculation based on private behavior."[89]

In light of the above, political action – and administrative action, in particular – shall not be conducted as it were private behavior. The stakes are higher. So must be the considerations reflecting the values of our society.

A close argument in support of moral considerations to cost-benefit analysis on the membership in the Climate Change Agreement is the principle of common but differentiated responsibilities and respective capabilities (CBDRRC).[90] According to this principle, which still binds the United States because it remains a party in the UNFCCC,[91] responsibility for current and historical contributions need to be factored. In this context, the accusations by President Trump are not sound, because developing states have contributed less to the current concentration of greenhouse gases and overall threshold on carbon saturation.

Importantly, cost-benefit analysis can "actually help us when we are in doubt about where to set the threshold of citizen's basic entitlements. . . . More generally all rights have costs, so thinking about where to set the threshold level of any right is sensibly done with these costs in mind." [92]

In such context, it is noteworthy to discuss two climate change principles which carry moral considerations. Those principles derive from the nature of the protection, namely, the common good and the no limitation of boundaries if damages are incurred. This note address, thus, the following climate change principles which have a moral orientation, are difficult to be monetized and pertain to International Law: the precautionary principle and the intra-and-inter-generational equity.

[89]Kelman, *supra* note 85, at 37.http://unfccc.int/tools_xml/country_US.html
[90]Article 3 (1) of the UNFCCC determines that: "The Parties should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities."
[91]Confirming the U.S. membership in the UNFCC Treaty: http://unfccc.int/tools_xml/country_US.html
[92]Nussbaum, *supra* note 85.

The precautionary principle is stated at Article 3 (3), of the United Nations Framework Convention on Climate Change (UNFCCC), and determines that parties should take precautionary measures to anticipate, prevent or minimize the causes of climate change, mitigate its adverse effects, while emphasizing that lack of scientific certainty should not be used to postpone such measures where threats of serious or irreversible damage exist.[93] The same provision states that policies and measures to deal with climate change should be cost-effective in order to ensure global benefits at the lowest possible costs.[94]

In this scenario, and to extent that the United States remains a party to the UNFCCC, the United States is obligated, under international law, to reduce emissions of greenhouse gases (GHS), whose impacts are notoriously difficult to reverse. This is a controversial claim, because some commentators would argue that precaution needs also cost-effectiveness and is not a binary all or nothing approach, but a spectrum.[95]

This note contends, however, that the precautionary principle would at least oblige the United States to achieve its voluntary quota under the Paris Accord. This the case, because this note interprets the precautionary principle as having another manifestation, namely, the prohibition of setbacks. Countries, on this view, should not be moving backwards in climate change matters. After all, in the case of climate policy, precaution would largely be applicable to limit old technologies, such as fossil fuels.[96] Moreover, effective policy-making is based on the assessment of complete policy impacts, including ancillary costs as well as ancillary benefits.[97]More significantly, perhaps, is that we may be beyond precaution now, as "we probably blew past our

[93]Article 3 (3) of the United Nations Framework Convention on Climate Change (UNFCCC): https://unfccc.int/resource/docs/convkp/conveng.pdf
[94]*Id.*
[95]Jonathan B. Weiner, Precaution and Climate Change, in The Oxford Handbook of International Climate Change Law, ed. Cinnamon P. Carlarne, Kevin R. Gray, Richard G. Tarasofsky (2016), at 166-168.
[96]*Id.,* at 170.
[97]*Id.,* at 171. For an in-depth discussion about ancillary harms and benefits (co-benefits), see: Revesz, and Michael Livermore, Retaking Rationality: How Cost-benefit Analysis can Better Protect the Environment and Our Health, supra.

precautionary opportunity sometime in the 1980's. We are now, and have been for some time, in a post-cautionary world."[98]

The principle of intra-and-inter-generational equity is defined in the first part of article 3 (1) of the UNFCC.[99] This principle defines rights and obligations regarding the use and enjoyment of natural and cultural resources, inherited by the present generation and to be passed on to future generations in no worse condition than received.[100] The legal force of this principle is disputed, but it should be consider among the factors that will inform policy decisions regarding climate change.[101]

International human rights bodies have consistently contended that environmental harm can adversely affect the enjoyment of human rights.[102] The right to life can be threaten by natural events attributed to climate change, namely: floods, storms, droughts, hunger, malnutrition, scarcity of water, proliferation of tropical deceases, such as malaria; the right to housing is also affected, due to forced misplacement, among others.[103] Because climate change is a type of environmental harm, human rights obligations that are applicable "in the context of environmental harm generally should apply to climate change as well."[104] Moreover, the regressive nature of carbon-pricing lead costs to be borne by consumers and, thus, those with lower income who spend proportionally more on non-discretionary goods and services will be more affected.[105]

IV. CONCLUSION

[98]Lisa Heinzerling, *Climate Change, Human Health, and the Post-Cautionary Principle*, 96 Georgetown Law Journal, 455, at 452.
[99]Article 3 (1) of the UNFCCC determines that: "The Parties should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities."
[100]Catherine Redgwell, Principles and Emerging Norms in International Law: Intra-and-Inter-generational Equity, *in* The Oxford Handbook of International Climate Change Law, ed. Cinnamon P. Carlarne, Kevin R. Gray, Richard G. Tarasofsky (2016), at 188.
[101]*Id.,* at 195-196.
[102]John H. Knox, Human Rights Principles and Climate Change, *in* The Oxford Handbook of International Climate Change Law, ed. Cinnamon P. Carlarne, Kevin R. Gray, Richard G. Tarasofsky (2016), at 217.
[103]*Id.,* at 219.
[104]*Id.,* at 220.
[105]Trebilcock, *supra* note 13, at 121.

This note considered some of the many relevant factors on why the United States' withdrawal is not maximizing the overall wellbeing of its population, focusing on the cost considerations associated with it. In addition, this research clarified how President's Trump choice abruptly departs from the previous administration with regard to reasoned regulatory action.

Furthermore, this note argued that the moral dimensions should also be part of such analysis, while addressing two specific climate change principles which are based on moral concepts, namely, the precautionary principle, and intra-and-inter-generational equity. This note contained that, once this moral perspective is included, the costs of the United States' withdrawal become even more significant.

The assessment of the benefits and costs of the policy illustrates how the withdrawal is unlikely to produce winners in the medium and long runs. U.S. enterprises, consumers and citizens, generally, will have to coop with a polluted environment by coal industries longer than needed, and without getting benefits for themselves. This note briefly contrasts the United States position with the paradigmatic case of India.

In conclusion, the United States' withdrawal of the Paris Accord is costly on traditional considerations, without benefits on the medium nor the long run. If moral considerations are factored in the analysis, the costs are even higher. The United States' withdrawal sharply contrasts with India, a country which moved from reluctant signatory to active member of the Accord and recent leader on climate change policy. Hence, the United States choice of withdrawing from the Paris Agreement should not have occurred. From this normative approach, the United States not only should have remained in the Accord, it should have continue to be a leading force on reducing carbon emissions and mitigating the impacts of climate change.

OPTIMAL MAGNITUDE AND PROBABILITY OF FINES WHEN COURTS DISLIKE PUNISHMENT

- *Nuno Garoupa*[*]

I. INTRODUCTION

The proposition that crime rates respond to risks and benefits is called the deterrence hypothesis in the economic literature. It asserts that individuals respond significantly to the incentives created by the criminal justice system. If so, increasing the resources that society devotes to the arrest, prosecution, conviction, and punishment of criminals will reduce the amount and social cost of crime.

Suppose that there is a particular offense that we wish to deter, say, illegal parking or a specific unlicensed activity. It might be possible to eliminate them, or very nearly eliminate them, by imposing a severe punishment with high probability. However, deterring illegal parking or unlicensed activities in this way may run into a cost problem. Apprehending, prosecuting, and punishing offenders can be significantly expensive. Policy-makers need to balance these costs against the advantages of reducing illegal parking (Garoupa 1997, Polinsky and Shavell 2000).[1]

In this essay, we reconsider the high fine-low probability result by Becker (1968): When deciding whether or not to commit an act, an individual compares the benefit from the act with the expected punishment.[2] The expected punishment is given by the probability of detection and

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[1] Garoupa, N., 1997. The theory of optimal law enforcement, Journal of Economic Surveys 11, 267-295.
Polinsky, A. M., and Shavell, S., 2000. The economic theory of public enforcement of law, Journal of Economic Literature 38, 45-77.

[2] Becker, G. S., 1968. Crime and punishment: an economic approach, Journal of Political Economy 76, 169-217.

punishment times a monetary sanction. A fine is a costless transfer from the convicted offender to the government. In contrast, detection is expensive. Consequently, the government should set the fine equal to an offender's entire wealth and complement it with the appropriate probability in order to achieve optimal deterrence. This high fine-low probability result suggests the following corollary: If the agents' wealth goes up, the government should increase the sanction and, at the same time, reduce the probability of detection. That way the government still provides for optimal deterrence, but saves resources on law enforcement.

I have already shown that this intuitive corollary (the substitutability between fine and probability) only holds if the social optimum involves nearly or is close to full deterrence.[3] If there is substantial under-deterrence (the expected fine is significantly less than the social damage caused by the offense), then there is a complementary relationship between the two variables. When the fine goes up, so should the probability of detection.

In order to understand this result, consider a rather extreme case where the agent's wealth is zero. In this case, fines are zero and the deterrent value is zero. Thus, it makes absolutely no sense to spend money on enforcement. When wealth goes up, so do fines. Now it becomes worthwhile for the government to engage in some detection and punishment.

As a consequence, we have a complementary relationship between fine and probability when there is substantial under-deterrence (alternatively, when offenders are poor and monetary sanctions are very low). This contrasts with the conventional substitutability which holds if the expected sanction is close to the social damage caused by the offense (that is, when offenders are wealthy and monetary sanctions are severe).

The standard analysis implicitly assumes that courts are willing to implement Beckerian fines. Suppose, however, that courts dislike severe punishment. Maximal sanctions could induce a countervailing effect. Courts might opt for acquittal rather than punishment with an extremely

[3] Garoupa, N., 2001. Optimal magnitude and probability of fine, European Economic Review 45, 1765-1771.

severe punishment. They could also consider conviction for a less severe crime in order to modulate the magnitude of punishment. Clearly, in these situations, severe punishment is no longer effective. Fines should be lower to take into account court preferences. The impact on the probability follows the analysis of 2001 study.[4]

A numerical example can illustrate the insight of the present analysis. Suppose a particular crime generates harm of 100. The maximal sanction is 2,000. Under the multiplier principle (which eliminates under-deterrence), the probability should be 5%. However, notice that the optimal probability should be less than 5% due to enforcement costs. In a world where courts dislike punishment and can opt for acquittal rather than conviction, the maximal sanction cannot be effectively implemented. Let us assume that the maximal sanction courts are willing to implement is 500. Under the multiplier principle, now the probability should be 20%. We show in this essay, following my 2001 study, that the optimal probability could be less than 10% due to enforcement costs. When such result occurs, not only the severity of punishment goes down due to court preferences, but the probability also goes down in order to maximize social welfare. As a consequence, we can say that when courts dislike punishment, substantive under-deterrence can take place.

The essay is organized as follows: the result is formally derived in section two; applications and final remarks are addressed in sections three and four respectively.

II. THE MODEL

Risk-neutral individuals choose whether or not to commit an act that benefits the actor by b and harms the rest of society by h. The policy-maker does not know any individual's b but knows the distribution of parties by type described by a general density function $g(b)$ with support $[0, \infty)$, a cumulative distribution $G(b)$. Some acts are socially beneficial: $h < \infty$.

[4] Id.

The government chooses a sanction *f*and a probability of detection and conviction *p*. The expenditure on detection and conviction to achieve a probability *p* is given by *x(p)*, where *x'>0* and *x"≤0*. The maximum feasible sanction is *F*, which can be interpreted as the maximum wealth of individuals. We further assume that the sanction is costless to impose and collect.

The objective function to be maximized is the sum of individuals' benefits minus the harm caused by their acts and enforcement costs (Polinsky and Shavell, 2000).[5]

Risk-neutral individuals commit an offense if and only if *b≥pf*. Given each individual's decision to be honest or dishonest, social welfare is:

$$W = \int_{pf}^{\infty} (b - h) dG(b) - x(p)$$

The government maximizes the welfare function with respect to *f* (severity of punishment) and *p* (probability of punishment)subject to $f \leq F$. We study non-trivial solutions. Therefore, we ignore the following constraints: $f \geq 0$ and $0 \leq p \leq 1$. We assume that these constraints are not binding. The public sector budget is financed by lump-sum taxation.

Proposition 1

(1) The optimal fine is the maximal fine*F*.
(2) The optimal probability of detection and conviction *p**satisfies *F (h- p*F) g(p*F)= x'(p*)*.
(3) Some underdeterrence is optimal: *p*F < h*.

[5] Polinsky, A. M., and Shavell, S., 2000. The economic theory of public enforcement of law, Journal of Economic Literature 38, 45-77.

Proof of Proposition 1

See Garoupa (2001). QED

This proposition formally introduces Becker's argument.

Suppose now that courts are not willing to enforce a fine higher that F'. In other words, if the optimal fine is more than F', courts will prefer acquittal rather than conviction.[6]

Proposition 2

(1) The optimal fine is the sanctionpreferred by the court and equals F'.
(2) The optimal probability of detection and conviction p' satisfies $F'(h-p'F')\,g(p'F')=x'(p')$.
(3) Some underdeterrence is still optimal: $p'F'<h$.

Proof of Proposition 2

Suppose the government sets the maximal fine F. Then courts will acquit criminals and social welfare will be minimal, with expected fine equal to zero. As consequence, by the same reasoning of Proposition 1, the optimal fine should be F' and the probability adjusts appropriately. QED

The distaste for severe punishment exhibited by courts forces formal sanctions down. The remaining question is the extent to which the probability goes up to compensate. More fundamentally, is p^* more or less than p'?

We know from Garoupa (2001) that the optimal probability is not necessarily monotonically decreasing in the fine. Suppose for a moment that the marginal cost of punishment is zero. We know that $p^*F=p'F'=h$. Therefore, when the marginal cost of punishment is zero, it is necessarily

[6] This is a model of law enforcement with false negatives. Unlike previous literature (Polinsky and Shavell, 2000) where false negatives are exogenous, in this version they are endogenous to the sanctioning policy.

the case that $p^*<p'$. By the same reasoning, in order for $p^*>p'$ to be a serious possibility, it has to be the case that the value of the marginal cost of punishment is significantly relevant. As in Garoupa (2001), that could be the consequence of a reduction in fine making detection relatively more expensive.[7]

If the original fine is high, the level of deterrence is also high and the difference between full internalization of harm and optimal deterrence is small. When the fine is reduced, the probability p should increase, achieving the same deterrence level but at higher enforcement costs. This is Becker's trade-off.

However, if the new fine is very small, the level of deterrence is very low. In this case, a decrease in the fine diminishes substantially the value of deterrence for any given probability and thus makes it more profitable to simply reduce p. Thus, in this range of parameters, the probability and magnitude of fines are complements rather than substitutes.

Summing-up, when courts dislike punishment, we might observe a reduction of severity (due to court preferences) and probability of punishment (due to technology costs) at the same time.
Consider now the following the extension of the model. Suppose that only a fraction β of courts is not willing to enforce a fine higher that F'. In other words, if the optimal fine is more than F', a fraction β of courts will prefer acquittal rather than conviction.

For a moment, let us consider the case where enforcement is costless. By construction, we know that the expected sanction equals harm. Therefore, the government has to pick one of the following two solutions:

(a) Solution A: the fine equals F' and the probability is simply h/F'.

[7] Mathematically, under Proposition 2, notice that the marginal cost $x'(p)$ is divided by $g(pf)f$.

(b) Solution B: the fine equals *F,* the average fine is *(1-β)F* due to the remaining *β* courts setting a zero fine and the probability is *h/(1-β)F*.

Proposition 3

When enforcement is costless,

(1) The government is indifferent between solution A and solution B.

(2) The optimal probability of detection is lower under solution Aiff *β> 1- F'/F*.

(3) There is full deterrence.

Proof of Proposition 3

Since enforcement is costless and both solutions guarantee that expected sanction equals harm, they are equivalent. The difference between the probabilities of detection is determined by *F'* and *(1-β)F*.

If the fraction of courts disliking punishment is high, *F'* is greater than *(1-β)F*and therefore the probability is lower under solution A. The converse takes place if the fraction of courts disliking punishment is low. QED

We can offer an immediate interpretation of the main insight. Suppose, initially, a lot of courts dislike punishment (that is, β is close to one). Then solution A is more appropriate, with a less severe sanction given by *F'* (lower than F) and a lower probability given by *h/F'*. As time goes by, let us imagine that the government packs courts with judges who like punishment or suppose announcing tougher law enforcement induces a self-selection pattern by which people who like punishment are more willing to become judges (that is, β gets closer to zero). At some point, the threshold *1- F'/F* is crossed. Now solution B is more appropriate. A maximal sanction should be imposed (even though a small fraction β will deviate and acquit offenders). The probability is given by *h/(1-β)F*.

Another way of looking at our suggested interpretation is to say that as more and more courts dislike punishment, sanctions go down and probability goes up, initially as function of β and later is simply given by *h/F'*.

Once enforcement is costly, the results are more cumbersome since optimal probabilities should take into account enforcement costs. However, we can develop the basic intuition. For a moment, let us assume that full deterrence is still optimal. The government should favor solution A when the probability is lower, namely, when *F'* is greater than *(1-β)F*. The government should favor solution B otherwise.

As probabilities need to be adjusted for incomplete deterrence as shown by Proposition 2, following Garoupa (2001), the optimal policy is necessarily more nuanced. In fact, let us define the pair <*p',p"*> as the following implicit probabilities:

$$F'(h-p'F')\,g(p'F') = x'(p') \qquad (1)$$

$$(1-\beta)F\,(h-p''(1-\beta)F)\,g(p''(1-\beta)F) = x'(p'') \qquad (2)$$

We can write that *p'* is above *p"* when the left-hand-side of (1) is higher than the left-hand-side of (2). The left-hand sides measure the marginal gain from enhancing the probability of punishment given a specific marginal cost measure by *x'(p)*. In fact, by equalizing both left-hand sides of (1) and (2), we derive an implicit threshold for β taking into account that enforcement is costly.

Let us illustrate the specific trade-off with a simple linear example. The enforcement cost function is given by x(p)=xp and assume the type are described by a uniform distribution with support [0,1], with h<1 so that some acts are socially beneficial. From (1) and (2), we derive the following results:

$$p' = h/F' - x/F'^2$$

$$p'' = h/(1-\beta)F - x/(1-\beta)^2F^2$$

The fundamental exercise is easy to understand. When the sanction is *(1-β)F,* rather than*F',* should we expect the probability to go up or down? The answer depends on two distinct effects. The first

piece, as we have seen before in Proposition 3, is how *(1-β)F* relates to *F'*. The second concern is the substitutability of severity and probability of punishment following Garoupa (2001).

III. APPLICATIONS

There are important applications of the simple model developed in this article. First, reform of criminal law cannot ignore the willingness of courts to impose tougher sanctions. Under our analysis, severe sanctions could induce more acquittals thus undermining reforms that enhance law enforcement. Second, the results suggest a significant concern about the political economy of criminal sanctions. A prevalence of liberal judges opposing severe punishment coupled with a government favoring tougher law enforcement might force a reduction in probability and severity of punishment at the same time. Third, judicial preferences can undermine sentencing guidelines and other mandatory sentencing policies in ways that are detrimental for criminal deterrence.

Another area of application of these results is regulation. A divergence between regulators and courts concerning appropriate sanctions might diminish not only effective regulatory penalties but also the incentives for regulatory enforcement. When regulators are more demanding than courts we might end up with lower sanctions and lower probabilities if there is significant under-deterrence. In fact, our analysis suggests that the experience of regulatory decisions being reversed by courts frequently as we have observed in a few jurisdictions cannot be addressed or solved by escalating sanctions.

IV. CONCLUSION

In this essay, we have observed that when courts dislike punishment, sanctions naturally go down. We have also argued that the trade-off between probability and severity of punishment may not be consistent with optimal law enforcement when there is substantial under-deterrence. When sanctions are sufficiently large, we approach complete deterrence (the negative externality is fully internalized). By decreasing the fine, we must increase the probability achieving the same

deterrence level but with more significant enforcement costs. However, when sanctions are low, we have substantial under-deterrence. By reducing fines, we should also decrease the probability making further losses in deterrence.

TOWARDS PRECISE NORMS FOR LAND ACQUISITION IN DEVELOPING COUNTRIES

- *Hans-Bernd Schäfer*[*]

I. INTRODUCTION

We relate the law and economics discussion of precise legal rules versus broad and information-intensive legal standards to the impact of the law on economic development and to economic and political features of low and middle-income countries in general and to how land acquisition law work in this setting. We review the conceptual differences between rules and standards. Next, we relate our findings to taking law in developing countries, where clear rules often serve the purpose of the law better than standards. We describe how the perspective on eminent domain power has been shifting since the 1950s, when developed economics regard powerful planning by the state as the most important agent of economic development, to present day views, which are dramatically different and in which "land grabbing" by the government has become paradigmatic of misguided economic development. We support clear and precise rules regulating eminent domain power. The rationale for such rules is pervasive as they cut into individual rights. But for many developing countries additional reasons for precise rules exist.

II. RULES VERSUS STANDARDS

Kaplow (1992) introduced the categorization of legal norms as either rules or standards. Rules are crystal clear legal commands. They are blueprints for action and allow for mechanical legal decisions. Standards, by contrast, are complex and often mission-oriented norms with a vagueness resulting from a wide range of possible interpretations. A per se norm in competition law is a rule, a rule of reason in the same field is a standard. A speed limit for motor vehicles is a rule, negligence in tort law is a standard.

(1) The costs of establishing and maintaining a body of law consist of the fixed costs of norm specification, e.g. drafting and issuing a statute, which are independent of the number of legal cases, and the variable costs of adjudication and/or administration. A legal statute consisting

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of imprecise standards clearly economizes on the costs of norm specification at the expense of high costs of norm application and adjudication, whereas a statute consisting of precise rules entails high costs of norm specification but lower costs of adjudication. Rules with high costs of norm specification but low costs of norm adjudication generate lower total costs if the number of cases is high. In areas of the law, in which cases are numerous and repetitive, rules should be preferred over standards.

(2) While the costs of norm specification are paid by the state, i.e. the tax payer, most of the costs of adjudication – court fees and lawyers' fees, costs for witnesses and expertise– are borne by the parties. Thus, the choice between rules and standards determines to what extent either the parties or the taxpayers are burdened with the costs. High costs of adjudication especially deter consumers, employees or citizens from taking action against the state. Administrative acts often cut into the interests and rights of individuals. Precise rules, which reduce the costs of seeking justice, then facilitate access to administrative courts.

(3) A country's average level of expertise of judges and civil servants tends to correlate with its per-capita income. Low income countries will likely have fewer well-trained judges, civil servants and experts with a good understanding of the legal and societal problems to which a body of law is directed. In such countries, a law which requires subtle understanding and reasoning might overtax the capacities of many civil servants and judges. General standards are fact-intensive legal norms that require fact finding, data processing and relating the facts to the teleology of the law. The decision process is lengthy and fraught with potential mistakes, avoiding which will require all the expertise and training of the decision-makers. With poorly trained judges and administrators, legal standards then lead not only to relatively high variable costs of applying the law but also to more mistakes, with adverse effects on society. This gives rise to a tendency to concentrate the scarce human capital at the top of the legal system for the drafting and amending of precise norms whose adjudication or administration is relatively easy.[1]

(4) Poor decisions on the part of judges and regulators can result not only from insufficient training but also from a lack of independence or from corruption. This is another reason to prefer rules over standards in many low-income countries. Decisions which violate rules are more easily observed and criticized than decisions which violate information-intensive standards. A critical press, civil society organizations or internal controllerswill have more trouble criticizing a public decision based on the subtle interpretation of a standard than one which violates a clear rule. If, in violation of a rule forbidding him to do so, a manager sells

[1] H.B. Schäfer,*Rules versus standards in rich and poor countries: Precise legal norms as substitutes for human capital in low-income countries,* 14 Sup. Ct. Econ., 113-134 (2006).

the company's products to himselfand gets away with it,that situation is much more easily observed than if the manager were entitled to such sales but were bound by fiduciary duties.

(5) Rules reduce the power of independent courts. This however does not imply a general interest of the executive and parliament in precise norms. On the contrary, a state whose regulatory laws interfere with individual interests, entitlements and constitutional rights might prefer standards and vague norms to expand the decision power of its administration.The German constitution (Grundgesetz) requires legal clarity (Normenklarheit) and legal definiteness (Bestimmtheit) of any sub-constitutional regulatory law that affects fundamental constitutional rights. State intervention in rights is possible for legitimate policy aims such as public health, consumer protection and the environment if the intensity of the intervention corresponds to the level of precision of the infringing rules (Regelungsdichte).[2] This should precisely delimitate the authority of the administration and enable lower administrative courts to check with little information whether an administrative act affecting individual rights is compatible with the law. If a legal norm does not pass this test, the constitutional court will uplift the norm for being too vague.

III. CHANGING VIEWS ON EMINENT DOMAIN POWER

The coercive taking of private property – mainly of land and mostly of agricultural land – is a legal instrument in all countries. Takings cut into private property, conceptually an absolute right which protects the owner against anyone else including the state. In most countries, property is also a fundamental human right[3] and not a privilege to be given and taken by a ruler, even though the term "eminent domain " (from medieval Latin "dominium eminens" meaning "supreme lordship") in common law countries points to tribal and feudal origins of property rights for land and the prerogative of a duke or king.[4] The economic rationale for takings evolves from hold-up positions, which arise if the government or a private investor requires a large and contiguous piece of land for a project like a railway or a production site, land which is currently owned by

[2] Maunz/Dürig/Grzeszick, *im Wert- und Anspruchssystem des Grundgesetzes,* VI. Rn. 105-106 (2008). This implies a prohibition of delegation from parliament to the administration. Parliament must regulate the essential points in the law and cannot shift the decisions to the administration. See especially the decision by the German Constitutional Court on this matter. BVerfGE 49, 89, 126 ff. (insb. Rn. 12, 68, 70 ff.).

[3] Property is a human right in all 47 member countries of the Council of Europe. India is a counterexample: Private property is not included in the list of fundamental rights stipulated in Part 3 of the Indian constitution.

[4] F.R. Herber, *On the Importance of Expropriation in the Roman Empire and in Modern Europe*, 11(1) European Scientific Journal , 5 (2015): No such origin in tribal land law can be found in classical Roman law, which became formative for civil law countries. In republican and imperial Rome, the taking of land was an "ultima ratio" used only after intensive efforts to buy the land. At the zenith of his power, Emperor Augustus shied away from takings for public buildings in Rome.

many individual parties. In such a situation, a voluntary sale of each lot is often not possible or unreasonably difficult. Therefore, constitutions allow takings for the public welfare or public purposes if fair compensation is paid. In many developing countries, taking may occur without due procedure, with ample discretion for the bureaucracy, by outsourcing the taking decisions to private firms, without temporary relief, without constitutional review and in return for compensation far below a damage award in civil law cases. This is not to mention the cases of outright land grabbing, where individuals whose legal entitlements are ill defined are displaced without any compensation at all – a problem which is beyond the scope of this paper.

An important economic reason for taking laws and practices that gave ample discretion to developing country administrations was the influential theory of state-led economic development, which dominated development economics from the 1950s to the 1980s. From the 1940s onwards, many newly independent African and Asian countries, as well as several Latin American countries, implemented various types of socialism and planning. It was in this political environment that development economics emerged as an academic discipline. In the 1940s-50s, many of its most prominent scholars taught that developing countries needed state leadership of the economy.[5]These theories maintained that a market economy might be good for rich countries but that in poor countries, free markets would create so many deviations from the workable market model that the state should lead the economy. Development theory diagnosed a whole Olympus of market failures in poor countries, ranging from increasing returns to scale and natural monopoly via unbalanced growth to the necessity of a state-led big push. Moreover, such market failures were also attributed to linkages that are positive spill overs between firms not internalized by prices as well as dualistic economies with wages differing from the opportunity costs of labour. These considerations fuelled the demand for a strong government hand to plan the economy. In a planned or mixed economy, the legal protection of private property is inevitably weaker than in a market economy. The state must have planning capacity and the taking of private property by the state must be relatively easy to promote economic development. This view contributed to "property" being removed as a fundamental right from the Indian constitution in 1978.[6]

[5] The economist and Nobel laureate Gunnar Myrdal captured the spirit of development economics in the 1950s as follows: "The most important change in state policies in underdeveloped countries is the common understanding that they should each and all have a national economic development policy… Indeed it is also universally urged that each of them should have an overall, integrated national plan. All underdeveloped countries are now attempting to provide themselves with such a plan, except a few that have not yet been reached by the Great Awakening." G. Myrdal ,*Economic Theory and Underdeveloped Countries*. London: Duckworth (1957).

[6] N. WAHI, THE HANDBOOK OF THE INDIAN CONSTITUTION (Oxford University Press 2016).

Development economics was also influential before the rise of public choice economics and institutional economics, both of which look at state action with a cold eye. It was a widespread view that government is an agent for salutary change, not motivated by profits or self-interested, and that agencies and offices need ample discretion to handle selfish landowners. While development economics is now no longer the dominant paradigm pertaining to developing countries, the legal structures supporting a planned or mixed economy are still in place in many developing countries.

However, the last three decades have seen a dramatic shift in public opinion. The focus of attention is no longer the "selfish property owner" but rather the individual displaced by the grabbing hand of the state.[7] Cernea (2000) has estimated the number of people who lost their homes in the 1990s at 90 to 100 million. In some countries, large infrastructure projects such as dams, ports and airports have displaced almost 1 per cent of the population, especially in China and Africa.[8] It is estimated that in the four decades after the country's independence, 20 million people were displaced in India (Cernea 2000).[9] This displacement was then followed by the liberalisation of the Indian economy. This signalled a shift from a state-led growth model to one where the market economy was decentralised. India also followed the change in the public opinion, where the mindset shifted from socialist to that of protecting the individual. This required a change in law as well, where the law of eminent domain had to factor in stronger private property protection.

IV. THE CASE FOR RULE-BASED TAKING LAWS IN DEVELOPING COUNTRIES

A) EASIER AND CHEAPER ACCESS TO COURTS

Since taking cuts deeply into a personal and fundamental right, the legal basis for the administration to expropriate land should be as precise as possible without questioning the rationale for takings. This reduces the administration's leeway and scope for arbitrary decisions. It also renders the decisions of administrative courts simpler, less information-intensive and thus cheaper, reducing the obstacles to civic action against the state. While these two rationales for

[7] Ilya Somin, *Controlling the Grasping Hand: Economic Development Takings after Kelo* ,Sup. Ct. Econ. Rev.183 (2016).

[8] A. Azuela and C. Herrera, *Taking Land Around the World: International Trends in the Expropriation for Urban and Infrastructure Project* 2 Lincoln Institute of Land Policy, Working Paper 2 (2007).

[9] M.M. Cernea, *Risks, Safeguards and Reconstruction: A Model for Population Displacement and Resettlement*, In M.M. Cernea and C. McDowell (eds.) *Risk and Construction: Experiences of Settlers and Refugees*. Washington DC: World Bank, 2 (2000).

precise taking norms apply in all countries, the argument carries even more weight in poor countries. The affected parties are often small farmers with little income. As argued before, the choice between rules and standards influences – in opposite directions – the costs of norm adjudication, which are borne largely by private parties, and the costs of norm specification, which fall on the taxpayer. Taking law in the shape of rules rather than standards gives greater incentives to poor people to fight against wilful government decisions as the legal fees will be relatively low. This argument is further enhanced if we take into account the so-called and much discussed "urban bias" of development politics. In developing countries, the rural population is large and therefore difficult to organize, much like consumer interests. Urban interests are better organized and represented in the political system. Publicly administrated wealth transfers from the traditional sector to the modern sector and from the rural to the urban population are therefore a pervasive feature of the political systems in many developing countries.[10] Farmers are particularly vulnerable in this public choice constellation and require protection against systematic government discrimination.

B) MANY CASES OF TAKING IN DEVELOPING COUNTRIES

We saw above that the economic rationale for rules rather than standards increases with the number of cases. Statistics on takings are almost non-existent because takings are decided locally and the statistics are not aggregated to the national level.[11] Yet we may be certain that developing countries feature a much greater number of expropriation cases than rich countries, for two reasons: Firstly, population growth in rich countries is much slower on average, which means there is less need to adapt the infrastructure – railways, ports, airports, utilities, universities etc. Secondly, many low and middle income countries, notably China and India, have faster per capita income growth, which also leads to more taking decisions for public and private projects. With more instances of taking in developing countries, the fixed costs of norm specification are spread over more cases, so – other things being equal – rule-based taking laws are to be preferred.

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[10] D.J. Bezemer and D. Headey, *Agriculture, Development and Urban Bias* World Development 36(8): 1342-1364 (2008).; M. Lipton *Why poor people stay poor: urban bias in world development*, Cambridge: Harvard UP(1977).; H.B. Schäfer, *LandwirtschaftlicheAkkumulationslasten und industrielleEntwicklung*, Springer (1982). The urban bias against agriculture, which was first criticized by the French physiocrat François Quesnay, has persisted since the times of mercantilism. Paradigmatic examples include communism under Stalin, peronism in Argentina, the government of Nkrumah in Ghana, and many other African countries, which systematically favoured urban life through cheap food prices, export taxes on agricultural products and many other discriminating state interventions at the expense of traditional agriculture. Ruthless takings and land grabbing are widespread contemporary examples of the urban bias.

[11] A. Azuela and C. Herrera, *Taking Land Around the World: International Trends in the Expropriation for Urban and Infrastructure Project* 2 Lincoln Institute of Land Policy, Working Paper 2 (2007).

C) PRECISE RULES REDUCE INCOMPETENT AND CORRUPT TAKING DECISIONS

The advantages of strict rules discussed above apply to many developing countries. Taking decisions based on vague norms like "economic development" require expert knowledge of cost-benefit-analysis or other economic expertise about weighing interests, which judges in developing countries often lack. It is more cost efficient to concentrate this scarce expertise in the design of precise but still reasonably efficient rules than to try to enable all administrative courts to take good decisions on the basis of vague standards. Also, administrative courts are often not fully independent of state influence. While telephone justice as in totalitarian countries, where public officials instruct judges, is in fact rare, we do see more subtle types of influence in many countries.[12] Law enforcement may be in the hands of local governments rather than courts, leading to delayed enforcement if the government does not agree with the court decision. Judges may be removed from a case by a political decision, they may only be appointed for a limited term or their pension may be questioned. A local government might deny low-cost housing to a judge. In such an environment, rules have an obvious advantage over standards because judicial non-compliance with rules is easily observable whereas non-compliance with standards is not. A critical press and organizations of the civil society can react to court decisions that violate precise rules. The use of rules can therefore serve to offset the tendency for governments to capture administrative courts.

Similar arguments in favour of precise norms apply when judges are corrupt. Superior officials and inspectors, the public and civil society organisations can observe violations of a rule more easily than a deviation from the loyal interpretation of a standard, so corrupt judges are more easily named, shamed or punished.

D) SOME PROPOSALS FOR CLEAR AND PRECISE TAKING LAW IN DEVELOPING COUNTRIES

a. Expropriation only after serious attempts to buy the land

If land acquisition was not permitted, public projects would automatically be situated in areas where ownership of land is lower. This is because in places where there is widespread private

[12] World Bank, World Development Report 2002, Building Institutions for Markets, Ch. 6, The Judicial System, 116.

ownership of land, the acquisition of land without resorting to expropriation would have the largest number of roadblocks. Taking laws should still require that serious efforts are made to buy the land at market value and that the coercive transfer of ownership remains the state's last resort. Methods that at least partially preserve the voluntary character of the transaction include a bid for the land that becomes effective if a supermajority of the owners accept.[13]

b. Expropriation only for clearly specified purposes

Following the rationale of choosing rules over standards in the taking laws of developing countries, the law should clearly define the public benefit from takings. This recommendation would entail dramatic changes in many countries. For instance, the Chinese state can easily remove land use rights. The public interest is defined neither in the Chinese constitution nor in statutory or case law, which gives the government "virtually unlimited power for taking farmland for any purpose".[14] In some countries like in South Africa, takings are possible for the purpose of social justice.[15] In the USA, the courts tightly control eminent domain power but accept the widely defined standard of taking for "economic development". The Supreme Court in the much-discussed case "Kelo v. City of New London" held a taking to be constitutional as it was part of a general plan of economic development and raising local tax income. By contrast, the German Constitutional Court demands that the public interest for taking be accurately defined in either federal or state law – a municipal zoning law or any other municipal statute will not suffice in this regard. This norm makes sense from a public choice perspective because it is especially local public choice constellations that tend to drive taking decisions that serve not the public interest but rather the local politicians. The constitutional court has two instruments of control at its disposal. If the rationale of the taking decision cannot be found in either a federal or a state law, the taking is unconstitutional. Any rationale must be clear, specific and exact, and it must describe a severe public interest. Undisputed public interests that justify taking include the construction of power lines, railway tracks, canals, roads, public airports and, with some further specifications, also schools and sports facilities. The creation and preservation of jobs is disputed; its constitutionality as a rationale for taking would largely depend on the scale of the expected

[13] In India a reform of the Land Acquisition Act in 2013 included a consent clause. Takings for private use require a consent of 80 per cent and for private public partnerships of 70 per cent of landowners.

[14] International Review, Center for International Law, Newsletter, New York Law School, 2012, 14(2), Eminent Domain Laws around the World, Taking Property for the Public Good, pp. 7-19, p. 15; Peter Yuan Cai, In the Shadow of Pandora: China's Expropriation Law, East Asia Forum (Feb. 6, 2010),

[15] International Review, ibid. p.16.

benefits. Higher tax income cannot not justify takings from a constitutional point of view,[16] which makes sense since higher tax income per se is not in the public interest.

Sometimes it is difficult if not impossible to formulate the rationale of certain takings in an abstract and yet precise way. German constitutional law then requires that the rationale be provided by a specific law and thus ensures that the taking decision is not based on a mere bureaucratic act but on a majority decision by a democratically elected parliament. An example is a taking law in favour of Airbus Industries in Hamburg, which sought to extend the factory runway to accommodate the future A380 model passenger jet. At the time, there was no legal basis for a taking for a privately rather than publicly used airport. The Hamburg state parliament then passed a specific law for the taking of land for the benefit of the Airbus Corporation, describing in detail the expected positive effects on the economy of the city state. The courts subsequently accepted the taking decision on the basis of this law.[17]

It is worth noting that the constitutional protection of property against taking appears to be stronger in Germany than in the USA. According to its constitution, Germany is a "democratic and social federal state" (Sec. 20, 1 GG), whereas the word "social" does not enjoy that status in the USA. It is therefore noteworthy that taking decisions must be based on precise legal rationales given in statutory laws. This would exclude "economic development", which legitimizes a taking in the USA. It would also exclude "increasing tax income" because this is not per se in the public interest. And it would also exclude takings for "a social purpose" if that purpose is not clearly specified in a sub-constitutional law. Property protection against eminent domain power seems to be more libertarians in Germany than in the USA.

c. Transparent and fixed formula compensation

A large literature shows that compensation for land takings in developing countries often falls short of the fair market value of the land and rarely covers other damages such as the non-financial harm of losing one's home.[18] The formulas for compensation are often not clear, mentioning fair compensation, just compensation or adequate compensation in different legal

[16] Taking for fiscal reasons is unlawful in Germany. W. Leisner, *Eigentum, Handbuch des Staatsrechts*, 4 386 (2010).

[17] Taking law for the expansion of the factory airport in Hamburg-Finkenwerder (Werkflugplatz-Enteignungsgesetz) of February 18, 2004.

[18] Y.-C. Chang, Private Property and Takings Compensation, Theoretical Framework and Empirical Analysis", Edward Elgar; A. Azuela and C. Herrera (2007), op. cit.; International Review, ibid., p. 15; Peter Yuan Cai, op. cit.; R. Singh (2012) "Inefficiency and Abuse of Compulsory Land Acquisition: An Enquiry into the Way Forward" Economic and Political Weekly 47(19): 46-53.

texts.[19] The term "fair market value", which is related to the Hull formula in international law, is a muddy standard, leaving open whether it denotes the market price, the discounted future income stream or the book value. It also leaves open the time of valuation, especially before versus after the announcement of the taking. In developing countries, the observed market price is often lower than the actual market price as side payments to save taxes are common.

Some developing countries have introduced flat rate compensation without proof of damage in parts of tort law. Given the specific problems with the law in many low and middle-income countries, this seems a step in the right direction. In India, section 140 of the Motor Vehicles Act of 1998 grants flat rates in case of death and permanent disablement. The Act also includes fixed formulas for funeral expenses, loss of consortium, medical expenses, pain and suffering and loss of income. This was explicitly introduced to avoid drawn-out litigation and delay in payment for victims and their heirs who are in need for quick relief. Fixed formula compensation is also granted for instance in Brazil, where a set solatium for grief is paid.

In taking law, too precise formulas for damage compensation can offset poor judicial expertise and make the procedure less information-intensive and costly. For instance, the non-pecuniary damage of a displaced homeowner could be fixed by a formula that considers wage rates and the number of years the person has lived in the neighbourhood, similarly to golden handshakes for dismissed employees. Fixed formulas could also be used to evaluate the land. Notwithstanding their unreliability, they would allow speedy decisions and could do no harm if courts used them as a default rule, leaving the affected party free to accept them or insist on a lengthy and information-intensive decision procedure to determine the damage award.

d. Specific taking rules for private and profit-oriented investors

The hold-up problem necessitates takings even in favour of private and profit-oriented firms. This applies especially in and around the rapidly growing cities and megacities in developing countries. Yet the specific features of such takings for private beneficiaries call for specific legal norms.

- A private entity that benefits from an act of taking is fundamentally free to utilize the property received in any way it pleases – which is not the case if the 'taker' is a public body bound by administrative law and by the stated purpose of the taking in the public interest. Therefore,

[19] H.B. Schäfer (2017) "Taking Law from an Economic Perspective with Reference to German Law"in I. Kim, H. Lee, & I. Somin (eds.), Eminent Domain: A Comparative Perspective (pp. 8-37). Cambridge: Cambridge University Press; N. Birch (2010) "Comparative Compensation" in W. Schill, International Investment Law and Comparative Public Law, Oxford Scholarship Online, 2-31.

expropriation laws which enable an involuntary transfer of property to a private investor should include safeguards that the specific public purpose that justifies the taking is indeed met.

- For the taking to be lawful, the state should be obliged to show (and convince a court) that the private investor can be trusted to use the land in pursuance of the specified purpose. The required commitment could be achieved by a contract between the investor and the state with penalties to be imposed if the investor fails to use the land in the specified manner. Such rules would probably have prevented the much debated Kelo taking in the USA, where homeowners were evicted but the development company subsequently lacked the financial resources for the planned investment.[20] The author has visited sites in India which the government took for the benefit of private investors but which then lay idle for years. A few simple rules of eminent domain law would suffice to avoid such wasteful outcomes.

Also, as I have argued in a paper with Ram Singh, there are strong economic arguments that compensation for takings in favour of private profit-oriented investors should exceed the usual "fair market value" of the real estate. The fair market value covers neither the non-financial damages, nor the damages from interference with any ongoing or future contractual arrangements pertaining to the property, nor any number of other damages. Only full damage compensation will prevent economically inefficient takings, i.e. ensure that the new owner values the land more highly than the old owner.[21] Only then will the new owner be interested in the investment, as Calabresi and Melamed have shown in their well-known proposition. This beneficial effect of full compensation is neither guaranteed nor probable if the new owner is not a private investor but the state. The state pursues its own interest, much like any actor. Yet the state maximises not wealth but other metrics, for instance votes. Consequently, the level of compensation cannot incentivize the state in the same way as a private investor. For a simple bright line rule, one might envision that the compensation payable by a private acquirer must exceed that to be paid in case of public use by a certain factor greater than one.

[20] Ilya Somin, *Controlling the Grasping Hand: Economic Development Takings after Kelo* ,Sup. Ct. Econ. Rev.183 (2016).

[21] For an analytical exposition, see H.B. Schäfer and R. Singh (2017) "Takings of Land by Self-interested Governments, Economic Analysis of Eminent Domain Law" forthcoming in the Journal of Law and Economics. See also H.B. Schäfer (2017) "Taking Law from an Economic Perspective with Reference to German Law" in I. Kim, H. Lee, & I. Somin (eds.), Eminent Domain: A Comparative Perspective (pp. 8-37). Cambridge: Cambridge University Press.

e. A brief note on the proportionality principle and substitutes

Whenever the state infringes a personal or a fundamental human right, the questions arise as to what the limits of state power should be, when its exercise is legitimate and which role courts should play to check it. The gold standard of a legal principle enabling courts to check state power is the so-called proportionality principle. Originally invented by German administrative courts to check police power and further developed by the German Constitutional Court, the principle has enjoyed an incredible international career. Among other countries, the Supreme Courts of Canada, Israel and South Africa and all constitutional courts in Europe rely on it, while the USA do not. The principle is also routinely applied by the European Court of Justice, The European Court of Human Rights and the appellate body of the World Trade Organization.[22] If a state acts in pursuit of a legitimate policy target for which land taking is necessary, for instance building a slip road to the highway, and if all the legal requirements discussed so far are met, the proportionality principle can still enable a court to declare the decision illegal and void. The principle comprises 3 tests.[23]

First, if the administrative act which infringes a right has no positive effect whatsoever on the statutory policy target it is unlawful. Taking land for expanding a grocery store in a subway station into a large shopping mall would be illegal if the legal rationale of grocery stores in public stations is to give travellers easy access to provisions and thus to improve public transportation services. A second test is the necessity test. A taking of land for a university campus would be illegal if the campus can be erected at less interference with personal rights, e.g. if the government already owns enough land nearby or if the campus could be built on half as much land. A third test is a cost-benefit-test. A taking decision for constructing a slip road can be unlawful even if it contributes to the policy target of improving transportation and if it constitutes the mildest possible intervention to realize the project. A second slip road in a small city with trivial benefits for car drivers would not justify large infringements to many landowners.

The proportionality principle has proved to be a powerful legal tool to check the ruthless exercise of government power worldwide. Yet it has a major shortcoming in the context of our discussion: It is almost a textbook example of a legal standard, rather than a legal rule. Its application requires extensive information in the court room and subtle understanding and expertise on the part of the judges, who must be independent and loyal. Like a luxury car that will not run well on poor roads, applying the proportionality principle if the conditions are not right

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[22] Bernard Schlink, *Proportionality In Constitutional Law: Why Everywhere But Here*?, 22 Duke L.J. 291-302 (2012).

[23] Maunz/Dürig/Grzeszick, *Die Eigentumsgarantie des,* XIV. Rn. 105-106 (2008).

may lead to unwanted effects. Therefore, we hesitate to recommend the application of the principle in its present form to developing countries across the board. However, the rationale of the principle can certainly be exploited for takings decisions in developing countries. Expert commissions could establish how much land is necessary to realize a school, college or university and how the compensation has to be fixed. Such expertise could be made binding for takings decisions. Travelling in developing countries, one cannot help but notice the oversized campuses populated by all kinds of private shops, private houses and even private hotels. The proportionality test would have avoided this outcome. Yet other, more rule-based methods of achieving proportionality may also be available.

INTER-DISCIPLINARITY IN LAW: ITS NECESSITY AND CHALLENGES

- *Régis Lanneau*[*]

I. INTRODUCTION

"My gain from hearing or reading what other people thought was that it changed, as it were the colours of my own concepts. What I heard or read did not enable me to reproduce their thought but altered my thought. I would not retain their ideas or concepts but modify the relations among my own"

- F.A. Hayek

When I started law school, a professor of a certain age was in charge of the welcoming speech. I remember perfectly his words: "Law is a mathematics of language". An explanation followed on the virtues and the power of the famous legal syllogism, the myth of which persists among bachelor students and certain colleagues; I admit to being impressed by this "demonstration" which seemed to me of an impeccable logic. Law would be a perfectly autonomous discipline. The lawyer should be content to know the "mathematical" rules of law (including cases) while striving to apply them rigorously, penetrated by the wisdom of precedent and academic enlightenment. This vision would be reinforced by a supposed civil law tradition – I am French – making the judge the simple mouth of the law[1] (with his theory on economic development perhaps one of the most beautiful heresy of Montesquieu), the executor of Parliament's wills (supposed to represent the no less mythical general will). It does not matter that this representation is far removed from the inspirer of the Civil Code-Portalis[2]; it will be enough to read his speech on the civil code to be

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[1]CHARLES DE SECONDAT, BARON DE MONTESQUIEU, THE SPIRIT OF THE LAW, CAMBRIDGE 1989 (Cambridge Univ.Press 1748).

[2]Portalis was aware of some limitations of the civil code. He said: "*A code, however complete it may seem, is no sooner finished than thousands of unexpected questions present themselves to the magistrate. For these laws, once drafted, remain as written. Men, on the other hand, never rest. They are always moving; and this movement, which never ceases and whose effects are variously modified by circumstances, continually produces some new fact, some new outcome. Many things are therefore necessarily left to the authority of custom, to the discussion of learned men, to the*

convinced. It does not matter that the legal tradition does not name the thing - the syllogism - by its name, the modus ponens, and thus reveals that this mode of reasoning is above all one of the logical structures identified by Aristotle[3]. Myths are hard, and believers are faithful to dogmas.

However, the simple fact of giving a history to the notion supposed to have found the autonomy of legal reasoning and thus, of the legal "discipline", since the disciplines are defined today more by their methods than by their object[4], suggests that the law is merely, at least, borrowing from logic- one of its tools, thereby putting the idea of a seal between disciplines - or purity of the discipline - at the level of logical impossibility. To be content with an interdisciplinarity limited to logic would however still be far too charitable because, all things considered, legal disciplinesare defined more by their object than by their method. This approach allows both the autonomy of the discipline and interdisciplinarity to be saved. The latter would not in any way affect the autonomy of the discipline (defined as object). Better, it would broaden the scope of legal thinking to make jurists not mere performers but real actors in the evolution of legal norms.

Such an affirmation must, however, be "proven" (improper language if one understands by the proof the mathematical rigor) or at least prove convincing by using a quasi-logical structure and the tools of the traditional rhetoric. This article is itself interdisciplinary in its method, while being legal by its object.

To want autonomy of the discipline as a method does not resist long the analysis of the facts. If, as my former teacher said, law is a mathematics of language, the legal method (what can it be?) should be able to guide judges, lawyers, academics and more generally practitioners to identify, more or less easily but always with certainty, THE legal solution. Indeed, if this solution is not unique, the legal method would not be able to allow a strictly legal decision and it would then be necessary to appeal to an external element which is refused in principle. If we then consider that

arbitration of judges" (Jean-Etienne-MariePortalis, Preliminary Address on the First Draft of the Civil Code, 1801).

[3]ARISTOTLE, ORGANON.

[4]Gary Becker, *The Economic Way of Looking at Life*, NOBEL LECTURE 1992, http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1992/becker-lecture.pdf.

there are rules imposing the use of another discipline to "decide" between several solutions, these rules do not allow to remove the difficulty: they are indeed legal and if these rules cannot be pinpointed or can be challenged, the problem is only postponed one step further and the autonomy disappears again.

The myth of the unique solution is still widely taught ... however, it does not seem logical. After all, the mere fact of using lawyers at a trial to "convince" a judge sufficiently reflects the absurdity of what would be a radical autonomy of law. Do we need three mathematicians to solve a mathematical problem? If the law is a mathematical language, why should we appeal to three entities (two lawyers and one judge)? Isn't it possible to consider that the "mouth of the law" sufficient? It is indeed necessary here to be charitable, the error of inattention is certainly possible, but it is less frequent than the lawsuits. Lawyers can certainly be stupid and narrow-minded, but then you may wonder why they always find a few things to stay in the business. Would it not be possible to develop software to systematically determine "good" decisions?

Of course, the modus ponens is a structure of presentation that could give the illusion that the solution is "imposed" to the judge when he presents it - our Supreme Courts are experts in this art, which is not always subtle - but we should not confuse effective rhetorical structure with the autonomy of legal reasoning. After all, the field of law is that of the practical decision which is characterized by the fact that things can be other than what they are; mathematical rigor is not entitled to be mentioned in this order; the power of conviction replaces the proof and sometimes claims to be scientific when it is only the *ars juris*, which is not dishonorable, on the contrary.

Founding myths certainly have their virtues - and the autonomy of law is one - but they should not restrict our ability to think. The cycles and epicycles of Ptolemy were built on the dogma that the perfect movement can only be the circle[5]; the elliptical movement probably does not agree with dogma but has given reasoning an ability to surpass itself. Interdisciplinarity in law is nothing else.

[5]For example, Arthur Koestler.

The law wanted to think itself as scientific, mimicking mathematical reasoning and, by so doing, ignoring its own nature. It is indeed not interdisciplinarity which is a recent phenomenon, it is the interdisciplinary thought as interdisciplinarity (I). Is this to say, however, that interdisciplinarity must be adorned with all the virtues? As in physics everything depends on what you want to do. The geocentric model is enough to navigate; the model of Newton sufficient to explain many phenomena with some disturbing approximations (the perihelion movement of Mercury for example) but not always crippling; that of Einstein could certainly replace the previous while exceeding them… but remains more complex to handle; it remains the only one that allows the GPS to reach its accuracy. Choosing simplicity is sometimes more efficient for solving the problems of daily life. In other words, the complexity of the theories is not without generating costs (II) that must be taken into account to assess the relevance of a less confidential use of interdisciplinarity (or at least more standard) including, of course, law and economics.

II. INTERDISCIPLINARITY, A RECENT PHENOMENON?

Contrary to what some would suggest, interdisciplinarity is inherent in law and it has always been so. It is not a new reality (A). Why then do we want to fight it and refuse, with so much relentlessness (at least in some part of France, Germany or India), the introduction of transdisciplinary courses likesociology of law, law and economics, even the psychology of the courtroom? Simply because, now, interdisciplinarity is rationally considered (B) and, as such, imposes a little more rigor in some traditional legal reasoning!Moreover, it challenges many dusty doctrines and it is also at this level that the rupture takes place, that the novelty exists: the disciplines having evolved, the law must follow their evolution to remain in adequacy with its very nature and to gain in both practical and logical power. If this intellectualization of interdisciplinarity also gives it its power, it is not without compromising the comfort of conservatism sometimes preferring legal mythologies to their disenchantment.

A)HAS THE LAW NOT ALWAYS BEEN INTERDISCIPLINARY?

The question of interdisciplinarity in law could not be posed in modern terms without specific

disciplines having asserted their "autonomy" and being able to tell us something about the legal system (in the broad sense); there is no interdisciplinarity without disciplines. However, these disciplines have appeared only recently in the history of the law: economics is often associated with Adam Smith[6], sociology with Durkheim[7] and Weber[8], psychology with Freud[9], statistics with Quetelet[10] (even if the mathematical foundations of statistics have been largely developed by Pascal, Fermat, Bayes, Laplace or Condorcet[11]).

The question of interdisciplinarity has not been raised for several centuries. It should not be forgotten that the social sciences have often developed precisely to influence legislation, in other words, to change the law. Did Adam Smith not criticize the mercantilists and their conception of economic regulation? Did he not consider that the economy was part of the science of the legislator[12]? Did Bentham not develop utilitarianism to better legislate[13]? Did Ricardo not construct the theory of comparative advantages to criticize Corn Law[14]? And the list could go on and on. These evolutions concern more the art of legislating than the art of judging. It goes without saying that the art of legislating is interdisciplinary in nature: how to legislate without understanding the system that one wishes to govern? And how not to consider that this system is multidimensional in essence? In other words, how can one legislate without appealing to the diversity of knowledge offered by different disciplines? It is unlikely that interdisciplinarity at this level is really problematic, even for fierce partisans of some kind of "purity" of law. It would certainly be

6 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, 1776. [Hereinafter "Adam Smith]

7 EMILE DURKHEIM, LES REGLES DE LA METHODE SOCIOLOGIQUE (Flammarion 2010).

8 MAX WEBER, BASIC CONCEPTS OF SOCIOLOGY, SECAUCUS (Citadel 1962).

9 SIGMUND FREUD, THE PSYCHOPATHOLOGY OF EVERYDAY LIFE, (W. W. Norton & Company 1971).

10 ADOLPHE QUETELET, DU SYSTEMESOCIAL: ET DES LOIS QUI LE REGISSENT (Forgotten Books 2015).

11 STEPHEN STIGLER, THE HISTORY OF STATISTICS: THE MEASUREMENT OF UNCERTAINTY BEFORE 1900(Belknap Press 1990).

12 Adam Smith, *supra* note 6.

13 JEREMY BENTHAM, THE PRINCIPLES OF MORALS AND LEGISLATION (Prometheus Books 1988).

14 DAVID RICARDO, THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION (J.M. Dent & Sons Ltd. 1911). See also THOMAS MALTHUS, THE GROUNDS OF AN OPINION ON THE POLICY OF RESTRICTING THE IMPORTATION OF FOREIGN CORN: Intended as an Appendix to "OBSERVATIONS ON THE CORN LAWS" 1815, In 7 EDWARD A. WRIGLEY AND DAVID SOUDEN, THE WORKS OF THOMAS ROBERT MALTHUS 151 – 174 (Pickering 1986).

possible to consider that the law is above all natural and imminent, but this approach is far from common today and would pose formidable difficulties as to the relevance of the institutional structures adopted in most developed and developing countries: how to justify democracy or collective decision if the law is "natural"?

It is obviously possible, to reject interdisciplinarity in law, to distinguish between the art of legislating and the art of judging. The first would be "political" and not strictly legal; the second, on the contrary, would be "legal". Is *ars juris* interdisciplinary in nature? If we put rhetoric back at the heart of the art, there is no doubt that it is: to convince is not to be limited to a category of argument, it is to mobilize symbolic values, to adorn the reasoning with the prestige of science, to use psychology; it's not just being "legal". And by saying that, a first abuse of language occurs: what is this "legal"?

Being legal is the fact of using legal references in other words to speak of the object, not to be limited to a predefined method. From a practical point of view, the lawyers or the judges will all confirm the importance of the experience for the practice of their profession. This experience means that the law (in the sense of a set of normative propositions considered valid by a community) is not enough. While experience can give reflexes to go faster in the resolution of cases, it is not just that. The experiment also aims at knowing how to express oneself in the face of a judge, how to formulate his arguments and it is a safe bet that the knowledge of the disciplines outside the law should allow lawyers, as well as judges, to be more efficient.

More concretely, how to judge a case in competition law without understanding the economic issues? The opinions of competition authorities (whatever their nationality) constantly demonstrate a porous border between law and economics ... and this example can be extended to all regulatory authorities and even judges. Even when the reasoning may seem legal at first, economic dimensions appear quickly. In the case of Ville de Dreux[15], this double dimension is revealed by

15 Council of State, 13 May 1994, n°116549: "Considering that, by a deliberation of December 18, 1984, the municipal council of Dreux decided that from 1 January 1985, the school of music could only accommodate children whose parents have their effective home in Dreux, as well as adults living in this city, and that only derogations could be granted to non-resident pupils in

the reading of the conclusions of the public rapporteur: less than an application of the "principle of equal access to public service", it is the economic and fiscal consequences which led to the solution; in other words, dimensions considered by some as "extra-legal". In the Poussin case[16], the fact that the expert was not held responsible can easily be explained by the so-called "judgment-proof" problem and the idea of error cannot be understood without a minimal understanding. the functioning of the art market. Certainly, the tendency is to retain only the solution forgetting the facts, but these are the only ones to allow a real intelligibility (within the framework of a system built to think the law in its coherence) of the rendered solutions.

This multiplication of disciplines has not left the law indifferent. Two attitudes can be identified in its evolution itself.

The first, which is well known in France or Germany, is an attempt at radical autonomation of the discipline by constituting a science of law. Kelsen's name comes immediately to mind. Let us note, however, that this approach makes law the object of science and not a science in itself; better still, all science is necessarily external to its object. The science of law, even if it claims to be strictly legal, nevertheless remains a discourse on an object. Therefore, nothing prevents us from observing this object from different angles offered by the different disciplines of the social sciences; to separate the law from the science of law is to open the possibility of interdisciplinarity.

Dreux for whom additional external financing would be provided;
Considering that, in the case of a non-compulsory public service created by a municipality, whose object does not exclude that its access may be reserved for certain categories of users, the principle of equality of public service users does not prevent the municipal council from restricting access to this service by reserving it to students with a particular link with the municipality and thus being in a situation different from all other potential users of the service ; that, however, the municipal council of Dreux could not legally limit, as it did, the access of the school of music to the persons domiciled or living in Dreux, by refusing to accommodate pupils who, because they have at Dreux the place of their work, or because they are schooled in the commune, have with it a sufficient link".

16 Cassation, civ 1ère, 13 December 1983. A painting that the family tradition gave for a Poussin (a famous painter) was sold at an auction, with the mention "attributed to the school of Carrache" to be in accordance with the opinion of the expert consulted by the auctioneer of the sale. The painting was acquired by the Meeting of National Museums following the exercise of his pre-emptive right in the matter. This institution decides to present it, later, as an authentic Nicolas Poussin. The seller then acts on the basis of the error, despite the reservation on the authenticity of the painting expressed by the mention of "attributed to" in the catalog.

Moreover, Kelsen's positivism[17], far from being a closure, promotes it by concentrating only on one aspect of the law; aspect which, by itself, is not sufficient for decision-making since it focuses on the formal relations between norms[18]. This tightening of "law" (as a scientific discipline) leads to a void: the practitioner of the object does not have the tools to decide (at most he will be able to identify options available to him), he has then to look elsewhere ... and especially towards other disciplines.

The second attitude is the realistic attitude (Kelsen is obviously realistic in terms of interpretation[19]), especially in its American version[20]. The caricatured ideology of a mechanical jurisprudence does not stand up to facts; the law is indeterminate both logically and causally[21] and cannot therefore be autonomous; the life of the law is guided by the facts of the case less than by precedents or normative propositions which can always be interpreted. It is therefore necessary, in order to grasp the mechanics or more precisely the biology of this dynamic, to rely on the other social sciences likely to offer relevant insights. This approach is firmly anchored in practice: if the law is indeed a tool for social engineering, if it seeks to modify the behavior of individuals, it cannot neglect either the social sciences or literature. Learned Hand J. expresses this idea in a remarkable way: "I venture to believe that it is as important to a judge called upon to pass on a question of constitutional law to have a bowing acquaintance with Acton and Maitland, with Thucydides, Gibbon and Carlyle, with Homer, Dante, Shakespeare and Milton, with Machiavelli, Montaigne and Rabelais, with Plato, Bacon, Hume and Kant, and with books that have been specifically written on the subject… The words he must construe are empty vessels into which he can pour nearly everything he will"[22]. For Learned Hand, statutes and case law form only a

17 HANS KELSEN, THE PURE THEORY OF LAW (University of California Press 1967).

18 See for more example, RÉGISLANNEAU, TO WHAT EXTENT DID EUROPEAN LEGAL THEORY PAVE THE WAY FOR AN ECONOMIC ANALYSIS OF LAW? Insights from 23 KELSEN, HART and DEL VECCHIO, HISTORY OF ECONOMIC IDEAS 195-224 (2015).

19See for exampleMICHEL TROPER, LA THEORIE DU DROIT, LE DROIT, L'ETAT (PUF 2001).

20 See for example WILLIAM FISHER, MORTON HORWITZ & THOMAS REED (EDS), AMERICAN LEGAL REALISM, (Oxford University Press 1993).

21BRIAN LEITER, NATURALIZING JURISPRUDENCE (Oxford University Press 2007).

22LEARNED HAND ET IRVING DILLARD (EDS), THE SPIRIT OF LIBERTY: PAPERS AND ADDRESSES OF LEARNED HAND, especially "*Sources of Tolerances*" 66-83 (Knopf 1952).

grammar for the formulation of legal statements that may be considered relevant. This grammar does not "dictate" a solution and is only a relative constraint in the argumentation.

Ars juris, whether restricted to the simple dimension of judgment or broaden to include legislative choice, is by nature multidisciplinary, if only for its effectiveness or practical effectiveness. It seems difficult to deny this reality or to consider that interdisciplinarity is a recent phenomenon. The fact that it is now thought is the only thing that is truly recent.

B)THE NOVELTIES OF A CONSCIENT INTERDISCIPLINARITY

From now on, interdisciplinarity is rationally considered of and this is the only novelty for law. This novelty is disturbing since the tendency will then be to examine the nature of the arguments put forward: are they legal? extra-legal? Focusing on the classification, however, is losing the objective: to convince for the lawyer, to decide for the judge, or to structure and to participate in the evolution of the thought for the academic ... or more widely to judge and thus to alter, at least potentially, the social order or at least certain behaviors. However, through some thinking regarding the concept of multidisciplinarity, the lawyer gains in precision and analysis, which allows him to question doctrines that seemed consistent under the influence of an unconscious interdisciplinarity; by grasping the totality - or at least a greater number - of the underlying issues, it should be able to "better" judge. By shaking up certainties, interdisciplinarity is therefore logically opposed since knowledge is to be re-founded: from the virtues of democracy[23] to the separation of powers[24], the concept of the general interest[25], the will of the legislator[26], international customs[27], the efficient breach of the contract[28] or the *pater familias*, few are the notions that emerge unscathed

23JAMES BUCHANAN ET GORDON TULLOCK, THE CALCULUS OF CONSENT (Michigan University Press 1962).
24ROBERT COOTER, THE STRATEGIC CONSTITUTION (Princeton University Press 2000).
25KENNETH ARROW, SOCIAL CHOICES AND INDIVIDUAL VALUES (Yale University Press 1963).[Hereinafter "Arrow"].
26 Kenneth Shepsle, *Congress is a "they", not an "it",* 12 Int'l Rev. L. & Econ., 239-256 (1992).
27JACK GOLDSMITH AND ERIC POSNER, THE LIMITS OF INTERNATIONAL LAW (Oxford University Press 2007).
28ERIC POSNER, CONTRACT LAW AND THEORY (Aspen Publishers 2011).

from the confrontation of points of view.

It is useless to multiply the examples here. The concept of general interest, often mentioned in administrative law or constitutional law, will suffice to illustrate the point. It is clear that despite its apparent importance, its meaning often escapes when trying to grasp the concept. The legal word is only a "tûtû"[29]: it allows to anticipate the consequences that should take place in the legal world but its meaning remains to be built. The grammar of the law is therefore a point of arrival and not the starting point of reflection. There is no doubt that the meaning of the "legal" concept of general interest can be enriched - or even constructed - by the other social sciences, which will then facilitate the acceptability of the interpretation that we wish to give it. Whether it is sociology with the idea of conventional norms, economics with the distinction between the rule and the legal standard, or the psychological approach insisting on the symbolic burden, these different points of view on the notion can be mobilized by the jurist to enrich his reflection but also gain in power of conviction. To those who might still think - but we can hope that their number is reducing - that the general interest is something objective, we can only mention the famous impossibility theorem of Arrow[30]: there is no procedure for aggregating individual preferences at the collective level which could be considered as satisfactory; the general interest then depends on a decision procedure and cannot therefore be a characteristic of the resulting solution.

Interdisciplinary is now based on constituted disciplines and thus on identified methods. Economics, for example, is generally based on a methodological individualism coupled with the two concepts of rationality and efficiency. Variations between schools refer[31], very often, only to variations in the meanings of these last two concepts. Neoclassical economics will approach rationality in a formalized version stressing maximization under constraint[32]; behavioral economics

29 Alf Ross, *Tû-Tû*, 70 (5) Harv. L. Rev., 812-825 (1957).

30 Arrow *Supra* note 25.

31 See for example NICHOLAS MERCURO& STEVEN MEDEMA, ECONOMICS AND THE LAW, FROM POSNER TO POST-MODERNISM (Princeton University Press 1997).

32Any microeconomics book would be sufficient to understand that.

will emphasize cognitive biases and the limits of neoclassical rationality[33]; the Austrian school will introduce the possibility of learning and the radical subjectivity of preferences[34]. All these schools will only be able to paint a perspective on an object - but does not the perspective really constitute the object? - without being able to comprehend it in its totality. By offering then a more complete systematization of "external" knowledge - but are they? - it is possible to appreciate their limits and therefore their value; this assessment is not only a question of the discipline which merely verifies that the statements are well formed; it is strictly speaking a "judgment" to the extent that the idea of "truth" in social science does not respond to the logic of demonstration but of conviction (in other words, the space of the social sciences is not Popperian[35] ... and the epistemology of Feyerabend[36] is certainly more relevant). Above all, by their systematization, these disciplines offer ways to start thinking where the law provides only a grammar to close reasoning. In economics for example, the analysis starts from three rather simple questions: who are the agents? what are their preferences? what are their constraints? To these questions is added a general idea: to understand social phenomena, it must be understood that these phenomena are the product of the incentive system in which the agents evolve; in other words, in order to change social equilibrium, to transform incentives is the key. The transposition of these principles into law leads to perceiving it as a tool of social engineering[37] whose object is precisely to alter the equilibrium considered unsatisfactory. To accept this logic is not necessarily to recognize that only economics is relevant to complete the ambitions of the law ... but to make law, it is necessary to know the Man ... and the "legal sciences" do not offer any theory to understand this peculiar object.

This systematization increases the value of interdisciplinarity for the lawyer. Indeed, it offers him a point of reflection. Since the premises are known, the conclusions can be appreciated; the

33 CASS SUNSTEIN, BEHAVIORAL LAW AND ECONOMICS (Cambridge University Press, 2008).

34 See for EXAMPLE LUDWIG VON MISES, HUMAN ACTION: A TREATISE ON ECONOMICS (Liberty Fund 1996).

35 JEAN CLAUDE PASSERON, LE RAISONNEMENT SOCIOLOGIQUE : UN ESPACE NON POPPERIEN DE L'ARGUMENTATION, (Albin Michel 2006).

36 PAUL FEYERABEND, AGAINST METHOD (1975).

37 BRIAN TAMANAHA, LAW AS A MEANS TO AN END: THREAT TO THE RULE OF LAW (Cambridge University Press 2006).

deformations of the mirror being identified, the reflections of law - or the shimmers mentioned by Dean Carbonnier[38] - can be grasped to their proper measure.

In a recent book[39], Acemoglu and Robinson make institutions the key to societal development: alongside inclusive institutions are extractive institutions. It would be damaging if the French or Indian "legal sciences", by a conservative withdrawal, do not explore the potentialities of a reflection enriched by interdisciplinarity and the benefits of diversity. It must be noted, however, that the incentive system in place leaves very little room for optimism.

III. THE LIMITS OF INTERDISCIPLINARITY

Although interdisciplinarity obviously enriches reflection, it does not mean that we must abandon the "monodisciplinarity" as it is true that the interdisciplinary is built from monodisciplinarities. This necessary tradeoff (B), which will not be solved in the same way between the disciplines and within them, is obvious when the costs of interdisciplinarity are brought to light (A).

A)THE COSTS OF INTERDISCIPLINARITY

Interdisciplinarity has not yet found its full place in teaching or research. This situation is easily explained from a theoretical point of view: individuals are not encouraged to practice or introduce it; its benefits are not yet greater than its costs because of the structure of the social systems involved (university, constraints formed by employers and scientific reviews and journals). This explanation remains purely theoretical but opens avenues for reflection to understand the dynamics in the teaching of law, which the law is not able to do.

That interdisciplinarity generates costs is obvious. Mastering two or more disciplines implies an investment far more important than the mastery of a single discipline: the hours of classes are

[38]JEAN CARBONNIER, SOCIOLOGIE JURIDIQUE (PUF 2004).
[39]DARON ACEMOGLU ET JAMES ROBINSON, WHY NATIONS FAIL (Profile Books 2013).

more numerous, the time spent revising, the purchase of books also generate costs, the intellectual gymnastics sometimes complex, especially when knowledgesare far apart. Synergies are obviously possible and certainly make it possible to reduce the costs of interdisciplinarity through increased brain plasticity and a wider culture, but the costs remain.

Some even go as far as to say that one cannot master two disciplines perfectly in order to better weave into a comfortable status quo, thereby confusing knowledge and skills. To follow the example of the economic analysis of law, most of its practitioners in American law schools have been trained and obtained doctorates in both disciplines, often in prestigious universities. To consider that at the level of the same degree, they would be less "good" because they also obtained a doctorate in another discipline seems simply absurd. This situation also raises a question, what does this "good" mean? "Good" in terms of technical know-how, research, intellectual innovation? This qualifier is far too subjective to try to seriously objectify it. It is obvious that if the number of publications counts, the interdisciplinarity does not give rise to any handicap, in fact, on the contrary (is serendipity not reinforced by what might seem to be externalities?); in terms of teaching, it is also difficult to see how interdisciplinarity would be penalizing; in terms of practical mastery, at most it will be noted that Romieu[40]was a polytechnician, that P.N Bhagwati was also trained in mathematics, that all the best universities and business schools offer their students courses in different disciplines[41] (in the absence of courses strictly interdisciplinary) and that the learning does not stop with the university; human capital is less pure knowledge than skills and adaptability to new situations ... The former director of my department at the *Ecole NormaleSupérieure* said to me one day: "You know, a lawyer, does not know much, but he knows how to find and use what he has found". It must be admitted, however, that if this representation does not become standard, interdisciplinarity is unlikely to develop fully.

[40]A famous French Judge at the Conseil d'Etat (Council of State). We could also have mentioned, in another domain, Lewis Carrol who was also a mathematician.

[41] The ESSEC is France is also offering courses in the History of Art!

The costs of interdisciplinarity are today reinforced by the low incentives to invest this type of research or teaching. Interdisciplinarity is sometimes misunderstood by recruiters or colleagues (few are those who have been trained in at least two disciplines), famous law journal and reviews in France, Germany or India remain very conservative and rarely take the risk of publishing outside their tagged field and well codified approach. The separation of disciplines within universities is not without favoring a certain conservatism. The thing may also appear quite paradoxical in law since law schools were the first in France to understand the benefits of having courses in other disciplines, including political economy!

Although these costs have long been prohibitive, the proliferation of training - based on the mastery of several disciplines - offers hope for some changes in the years to come. Nevertheless, this multiplication concerns rather the undergrad courses and rarely the masters program. Indeed, these first years respond more to a request from parents or even students who often wish not to close doors than a request from the professional world. If it turns out that the latter favor expertise in one discipline and specialized training, the incentives to develop interdisciplinarity at master's level will remain low. However, while it is certain that the benefits of an interdisciplinary training will not result directly in an increase in hiring at the end of the master's degree, this strategy may be relevant in the long term. In France, it is not that surprising that law firms are eager to hire lawyers who also obtained a business degree because such a knowledge is considered as an asset within the firm.

Interdisciplinarity when it is practised at the decision-making level also entails costs. It is certain that taking into account the multidimensionality of problems and approaches can lead to longer delays in decision making, which will not always be optimal. The fact that the law has introduced exemption regulations for certain categories of anticompetitive practices reflects precisely that. The cost of taking into account all the parameters to assess the relevance of a practice is prohibitive compared to the expected benefits of this consideration. Some solutions may therefore appear suboptimal without the system itself being suboptimal if we take into account the costs of decision-making. However, it should not be inferred that the costs of interdisciplinarity are still

prohibitive in decision-making. The "more economic" approach to competition law[42] has certainly led to the strengthening of the competitiveness of some companies. Must we recall in this respect that the economic analysis of law is precisely born from a critique of traditional "legal" reasoning from the point of view of the creation of well-being?

B)THE NECESSARY TRADEOFF BETWEEN MONO AND INTERDISCIPLINARITY

How to find a balance between mono and interdisciplinarity? It is certain that the second is built on the first. The answer proposed here will probably be unsatisfactory for many: there is no way to establish, *a priori*, the "optimal" position of the cursor. The costs and benefits of these practices vary not only between disciplines but also within disciplines, not to say within each problem. Interdisciplinarity in mathematics or physics may, at first sight, seem less relevant than interdisciplinarity in the social sciences (we can however report the work of Von Neumann in mathematics, physics, computer science or economics). If the latter study the Man, it is indeed surprising that they are always content with a mere perspective from the side, without perspective on the boundaries of the disciplines being taught or practised. This is certainly the message conveyed by Hayek's work, which sweeps practically all fields of the social sciences with a constant concern for the methodological retreat: from psychology to economics, from epistemology to the sciences. policies or the systemic or complexity sciences. It would be absurd to consider that this work does not have its virtues despite sometimes, the ideological approach is what one lends to it.

Moreover, it is impossible to determine, *ex ante*, the value of the results that can derive from an interdisciplinary approach, or even a simply multidisciplinary teaching. Few people were able to anticipate the emergence of an economic analysis of law, the fertility of the application of game theory in biology, the dangers of the crossroads between theory of evolution and sociology (and more broadly the sociobiology) ... but all recognize, to limit themselves to the less "controversial"

[42]In the late 1990s, the European Commission embarked on a long process of introducing a 'more economic approach' to EU Antitrust law. One by one, it reviewed its approach to all three pillars of EU Antitrust Law.

interdisciplinary practices today that the philosophy of law or the history of law, even a basic understanding of economic phenomena, is today a necessity for lawyers. When I was a master, our professor of the theory of law (jurisprudence) recommended us to read Paul Veyne's book "How we write history"[43]. This choice might seem surprising (a work of history, or more precisely of epistemology applied to history) ... and yet the links that can be drawn between this book and the practice of law are numerous even if the substance even of these links is difficult to express.

Nevertheless, asserting that optimality is not at the extremes, is to recognize the relevance of the diversity of approaches, which seems sufficient to consider a greater integration of different disciplines in traditional university courses, in research and, in the future, in professional practices.

However, there remains one difficulty: is the law a "mono" disciplinary approach? Previous developments claim that it is not. However, if we take the discipline as a set of social conventions on how to practice it (Kuhnian version[44]), it is possible to reconcile the whole. Law is not monodisciplinary: it borrows far too much from almost all social sciences. Philosophy and history are not considered as constituting a problematic use; psychology could be incidentally relevant; sociology is often required to understand the evolution of societies; economics is also sometimes used in certain fields. Yet, what unites jurists to make them a community are the social norms shared on the heart of the practice; not that this heart can never evolve or be perfectly stable, but the learning of the law can make sense only if this heart exists. These social norms are often not clarified, making the introduction of what some perceive as external elements even more difficult. So, what is termed interdisciplinarity in law is only the extension of interdisciplinarity (not thought as such) and already contained in the social norms of the practice of this "discipline" ... Let's dare to call things by their name.

[43] PAUL VEYNE, COMMENT ON ECRIT L'HISTOIRE (Seuil 1971).

[44] THOMAS KUHN, THE STRUCTURE OF SCIENTIFIC REVOLUTIONS (University of Chicago Press 1962).

IV. CONCLUSION: PUTTING THE ART OF JUDGING AT THE CENTER OF LEGAL THINKING

I have always been struck by the presence of three forms of principles of action in Aristotle. For the Greek philosopher, one does not reason in the same way when things cannot be other than they are and when they can be. Episteme, techné and praxis[45] then become three types of rationality to consider the problems of three distinct kinds of problems. Law is not the domain of episteme but of praxis. The right decision does not depend on its content but on the procedure that led to it; it results from an art of judging, that is to say from an ability to apprehend the problem in its many dimensions in order to be able to decide at best. This art is profoundly interdisciplinary by its very essence. It would be harmful, in the name of a scientific prestige whose meaning we do not always understand, to forget it.

45 TERENCE MARSHALL, À LA RECHERCHE DE L'HUMANITE (PUF (« Leviathan ») 2009).

FRUSTRATING OR PERHAPS SUPPORTIVE OF ECONOMIC ACTIVITY? A LAW AND ECONOMICS TAKE ON LABOUR LAW IN INDIA

- *Jaivir Singh*[*]

I. INTRODUCTION

Of course, there is much that is written and discussed about Indian labour laws and in most of the mainstream writing there is a sense that these laws frustrate economic activity on many accounts. It is said there are too many laws making compliance difficult for the businessman, the restrictions that they impose lead to inefficiencies and that the law must change substantially (at least as they are in their present form) –the recent move to collapse labour laws into codes is conceivably the culmination of this chain of thinking. While there may or may not be sufficient virtue to the idea that to study labour law is to gauge how it impedes economic activity, this direction of study is perhaps not entirely in the spirit of the analysis favoured by the *law and economics* understanding of approaching the problem. Though there are varieties of law and economics approaches – my broad understanding goes back to the cradle of the discipline emphasising the key insight featured by Coase that law effects efficiency when transaction costs are present.[1] My intent here is to highlight a set of transaction costs – the ones that are characteristically emphasised by the *incomplete contracts* literature. Such transaction costs are endemically present in the labour market and I therefore argue that our attention needs to shift by analysing law in this light. Thus, rather than obsessively viewing law as an impediment, we need to appreciate the point that the many labour laws are perhaps present to correct some market failure i.e. counter the presence of transaction costs. If indeed this is accepted we might see (at least a sub set) of labour laws are supportive of efficient productive activity rather than being efficiency thwarting. This has many implications for

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[1] R. H. Coase, *The Problem of Social Cost, 3* JOURNAL OF LAW AND ECONOMICS, 1-44 (1960).

the ongoing labour reform which should be taken into cognisance above all else to genuinely encourage productive relations.

To make this point I begin by discussing the many thresholds specified by Indian labour law in terms of coverage -size of the unit, definition of workers etc., and the fact that much of labour reform is directed at constricting this coverage. The analytical basis of this seems to lie in the belief that labour markets are competitive and I briefly go over the literature which has furthered this view in the Indian context. If we correct this analytic and pay attention to how the contours of the firm have come to be defined within the incomplete contract framework, then it is also evident that this frame allows us to approach law and the labour market with greater insight than is the case otherwise. Thus, over the next two sections I briefly go over the central arguments associated with incomplete contract theory and how it is of relevance to understanding the labour market. In the final part of the essay I attempt to use the insights gathered to briefly remark on the law pertaining to contract labour and apprentices in India. This is followed by a concluding comment.

II. THE MANY THRESHOLDS OF INDIAN LABOUR LAW

India has a plethora of labour laws and one of the key characteristics of these laws is that they are oriented to covering specific categories of establishments and workers, producing a minutia of thresholds. For instance, safety and health requirements for workers become mandatory only if the *Factories Act 1948* is applicable to the unit- thus the factory unit needs to be using power and employing 10 or more workers, and if not using power, employing 20 or more workers on any day of the preceding 12 months for the requirements of the Act to be bestowed on workers. Similarly, the labour laws covering social security such as The *Employees' Provident Fund and Miscellaneous Provisions Act 1952* comes into force only if the unit is employing more than twenty workers. The size of the establishment is also a criterion for the prevalence of standard terms of employment and the requirement that due procedure be followed when disciplinary action is initiated against workers -these issues become legally binding only in establishments that employ fifty or more workers and thus come under the cover of *the Industrial Employment (Standing Orders) Act, 1946*.

More notoriously under the *Industrial Disputes Act 1947* only establishments employing more than hundred workers (recently in some states this threshold has changed) need to get permission from the government before lay-offs, retrenchment or closure is allowed to be put into effect. It is the case that not only must the establishment in which the worker is working be covered by the appropriate law but the worker herself must belong to a category that has access to the law – typically for a worker to have the legal standing to raise an industrial dispute she must be a 'workman' as defined by Section 2(s) of the Industrial Disputes Act[2].

Over time of course there have been many changes to the law, largely by initiating changes in thresholds and the coverage of laws. Since labour lies in the concurrent list of the Indian Constitution, it is the case that many of the states periodically amend labour legislations. A recent spate of amendments by states has re-specified some of the thresholds as gestures of reform. For example, the state of Rajasthan changed the coverage of three prominent labour legislations:

i. The *Contract Labour (Regulation and Abolition) Act, 1970* which was applicable to establishments employing 20 or more workers, has now been made applicable to establishments employing 50 or more workers;
ii. The Factories Act 1948, which as we have noted above was legislated to cover establishments employing 10 or more workers (using power) and 20 or more workers (not using power), has now been amended to cover only establishments employing 20 or more workers (using power) and 40 or more (not using power);
iii. Chapter V B of the *Industrial Disputes Act 1947*, which required establishments employing more than 100 workers to seek permission from the government before they initiated lay-offs, retrenchments or closure, has been amended so that now only establishments employing 300 or more workers are required to seek permission. Similar *threshold* - oriented changes have been made in the states of Madhya Pradesh and of Gujarat as well. It is also the case that the shrinking coverage of labour laws is not confined to legislative changes but

[2] See JAIVIR SINGH, LABOUR, EMPLOYMENT AND ECONOMIC GROWTH IN INDIA (Cambridge University Press Delhi 2015).

also extends to the gradual changes initiated by the higher judiciary of the country as they refine the point as to which category of workers will be covered by the law.

The Supreme Court of India has played an important role in this matter – when called upon to define the rights of contract labour (labour that is hired through a labour contractor and referred as agency workers to in other parts of the world)in the case of *Steel Authority of India*[3], a Constitution Bench of the Indian Supreme Court ruled that there was no obligation on the employer to employ the contract labour that had been abolished by the government (a move that would be initiated because contract workers were doing the jobs meant for regular labour invoking the *Contract Labour (Regulation and Abolition) Act*).Further, as per this judgment the question as to whether contract labour is doing the work of regular worker is an independent issue, which the Bench said needs to be litigated as an industrial dispute separately. A subsequent case[4] said that the test to discern whether the contract labour agreement is "sham, nominal and is a mere camouflage", requires one to see who pays the salary -if the contract is for the supply of labour then the worker will work under the 'directions, supervision and control of the principal employer" but since the salary is paid by the contractor the "ultimate supervision and control lies with a contractor". The originality of the judgment is to label the contractor's control as *primary* and the principal employer's control as *secondary*. This test is undoubtedly calculated to make it tougher for workers hired as contract labour to establish an employment relationship with the principal employer. These judgments and others of their kind[5] have engendered a very large shift in the proportion of the workers employed as contract workers – in fact according to data obtained from the Annual Survey of Industry by 2015 thirty five percent of the labour force employed in the formal manufacturing sector consists of contract labour.[6]

III. LABOUR LAW AND THE EFFICIENCY-EQUITY TRADE-OFF

[3] Steel Authority of India v. National Union Water Front Workers, AIR 2001 SC 3527.
[4] International Airport Authority of India v. International Air Cargo Workers Union, (2009) 13 SCC 374.
[5] Secretary, State of Karnataka and Ors vs. Umadevi and Ors, AIR 2006 SC 1806, (2006) 4 SCC 1.
[6] For a discussion on the connections between the Supreme Court judgments and the growth of contract labour see DEB KUSUM DAS ET. AL, EMPLOYMENT POLICY IN EMERGING ECONOMIES: THE INDIAN CASE 42-63(Routledge: London 2018).

It is of course not the intent here to list the many intricacies of Indian labour law in detail but the point is that the labour law reform is centred around a discourse that apart from encouraging self-certification in lieu of having a regime of factory inspectors[7], seeks to constrict the number of workers and establishments that are covered by labour laws. A good deal of this orientation follows from the premise that Indian labour laws lower the demand for labour as well asthe perception that it is very cumbersome for a firm to meet the requirements imposed by various labour laws. This kind of thinking which lies at the core of the policy rhetoric, is quite firmly sourced in the academic work on the Indian labour market. The standard literature on the formal sector labour market in India has focused on the obstinate paradox that typifies the Indian economy – viz., that in spite of a comparatively high rate of growth of output, the expansion in employment is quite small. The overarching practice has been to suggest that this is due to the contraction in the demand for labour produced by restrictive labour laws. Starting with the earliest exposition on the matter which showed that the (in) famous Chapter VB of the Industrial Disputes Act dampens the demand for labour[8], successive work has continued to target the Act as the source of critical rigidity in the law. A recurrently cited paper by Besley and Burgess relates pro-labour/pro employer legislative changes made by Indian states to the Industrial Disputes Act to both levels of output and employment, concluding that pro-labour states perform poorly on both counts[9]. These results have been criticized in the grounds that the methodology is flawed but this point has been largely ignored[10]. In fact, subsequent work has continued to use the same

[7] In 2014 the Government of India launched a slew of reforms designed to reduce lengthy inspection and compliance procedures. Prominent among these moves is the *Shram Suvidha Portal* which, allows employers to submit a self-certified single compliance report for 16 Central labour laws. This reform is expected to simplify business operations by putting the onus of compliance on enterprises through self-certification.

[8] P.R. Fallon & R.E.B. Lucas, *Job Security Regulation and Dynamic Demand for Industrial Labor in India and Zimbabwe,* 40 (2) JOURNAL OF DEVELOPMENT ECONOMICS, 241- 275 (1993).

[9] T. Besleyand R. Burgess, *Can Regulation Hinder Economic Performance? Evidence from India*, 119 QUARTERLY JOURNAL OF ECONOMICS, 91-134 (2004).

[10] Aditya Bhattacharjea, *Labour market regulation and industrial performance in India: A critical review of the empirical evidence,* 49 (2) INDIAN JOURNAL OF LABOUR ECONOMICS, 211-232 (2006).
Aditya Bhattacharjea"*The Effects of Employment Protection Legislation on Indian Manufacturing,* 44 (22) ECONOMIC AND POLITICAL WEEKLY, 55-62 (2009).

measure[11], while others have expanded it to incorporate changes in other labour laws as well – all these studies underline the assessment that that the more pro-labour states have worse labour and output outcomes[12].

The idea behind these studies is that labour laws inhibit employers from hiring workers because employers have to carry 'stocks' of labour in the face of product market downturns, leading employers to constrain hiring and possibly also to increase capital – labour ratios. The efficiency cost is further compounded because the restriction on the ability of firms to make adjustments in response to exogenous changes harms all workers (as a group) since long run demand for labour diminishes. This kind of thinking is firmly based on the premise that the labour market is typically competitive, where wages reflect the capacities of workers and if the market is allowed to function without impediments it would result in the efficient allocation of resources, including labour. Admittedly these outcomes may be inequitable and in the absence of perfect insurance markets for labour impose the costs of unforeseen shocks on workers. The many laws and institutions pertaining to minimum wages, unions, termination compensation, unemployment insurance, centralized bargaining to name a few, come to be typically viewed as devices that compensate for these risks and inequities. If one works with the conviction that the labour market is competitive then such labour laws cannot but be a source of inefficiency, implying that we have to eternally confront an inescapable equity (fairness) - efficiency trade off that will always accompany legal intervention in the labour market. It is thus no surprise that reform of labour law has come to be associated with restricting coverage to a sequentially smaller fraction of the labour force – after all it follows that if the coverage and content of labour law were expanded, it is but pernicious - while it may increase the welfare of some workers, it would lead to an enormous efficiency loss.

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[11] P. Aghion, R. Burgess, S. J. Redding and F. Zilibotti, "*The Unequal effects of Liberalization: Evidence from dismantling the License Raj in India*, 98 (4) AMERICAN ECONOMIC REVIEW, 1397-1412 (2008).
Ahmad Ahsan and Carmen Pagés, *Are All Labor Regulations Equal? Evidence from Indian Manufacturing,* 3394 INSTITUE FOR THE STUDY OF LABOR (2008).

[12] Sean M. Dougherty *Labour regulation and employment dynamics at the state level in India*, 1 (4) REVIEW OF MARKET INTEGRATION (2009).
Sean M. Dougherty, V.C.F. Robles and Kala Krishna, *Employment Protection Legislation and Plant-Level Productivity in India*, 17693 NATIONAL BUREAU OF ECONOMIC RESEARCH (2011).

However, the discussion changes somewhat if we disabuse ourselves of the competitive market fetish and follow MacLeod's lead to take cognisance of the fact that some form of *labour law* has been in place since antiquity and this probably indicates the point that labour market institutions are a response to some market failure - the institution in question (labour law inclusive) may actually be solving a resource allocation problem rather than creating a problem.[13] This is of course precisely the point of *law and economics* analysis underscored in its genesis by Coase – law has consequences for efficiency in a world where transaction costs are important.[14] How precisely the law matters of course varies across different contexts and in the labour market there are a variety of circumstances but I would like to pursue a chain of thinking that has originated from the work pioneered by Coase on the boundaries of the firm[15].

IV. INCOMPLETE CONTRACTS

Coase in his classic 1937 paper, sought to provide an explanation for the existence of the firm – he suggested that the hierarchical commands replace the market in certain instances when the 'costs of the price mechanism' make the organization of economic activity in the market costly and this makes for the firm. The limits of such firms are reached when the marginal benefit of working inside the firm equals the marginal cost of administrative errors. Although Coase explained the 'costs of the price mechanism' (the term that metamorphosed into transaction costs) as negotiation costs, later work by Williamson[16] and Klein *et al*[17] went on to link transaction costs with opportunism associated with relationship-specific investment that leads to hold up problems. This work established that vertical integration can prevent such opportunism, but, because it stresses only the benefits of integration, the limits to the firm remain undefined. The limits of the firm

[13] O. ASHENFELTER & D. CARD, 4B HANDBOOK OF LABOR ECONOMICS 1591-1696 (North Holland 2011).
[14] R. H. Coase, *The Problem of Social Cost, 3* JOURNAL OF LAW AND ECONOMICS, 1-44 (1960).
[15] R. H. Coase, *The Nature of the Firm,* 4 (16) ECONOMICA, NEW SERIES, 386-405 (1937).
[16] OLIVER WILLIAMSON, MARKETS AND HIERARCHIES: ANALYIS AND ANTITRUST IMPLICATIONS (New York: Free Press 1975).
OLIVER WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (New York: Free Press 1985).

[17] Benjamin Klien, R. Crawford and A. Alchian, *Vertical Integration, Appropriable Rents and the Competitive Contracting process* 21 JOURNAL OF LAW AND ECONOMICS, 297-326 (1978).

came to be more fully specified in the classic paper by Grossman and Hart[18]. In this work they suggest a model of two stage economic activity – an ex-ante stage where agents make relationship specific investments and an ex post stage when production decisions are taken. Though ex-post contracts are presumed to be efficient, ex-ante contracts are characterised as being typically incomplete because of the presence of transactions costs associated with hold ups. In this scenario, ownership defined as residual rights (property rights that remain with a party in relation to non-human assets after contractual activity is over)becomes an important determinant of the ex-post surplus, which in turn affects incentives to make ex-ante investments. Accordingly, a merger does not generate unequivocal benefits since the owner-manager (who is taken over) loses incentives to invest in the ex-ante relationship specific investment. Hence if the criterion for the efficient size of the firm is the most favourable level of ex-ante investment, then highly complementary assets should be owned in common but as the firm grows and the relation of one asset to the other diminishes then separation is better.

To phrase the point differently though integration checks hold ups, such gains do not always adequately compensate incentive losses. The Grossman- Hart model looked at costs and benefits of integration from the perspective of incentives for top management but later work by Hart and Moore extends the model to look at the impact of changes in ownership on incentives of not only owner managers but also non-owners of assets (employees)[19].The representative situation examined in this work involves an asset when employers have ownership rights but workers do not and involves analysing how the incentives of employees change as integration occurs or, to phrase it differently, when asset ownership becomes more or less concentrated. In this model agents take action at time period 0– say make an asset specific investment in developing a skill, which will pay off at time period 1 as the fruits of increased productivity. However, such a pay-off will ensue to the agent only if she has access to the specific asset in question. Since writing complete contracts at

[18] S. Grossmanand O. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration,* 94 JOURNAL OF POLITICAL ECONOMY, 691 (1986).

[19] Oliver Hart and John Moore, *Property Rights and the Nature of the Firm,* 98 (6) THE JOURNAL OF POLITICAL ECONOMY, 1119-1158 (1990). A more general non-specialist account can be found in Oliver Hart, *An Economist's Perspective on the Theory of the Firm*: *Contractual Freedom in Corporate Law,* 89 (7) COLUMBIA LAW REVIEW, 1757-1774 (1989).

time period 0 to cover such situations is not possible (returns at time period 1 being un-contractible at time period 0) the agent's marketability/bargaining position at time period 1 will depend on her access to assets and is hence sensitive to allocation of asset ownership. Consequently, the act of investment by an agent at time period 1 is connected to whether he owns the asset and if he does not own it, then who owns it. The broad propositions to emerge from the model are that:

i. for efficient investment, ownership of assets should lie with agents who are indispensable to the economic activity in question even though they do not necessarily make the ex-ante investment decisions and;
ii. for efficient investment assets that are complementary should be owned together.

V. INCOMPLETE CONTRACTS AND THE LABOUR MARKET

By now the insights of the incomplete contracts model have been extended to many branches of economics (the Nobel prize for economics was handed out to Oliver Hart in 2016) and the incomplete contract model has much to offer to help us think of the labour market as well. There is of course a very large literature[20]on incomplete contracts and labour markets but for my current expositional purposes, it is perhaps best to turn back to the early work to appreciate the role of the incomplete contract paradigm in labour markets. To quickly recapitulate, the seminal paper by Klein *et al*[21] is concerned with hold up problems. They tell us that *ex- ante* contracts involving relationship specific investment cannot cover risks that show up *ex-post*, on account of the physical unfeasibility of writing up such complex contracts. They point out that the more specific an investment is to a relationship, greater is the possibility of at least one of the parties usurping

[20] For example see James M. Malcomson, *Contracts, Hold-Up, and Labor Markets, 35 (4) JOURNAL OF ECONOMIC LITERATURE*, 1916-1957 (1997). Also among many other works see W. B MacLeod and V. Nakavanchara, *Can Wrongful Discharge Law Enhance Employment?* 117 ECONOMIC JOURNAL, F218–F278 (2007).

[21] Benjamin Klien, R. Crawford and A. Alchian, *Vertical Integration, Appropriable Rents and the Competitive Contracting process* 21 JOURNAL OF LAW AND ECONOMICS, 297- 326, (1978).

'quasi-rent' from the gains of the relationship ex-post. The anticipation of this can prevent value generating ex-ante decisions to invest. They suggest that vertical integration can somewhat assuage this problem, leading to more efficient levels of investment.

In the labour market context Kline *et al* call attention to the point that vertical integration ends up being approximated by long-term contracts or even by extra-legal implicit contracts. The import of such institutions is apparent when we reflect on an example-let us take the notional case of a worker hired to maintain an asset and if he does not do a good job, he can be fired but were it the case that he is the only person who has learned the skill of maintaining the asset and has the special ability to do so, he can then hold up the owner of the asset and earn a quasi-rent. To resolve the difficulty, it is not conceivable to vertically integrate as in other markets – employers cannot 'own' the worker on account of anti-slavery laws. So, some form of vertical integration such as having a long-term relation – a franchise agreement or even an agency agreement perhaps, which is more vertically integrated with an employer than the case of a worker who can be fired at will,is better at preventing a large hold-up.

The Klein *et al* paper also talks of human capital investments undertaken by workers – such investments have elements that are captured very well by the incomplete contracts rubric. The classic work of Becker brought out the distinction between general and specific capital with general capital defined as being useful across employers and specific capital being associated with increasing the productivity of the worker in her current job[22]. While general human capital is another matter, specific human capital involves a series of ex ante investment decisions by both employers and workers, which are subject to an ex-post risk of quasi-rent appropriation. Consider the appropriation of quasi rent by employees when employers invest in specific human capital. In such instances employees can quit after gaining valuable training provided by employers – a reaction by employers can push up wages to retain workers, but that is no guarantee that workers will remain and complex wage schedules are atypical with wages often tending to be rigid. This train of thinking has generated a large literature emphasising the wide variety of institutions that

[22] GARY BECKER, HUMAN CAPITAL (The University of Chicago Press 1964).

govern quantitative adjustments in labour markets.[23] There are concerns of the appropriation of quasi-rent at the other end of the relationship as well – consider the case where workers have invested in specific human capital on the job and before taking the job and employers opportunistically fire workers nearing retirement depriving them from enjoying the returns of investing in the job. While the role of trade unions is conventionally relegated to forming a cartel to engineer wage setting, they are probably particularly important as institutions that play an important role in monitoring and enforcing long term contracts to help preserve returns to employees with investments in specific human capital.

VI. INCOMPLETE CONTRACTS IN THE LABOUR MARKET AND INDIAN LABOUR LAW

Though it will be only a tip of the iceberg, I would like to bring up a couple of contexts within which our general discussion finds some place in specific instances. One of these is in relation to the large-scale deployment of contract labour mentioned earlier, and the other in relation to *The Apprentice Act 1961* and the *Skilling India* Policy of the Indian government.

A) CONTRACT LABOUR

There is an obvious echo of the concerns raised by the incomplete contract framework that is reflected in the contents of a qualitative study on contract labour that I have been involved with[24]. Over this study it was found that contract workers in a number of industries and locations all over India, seldom, if ever, belong to unions and unions are not interested in having contract workers as members. This generally observed pattern can be explained by the law laid down by the Supreme Court in relation to contract labour which was referred to earlier – as was noted after the Steel

[23] For example, see Hashimoto, Masanori, and Ben T. Yu, *Specific capital, employment contracts, and wage rigidity,* 11 (2) THE BELL JOURNAL OF ECONOMICS, 536-549 (1980). and also see Hashimoto, Masanori, *Bonus payments, on-the-job training, and lifetime employment in Japan*, 87 (5) THE JOURNAL OF POLITICAL ECONOMY, 1086-1104 (1979).

[24] PANKAJ KUMAR ET. AL, ISSUES IN LAW AND PUBLIC POLICY ON CONTRACT LABOUR IN INDIA: COMPARATIVE INSIGHTS FROM CHINA (Springer Singapore 2018).

Authority[25] judgement of the Indian Supreme Court Indian employers can hire contract labour through the offices of a contractor and are under no obligation to absorb them into permanent jobs. This effectively means that contract workers do not have many rights that the court will uphold – indeed subsequent to the Steel Authority judgment, it is the case that the rights of all temporary workers were definitively curtailed by the Supreme Court in the Uma Devi case[26].

With no rights for contract workers, it is not surprising that contract workers do not interact with unions and vice versa. For employers while this has meant paying out lower wages and flexibility to fire workers, it has also meant that many of them complain that the workers they hire are not sufficiently skilled and do not stay long enough to be skilled. Perhaps the most interesting part of the qualitative study that illustrates this is from Rudrapur. Rudrapur is a town located in the foothills of the Himalayas near Nainital where a number of industries have set up manufacturing units following fiscal incentives given out by the government, ostensibly to develop the region and provide employment to the people residing in the hinterland of the town. Over the interviews conducted, most of the manufacturing firms in the region expressed precisely this dilemma – while contract workers can be flexibly fired and used as substitutes for regular workers, they do not stick around and generally do not adequately invest in doing the job. In this setting there was an interesting anomaly, which makes a point of import. A heavy transport manufacturer located in the Rudrapur region was able to raise the productivity of workers by signing an agreement with a trade union, which enabled contract workers (this was one of those very rare cases when unions and contract workers interacted with each other) to be treated at par with regular labour. Among other benefits that accrued to contract labour was the fact that they were assured of tenure till the age of 58 years. Presumably this was the source of the phenomena that contract workers actually took care to invest in the job and raise productivity. While the agreement that allowed contract workers to get benefits that were similar to those of regular workers was the joint product of both the management as well as the trade unions playing a crucial role, the agreement was also under strain because the local government machinery considered it illegal. Under the *Contract Labour (Regulation*

[25] Steel Authority of India v. National Union Water Front Workers, AIR 2001 SC 3527.

[26] Secretary, State of Karnataka and Ors vs. Umadevi and Ors AIR, 2006 SC 1806, (2006) 4 SCC1.

and Abolition) Act, 1970 the government labour department needs to initiate moves to abolish contract labour if the job such labour has been hired for is perennial. It is precisely this sort of riddle that labour law reform in India needs to address. By confusing the removal of coverage of various facets of labour law as law reform, the system is encouraging a de facto *employment at will* type regime which may work well if one worker is substituted easily for another – as is the case with unskilled work. However, to the degree that one worker *cannot* be substituted one for another, where investment in the job and in the location where the job has been gained are important and specific human capital as skill is important, it becomes vital for labour law to offer variegated terms to workers – some categories of workers need to be assured of tenure if they are to invest in the job. This is best done by having some basic rights for all labour in place and then proceeding to allow employers to design contracts that suit them best with worker interests being represented by unions. The mere creation of thresholds in statues and judgments invariably leads to perverse effects rather than support for economic activity.

B) THE APPRENTICE ACT 1961 AND THE 'SKILLING INDIA' POLICY

Though the 'flexibility' of the formal labour market has been an omnipresent presence in relation to the discourse around labour law in India – till recently, there has been little talk about connecting labour and labour law with skills. However, a law was put in place about fifty years ago namely the Apprentice Act 1961, which was set up to make it mandatory for certain employers to engage apprentices in designated trades. Broadly speaking, the Act regulates and controls the programme of training of apprentices. Apart from providing the structure of training to apprentices, the law also specifies that a contract of apprenticeship be required to engage a person as an apprentice. Further the obligations of employers are listed, which included provision of training, proper training personnel and the carrying out of obligations under the contract of apprenticeship. The obligations of the apprentice include a conscientious attempt to train oneself, to attend classes regularly and carry out the lawful orders of the employer as well as carry out obligations listed in the contract of apprenticeship. The Act also governs payment of stipend to apprentices at a rate not less than a specified minimum and cannot be paid on a piece rate basis.

There is a restriction on working hours and overtime is discouraged and apprentices are supposed to be able to enjoy the holidays listed in the establishment of apprenticeship. The law does not give the apprentices any rights to a future job and the case law also supports the position that apprentices do not have any rights to a job[27].

There have been minor amendments[28] to the Act over the years but recently a consciousness has emerged that Indian workers are not adequately skilled. Thus, more substantial changes to the Act were initiated in 2014 upon the recommendations of an Inter-Ministerial Group (IMG).[29] The changes were aimed at ostensibly (rhetorically) making apprenticeship more responsive to youth and industry and also aimed at providing greater incentives to employers by making the terms of the enterprise more favourable so that employers are encouraged to train and hire apprentices. The red tape associated with the functioning of the law has been cut down and the new law allows the incorporation of new trades for the purpose of apprenticeship.

The point that needs to be noted over the changes in the law is that apart from some enhancement in the stipend and an 'opportunity to get skilled' the Act does not really provide or rather provide weak returns to workers who may apprentice themselves. Section 22 of the Apprentice Act says "It shall not be obligatory on the part of the employer to offer any employment to any apprentice who has completed the period of his apprenticeship training in his establishment, nor shall it be obligatory on the part of the apprentice to accept an employment under the employer." In this context the Apprentice (Amendment Act) 2014 adds the clause "Every employer shall formulate its own policy for recruiting any apprentice training at his establishment" This is somewhat hopeful from the viewpoint of workers who may be able to invest in the jobs if the employment policy offers some form of tenure. However, it may be noted that one needs a particular kind of

[27] For example see Management of T.I. Diamond Chain Ltd. v. P.O. Labour Court, 2003 I CLR 57 (Mad.H.C.), Petroleum Employees Union v. Indian Oil Corporation Ltd., 2001 I CLR 785 (Bom.-D.B.).
[28] Since its initial legislation, the Apprentice Act has been amended in 1973, 1986, 1997 2007 and most recently in 2014.
[29] The Inter Ministerial Group (IMG) was constituted comprising representatives from Ministry of Railways, Ministry of Micro Small Medium Enterprises, Ministry of Power, Ministry of Defence, Planning Commission, National Skill Development Agency (NSDA), Working Group on The Directorate General of Employment and Training WG (DGE&T) for discussion on the suggestions received from PM's National Council on Skill Development (PMs NCSD), Central Apprenticeship Council (CAC) , National Commission on Labour (NCL), Indian Labour Conference (ILC) and CII.

wider legal regime that would support employer - employee contracts to be signed, particularly a robust union movement. As we noted above neither the statue nor the case law holds up any apprentice rights to a job.

After the passing of this legislation, in 2015 there has been a declaration of a National Policy on Skill Development and Entrepreneurship[30] under which an entire ministry called Ministry for Skill Development and Entrepreneurship has been set up to encourage the skilling of the workforce. While the document emphasizes various programs for increasing skills, there is very little mention on ensuring that workers are able to gain some sure returns to the investment that they would have put in to gain the skills. As long as the workers are not convinced about the ex-post benefits or return to be accrued out of such programme, it is obviously very low likelihood that they would want to invest in skills. Moreover, in a country like India, which is largely characterised by institutional deficits, workers will be less keen to invest in their skills which could affect skill building as a prime objective of these measures.

VII. CONCLUSION

India clearly needs law reform that will enhance ex-ante investment by workers – this is the only way the much-desired skilled work force will come into being. Empirical work has by now made it quite clear that a country's labour market institutions ((read law) affect workers skills and in turn determine the value and profile of the goods exported – in this the frame envisioned by the incomplete contract model is vital to understanding the economic processes.[31] Thus, we need less of reform that is merely 'pro-employer' – To make the case in point, one such 'pro-employer' change to the Factories Act in Rajasthan has the law saying that complaints against the employer upon violation of the Act would not receive cognizance by a court without prior written

[30]NATIONAL POLICY ON SKILL DEVELOPMENT AND ENTREPRENEURSHIP 2015, http://www.skilldevelopment.gov.in/assets/images/Skill%20India/policy%20booklet-%20Final.pdf (last visited Aug. 11, 2018).

[31] Heiwai Tang, *Labor market institutions, firm-specific skills, and trade patterns,* 87 JOURNAL OF INTERNATIONAL ECONOMICS 337–351 (2012).

permission from the state government. By merely making life more cumbersome for the employee rather than the employer, the law is not enhancing efficiency, rather as I have tried to argue, efficiency is contextual and when there is value to be generated from an ex-ante relationship specific investment, the correct law is one that governs the relationship over a long period and this is important for gaining value.

In fact, in relation to this I want to draw from an opinion piece written by Ram Singh where he exhorts the Indian judiciary to appreciate the economic consequences of the judgments it makes - but he warns that this should mean that it takes to treating public purpose narrowly as is often the wont – "treating economic growth and the revenue of the state as public purposes is walking on a slippery slope".[32] Instead it is more important than ever before for the courts and the legislature to work with analytical rigour that is cognisant of the complex interactions that form economic life. In many instances the wisdom and interpretation of the courts is particularly vital - as MacLeod and Nakavachara tell us that while legislation best governs the average case, but it is often the cases that come to be determined in courts on account of egregious behavior of employers are the crucial marginal cases[33]. These are the ones that need to be correct, otherwise we end up with a preventative fall in productive relations.

[32] Ram Singh, *Acres of Contention (Comment),* THE HINDU (June 19, 2018).
[33] W. B MacLeod and V. Nakavanchara, *Can Wrongful Discharge Law Enhance Employment?* 117 ECONOMIC JOURNAL, F218–F278 (2007).

REVIEW: THE CRIME DECLINE, MASS INCARCERATION, AND SOCIETAL WELL-BEING

- *Thomas Ulen*[*]

I. INTRODUCTION

One of the most dramatic events in the United States of the past almost 30 years has been the remarkable decline in the amount of crime. Since 1991 there has been an almost (an important qualifier, as we shall see) continuous decline in both violent and non-violent crime in the United States.[1]

At the same time that this decline was occurring, there was an increase (although not a continuous increase, as we shall also see) in the number of people incarcerated in prisons and jails in the U.S. The figures are stark. In 1980 there were approximately 500,000 people being held in all federal and state prisons and local jails in the country. By 2005 there were 2.5 million people incarcerated in the United States. That figure was by far the highest rate of incarceration in the developed world. In addition, the United States accounted for 25 percent of all the prisoners in the world.

These two developments raise mixed emotions. The crime decline has been, as Professor Sharkey demonstrates, an unqualified social benefit. On the other hand, the fact that recently 1 in every 100 people was incarcerated raises mixed emotions. There are large direct and indirect costs of incarceration on that large scale. The direct costs of building, maintaining, and staffing prisons and jails are immense, estimated to be around $80 billion per year. The indirect costs to the individuals incarcerated and their families and communities in the lives that are disrupted and frequently never quite put back on track are also immense. If, however, that high rate of incarceration and its costs have played a significant role in causing the decline in crime, then just possibly the mass incarceration may have been worth pursuing. Even if that is so, it does

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I would like to thank, very warmly, Professor and Dean Ranita Nagar of GNLU for her invitation to write this review and for her many kindnesses over the past years. I want to offer my congratulations to her and her team on the inauguration of this review and of their great success in building their law-and-economics program at GNLU.
[1] See Section II for statistics on and various explanations of the crime decline.

not speak well for U.S. society that we had such high rates of crime before 1991 and had, apparently, to adopt such draconian measures to reduce those crime rates.

These matters have been the subject of a great deal of scholarly inquiry. That scholarship has focused on two related questions: First, why did crime decline so dramatically after 1991? And second, what role did "mass incarceration," as it is called, play in the crime decline? The payoff to getting correct answers to these questions is extremely high. For instance, to the extent that we can identify the causes of the long decline in crime (and presumably, the causes of the large rise in crime in the late 1960s, 1970s, and 1980s), the greater our ability to adjust policy levers so as to stave off a future increase in crime (on the assumption that the factors we identify repeat their causal roles in the future) or to reduce crime if it spikes. Relatedly, if we can identify the reasons for increases and decreases in the rate of crime, the more focused our criminal justice policy can become. Although the scholarly search for reasons for fluctuations in the crime rate has become far more sophisticated, there are still a distressingly large number of potential reasons adduced to explain both the rise and fall of crime in the U.S. and, as a result, the lack of a clear, agreed-upon account of what happened and why after 1991. In view of that hodgepodge, our criminal justice system policy is struggling to figure out what lessons to take from the last 30 years.

As the readers of this journal will know, the field of law and economics has been deeply interested in criminal law and punishment issues for a long time. One of the foundational articles in the field is Gary Becker's 1968 article on the economics of crime and punishment, which shifted the focus on crime away from socio-economic causes to the consideration of incentives to commit crime and to avoid punishment.[2] Many readers will be familiar with this literature, including the remarkably robust literature over the last 40 years on the deterrent effect of the death penalty.

The books that I shall review here – John F. Pfaff, *Locked In: The True Causes of Mass Incarceration and How to Achieve Real Reform* (2017) and Patrick Sharkey, *Uneasy Peace: The Great Crime Decline, the Renewal of City Life, and the Next War on Violence* (2018) – examine two different aspects of crime in the United States. Pfaff focuses on mass incarceration and offers a novel theory of the reasons for mass incarceration and empirical evidence to support that theory. Sharkey focuses on crime and the urban landscape. In particular, he

[2]Gary S Becker, *Crime and Punishment: An Economic Analysis*, 76 J. POL. ECON. 169 (1968).

examines the great benefits of the crime decline to urban living and particularly to urban minority communities.

Before turning to those works, I shall, in Section II, give some background on what is called the "great crime decline" of the 1990s and early 2000s.

Then in Section III I shall turn to a discussion of Professor Pfaff's account of why there has been such heavy use of incarceration as a crime-deterring strategy in the United States. He argues that society has been driven to overuse imprisonment because prosecutors have overly strong incentives to pursue imprisonment for criminal offenders. Pfaff suggests that the result is that, from a societal well-being perspective, there are too many prisoners. He offers correctives that will, he argues, trim prosecutors' incentives to overuse imprisonment.

Then in Section IV, I turn to a discussion of Professor Sharkey's account of the important relationship between the level of crime and societal well-being. He first shows that the increase in crime in the 1960s through the late 1980s had a wide-ranging adverse effect on society. Crime obviously has very ill effects on the victims of crime, but Sharkey points out that the knock-on effects of crime on all of society are also devastating. It follows, as he demonstrates, that when crime declines, the benefits to society as a whole are very large. In the course of these important demonstrations, Sharkey identifies at least one interesting and heretofore underreported causal effect on the crime decline.

A brief conclusion follows.

A fair question is, "What has all this got to do with India?" The matters discussed in these two books should have appeal to those who are curious about broad social trends in crime, why crime rates fluctuate, what the consequences for societal well-being are when crime declines or increases, and what tools the United States has used to combat crime increases and whether those tools are effective. Moreover, those who are interested in the field of law and economics ought to find these books of interest in that they explore areas in which law-and-economics scholars have taken a deep interest.

II. THE GREAT CRIME DECLINE AND MASS INCARCERATION

To put these two books into context, we need to review the "great crime decline" that began in 1991, continued until the present, and has been one of the defining events in recent U.S. history. I shall first review some of the principal facts about the decline and then briefly survey some of the scholarly literature that seeks to explain what happened and why.

A. The Great Crime Decline

From 1965 to 1974, United States crime rates (typically measured as the incidence of a reported crime per 100,000 people) rose significantly and became a significant public policy issue. Between the mid-1970s and the early 1990s, crime rates in the U.S. remained high and fluctuated within a relatively narrow band. Interestingly for what will come later, our closest neighbor, Canada, also experienced a parallel 10-year increase in crime between the mid-1960s and the mid-1970s but delayed from the U.S. increase by one year.[3]

To give a sense of this era, note that in the early 1960s "fewer than 500 people were murdered annually in New York City. But by 1980 more than 1,800 homicides took place every year. A decade later the level of violence worsened: More than 2,000 people were murdered [in New York City] in each of the first few years of the 1990s."[4]

Then in 1991 and continuing through at least 2015 the crime rate fell to about half of what it was in 1991. "Violent crime has fallen by 51 percent since 1991, and property crime by 43 percent."[5] This decline was not localized or affecting only certain regions of the country. It happened everywhere – in "cities, suburbs, towns, and rural areas, [and] in all regions."[6] It affected all manner of crimes and, after 1993, all ages and categories of offenders and victims.[7] Nothing of this duration had occurred in the U.S. since World War II, and no decline has lasted as long as either the one in the 1990s or the one that has continued through at least the mid-2010s.

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[3]FRANKLIN E. ZIMRING, THE GREAT AMERICAN CRIME DECLINE 200 (2006).
[4]PATRICK SHARKEY, UNEASY PEACE: THE GREAT CRIME DECLINE, THE RENEWAL OF CITY LIFE, AND THE NEXT WAR ON VIOLENCE xv (2018).
[5]OLIVER ROEDER, LAUREN-BROOKE EISEN & JULIA BOWLING, WHAT CAUSED THE CRIME DECLINE? 3 (2015). This study is the source of much of the information in this section.
[6] Zimring, *supra* note 5, at 196.
[7]*Id.*

At about the same time, other developed countries experienced a similar but smaller decline in some crimes. Only one of the G-7 countries, Canada, had as long and large a decline as that that occurred in the U.S.[8]

To illustrate how much things had changed since before 1991, Professor Sharkey reports:

> In [New York City,] where more than 2,000 people used to be murdered each year, 328 people were killed in 2014, the lowest tally since the first half of the twentieth century. … Violent crime fell in almost every American city from the early 1990s to the early 2010s, and it plummeted in many major urban centers. In Atlanta, Dallas, Los Angeles, and Washington, the murder rate fell by 60 to 80 percent, similar to the crime drop in New York City. Even in places that continued to have high levels of violence, like Oakland and Philadelphia, the homicide rate fell by at least 33 percent.[9]

Put somewhat differently, "By 2014, the homicide rate in New York City had fallen to 4 per 100,000."[10]

As we shall see in Section IIC below, some have contended that there has been a recent uptick in crime and that a worrisome reversal of the trend of the past nearly 30 years has begun.

B. Causes of the Crime Decline

[8] *Id.*, at 197. Michael Tonry, Professor of Law and Public Policy at the University of Minnesota, in a marvelous piece of scholarship, *Why Crime Rates Are Falling Throughout the Western World*, 43 CRIME AND JUSTICE 1 (2014), takes partial issue with Zimring's account. Tonry persuasively argues that "crime rates have moved in parallel in Western societies since the late Middle Ages." For example, over 400 years or so homicide rates had declined from between 20 and 100 per 100,000 in most Western countries to about 1 per 100,000 around 1900. Then, from "the 1960s to the 1990s, rates for violent and property crimes rose in all wealthy Western countries. Since then, rates in all have fallen precipitately for homicide, burglary, auto theft, and other property crime." On the general theme of declining violence in human societies, see STEVEN PINKER, THE BETTER ANGELS OF OUR NATURE: WHY VIOLENCE HAS DECLINED (2011) and PINKER, ENLIGHTENMENT NOW: THE CASE FOR REASON, SCIENCE, HUMANISM, AND PROGRESS (2018); At the same time that homicide has been declining in much of the developed world, Latin America has become the center of homicide. For example, "[o]n January 11, 2017, no one was murdered in El Salvador – a fact that was reported as far away as New Zealand, Thailand, and Russia. … [El Salvador] had [at that time] the highest murder rate in the world: 81 per 100,000, more than ten times the global average. On most days more than a dozen Salvadoreans lost their lives to gang warfare, police shootings, and domestic disputes." "Murder in Latin America: Shining Some Light," *The Economist*, April 7, 2018, at 16. "Latin America, which boasts just 8 percent of the world's population, accounts for 38 percent of its criminal killing[,] 140,000 people last year, more than have been lost in wars around the world in almost all of the years this century." *Id.* at 16.

[9] Sharkey, *supra*note 6, at xvii-xxviii.

[10] *Id.* at 31.

Naturally, there is great interest in explaining why crime declined. I shall briefly describe two relatively early attempts to explain the decline of the 1990s and then turn to more recent attempts to explain the entire period of 1991 to the present.

1. Accounts of the Decline of the 1990s

In 2004, Professor Steve Levitt published an important article in the *Journal of Economic Perspectives* that attributed the decline of the 1990s to four factors and dismissed six other factors that although plausible possible explanations, are far from being causal factors in the decline.[11]

The six factors that Levitt argued had little or no effect on the crime decline of the 1990s were (1) the strong economy, (2) changing demographics, (3) better policing strategies, (4) gun control laws, (5) laws allowing the carrying of concealed weapons, and (6) the death penalty. Bob Cooter and I have elsewhere summarized Levitt's arguments as to why these factors played little or no role in causing the crime decline.[12]

The four factors that Levitt believes to have had a large effect on the crime decline of the 1990s are (1) increases in the number of police, (2) the rising prison population, (3) the receding crack cocaine epidemic, and (4) the legalization of abortion in the early 1970s.[13]

In his previous work, Levitt had found that the elasticity of crime with respect to numbers of police was between -0.43 and -.50, meaning that a ten percent increase in the numbers of police would cause between a 4.3 and 5 percent decline in the amount of crime.[14] Given that the number of police in the United States increased by 50,000 to 60,000 in the 1990s (an increase of 14 percent) and assuming an elasticity of crime with respect to police officers of -0.4, this factor alone explains 5 to 6 percent of the decline in crime in the 1990s – that is, between one-fifth and one-tenth of the entire crime decline.

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[11] See Levitt, *supra* note 7.

[12] ROBERT D. COOTER & THOMAS S. ULEN, LAW AND ECONOMICS 526-29 (6th ed. 2012).

[13] *Id.* at 530-31. We shall return to the possibility that changing police strategies played a significant part in the crime decline when we look at more recent studies of the entire 1991-to-the-present period.

[14] Steven D. Levitt, *Using Electoral Cycles in Police Hiring to Estimate the Effect of Police on Crime*, 87 AM. ECON. REV. 270 (1997). But see Justin McCrary, *Do Electoral Cycles in Police Hiring Really Help Us Estimate the Effect of Police on Crime?*, 92 AM. ECON. REV. 1236 (2002) and this reply: Steven D. Levitt, *Using Electoral Cycles in Police Hiring to Estimate the Effects of Police on Crime: Reply*, 92 AM. ECON. REV. 1244 (2002). See also AARON CHALFIN & JUSTIN MCCRARY, THE EFFECT OF POLICE ON CRIME: NEW EVIDENCE FROM U.S. CITIES, 1960-2010 (2014) (using a broader panel database and stronger estimation techniques that largely support Levitt's 1997 estimates).

We know that the U.S. prison population increased by fourfold between 1980 and 2000, and the deterrence theory of punishment suggests that this increase might have played a significant role in the decline in crime in the 1990s. Earlier research suggested that the elasticity of crime with respect to expected punishment (measured by the change in the number of prisoners) was between -0.10 and -0.40, meaning that a 10 percent increase in the number of prisoners causes between a 1 and 4 percent decline in the amount of crime. The suggestion of these earlier estimates is that the elasticity of violent crimes with respect to imprisonment was at the higher end of this range and that for property crimes was at the lower end. Using estimates of -0.30 for the elasticity of violent crimes and -0.20 for that of property crimes, and assuming that approximately half of the growth in prisoners from 500,000 to 2 million occurred in the 1990s, Levitt writes that increased imprisonment "can account for a reduction in crime of approximately 12 percent [for violent crime] and 8 percent for property crime, or about one-third of the observed decline in crime" in the 1990s.[15]

Crack cocaine was an innovative consumer product introduced in the mid-1980s to make cocaine affordable to lower-income consumers.[16] The innovation was so successful that it set off fierce (and deadly) competition among criminal enterprises to capture greater market share.[17] As a result, homicides among young black males rose significantly from 1985, becoming the leading cause of death among black males 35 years of age and younger. But then for reasons that are not entirely clear, the crack epidemic began to recede. As it did, so did the homicide rate among young black males, falling 50 percent between 1991 and 2001. (During that same period the homicide rate among adult white males fell by 30 percent.)

Levitt estimates about 15 percent of the 1990s homicide decline to the receding crack cocaine epidemic and about 3 percent of the entire crime decline of the 1990s to the reduction in the crack cocaine market.

[15] See Steven D Levitt, *Understanding Why Crime Fell in the 1990s: Four Factors That Explain the Decline and Six That Do Not*, 18 J. ECON. PERSP. 163. 178-79 (2004).
[16] See Steven D. Levitt, "The Freakonomics of Crack Dealing," TED2004, February, 2004, available at https://www.ted.com/talks/steven_levitt_analyzes_crack_economics.
[17] The definitive account of the effects of this market on a city – its police, the dealers, education, labor, politics, and newspaper sectors – are the five seasons of *The Wire* (2002-2008). See https://www.hbo.com/the-wire.

Finally, Levitt and his co-author John Donohue[18] famously attributed 50 percent of the decline in crime in the 1990s to the legalization of abortion in *Roe v. Wade* in January, 1973.[19] The article and its argument are famous, and so, I can sketch it here. Moreover, I shall return to this topic in my discussion of Professor Zimring's book in this section and in the discussions of more recent scholarship in the following section. Levitt and Donohue both noted that the beginning of the great crime decline coincided with the 18th anniversary of *Roe* in 1991 and wondered whether there might be a connection. What connection could there possibly be? As a result of the decision legalizing abortion in the first two trimesters of pregnancy, the number of legal abortions increased from a very small number in 1972 to 1.6 million in 1980 – that is, one abortion for every two live births. One of the implications of that remarkable number is that there was a declining percentage of children in U.S. society from 1973 on. About half of those children, born and unborn, are male, and young males account for a disproportionately high percentage (between 40 and 45 percent) of all crime. So, all other things equal, fewer young males in society means less crime. Additionally, the five states that legalized abortion before Roe was handed down, experienced crime declines before the other 45 states.

Donohue and Levitt refer to this as the "cohort size effect" and attribute 25 percent of the total decline in crime in the 1990s to the decline in the percentage of young males in the population.

But there is more. The authors also argue that the legalization of abortion empowered women to choose when to have children. That is, if circumstances were not good for having a child – if, for example, there was no partner or family member who could provide childcare; there was no suitable medical coverage for birth and healthcare expenses; or the mother or father was unemployed, then abortion allowed early termination of pregnancy and waiting till circumstances improved. As a result, the young people – especially the males – born after 1973 tended to arrive in what were better circumstances. Generally, their families were in better financial shape; they had help with childcare; they were employed. The implication is that these post-1973 children were less likely to commit crime.

Donohue and Levitt refer to this as the "cohort quality effect" and attribute 25 percent of the decline in crime in the 1990s to this effect.

[18]John J. Donohue III & Steven D Levitt, *The Impact of Legalized Abortion on Crime*, 116 Q. J. ECON. 379 (2001).
[19]*Roe v. Wade*, 410 U.S. 113 (1973).

The distinguished criminal law expert and criminologist Professor Franklin Zimring[20] took stock of the 1990s crime decline in a 2008 book[21] and reached slightly different conclusions from those of Professor Levitt about the causes of that decline.

First, Zimring holds that the "crime decline of the 1990s was a classic example of multiple causation, with none of the many contributing causes playing a dominant role."[22]

He notes some of the same factors as had Levitt:

> The percentage of the population in the high-risk ages of 15-29 dropped from 27.4 percent of the U.S. population in 1980 to 20.9 percent in 2000, a major decline. The economy expanded consistently after 1992 – and this longest consecutive postwar economic expansion tracks the crime decline almost exactly. The boom years of the late 1990s reduced the percentage of 16- and 17-year-olds who were neither working nor in school by one-third, a measure of activity that is plausibly related to crime commission rates.[23]

But Zimring departs from Levitt by noting that the parallel decline in crime in Canada is a control case that sheds great light on the U.S. experience. Canada had none of the increase in numbers of police nor of prisoners that the U.S. had during the 1990s but did have the same "reduction in the relative size of the youth population."[24] Therefore, Zimring is inclined to give that demographic factor more weight than is Levitt. And for different reasons, as we shall see.

And he is understandably puzzled by the failure of professional students of crime to foresee the crime decline:

> This lack of certainty about the causes of fluctuations in crime is the only explanation for the failure of crime and criminal justice specialists to see some crime decline on the horizon in the 1990s. The population and imprisonment trends of the 1990s were well known by 1995, but nobody was predicting that a crime decline was just around the corner, even after it had begun! Liberals and conservatives seemed united in pessimism about the

[20] Zimring is William G. Simon Professor of Law and Wolfen Distinguished Scholar at the University of California at Berkeley School of Law (Boalt Hall).
[21] See Zimring, *supra* note 5.
[22] *Id.* at 197.
[23] *Id.*
[24] *Id.* at 198.

period after 1995, even when an economic boom joined the prison and demographic trends. The reason for this was the 1980s. Between 1985 and 1990, the prison population grew at the greatest rate in history, the youth population declined, the economy boomed, and life-threatening crime in the United States went up.[25]

Additionally, as I have already noted, Zimring contends that one cannot undertake causal explanations of the U.S. crime decline without also examining the reasons for Canada's parallel experience in the 1990s. Recall that Canada also had a significant decline in violent and property crimes that matched the timing and duration of the U.S. decline and was at about 70 percent of the U.S. magnitude.[26] Canada and the U.S. had very similar abortion liberalization (although Canada had more limited abortion rights prior to 1989 than did the U.S.), and yet there is no evidence that the decline in serious offenses in Canada was concentrated in younger offenders, as was the case in the U.S. This suggests that something besides abortion legalization and changing demographics were significant in the Canadian experience. Nor did Canada experience a crack epidemic like that in the late 1980s in the U.S.

Zimring also draws special attention to the experience of New York City during the 1990s. The crime drop in the 1990s in the nation's largest city (at 75 percent) was twice as large as the national average. What could have been the cause for this much-larger-than-average decline? Zimring notes that New York City went through three major changes in its police department: "more cops, more aggressive policing, and management reforms [that may] account for as much as a 35 percent decrease (half the total)."[27]

Zimring's final lesson of *The Great American Crime Decline* is what he calls the last and most important lesson of the 1990s: *Whatever else is now known about crime in America, the most important lesson of the 1990s was that major changes in rates of crime can happen without major changes in the social fabric*.[28]

[25]*Id.* at 198-99. Recall that Canada had an increase in crime from the mid-1960s to the mid-1970s that also paralleled the U.S. increase in that period. See text at n. 10 *supra*.
[26]*Id.* at 199.
[27]*Id.* at 201.
[28]*Id.* at 206, italics in original.

For example, we know that New York City during the 1990s experienced a crime decline that was twice as large as the national average, and yet:

> The most remarkable part of this story is not what changed in New York City over the 1990s but what did not change, which was most of New York: the subways didn't change, nor did the schools, the streets and surface transportation system, the population, or the economy. … The very substantial drop in crime was most important not for its testament to particular causes but as evidence that crime propensities are not inherent characteristics of either a population or an urban setting but rather are highly variable aspects of an urban environment. The same city can have radically different rates of crime if only relatively superficial environmental conditions change.[29]

Moreover and amazingly, this lesson was lost on politicians and on professionals who follow criminal justice matters:

> The right had confidently predicted crime increases through the 1990s. That didn't happen. The left has typically said 'no peace without justice' and has cited socioeconomics, lack of opportunity, cultural factors, racism, and discrimination as causes of crime. None of that changed in New York City even while the crime rate went down so dramatically. The sharp decline in crime that happened to New York City is thus of no comfort to either side in the endless debate about human nature versus social environment as an explanation for crime in the United States.[30]

2. More Recent Accounts of the Decline Over the Period 1991-2015.

There was no doubting the reality of the great American crime decline of the 1990s. There was, as we have seen, a lack of consensus about what caused the decline. Professor Zimring noted that none or few of those whose professional expertise was in criminal justice predicted the decline of the 1990s. And not having fully understood why that decline occurred, they did not accurately predict what would happen to crime after 2000. I think that it is fair to say that scholars and criminal justice professionals have been surprised by the continued decline in the 2000s. The surprise is partly just a confession of a primitive belief that there are cycles in crime as in other social forces and that the 1990s decline was inevitably to be followed by an increase in crime.

[29] *Id.* at 207.
[30] *Id.* at 208.

But there are other reasons for surprise. One such reason is the Great Recession of 2008-2009. To the extent that the long economic boom of the 1990s was one cause of the crime decline of the 1990s, the severe financial and real downturn near the end of the first decade of the twenty-first century should have signaled that an uptick in crime might be imminent. But crime did not increase after the Great Recession. Indeed, it continued to fall, although more slowly than in the 1990s.

Another reason for surprise was that the percentage of 18- to 24-year-old males in the population began to increase early in the twenty-first century. It rose from just below 25 percent of the entire population around 2000, to about 27 percent around and slightly after 2010, has receded slightly since then, but is expected to resume a long upward crime from about 25 percent in 2020 to close to 35 percent in 2050.[31] On the assumption that 18-24-year-old males account for a disproportionately large number of crimes committed in any society, the demographic figures for the post-2000 period would seem, all other things equal, to predict an increase in crime. Again, that did not happen or, more cautiously, has not happened yet.

One more surprise is that, as we shall soon see, the number of prisoners incarcerated in the United States in the first 15 years of the new century has not changed very much, if at all. (Indeed, it may have declined.) So, those who associate crime decreases with incarceration increases should be surprised by the twenty-first century record.

In my view, the best and most comprehensive overview of the causes of the crime decline since 1991 is that produced in 2015 by the Brennan Center for Justice at New York University School of Law.[32] Their analyses consider a wide range of possible factors contributing to the crime decline and also divide the period of 1991 to 2014 (or so) into two distinct sub-periods: the 1990s and the 2000s in order to explore whether the causal factors in those two periods might be different. Their principal analytical technique is multiple regression.

The center has three central findings:

1. "Increased incarceration at today's levels has a negligible crime control benefit: Incarceration has

[31] See http://www.newgeography.com/content/00269-number-18-24-year-olds-united-states-2000-2050. That graph does not distinguish between males and females. But I also consulted U.S. Census 2010 figures for males and females of particular ages and found a general consistency between the figures reported there and the pattern shown in the text.
[32] See Roeder et al., *supra* note 7.

been declining in effectiveness as a crime control tactic since before 1980. Since 2000, the effect on the crime rate of increasing incarceration has been essentially zero. Increased incarceration accounted for approximately 6 percent of the reduction in property crime in the 1990s and accounted for *less than 1 percent* of the decline in property crime this century. Increased incarceration has had little effect on the drop in violent crime in the past 24 years. In fact, large states such as California, Michigan, New Jersey, New York, and Texas have all reduced their prison populations while crime has continued to fall."[33]

2. "One policing approach that helps police gather data used to identify crime patterns and target resources, a techniques called CompStat, played a role in bringing down crime in cities: Based on an analysis of the 50 most populous cities, this report finds that CompStat-like programs were responsible for a 5 to 15 percent decrease in crime in those cities that introduced it. Increased number of police officers also played a role in reducing crime."[34]
3. "Certain social, economic, and environmental factors also played a role in the crime drop: According to this report's empirical analysis, the aging population, changes in income, and decreased alcohol consumption also affected crime. A review of past research indicates that consumer confidence and inflation also seem to have contributed to crime reduction."[35]

Below is a summary table that captures the Brennan Center's findings:

Table 1: Popular Theories on the Crime Decline[36]

Decade	**Factors Contributing to the Crime Drop**	**Factors that Did Not Seem to Affect Crime**	**Disputed Factors**
1990-1999	Aging Population (0-5%)	Enactment of Right-to-Carry Gun Laws (no evidence of effect)	Decreased Crack Use*
	Consumer Confidence*	Use of Death Penalty (no evidence of effect)	Decreased Lead in Gasoline*

[33] *Id.* at 4.
[34] *Id.*
[35] *Id.*
[36] *Id.* at 5.

	Decreased Alcohol Consumption (5-10%)		Legalization of Abortion*
	Decreased Unemployment (0-5%)		
	Growth in Income (0-7%)		
	Increased Incarceration (0-10%)		
	Inflation*		
2000-2013	Consumer Confidence*	Aging Population (no evidence of an effect)	
	Decreased Alcohol Consumption (5-10%)	Decreased Crack Use*	
	Growth in Income (5-10%)	Decreased Lead in Gasoline*	
	Inflation*	Enactment of Right-to-Carry Gun Laws (no evidence of effect)	
	Introduction of CompStat**	Increased Incarceration (0-1%)	
		Increased Unemployment (0-3%)	
		Legalization of Abortion*	
		Use of Death Penalty (no evidence of effect)	

Source: Brennan Center analysis.
**Denotes summaries of past research. All other findings are based on original empirical analysis.*
***This report found that the introduction of CompStat-style programs is associated with a 5-15 percent decrease in crime in cities where it was implemented. From this finding, it can be concluded that CompStat had some effect on the national crime drop in the 2000s.*

A moment's study of Table 1 will show that there is some overlap between the factors that Professor Levitt identified as being important or unimportant in explaining the crime decline of the 1990s and those identified by the Brennan Center as important or unimportant for both the 1990s and the 2000s. For

instance, both studies find the aging population, economic improvement (decreased unemployment and growth in income), and increased incarceration to be important in explaining the crime drop in the 1990s.

But notice further that the Brennan Center study finds some new factors to be important for the entire period of 1991-2013, such as consumer confidence, decreased alcohol consumption, growth in income, and inflation (although those factors contribute differing amounts to the declines of the 1990s and the 2000s).

Additionally, both studies do not believe that enactment of right-to-carry gun laws or the use of the death penalty explain any of the decline in crime in the 1990s. The Brennan Center study is skeptical of the end of the crack cocaine epidemic, the decreased amount of lead in gasoline, and the legalization of abortion as factors in the crime drop in 1990s. The study goes farther than skepticism and finds no discernible effect of an aging population, decreased crack cocaine use, decreased lead in gasoline, enactment of right-to-carry gun laws, and the use of the death penalty in explaining the continued crime decline in the 2000s.

The Brennan Study adds the introduction of CompStat and similar software programs as an important factor in the crime drop of the 2000s.

There are two more tables in the Brennan Study report that I think are important in summarizing, first, the pattern of the crime decline over the entire period and in its subperiods and, second, the various causes of the crime decline over the entire period of 1991-2013 and two subperiods.

Table 2: Crime and Incarceration Rates (1990-2013)[37]

	1990-2013	**1990-1999 ("1990s")**	**2000-2013 ("2000s")**
Violent Crime (murder, nonnegligent manslaughter, forcible rape, robbery,	50% decline	28% decline	27% decline

[37] *Id.* at 7.

aggravated assault)			
Property Crime (burglary, larceny-theft, motor vehicle theft)	46% decline	26% decline	25% decline
Imprisonment	61% increase	61% increase	1% increase

Sources: Federal Bureau of Investigation, Uniform Crime Reports; U.S. Department of Justice, Bureau of Justice Statistics.

There is much of interest in this simple table, but focus for just a moment on the differences in the increases in imprisonment over the subperiods. The 1990s saw a significant increase in imprisonments – a 61 percent increase. During the 1990s there was a 28 percent decline in violent crimes, and a 26 percent decline in property crimes. The period 2000-2013 saw a trivial, 1 percent increase in imprisonment but also saw declines in violent and property crimes that were roughly the same as those of the 1990s. That supports Professor Zimring's speculation that the increased use of incarceration contributed virtually nothing to the decline of crime after the 1990s.

This final table from the Brennan Center study summarizes, on the basis of a state-level analysis, the contribution that various criminal justice polices, economic factors, environmental and social factors, and CompStat contributed to the crime drops of the entire 1991-2013 period and its subperiods:

Table 3: State-Level Analysis on the Crime Decline (1990-2013)[38]

Theory		**Percentage Factor in Crime Decline, 1990-2013**	**Percentage Factor in Crime Decline, 1990-1999**	**Percentage Factor in Crime Decline, 2000-2013**
Criminal Justice Policies	1. Increased Incarceration.	Violent: no effect Property: 0-7%	Violent: no effect Property: 0-12%	Violent: no effect Property: 0-1%#
	2. Use of Death Penalty	No evidence of an effect	No evidence of an effect	No evidence of an effect
	3. Increased	0-5%	0-10%	No evidence of

[38] *Id.* at 8.

	Police Numbers			an effect[#]
	4. Enactment of Right-to-Carry Gun Laws	No evidence of an effect	No evidence of an effect	No evidence of an effect
Economic Factors	5. Unemployment	0-3%	0-5%	No evidence of an effect
	6. Growth in Income	5-10%	5-10%	5-10%
	7. Inflation*	Some effect on property crime	Some effect on property crime	Some effect on property crime
	8. Consumer Confidence*	Some effect on property crime	Some effect on property crime	Some effect on property crime
Environmental and Social Factors	9. Decreased Alcohol Consumption	5-10%	5-10%	5-10%
	10. Aging Population	0-5%	0-5%	No evidence of an effect[#]
	11. Decreased Crack Use*	Possibly some effect	Possibly some effect on violent crime	Negligible
	12. Legalized Abortion*	Possibly some effect	Possibly some effect	Negligible
	13. Decreased Lead in Gasoline*	Possibly some effect	Possibly some effect	Negligible
Criminal Justice Policy	14. Introduction of CompStat**	5-15% decline in violent and property crime**		

Source: Brennan Center Analysis

**Denotes summaries of past research. All other findings are based on original empirical analysis.*

***These results were presented in Table 4 in the report, entitled "CompStat's Effect on Crime in 50 Most Populous Cities (1994-2012)." A note to the table reads: "The city-level analysis relies on monthly data. Monthly city-level crime data were unavailable for 2013 at time of publication of this report and therefore could not be included."*
#Indicated this variable did not increase or decrease significantly during the period to have an impact on crime.

CompStat is a police resource management software program that New York City Police Department Commissioner Bill Bratton introduced in 1994.[39] Other police departments around the country also used CompStat and similar programs, apparently to great effect, being responsible for between 5 and 15 percent of the crime decline in 1990-2013.

C. An Uptick in the mid-2010s?

Our President, a commentator not known for scrupulous accuracy,[40] has claimed that serious crime is on the rise, with the most dramatic increases coming in homicides in large cities like Chicago and Baltimore. He threatened to send federal officers into those cities to restore order if the local government officials could not do so.

Not surprisingly, there is no factual basis for the President's claim.[41] Nonetheless, Trump tweeted, under the title "USA Crime Statistics – 2015," a picture of a black man with a gun and cited some statistics – said to come from something called the "Crime Statistics Bureau," which does not exist – that, he said, showed that blacks killed 81 percent of murdered whites. Professor John Donohue calls that number "ludicrous."[42]

Then on October 28, 2016, near the end of the presidential campaign, Trump said, "You won't hear this from the media: We have the highest murder in this country in 45 years."[43] Wrong again.

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[39] See USDOJ BUREAU OF JUSTICE ASSISTANCE & POLICE EXECUTIVE RESEARCH FORUM, COMPSTAT: ITS ORIGINS, EVOLUTION, AND FUTURE IN LAW ENFORCEMENT AGENCIES (2013), https://www.bja.gov/publications/perf-compstat.pdf.
[40] Glen Kessler, Salvador Rizzo, and Meg Kelly, "President Has Made 3,251 False or Misleading Claims in 497 Days," *Washington Post*, June 1, 2018, https://www.washingtonpost.com/news/fact-checker/wp/2018/06/01/president-trump-has-made-3251-false-or-misleading-claims-in-497-days/?utm_term=.0b16b8808675. That is an average or more than 6 false or misleading claims per day across all days of Trump's presidency, including weekends.
[41] It must be said, however, that the President is not the only one confused by these events. In October, 2015, then FBI Director James Comey, in a speech at the University of Chicago Law School, predicted an explosion in violent crime on the basis of an uptick in murders in early 2015. Comey attributed the increase largely to an increase in urban, black crime. And he attributed that increase in urban, black crime to the so-called "Ferguson Effect," which hypothesized that urban police had scaled back their policing efforts in black urban areas in response to the events in Ferguson, Missouri, and the Black Lives Matter movement. The murder rate in 2014 was the lowest rate in the U.S. since 1957.
[42]John J. Donohue III, *Comey, Trump, and the Puzzling Pattern of Crime in 2015 and Beyond*, 117 COLUM. L. REV. 1297, 1297 (2017). The vast majority of all crime, including homicide, is intraracial.
[43]*Id.* at 1298.

The facts are that although there was a *jump* in the murder rate in 2015, "the murder rate in 2015 was around 50 percent lower than at its peak in 1991. Prior to Obama's presidency the last time the U.S. murder rate was as low as it was in 2015 was in 1963, 52 years ago."[44]

Professor Donohue calls the jump in the 2015 murder rate "unusually, indeed, shockingly large," but notes that even with that jump, the murder rate in 2015 was still about half what the prevailing U.S. murder rate was in the early 1990s.[45] Of course, we will not know for several years whether the jump on 2015 was the beginning of an upward trend or just a short-term jump. Consider the recent experience of homicide in Chicago as an illustration of the volatility of homicide totals in one of the leading cities in the U.S. for homicide:

Table 4: Homicides in Chicago, 2011-2018

Year	Homicides
2011	441
2012	532
2013	415
2014	416
2015	468
2016	762
2017 (through July 6)	650 (357)
2018 (through July 6)	252

There is no clear trend in these numbers, year-to-year or over the entire period. The numbers go up one year, down the next, or are about the same. Of course, 2016 stands out. That is a 58 percent increase in homicides over those of 2015.[46]

[44] *Id.*
[45] *Id.* at 1308.
[46] See Paul G. Cassell & Richard Fowles, *What Caused the 2016 Chicago Homicide Spike?: An Empirical Examination of the 'ACLU Effect' and the Role of Stop and Frisks in Preventing Gun Violence*, 2018 U. ILL. L. REV. --- (forthcoming). Cassell and Fowles argue that a voluntary agreement between the American Civil Liberties Union and the Chicago Police Department to suspend stop-and-frisks led to more armed criminals on the street and, therefore, more violence.

Another aspect of the data that warrants attention is Director Comey's and President Trump's specious claim that the 2015 increase in homicides is the result of criminal behavior by urban black males, especially Trump's race-baiting claim that four-fifths of the murders are of whites by blacks. Professor Donohue reports that the five states with the highest increases in violent crime in 2015 were Hawaii (a 24.0 percent increase), South Dakota (16.7 percent), Vermont (15.1 percent) Alaska (14.9 percent), and Wyoming (13.7 percent). All of those states have very small black populations.

Finally, this alleged and spurious increase in homicides in 2015 is an example of something that "everyone knows that isn't so." Even though, as we have repeatedly seen in this review, there has been a long-term decline of more than 50 percent in the rate of violent crimes since 1991, since 9/11/2001 and till today, "60-70 percent of Americans consistently answered that crime has risen over the last year."[47]

D. Mass Incarceration

I have already referred to the fact that the United States prison population increased significantly after 1980 so that today almost 20 percent of all the world's prisoners are in the United States, even though we account for only 5 percent of the world's population. Additionally, we have seen that a large part of this increase in incarcerations occurred in the 1990s and may have contributed to the crime decline of that decade but that there was a minor increase (of about 1 percent) in prisoners between 2000 and 2010 and yet crime continued to decline during that first decade of the twenty-first century (implying that imprisonment contributed little if anything to that second decade of crime decline).

I have also suggested that the principal reason for relying on imprisonment as our principal crime deterrent grew out of the work of Professor Gary Becker of the University of Chicago Departments of Economics and of Sociology. In his famous article of 1968,[48] Becker examined the decision to commit a crime using standard economic analysis. A potential criminal, he argued, might compare the expected benefits of successfully completing a crime with the expected costs and be deterred from committing the crime if those expected costs exceed the expected benefits. The criminal justice system could elevate those expected costs by increasing the probabilities of detection, arrest, and conviction and the size of the sanction that it would impose on a convicted criminal. Alternatively or collaterally, increasing the likelihood and remuneration for legitimate work could also be an effective means of deterring crime.

[47] *Id.* at 1302.
[48] See Becker, *supra* note 4. See also Cooter & Ulen, *supra* note 15, Ch. 12.

This relatively simple formulation of the problem of deterring crime led to an explosion of research that purported to show the deterrent effect of imprisonment and other sanctions (such as death). And the effect on criminal justice policy can hardly be exaggerated. Punishment and precaution could, the literature demonstrated, deter crime. States and the federal government grew serious about making the sanctions more certain and more severe through a series of changes that included reducing the discretion that judges had in sentencing, imposing extremely severe sanctions on those convicted of a third felony ("three strikes laws"), and imposing the death penalty more enthusiastically. And a casual observer (performing what a friend of mine refers to as an "ocular regression") could conclude that there was a causal connection between society's imposition of more severe sanctions and sentencing more people to prison and the later decline in crime.

Before we turn to a discussion of Professor Pfaff's account of mass incarceration in Section III, let me establish more groundwork by considering some additional facts about the rise of U.S. imprisonment.[49] "Between 1973 and 2009 the U.S. prison population grew from about 200,000 to about 1.5 million, a sevenfold increase in 36 years. [For the sake of comparison, the] U.S. population as a whole grew by about 46 percent during that same period."[50]

A widespread consensus has begun to emerge in the late 2000s that there were too many people in prison.[51] There were different motivations for those in this consensus. Some were troubled by the fact that so many black males (about one-third) had their lives disrupted by serving prison sentences and found it difficult to get back on the standard life track that so many of us enjoy. Some were troubled by the fact that our imprisonment rate (676 inmates per 100,000 people) is the second highest in the world and almost five times the average imprisonment rate of other developed counties (which is 145 per 100,000[52]). Our current rate is also remarkable by historical standards for this country. For the 50 years prior to 1975, our imprisonment rate was not significantly different from that in other developed countries – about 100 prisoners per 100,000 population.[53] Some were distressed by mass incarceration because there was

[49] I am here following the argument in the recent work of my colleague, Andrew Leipold. See Andrew D. Leipold, *Is Mass Incarceration Inevitable?* University of Illinois College of Law Working Paper (2018).
[50] *Id.* at 4-5.
[51] See Thomas S. Ulen, *Skepticism about Deterrence*, 46 LOY. U. CHI. L.J. 381 (2014).
[52] See Leipold, Table 2, at 13.
[53] Leipold, *supra* note 52, at 6.

believable evidence that its deterrence value had fallen close to zero. Some were appalled, in addition to all the reasons given heretofore, by the estimated $80 billion per year that localities, states, and the federal government were spending on imprisonment.

For these and additional reasons, the emerging consensus began to result in reforms designed to release prisoners and to find alternative means of sanctioning criminals. "Between 2006 and 2011, more than half the states reduced their prison populations, and in 10 states the number of people incarcerated fell by 10 percent or more.[54] … Between 2009 and 2015, the number of people behind bars dropped by about 5 percent, leaving about 1.5 million in state and federal prison, and about 728,000 in local jails."[55]

Suppose that we are in agreement that our incarceration rate is too high. And suppose, further, that we take as our goal to get our rate back to the non-U.S. average of 145 prisoners per 100,000 population. What would that involve? We would have to reduce approximately 75 percent of the 2.145 million people imprisoned to about 500,000. "We could empty every state and federal prison in the country, leaving only inmates in state and local jails, and still not reach that level."[56] That would be foolhardy.

Suppose instead that the U.S. took as its goal to cut its incarceration rate in half (to roughly 333 prisoners per 100,000 population). If it were to do so, thereby reducing its total imprisoned population to slightly over 1 million, we would still have a higher rate than 24 of the 25 largest economies (everyone except Russia, which has a rate of 430 prisoners per 100,000 population).

Other goals, such as dropping out of the top 10 leading imprisoners by rate or cutting the imprisonment rate by 25 percent, would be somewhat easier to achieve but still nearly a Herculean labor.

There are other ways. Suppose that we focus our attention on those prisoners who have been convicted of non-violent crimes. First, we must recognize that the number of property crimes is seven times larger than the amount of violent crime.[57] Nonetheless and second, we need to be aware that half of all state prison

[54] *Id.* at 3;JEREMY TRAVIS, BRUCE WESTERN & EDS. REDBURN, STEVE, THE GROWTH OF INCARCERATION IN THE UNITED STATES: EXPLORING CAUSES AND CONSEQUENCES (2014).
[55] Leipold, *supra* note 52 at 5-6.
[56] *Id.* at 14.
[57] "Violent crimes in general have higher clearance rates; on conviction these defendants are more likely to receive a prison sentence rather than probation, and those convicted of violent crimes receive the longest sentences among those who are sent to

inmates have been convicted of a violent crime. And third, the vast majority of all prisoners are state prisoners. The most recent U.S. Department of Justice, Bureau of Justice Statistics report on all state and federal prisoners indicates that at the end of December, 2015, there were 1,298,159 state prisoners and 178,688 federal prisoners.[58] That is a ratio of slightly more than 7:1, state prisoners to federal prisoners.[59]These three facts, taken together, mean that if we are to make a significant reduction in the total number of prisoners, we have to look to reducing the state prisoners first. But we are constrained by the fact that the majority of state prisoners have been convicted and sentenced for violent crimes. If we believe that it is far riskier to release violent criminals early than to release property criminals early, we need to focus principally on prisoners who have committed less-serious crimes. To illustrate that we have a starkly limited number of options in reducing the prison population, here are the percentages of all inmates in state prisons by category of crime:

Table 4: State Prison Inmates by Crime Category (2015)

Crime of Conviction	Percent of Inmates
Violent crime	54
Property	18
Drug	15.2
Public Order	11.6
Other	0.7

Source: U.S. Department of Justice, Office of Justice Programs, Bureau of Justice Statistics, "Prisoners in 2016," Table 12, p. 18 (January, 2016).

Just for the sake of comparison, note that the percentages of federal prisoners in different crime categories is markedly different, as the following table shows:

Table 5: Federal Prison Inmates by Crime Category (2015)

prison. (Indeed, more than 7 percent of state prisoners nationwide are incarcerated for murder or manslaughter, even though these crimes make up less than 0.2 percent of the index crimes each year.)" *Id.* at 16.

[58] See U.S. Department of Justice, Office of Justice Programs, Bureau of Justice Statistics, "Prisoners in 2016," Table 4, p. 6 (January, 2016).

[59] According the U.S. Bureau of Justice Statistics, if we add all the people held in local jails, the total number of inmates in the U.S. in 2013 was about 2.2 million. Another 4.7 million adults are on probation or parole. https://en.wikipedia.org/wiki/Incarceration_in_the_United_States.

Crime of Conviction	**Percent of Inmates**
Violent crime	7.7
Property	6.1
Drug	47.5
Public Order	38.2
Other	0.5

Source: U.S. Department of Justice, Office of Justice Programs, Bureau of Justice Statistics, "Prisoners in 2016," Table 14, p. 20 (January, 2016).

We have just seen how very difficult it will be to achieve almost any meaningful goal in reducing mass incarceration. But there is additional depressing news about seeking to have fewer prisoners: It might not save much money. One would have thought that cutting, say, 10 percent of the prisoners in a state's prison system would save about 10 percent of the state's total recurring prison budget (excluding the fixed costs of operating a prison system). For example, between 2010 and 2015 the State of New York decreased its prison population by 10 percent (about 6,000 people), which allowed it to close 14 prisons and reduce its prison employment by 11 percent."[60]

But New York may not be typical. There are at least three reasons to be skeptical. First, reductions in state prison inmates may be achieved (as they were, partially, in California[61]) by transferring state prisoners to county and local jails. This simply transfers the costs from the state budget to the county or municipality budgets but may not actually save money. Similarly, those released from state prison into mandatory supervised release (MSR) may require the hiring of additional probation officers.

Second, punishment is supposed to deter prospective criminals and convicted criminals from committing crimes. But the circumstances that contributed to a person's deciding to commit crime (such things as "lack of education, substance abuse, mental health problems, lack of a stable family like, and lack of

[60] Leipold, *supra* note 52, at 19.

[61] California made these transfers and some releases in response to a federal court order requiring them to reduce the number of prisoners in overcrowded state prisons. See *Brown v. Plata*, 563 U.S. 493 (2011). See also Nina Totenberg, "High Court Rules California Must Cut Prison Population," *All Things Considered, National Public Radio*, May 23, 2011, available at https://www.npr.org/2011/05/23/136579580/california-is-ordered-to-cut-its-prison-population.

realistic economic opportunities"[62]) will probably have to be addressed by both short- and long-term state and federal expenses designed to ameliorate those circumstances.

Third, assuming that states reduce prisoners only by releasing some subset of nonviolent prisoners, some of them may commit crimes after release, and those new crimes will have social costs. We know "that nationally about 50 percent of former prison inmates will be reincarcerated within three years of their release."[63]

These ambiguities about whether reducing the amount of mass incarceration will reduce state costs are reflected in the experience of the 23 states that have, since 2010, reduced their prison populations. As Professor Leipold reports:

> [S]lightly more than half [of the States] (13 of 23, or 57 percent) also decreased their spending, while the other 10 increased spending despite the lower inmate numbers. Among the States that decreased both the inmate population and prison spending, the relationship between the two was also murky. Some States cut their prison populations a lot and saved very little; other States cut their population very little and saved a great deal. [For example,] South Carolina cut its prison population 12 percent between 2010 and 2015 but decreased its prison spending by only 2 percent. Colorado cut its inmate population by 9 percent but saw a 0 percent change in constant dollars. Florida cut its inmate population by 1 percent but saw a 12 percent decrease in spending. Ohio cuts its prison size by 1 percent but saw a 12 percent decrease in spending. Ohio cut its prison size by 1 percent and cut its prison spending by 13 percent.[64]

Professor Leipold says that four factors must be present for the release of prisoners to save state costs: (1) that enough prisoners must be released so that prisons or parts of prisons can be closed and prison employees let go or reassigned to lower-paying jobs; (2) that "government dollars previously spent on prison inmates will be higher than the public assistance, housing, and health care dollars spent on those who are now incarcerated or are released earlier than they would have been; (3) that the costs saved by the first two points will not be fully absorbed by services needed to reduce the risk of recidivism

[62] Leipold, *supra* note 52, at 21.
[63] *Id.* at 9. There is some evidence to suggest that California's prisoner release mandated by a federal court was carefully done so that the increase in nonviolent crime did not increase significantly after the releases. See STEVEN RAPHAEL & MICHAEL A. STOLL, A NEW APPROACH TO REDUCING INCARCERATION WHILE MAINTAINING LOW RATES OF CRIME (2014).
[64] Leipold, *supra* note 52, at 21.

among those who are no longer in prison [or transferred to county or municipal jails]; and (4) that if we do not spend the money saved on programs addressing the criminogenic problems of former inmates, the recidivism rate will not drive the prison population up to unacceptable levels."[65]

III. PROFESSOR PFAFF ON THE CAUSES OF MASS INCARCERATION

Professor John F. Pfaff's[66] *Locked In* offers an important hypothesis on the causes of mass incarceration and empirical evidence that the author offers to support his hypothesis. Pfaff's hypothesis, in brief, is that "[p]rosecutors have been and remain the engines driving mass incarceration."[67] Legislators and judges do not play a central role, and, therefore, we should not look to legislative or judicial reforms to correct the problem of warehousing prisoners. Rather, Pfaff argues that if prosecutors are the problem, then we should look to restraints on prosecutorial discretion to cure the problem.[68] Because, as we shall see, he believes that prosecutors have exercised that discretion principally to accept more cases for prosecution (or plea bargaining) and to engage in more hard-nosed plea bargaining, Pfaff's correctives are to limit that discretion to proceed with cases or to be hard-nosed in plea bargaining.

Pfaff's hypothesis is meant to be a critique of what he calls the "Standard Story." That story, he claims, blames two principal developments for increasing prison populations: first, the "war on drugs,"[69] and, second, the increasing "harshness" of criminal sentences, which resulted in longer and longer prison sentences over the period 1980 to 2010. The policy implications of this version of the Standard Story, which Pfaff deems to be, like the theory, off target, are to decriminalize drugs and allow for less harsh sentences.

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[65] *Id.* at 23.

[66] JOHN F. PFAFF, LOCKED-IN: THE TRUE CAUSES OF MASS INCARCERATION AND HOW TO ACHIEVE REAL REFORM (2017). Professor Pfaff is Professor at Fordham Law School.

[67] *Id.* at 206.

[68] *Locked In* has been reviewed, mostly favorably, by the following, David Brooks, "The Prison Problem," *The New York Times*, Sept. 29, 2015; Jeffrey Toobin, "The Milwaukee Experiment: What Can One Prosecutor Do About the Mass Incarceration of African-Americans," *The New Yorker*, May 11, 2015; Barack Obama, "The President's Role in Advancing Criminal Justice Reform," 130 HARV. L. REV. 811 (2017); Shima Baradaran Baughman, *Subconstitutional Checks*, 92 NOTRE DAME L. REV. 1071 (2017); Daryl K. Brown, *What Can Kafka Tell Us About American Criminal Justice?*, 93 TEX. L. REV. 487 (2014); Samuel W. Buell, *Is the White Collar Offender Privileged?*, 63 DUKE L.J. 823 (2014); Angela J. Davis, *The Prosecutor's Ethical Duty to End Mass Incarceration*, 44 HOFSTRA L. REV. 10163 (2016); and Stephanos Bibas, "The Truth About Mass Incarceration," *National Review*, Sept. 16, 2015).

[69] This portion of the story is particularly associated with MICHELLE ALEXANDER, THE NEW JIM CROW: MASS INCARCERATION IN THE AGE OF COLORBLINDNESS (2010).

Pfaff's view is that the war on drugs is not responsible for the vast numbers of state and federal prisoners. In this he is right, as we have seen in the previous section. While drug offenders account for a large percentage (nearly half) of all federal prisoners, they account for just 15 percent of all state prison inmates. With adjustments for local jails, those held in pre-trial detention, and others, at most 20 percent of all inmates are there for drug offenses. This is a large number, but it had to have increased dramatically in the 1980s and 1990s, which it did not, to be the reason why so many of our fellow citizens are in the hands of the criminal justice system.

Pfaff also does not believe that harsher sentencing practices account for the large number of U.S. prisoners. Rather, he argues that the principal cause of rising incarceration numbers is that more people were sent to prison. Prosecutorial discretion took the form of an increasing number of criminal filings. Prosecutors decide whether to dismiss or charge criminal defendants when presented with a case from the police, and they can plea bargain with the defendant once he or she is charged. In effect, Pfaff claims that over the relevant time period federal and state prosecutors, apparently determined to appear to be "tough on crime," dismissed fewer cases and pled down fewer cases over time. The result was a significant increase in prison commitments.

There is much to admire in Pfaff's book. He has drawn attention to the important role of prosecutors in the criminal justice system. And in so doing, he has drawn attention away from legislators and judges, heretofore – in an alternative Standard Story – widely thought to have been the most important state actors in criminal justice. This is an important hypothesis, and Pfaff has done powerful empirical work to support that hypothesis.

I am not, however, convinced that his hypothesis is correct. I have three principal reasons for my skepticism. First, I find his "Standard Story" to be a straw man. There is a different standard story that is emerging from the scholarship of the past 20 or so years about both the decline in crime and the causes and consequences of mass incarceration. Indeed, we have already seen much of that story in the earlier sections of this review. I shall elaborate below.

Second, the evidence that Pfaff marshals does not provide strong support for his hypothesis. Those data are flawed in several technical ways so that they cannot buttress the case he wants to make. Pfaff has not

made the case that prosecutorial discretion can explain more than a fraction of the remarkably large change in our state and federal prison populations between 1980 and 2010. Indeed, other respected scholars have reached diametrically opposite conclusions to those of Pfaff about the principal reason for increase in prisoners – namely, that it was the lengthening of sentences, not just an increase in the number of prisoners committed to prison, that played the crucial role in mass incarceration.

Finally, as Section IID has already argued, I am not yet fully convinced that the premise of *Locked In* and much of the public debate is on target. That is, I am clear that mass incarceration has significant costs and may cry out for alternatives. I am also clear on the fact that in the 2000s incarceration had no discernible deterrent effect on crime, particularly violent crimes, even though it may have done so in the 1990s. But as Professor Leipold has so persuasively argued, there is no easy or clear path for getting from where we are now, to a United States in which there is far less incarceration and continuing low levels of both violent and property crimes.

Let me turn to these points in a little more detail.[70]

Pfaff's hypothesis is that increases in prison population through new commitments, and not the lengthening of sentences, is the principal factor responsible for mass incarceration. He writes that the "amount of time most people spend in prison [] is surprisingly short, and there is no real evidence that it grew much as prison populations soared."[71] He includes a table that shows that the time served by prisoners sentenced in 2000 and in 2010 for the same crimes has been "fairly stable."[72] He takes this as evidence that longer sentences have not been an important factor in mass incarceration. But it is, in fact, what we would expect. Remember that Zimring, the Brennan Center authors, and others have shown that during the period 2000 to 2010 the number of prisoners barely changed.

Raphael and Stoll, however, believe that longer sentences have been an important factor, especially in the 1990s.[73] They say that "in 1984 an inmate convicted of murder or manslaughter could expect to serve 9.2 years. By 2004 this figure had increased to 14.27 years." For the crime of rape, time served increased from

[70] I have benefited a great deal from the review of Pfaff's book by Professor Jeffrey Bellin of the William & Mary College of Law: *Reassessing Prosecutorial Power Through the Lens of Mass Incarceration*, 116 MICH. L. REV. 835 (2018).
[71] Pfaff, *supra* note 69, at 52.
[72] *Id.* at 57.
[73] Raphael & Stoll, *supra* note 66.

5 to 8 years; for robbery, from 3.5 to 5 years. For aggravated assault a year longer in 2004 than in 1984.[74]

Other scholars of these matters, such as Beck and Blumstein[75] and Neal and Rick,[76] have also found increases in length of criminal sentence to be a significant factor in the 1990s and 2000s. Bellin writes that Beck and Blumstein said that the "entire growth over the 30 years of the incarceration boom, 1980 to 2010, is 'attributed about equally to the two policy factors – prison commitments per arrest and time served.'"[77]

Why did Pfaff go wrong with all this? Largely because he focused on the first decade of the 2000s. As we have already seen, there was not much growth in prison population then. Such growth as occurred was mostly in the federal system, not the states, but Pfaff used largely state data.

The principal empirical evidence in support of Pfaff's other contention – that an increase in prison commitments is the principal cause of mass incarceration throughout the 1990s and early 2000s – is his finding that state felony filings rose significantly in the early 2000s. This happened, he argues, because prosecutorial discretion led prosecutors to do less plea bargaining than they had before the early 2000s and to dismiss fewer cases than they had before.

The evidence on which he relies comes from the National Center for State Courts (NCSC) and shows, he says that "between 1994 and 2008 the number of felony cases filed in state courts 'rose by almost 40 percent,' neatly paralleling the 40 percent increase in state prison admissions over that period."[78] But apparently there is some question about the data from the NCSC that Pfaff used. In 2003 the NCSC issued new guidelines for reporting state courts' workloads. Among other changes the guidelines recommended the following:

1. "Include 'reopened' and 'reactivated cases' – for example, probation or parole violations, to illustrate courts' '*actual* workload'";
2. "Move domestic violence prosecutions from the 'domestic relations' category into the criminal

[74] Bellin, *supra* note 73, at 840-41, citing Raphael & Stoll, *supra* note 66.
[75] ALLEN J. BECK & ALFRED BLUMSTEIN, TRENDS IN U.S. INCARCERATION RATES: 1980-2010 (2012). Beck and Blumstein say that increases in the number of prisoner committals explains the bulk of the increase in state and federal prison populations for the 1980s. Thereafter, they say that increases in prisoner committals and length of sentence were about equally responsible for changes in the total number of prisoners.
[76] Derek Neal & Armin Rick, *The Prison Boom and Sentencing Policy*, 45 J. LEG. STUD. 1 (2016).
[77] Bellin, *supra* note 73, at 840-41.
[78] *Id.* at 841, citing Pfaff, *supra* note 69, at 72.

filing category";

3. "Count preliminary hearings that occurred in one court prior to a case being filed in another as two felony cases."[79]

Assuming that the NCSC data reflected these changes only from 2003 forward, there would be a tendency to report more state felony filings even if there had been no real change (that is, under the older definitions) in the actual number of felony filings. For example, Raphael and Stoll report that as the prison population reached its highest level around 2000, "parole revocations grew to over a third of new prison admissions. Raphael and Stoll estimate that probation violations [at about the same time] account for another 10 percent of prison admissions."[80] Under the new guidelines, the NCSC would have counted these parole and probation violations as felony cases. And if those percentages persisted through the end of Pfaff's time period (2008), then taken together they would account for 40 percent of prison commitments. If so, then Pfaff's finding that state felony filings increased from 1994 to 2008 may largely be due to these definitional changes, not to a real change in the number of filings.

There's more. There is an alternative source of data on state courts – the Department of Justice, Bureau of Justice Statistics' "State Court Processing Statistics" (SCPS). That publication includes state court felony filings, and for the period 1994-2008 the SCPS series does *not* show an increase in state court felony filings.[81]

There are some other criticisms that Bellin and others have leveled at the Pfaff hypothesis. I take these criticisms seriously – for example, that prosecutors have discretionary power but that so do the police, legislators, judges, and the state governor; it would not be fair, these critics say, to place *all* of the blame for increased imprisonment on prosecutors; there is blame to be spread around. To be clear, there is some bite in Pfaff's contention that prosecutors may have (over a longer period than just 1991-2013) become "tougher" on crime by dismissing fewer cases and engaging in less plea bargaining. But even if so, prosecutors are responsible for a relatively small portion of the remarkable increase in prisoners.

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[79] Bellin, *supra* note 73, at 842.

[80] *Id.* at 844, citing Raphael & Stoll, *supra* note 66.

[81] Bellin, *supra* note 72, at 843. Bellin reports that in a 2011 paper posted on SSRN, "The Causes of Growth in Prison Admissions and Populations," Professor Pfaff says that the SPSC data contradict his finding that felony filings increased.

The "standard story" that emerged from the review of the literature on the great crime decline and on mass incarceration suggests that just as we are still not certain why crime rose from the mid-1960s to the late 1980s, we are not certain about the causes of the subsequent decline, although we know that those causes were many and varied over time. We suspect that the criminal justice system, legislators, and judges responded to the crime increases with the main tool that they had – punishment in the form of incarceration. And although Zimring is clear that even experts on criminal matters did not see the crime decline coming – even when they were in the middle of it, once it did become evident that something had changed, they "put down their [punishment] tools." So, to the casual observer, the criminal justice system worked: When crime increased, that system sent more people to prison. And when crime declined, the system stopped sending people to prison.

We know from Zimring, the Brennan Center, Levitt, Donohue, Raphael & Stoll, and many others that the story is much more complex, with multiple causes, gaps in the explanation, and confounding comparative experiences to bring into the story.

IV. PROFESSOR SHARKEY ON THE SOCIAL CONSEQUENCES OF THE CRIME DECLINE

Professor Patrick Sharkey[82] has written a different and fascinating book on the great crime decline, particularly about its consequences. Although Professor Sharkey includes brief and fresh summaries of the literature on the causes of the decline, his principal focus is on the effect that the decline had on societal well-being.

Sharkey uses a fluid prose style and compelling statistics to show that one of the underreported effects of the great crime decline was to make many of our largest cities much more pleasant places to live than they were before the early 1990s:

In 1993 about 40 percent of big cities had a homicide rate above 20 per 100,000 residents, but in 2014 only 13 percent still had a homicide rate this high. A small group of cities, like Flint, Michigan; Hartford, Connecticut;

[82] Patrick Sharkey is Professor in and Chair of the Department of Sociology at New York University and scientific director of Crime Lab New York (see https://urbanlabs.uchicago.edu/people?labs=crime-new-york).

Newark, New Jersey; and Baton Rouge, Louisiana, did not change much by 2014. But in cities like Fort Worth, New York, San Diego, and Washington, DC, the murder rate dropped by at least 75 percent. In Atlanta, Boston, San Francisco, Seattle, Tampa, and many other cities, it fell by at least half.[83]

A moment's reflection would suggest that these remarkable decreases would be felt by most residents as an increase in their safety. They might feel more comfortable walking around their neighborhood; they might spend more time in parks, not worrying so much about being accosted or the victims of drive-by shootings; they might not hesitate to send their children to the store for groceries; they might feel more comfortable driving through neighborhoods that they had theretofore avoided.

Sharkey surveys the literature on the causes of the great crime decline. He points, first, to some scholarly evidence that was new to me about the beneficial effect of having more police around. He notes that for many years scholars thought that "police were powerless to control crime [but that now] the new consensus is that more police on the street translates into less crime."[84] For example, citing the work of Jonathan Klick and Alex Tabarrok, Sharkey says that "if police patrols are increased by half, one should expect crime to drop by roughly 15 percent."[85]

Another factor in the crime decline to which Sharkey points is community groups. As an example, he describes the work on Juanita Tate and the group she founded, the Concerned Citizens of South Central Los Angeles. "They took action to make sure that alleys were no longer used for dumping or drug dealing, they worked with the city to train formerly incarcerated residents to clean up sidewalks and maintain the streets, and they built more than one hundred units of housing in their community."[86]

Sharkey was so taken by this example that he undertook a study to see if nonprofit community organizations formed in the largest cities in the U.S. between 1990 and 2012 could have played a role in reducing crime. "In a given city with 100,000 people, we found that every new organization formed to confront violence and build stronger neighborhoods led to about a 1 percent drop in violent crime and

[83] Sharkey, *supra* note 6, at 26.
[84] *Id.* at 47.
[85] *Id.* at 46, citing Jonathan Klick & Alexander Tabarrok, *Using Terror Alert Levels to Estimate the Effect of Police on Crime*, 48 J. L. ECON. (2005).
[86] *Id.* at 51. This is a private organization putting into action the "broken windows" hypothesis of reducing crime. See James Q Wilson & George L Kelling, *Broken Windows*, 249 ATLANTIC MONTHLY, 1982, at 29–38.

murder … We concluded that the explosion of community organizations that took place in the 1990s likely played a substantial role in explaining the decline of violence."[87]

Sharkey concludes his survey of the causes of the crime decline with the same conclusion as Zimring– that there is no single factor that can explain the decline. "Instead, I have come to believe that violent crime fell because many different segments of American society mobilized to confront it, and that the crime decline was largely caused by 'endogenous' forces – changes that were a response to the crisis of violence itself."[88]

I find the most striking contribution of Sharkey's to be his chapters on the benefits of the crime decline. I think that it is worth remarking that many of us – those of us leading stable, rewarding lives touched by nothing more than the usual travails of life – had been only tangentially affected by the violent crime of the 1970s and 1980s. We were, of course, disturbed to learn about it from newspapers, TV, and radio, and it might have affected the routes we drove in major cities or where we ventured in New York City, but we could, by and large, avoid being victims.

But there was one group that bore the brunt of the crime wave, particularly its violent component – the black community. Sharkey notes that of the 459 people murdered in Chicago in 2009, three-quarters were young black men.[89] Shockingly large as that number and percentage are, they are a significant reduction from the numbers of the late 1980s and early 1990s (or, as we have seen, from Chicago's record for 2015). Sharkey gives a very vivid example of the result for black men of that decline in violent crime:

> In 1991 black men could expect to die about eight years earlier than white men, on average. By 2012 the gap in life expectancy between white and black men was five years [72 instead of 77] … For black and white women and for white men, there is virtually no difference between trends in life expectancy with and without the crime decline. … Our estimates indicate that an African American boy born at the end of the crime wave could expect

[87] *Id.* at 53, citing Patrick Sharkey, Gerard Torrats-Espinosa & Delaram Takyar, *Community and the Crime Decline: The Causal Effect of Local Nonprofits on Violent Crime*, 82 AM. SOC. REV. 1214 (2017).

[88] *Id.* at 57. I think that one has to understand Sharkey's remark as suggesting not that community groups and grassroots movements were the endogenous causes of the decline but that all of the factors we have heretofore seen – more police, more vigorous prosecutors, incarceration, the vibrant economy, community groups, changing technology of crime fighting and precaution, and more – contributed and that all of them in one sense or another arose in response to the spike in crime from the mid-1970s to the early 1990s.

[89] Sharkey, at 64, urges his readers to Google "Derrion Albert murder" to see a particularly disturbing example. It is very hard to watch, but it is unforgettable. Another comparison – of lives lost to violence – across different social groups in 2012 illustrates the lingering problem: "For every 100,000 white women, just 82 years of life were lost to homicide in 2012. For every 100,000 white men, 192 years of potential life were lost, and for every 100,000 black women, 230 years of potential life were lost. For every 100,000 black men, on the other hand, 1,341 years of potential life were lost due to homicide." *Id.* at 70.

to live, on average, about three-quarters of a year longer due purely to the drop in homicides that took place from 1991 to 2012.[90]

To indicate what a remarkable achievement in life expectancy this is, Sharkey compares it to the increase in life span that would accrue to every American adult if they should all lose their excess weight – between one-third to three-quarters of a year, roughly equal to the effect on young black men of the crime decline.

There were other social benefits from the crime decline. Violent crime affects not just its victims but also friends, families, the children who witness it, and residents nearby. Sharkey tells us that he thought about these ripples of violence throughout society when he heard a lecture on epigenetics by Dr. Frances Champagne, a neuroscientist. One of the phenomena that Dr. Champagne described came from studies by David Diamond, a neuroscientist at the University of South Florida. Diamond measured what he called "predator stress" among rats, outside whose cages a cat prowled. After their exposure to that stress of the cat, those rats were given mazes to navigate. They were more error-prone when doing mazes than rats that had not been exposed to a predator.

Sharkey wondered if the same sort of lingering stress could affect children whose neighborhoods had been the sites of violent crimes. "If rats perform worse when they're exposed to a nearby cat, what happens to children if they are assessed just days after a homicide down the street?"[91] Sharkey undertook to study black Chicago children by means of a cognitive skills (IQ) test "in the days after a local homicide took place."[92] He found that those children did "on average four-tenths of a standard deviation worse on tests of verbal and language skills than black children in the same neighborhoods who were assessed at a different, (safer) time." That difference is equivalent to the homicide-affected children's having "missed the previous two years of schooling and regressed back to their level of performance from years earlier."[93]

Finally, Sharkey finds a direct effect of the crime decline on the degree of inequality in urban areas. Specifically, he finds that those cities that have had the greatest decline in violent crime have also and simultaneously experienced a significant decline in the concentration of poverty and a greater mixing of

[90] Sharkey, *supra* note 6, at 68.
[91] *Id.* at 84.
[92] *Id.* at 86, drawing on Patrick Sharkey, *The Acute Effect of Local Homicides on Children's Cognitive Performance*, 107 PROC. NAT'L. ACAD. SCI. USA 1173 (2010).
[93] *Id.*

low-, middle-, and upper-income residents.[94] And after summarizing the remarkable work of Raj Chetty and his co-authors,[95] Sharkey finds that:

> children who reached their teenage years at a time when the level of violence had subsided were substantially more likely to move upward in the income distribution by early adulthood, advancing further than their parents and further than others in the same city who had lived through a more violent time. Our results suggest that children who lived in an area where violence had declined by roughly half – which was not uncommon during this period – could expect to earn about $2,000 more in income every year during early adulthood.[96]

As should be clear, most of the societal benefits from the great American crime decline accrued to the most disadvantaged segments of our largest cities.[97]

Sharkey summarizes these societal benefits from the decline in crime ably:

> If there is a single fact that reveals just how much urban life has changed over the past twenty years, it is this: The poorest Americans are now victimized at about the same rate as the richest Americans were back at the start of the 1990s. … A poor, unemployed city resident in 2015 had about the same chance of being robbed, beaten up, stabbed, or shot as a well-off, high-paid urbanite in 1993.[98]

The final section of Sharkey's marvelous work turns to the broader topic of urban poverty. He disagrees with the view that the central issue to advance economic, social, and personal development in our largest cities is to rein in "warrior policing," as he calls it. That is an element of what needs doing – changing "warrior police" into "urban guardians," restoring the trust in the police and their communities, and re-establishing the "legitimacy of the law enforcement enterprise" – but there is so much more that must be done. I commend this section of the book with the same enthusiasm with which I commend the prior three sections.

[94] *Id.* at 105, drawing on Sharkey, Torrats-Espinosa, and Takyar, *supra* note 82.
[95] See Raj Chetty et al., *The Fading American Dream: Trends in Absolute Income Mobility Since 1940*, 356 SCIENCE 398 (2017), and Raj Chetty, Nathaniel Hendren & Lawrence F. Katz, *The Effects of Exposure to Better Neighborhoods: New Evidence from the Moving to Opportunity Experiment*, 106 AM. ECON. REV. 855 (2016).
[96] Sharkey, *supra* note 6, at 108.
[97] Magnus Lofstrom & Steven Raphael, *Crime, the Criminal Justice System, and Socioeconomic Inequality*, 30 J. ECON. PERSP. 103 (2016) reach the same conclusion.
[98] Sharkey, *supra* note 6, at 112.

V. CONCLUSION

The great American crime decline of 1991 to 2015 (and, perhaps, beyond) is one of the most remarkable stories of our time. Its causes were many and are still contested. As we have seen, we should resist the temptation to think that the causal story is the same for the entire period. Rather, we have seen that it is more illuminating to treat the 1990s and the 2000s differently. They are related, but the factors that were contributing to the almost continuous decline of the past nearly 30 years have changed slightly between the end of the twentieth century and the beginning of the twenty-first century. Moreover, as Professor Zimring noted, this dramatic change in crime occurred without any fundamental institutional, social, or environmental changes to which we can point as causes. There are tantalizing clues to the causes of the great American crime decline, but fundamentally the parts played by those causes are a mystery.

I have had the great pleasure to explore these issues through the lens of John Pfaff's wonderful *Locked In* and Patrick Sharkey's *Uneasy Peace*. They are superb pieces of scholarship, beautifully written, passionately argued, and deeply instructive.