Book Review

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The Legal Foundations of Micro-Institutional Performance: A Heterodox Law and Economics Approach
by: Sarah Klammer and Eric Scorsone
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Since capitalism is characterised by the private ownership of the means of production, it must be built on a foundation of law which defines and recognises private property, and a judicial system which can adjudicate between various claimants. That the law is fundamental to economics (and vice versa) should be a starting point for the discipline of economics, but surprisingly it is not, as Klammer and Scorsone tell us in their important book, *The Legal Foundations of Micro-Institutional Performance*. Neoclassical economics (especially) has parried the existence of law, so that market transactions are assumed to occur in a legal vacuum. But law matters, and economics and law cannot be separated.

Klammer and Scorsone offer a very helpful framework to understand how law matters and the fundamental connection between law and economics. After all,

> "the economic analyst needs a toolkit or language to frame the institutional or legal relations underlying the transactions that are occurring in the economy and the general level of interdependence between various agents in the economy." (pp.38–39)

The framework offered admirably does the job.

Perhaps not surprisingly, given the title, the book is well-grounded in institutional economics. The authors write well, and the book is structured logically. Thanks to a good introductory chapter there are no mandated prerequisites, although anyone with a rudimentary background in economics will perhaps benefit more.

The Legal Foundations of Micro-Institutional Performance is intended for graduate students, but the authors underestimate their potential audience: Not only can this book be read profitably at the undergraduate level, but any educated citizen can read and profit by it; and it should be required reading for all policy makers.

The book's nine chapters are divided into two parts:

1 institutions, law, and economics (Chapters 1–4)

2 applications (Chapters 5–9).

The first part lays the necessary groundwork for understanding the interdependence between law and economics. Chapter 1 (entitled 'Institutions'), in addition to underscoring the importance of institutions, stresses the ubiquity of transactions in a market economy and that interdependence between agents is fundamentally critical. Although the authors point out that this introduction is not a 'one-stop-shop' for those interested in learning about institutional economics and institutionalist traditions; nevertheless, if combined with a brief primer on institutional economics (such as Adkisson, 2010[1]) it will sufficiently provide the uninitiated reader with a good understanding, and the seasoned institutionalist with a better understanding of some of institutionalism's finer points.[2]

Chapter 2 presents the Hohfeldian legal framework of jural relations (the latter phrase defined as a "relation between parties with regard to a specific act" (p.43), developed by the Yale legal scholar[3] Wesley N. Hohfeld. His useful framework presents a formal way to model and understand interdependence by establishing the rights/privileges/duties/obligations of one agent vis-à-vis another. Yeah, there is a lot to digest in this chapter, but careful and thoughtful perusal will pay off well, for as the authors noted earlier,

> "Economic relationships are almost always defined by an underlying legal framework that informs the nature of interdependence between transacting parties, whether it is the Uniform Commercial Code, common law, statutory law, constitutional law, or even international law. Commons, Ronald Coase, and more recently Elinor Ostrom and others have explored the implications of the law for economic transactions and performance. Legal structures define the relationships of parties engaging in a transaction, including who has what rights or duties." (Klammer et al., 2022)

The Holdfeldian framework is extremely useful for understanding that "institutions [codified and enabled by law] enable and expand the opportunity set of some agents while simultaneously restricting the opportunity set of others" (p.148). Given a market transaction where one person has a right to own property, for example, others have a duty and obligation to respect that right. More specifically, the elements of the Holdfeldian framework entail four jural relations:[4]

- every *right*, i.e., a claim an individual (let us call her A) must do or not do something vis-à-vis, others entails a *duty*, i.e., another individual (let us call him B) must do or not do something in relation to A
- every *privilege*, i.e., the ability of A to act in a certain manner without being held liable for damages, entails an *exposure*, i.e., B is subject to damages from A's actions without legal remedy
- *power* (the ability to change one's legal status with others) is subject to *liability* (where B's relation to A is subject to change)
- *immunity* (B's relation to A cannot be legally altered by A) entails a *disability* (A is unable to change her legal relationship with B).

As can be seen even from this brief delineation, "each jural position can be viewed as having its unique opposite" (p.43).

Chapter 3 expands and clarifies some of the issues involved in understanding and using the framework. It becomes clear that unlike neoclassical economics which assumes

efficiency as the overall objective (sans any legal understanding) the Framework recognises that all possible alternatives can be efficient, with the crucial point that some rights are recognised over others: "the issue is not government or no government, but which interests, that is, whose interests the state is used to effectuate" (p.10).

A very helpful feature is the book's discussion of legal cases to understand the concepts, definitions, and framework (and in turn, the latter can be used to understand the former). And as someone with a life-long interest in law, I am now using the Framework to understand contemporary legal cases, and returning with a fresh look at the main legal cases in labour law (my doctoral specialty was labour economics).

Chapter 4 introduces the extremely helpful legal-economic-performance (LEP) framework, which is a formal model (based on the Hohfoldian framework) to conduct institutional impact analysis, i.e., "to explain how alternative institutional structures affect instances of human interdependence and substantive economic outcomes of wealth and its distribution" (p.87). The LEP framework is a piece of cake to digest after fully understanding the foundational Hofoldian framework.[5]

The goal of institutional impact analysis is "to predict or calculate the consequence or performance of some change in institutions as compared to the status quo" (p.87). Overall, the analysis is conducted using a situation/structure/performance matrix in which the current institutional structure is delineated, followed by identifying various institutional alternatives, then evaluating their performance, with each stage conceptualised in Hohfeldian terms. Unlike neoclassical analysis where the goal is to recommend the most efficient policy (absent any legal foundation) here the researcher's goal is not to make a choice, but to provide information so that all concerned can make choices. This is so since, "choice always involves some normative element of who or what should matter" (p.92).

In addition to laying out the framework, Chapter 4 provides a hands-on approach with numerous (and quite helpful) examples to demonstrate specific elements of the Framework that might be difficult and or confusing, especially for the novice, e.g., delineating the starting institutions with specificity, determining the exact state of interdependence, choosing between a panoply of various alternatives, and how to measure performance. In assessing performance, the researcher should be not constricted by only one methodology, e.g., econometrics, simulation, case study, experiments, etc, but should decide based on the specifics of the research problem.

While the framework is very helpful for "examining the rules and their context more closely to consider the numerous possibilities…for dealing with human interdependence … and get at the root of what is being gained and lost by all stakeholders" (p.146) the authors remind us that one "must still do the work of understanding relevant human behavior and collecting data, evidence and developing potential testable hypotheses" (p.99). Thus,

> "The first step of the LEP framework involves laying out the situation, or everything that is going on. Like most first steps of theoretical models, it involves observation… Before moving any further forward, like a detective, you must get your bearings and figure out what is really going on. Gathering as much information as possible about the context in which a problem occurs is key to understanding potential alternatives and outcomes" (p. 113).

But shouldn't this be how economists conduct research (assuming that they do)? How far has economics strayed from scientific precepts that such an exhortation must be made?

Chapter 4 also emphasises two additional points. One, the researcher has a wide array of choice in conducting each LEP stage,

> "the analyst in effect chooses which questions to ask, which structural alternatives to consider and the way in which performance may be evaluated. The analyst decides where to start the analysis and when – with consequences for performance measurements and how they may be compared." (pp.105–107)

And two, it is fundamentally important to connect the situation/structure/performance matrix with a model of human behaviour,

> "we do not presuppose that all human behavior is founded on rational choice. There are now a wide range of behavioral models that can be used…Institutional economists have explored many of these models going all the way back to Thorstein Veblen and his focus on the power of social traditions and history driving human decision making." (p.148)

While reading and preparing this review, I kept wondering why the LEP approach was never a part of economics (at least neoclassical economics), and why its offering is such a novelty. The neoclassical reader might object that this is what welfare economics is all about: to study and ascertain the before/after situation of policy changes. But alas, several key differences:

1 neoclassical welfare economics overtly assumes an equilibrium, a Pareto optimum where resources are allocated efficiently

2 the explicit bearing of the law and how explicit changes in the law can affect the welfare of the contesting parties are ignored within neoclassical welfare analysis

3 conflict and power, the heart of every transaction is routinely ignored

4 economic outcomes are not just gratuitously determined vis-à-vis some equilibrium, but overtly determined by the respective parties' rights and privileges

5 the LEP models beyond the straightjacket of rational choice

6 the researcher's flexibility in the LEP in terms of questions asked, performance methods, assumptions made, is stressed.

The second part of the book discusses/analyses legal cases, which really help to explicate and bring to life the concepts and definitions discussed in the book's first part. Each case is about competing rights, and each is analysed and understood via the LEP Framework, with its underlying Hohfeldian jural relations, underscoring whose rights get recognised and protected. Although all cases discussed are from the US Supreme Court, any reader from a western nation should be able to read this part with relative ease.

Chapter 9 provides a nice summary conclusion. The authors remind us that,

> "… institutions and more specifically the law, cannot be separated from the study of economics. All economic agents are tied together in a legal system given the inherent interdependent nature of transactions in a global economy…When we conduct any economic analysis… without domain knowledge about the operationalization of variables, mechanisms, etc., we run the risk of drawing misleading conclusions at best and useless or damaging conclusion at worst." (p.147)

Rounding out the book is a helpful appendix in which the finer details (and subtleties) of the court cases are discussed; a glossary defining legal terms (which I often utilised); very

helpful and enlightening references; and an index, all features enabling (and encouraging) frequent page thumbing, while cumulatively making the reading experience quite rewarding. Hats off to the publisher (Edward Elgar) for making everything come together (and in only 180 pages!) in a concise, informative, and well-argued book.

The book is published at a time (at least here in the USA) where confidence continues to erode in the US Supreme Court as a democratic institution.[6] The leakage of (and the probability of) Roe v. Wade being overturned underscores that law matters, and that specific laws and how they are interpreted, also matter[7]. The LEP helps us to understand how and whose rights are emphasised.

I see no reason why this book cannot become part of the undergraduate curriculum. In introductory/intermediate microeconomics, do we really need to devote one-third of the course to an overly deductive, anti-historical discussion of the theory of the firm, in which students are deductively taught the intricacies of how much a firm is supposed to produce, at what price, and if the firm makes a profit, but with students leaving the course knowing less about the actual firm than they did before? And rather than introduce the traditional discussion of taxes and tariffs with Pigou's welfare analysis, why not introduce the LEP?

Given the increased political ideology into the rendering and the interpretation of the law, this book, and the wonderful array of resources it offers will be quite useful to not just the economics student, but to all citizens. The LEP framework can be fruitfully applied to a multiplicity of situations: the impact of electing judges and appointing them, the specifics of traffic codes or rules, the resettlement of refugees, property tax assessment, dumping a surplus product, waitstaff and the minimum wage, classifying workers as independent contractors or employees, exercising imminent domain, etc.

In the introduction to *The Legal Foundations of Micro-Institutional Performance*, the authors wrote,

> "It is our hope that by the end of the text, the reader should come away with a better understanding of how to conduct a positive analysis of the regularities in behavior and subsequent performance that will emerge from a set of rules, as well as the ability to specify those sets of rules." (p.5)

The authors succeed admirably in their task.

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Notes

1 In addition, I highly recommend Whalen (2022) who adeptly explicates the major tenets and doctrines of institutional economics in order to comprehend today's most pressing problems.

2 For me, it was the plethora of the definitions of institutions.

3 Highly recommended are Hohfeld (1913) and Hohfeld (1920).

4 Please see Table 1 (p.43) and Table 2 (p.98), along with the very helpful discussion in the text.

5 Also see Klammer et al. (2022, pp.209–219).

6 See, *The Economist's* 'A countermajoritarian difficulty' (2022) and its accompanying editorial, 'How to Save the Supreme Court' (2022, p.9).

7 Case in point: the US Supreme Court's decision to revive a Trump administration rule that constricted a state's ability to protect rivers from pollution under the Clean Air Act. The ruling circumvented the normal Court process and was conducted via its shadow docket, a shortcut for only urgent matters, whatever urgent is defined to be, which the court has been increasingly utilising. See 'A countermajoritarian difficulty' (2022, p.18).