

The Rule of Law, Economic Efficiency, and Social Justice: A Primer for the President

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April 12, 2018

The critical role of the Enlightenment

- Development of science
- Development of basis of social organization not dependent on authority
 - Rule of law
 - Bases on reasoned discourse/deliberation
 - Advancing our understandings of social interactions
- Result was the basis of the wealth of nations
 - Growth not based on the exploitation of others
 - Changing the stagnation that had lasted for centuries

Some insights from Smith

- **Role of markets**

- Pursuit of self-interest leads, as if by an invisible hand, to the well-being of society
 - Not even Adam Smith believed in invisible hand—arguing for government intervention to prevent monopolies, to foster education, to reduce poverty

- **Need for anti-trust**

- “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices”

Further insights

- **Concerted effort to exploit workers**

Masters are always and everywhere in a sort of tacit, but constant and uniform, combination, not to raise the wages of labour above their actual rate [...] Masters, too, sometimes enter into particular combinations to sink the wages of labour even below this rate. These are always conducted with the utmost silence and secrecy

- **Political economy of labor legislation**

When workers combine, “the masters [...] never cease to call aloud for the assistance of the civil magistrate, and the rigorous execution of those laws which have been enacted with so much severity against the combination of servants, labourers, and journeymen.”

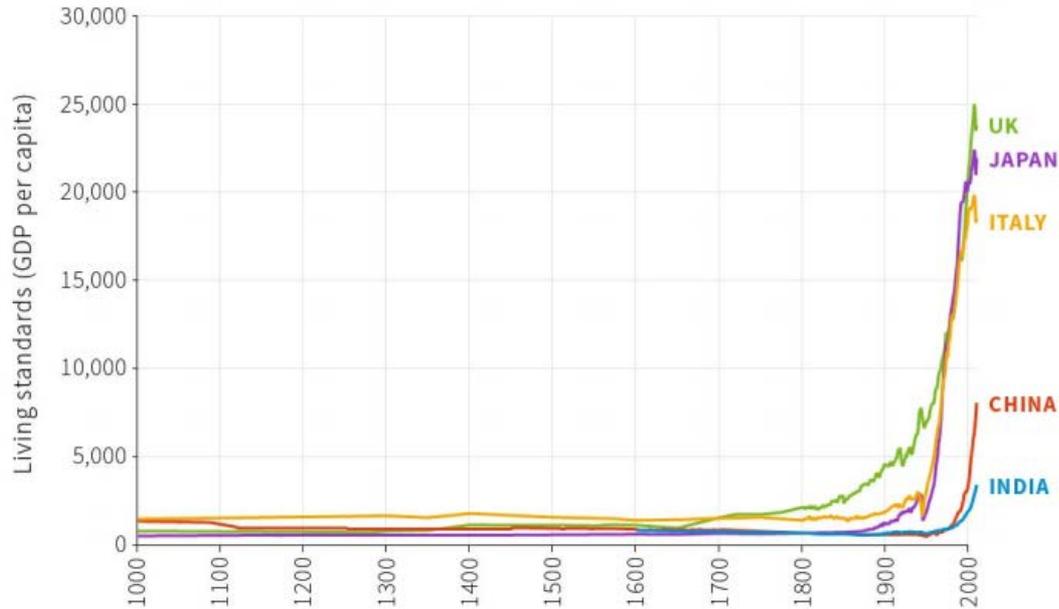
Role of regulation in determining the distribution of income and social justice

- *When the regulation, therefore, is in support of the workman, it is always just and equitable; but it is sometimes otherwise when in favour of the masters*

- ***More than law is needed: trust and norms***

If trust is too low in a society, savings will be insufficient to sustain positive output growth. Such a poverty trap is more likely when institutions – both formal and informal – which punish cheaters are weak.

Historical living standards



Source: INET

Real wages of London craftsmen, 1200-2000

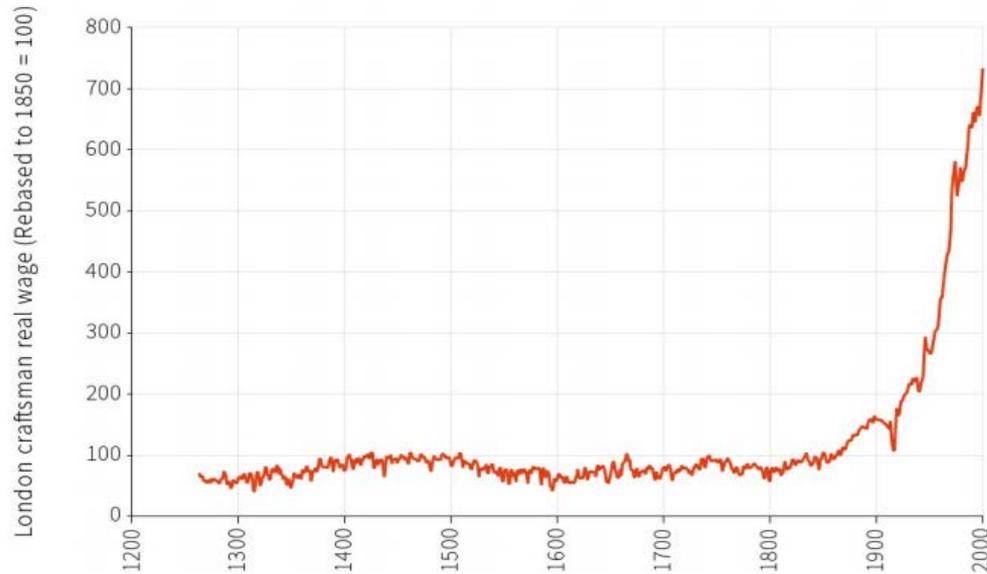
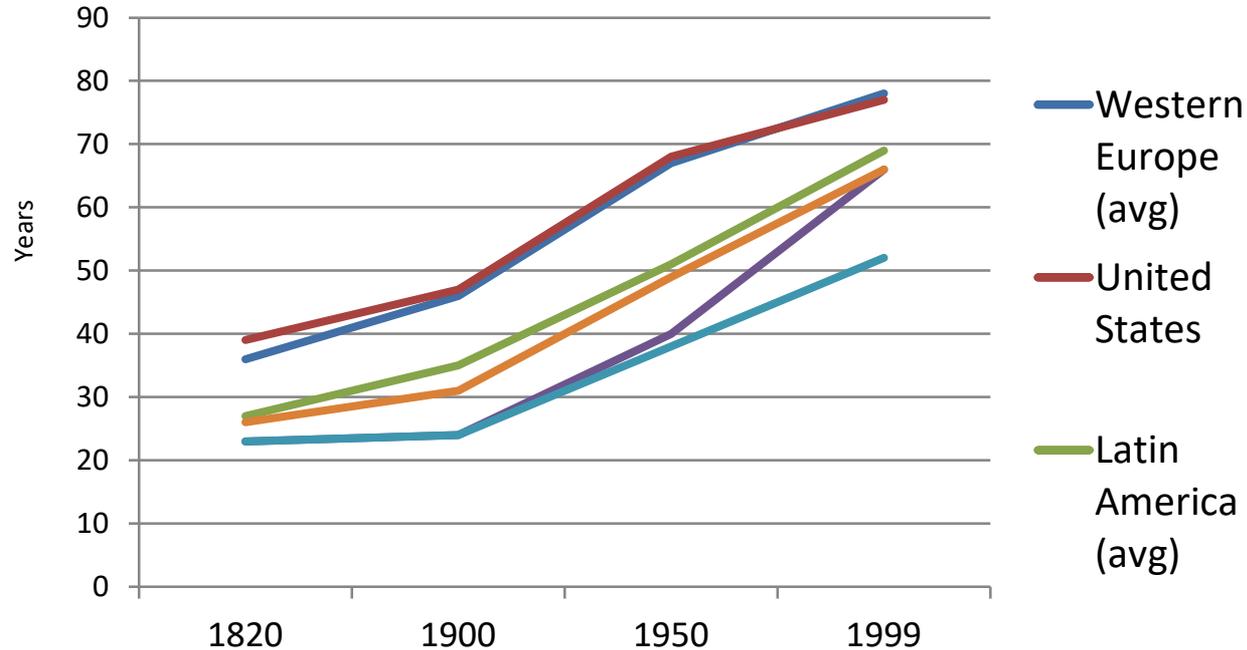


Figure 3. Real wages over seven centuries: craftsman (skilled worker) in London (1264-2001).

Source: INET

Improvements in life expectancy since 1820



Data are estimates from A. Maddison, 2001, "The World Economy: A Millennial Perspective," OECD.

Key insights of thinking about social organization

- Importance of coordination
 - Stop lights simplest example
 - Massive coordination failures
- Necessity of regulation
 - Pervasive social externalities
 - One person's freedom is another person's unfreedom
 - Limitations of markets
- Necessity of collective action
 - Markets don't exist in a vacuum—markets have to be structured
 - Thus law must *underlay* economics—sets rules of game
 - Key battles are about the rules of the game
 - Many problems where markets won't suffice—public goods

Chicago view of law and economics

- Based on a particular view of markets and human nature
 - Presumption that they are competitive
 - Even when there is a natural monopoly, competition for the market replaces competition in the market, yielding efficient solutions (markets are contestable)
 - Schumpeterian competition: monopolies are temporary, competition to be monopolists spurs innovation
 - So little need for anti-trust law
 - Presumption that conditions of Coase “theorem” are satisfied
 - So little need for regulation of externalities
 - Preferences are fixed, and in particular are unaffected by how the economy/society is structured
- Each of these presuppositions is wrong

Broader view of law and economics

- Law is formalization of norms, but also helps shape norms
- Law and norms reflects and shapes who we are as individuals and the nature of our society
- Markets are just one form of social organization, one which has certain advantages, but many limitations and disadvantages
 - Including shaping individuals to be more selfish
- Successful economies and good societies may consist of an ecology of institutional arrangements
 - Mix may change over time, with changing circumstances
 - Socially based microcredit schemes were more successful (and more sustainable) than for profit microcredit schemes and DeSoto's land titling agenda

Social organization without inherited hierarchical authority

- Based on rules, undergirded by rule of law
- Based on some version of merit
- Recognizing human fallibility
 - Dangers of concentration of power
 - Importance of checks and balances/separation of power
- Based on notion of deliberation
 - Representation/representativeness
- Dangers of inequality—benefits of equality (in income, power, etc)
 - Broader benefits of empowerment

Key role of truth-telling institutions

- Social organizations can't function without some way of assessing truth of competing claims (necessary for deliberations over “fairness,” resolution of disputes)
- Multiple and complementary truth-telling institutions
 - Universities, research institutes, and other education institutions
 - Media
 - Judiciary
 - “Administrative Bureaucracy”
 - Intelligence agencies
- While science emphasizes the inherent uncertainty with which we know things, there is no alternative reality, no alternative “facts”

Making Democracy Work

- Democracy was part of Enlightenment project
- Particular form of social organization—collective action
- Principles outlined in previous slides
- Can easily be corrupted by money
 - Rules of the (economic and political) game are set by political process
 - Economic power translates into political power
 - Political power used to perpetuate and reinforce economic inequalities
- Can be multiple equilibria: “good” equilibrium with high levels of economic and political equality, bad equilibrium marked by political and economic inequality
 - US may be in bad equilibrium, more closely described by “one dollar one vote” than “one person one vote”

Trump represents a threat to our economic and political system

- And to the Enlightenment Project which has underlay advances in economy in the past two hundred years and to our economy
- Not even based on good market economics
 - Rent seeking marked by exploitation of others and of political system
 - Trump University
 - Exploitation of bankruptcy laws, weaknesses in our legal system
 - Allegations of money laundering
 - Taking advantage of political influence to get zoning changes, etc.
 - Markedly different from the real bases of the wealth of nations
 - Worse: attacked our education and science institutions

Exploiting and bringing out baser elements

- Changing who we are as individuals and how our society functions
- Inequality/disempowerment is a serious problem
 - Caused by mismanagement of technological change and globalization
 - And, since 1980, rewriting rules of the economic and political game to favor those at the top and to undermine social protection of the rest
 - Didn't lead to higher growth: growth actually slowed
 - And predictably so
 - **Partially because we now realize that more equal societies have better performing economy**
- Trump has attempted to blame others (trading partners, immigrants) for failures, when the real blame is ourselves
 - His prescriptions/policies will only worsen the plight of those who have been doing poorly
 - **There is an alternative agenda: the progressive reform agenda based on promoting shared prosperity**

Law and economics

- Trump agenda threatens to undermine the bases of our civilization
- Most serious threat is to our “epistemology” and to the rule of law, the premises on which our democracy and our economy rest
 - Has sown doubt about both well established truths and our truth telling institutions
 - If one can sow doubt about whether cigarettes cause cancer and have other adverse effects, if one can sell bad products, one can sell bad ideas
 - Damage may be long lasting
 - We are just beginning to see its corrosive effects