

Law & Economics Analysis in Governance? An Introduction

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Law & Economics (L&E), most simply speaking, refers to the economic analysis of the law or – the other side of the coin – to the study of the influence of the law, widely understood and including institutions generally, on the economy. The first aspect of Law & Economics is a form of legal realism, i.e. the concern with what effect a law, statute, regulation or just decision really has, rather than with what effect it is supposed to have or addresses. The basis of this kind of Law & Economics, thus, lies in Plato's sentence, "This is what the law-maker must often ask himself: What is my purpose? Do I indeed achieve this or rather miss my goal?" (*Nomoi* 744a; on Plato and Law & Economics, see Drechsler 2002; 2003; 2005a) Key here is a differentiation between the simple goal of a law (etc.) and its *telos*, i.e. the final purpose it is supposed to achieve, which might be quite different from the goal. In fact, the realisation that a given law fulfills its goal but not its *telos* is sometimes one of the most helpful insights of a Law & Economics analysis.

The same holds true, *mutatis mutandis*, for the second aspect of Law & Economics, the "institutionalist" one, as well. This aspect goes back to the "natural" and traditional interweaving of legal and economic problems in the context of 19th-century Germany (see Grosseckter 2005, 690-692), which has manifested itself in an integrated "State Sciences" or *Staatswissenschaften* approach since the days of Christian Wolff. (See Backhaus 2005a, 1-2) This conceptualisation was neglected during most of the 20th century until its rebirth in the form of the concept of Governance.

Of course, all definition, or at least much of it, is a matter of power, or at least of dominance, and this is *a fortiori* true for areas, fields or research programmes such as Law & Economics, which are more "constructed" than "found". In that sense, whether it is possible "to let law and economics begin, not in the late 1950s in Chicago, but some 2300 years earlier" (Drechsler 2005a, 635) – or at least 200 years earlier, namely precisely with Christian Wolff (see Backhaus 2005a, 1; Drechsler 2005b; 1998) – depends on whether such a suggestion is accepted by whatever reference group one focuses on to measure this acceptance. Or, in Humpty Dumpty's words, "The question is ... which is to be master – that's all." (In Lewis Carroll's 1872 *Through the Looking-Glass, and What Alice Found There*; see Heath 1974, 192-194) On the other hand, as Gadamer says, "Words seek to denote something that, in the course of time, has been shaped, as it were, out of the great river of expe-

riences and images flowing by the Humankind.” (1995, 136) Especially a definitional term like “Law & Economics” must stay somewhat close to what is actually emphasised, i.e. what makes it different from any other phenomenon, or the term becomes meaningless.

Nonetheless, such a rather wide approach as the one outlined above seems certainly at least viable, as the publication and reception of J.G. Backhaus’ *Elgar Companion to Law and Economics* (2005a, which is the second edition, and there was a paperback edition of the first as well) and, more personally, the publications by Drechsler (Drechsler 2009a, 2009b, 2006, 2005a, 2005b, 2005c, 2003, 2002, 2001, 1998) indicate. Another question is whether in Law & Economics analysis, one has to focus on neoclassical/mathematical economics. Principally, one can argue the opposite is the case, because realism is systemic for Law & Economics, while neo-classical/mathematical economics is marked by a systemic lack thereof. (See Drechsler 2000)

On the whole, one should take a pragmatic approach in the selection of models to be employed in L&E analysis. While in some cases, models proceeding from the assumption of a rational actor may be helpful in predicting and explaining the actual outcomes of a law or policy, in many other situations, this assumption would simply be too unrealistic. In many areas of Governance, the models put forth by the behaviouralist stream in Law & Economics (which assumes that peoples’ decisions systematically deviate from the “ideal” rational choice) are likely to be more helpful. (See Sunstein 1999)

In line with the research programme of Tallinn University of Technology’s Public Administration department, L&E analysis is, then, primarily interpreted as a form of legal realism, based on an analysis via economic assumptions and methods – not necessarily neo-classical ones. Understood in such a way, L&E is particularly suited for the analysis of Public Administration and Management cases, and Governance generally, because of its objectivising function and its high predictive value, which means that L&E is an ideal tool to apply before a policy decision is made or put into effect. In its synthesis of perspectives and issues, this kind of L&E is in line with the tradition of *Staatswissenschaften* as explicated above. Governance, in this context, is understood as a more or less neutral concept that focuses on steering mechanisms in a certain political unit, emphasising the interaction of State (First), Business (Second) and Society (Third Sector) players, but emphasising the coordination functions of the first one. (Drechsler 2004) There is a specially designed and very popular undergraduate and graduate course in the department, developed over the years by Drechsler and later co-taught and eventually led by Raudla, with the same title and focus, and it was kindly suggested to the organisers to build the 2010 “Halduskultuur – Administrative Culture” around that very theme.

The current issue of *Halduskultuur – Administrative Culture* presents essays based on the very best papers from the conference, carefully and strictly refereed. Rather than presenting a general picture of what L&E Analysis in Governance could be, it may be argued that they “only” form some preliminary inroads into the possibility of this kind of perspective and its application. This has partially to do with the fact that “Halduskultuur 2010” was scheduled for and took place on 23 and 24 April 2010, which meant that the conference fell victim to the 2010 eruptions of the

Eyjafjallajökull volcano in Iceland and its interpretations and the subsequent closing of the European air space and uncertainty when and where it would be reopened. This made attendance very difficult or impossible for many of the confirmed participants, as was the case with many events worldwide. And while many participants who could not attend did submit their papers, others were just thwarted from doing so. Finally, a good number of submissions did not pass peer review; unfortunately, this included some of the more “classically” L&E contributions. We still hope that the current selection will be met with interest by readers from L&E and Governance backgrounds alike.

In his article, “Global Governance from the Perspective of Law & Economics”, Joaquim Ramos Silva demonstrates how the approach of L&E can be employed for analysing the issues of global Governance. This is a valuable contribution since the subject of global Governance – and its implications for global rules and institutions necessary for managing the globalised economy – has so far not been at the core of L&E, but, especially in light of recent developments, should certainly acquire a more important position in the field. The author raises some rather interesting issues, including the question of whether L&E is at all suited to analysing the topic of global Governance and what difficulties arise from the application of L&E to the analysis of global rules and institutions. Silva shows, however, that L&E can indeed provide some useful insights about global Governance. In particular, he argues that the notion of transaction costs helps us to understand why the movement towards global agreements and institutional frameworks is slow and complicated. He also demonstrates that the notions of spontaneous order (as opposed to constructed order) and competition among alternative institutional arrangements can help to take a differentiated stance when making normative prescriptions for Governance arrangements on a global level. Altogether, this article opens up the floor for further discussions on how the insights generated by L&E research can be applied to advancing the understanding of global Governance.

Looking at the issues of Governance in the constitutional and electoral arena, Nele Parrest discusses the impact of the law that limited political outdoor advertising during the last active campaign period in Estonia by making use of evaluative and normative approaches of L&E. This case study demonstrates very well how an act may fail to achieve the goals set by the legislature, if not preceded by a thorough analysis. For example, although one of the aims of the prohibition was to reduce the costs of election campaigns, this goal may not have been achieved because of the possibility to steer electoral campaign expenditures to other advertising channels. The author also shows that since the prohibition only applies to the active campaigning period, outdoor advertising is simply shifted to earlier periods, which is why the goal to liberate public space from excessive advertising may also have remained unfulfilled. Also, the given constraint does not guarantee that the electoral campaigns become more substance-oriented. Parrest also shows that, although the designers of the law argued that its implementation would not bring about any additional costs, the administrative costs of enforcing the prohibitive provisions have been rather substantial. Furthermore, this case study provides some good illustrations of how actors try to overcome this particular constraint on political advertising by creatively “testing” the boundaries of the prohibition.

Aleksandr Aidarov's essay, written with Wolfgang Drechsler, on "The Law & Economics of the Estonian Law on Cultural Autonomy for National Minorities of 1993 and of Russian National Cultural Autonomy in Estonia," is a classical L&E analysis in that it uses the opportunities of L&E to approach a politically tricky issue via an objectivising method, and it directly addresses a crucial issue of Governance, viz. the living-together of different ethnic groups within one country. Russian National Cultural Autonomy (NCA, a concept developed by Karl Renner for the Austro-Hungarian Empire 110 years ago) was in fact never established in Estonia – and the question would then be, why not? The L&E approach first of all suggests begging the question, i.e. investigating whether the purpose of the law actually was to further (Russian) NCA in Estonia to begin with. If it was, the next question is whether it would have been such a good thing to establish, and/or whether it would be feasible at all. The argument against NCA is that it does undermine the Nation State which Estonia still is and seems to be set to remain for any foreseeable future; for Estonian Russians, it is that NCA may be an inappropriate concept for this specific type of community.

Attila Gyorgy's and Adina Gyorgy's contribution on "Central Legislation Regarding Romanian Local Budgeting" is a particularly fitting article for this special issue since finances are a central element in Governance, and L&E also has a long tradition of analysing fiscal federalism and intergovernmental fiscal relations. Using an evaluative L&E approach, the authors analyse the effects that the changing repartition criteria, used as a basis for transferring central-government revenues to local-government units, have had on the local budgets. They show that although the aim of the local public finance law has been to reduce the financial disparities between the local governments, the existing criteria – the territory of the unit, the size of the population, financial capacity and revenue collection rate – are insufficient to achieve this goal. The analysis also indicates that the mechanism that takes into account the revenue collection rate by the local governments themselves (by reducing allocations from the central fund if the unit's collection of own revenues falls) does not create sufficient incentives for the local government to enhance revenue collection but, rather, acts as an arbitrary punishment for those localities that have been hit by economic misfortunes. The article also demonstrates that although the transfers from the central government's budget reserve fund were meant to be used for unpredictable expenditures, these transfers have been increasingly used for covering predictable – but underfinanced – expenditures of local governments.

The penultimate article in this issue combines two central elements of Governance – the constitution and public finances. In her article "Effects of a Constitution on Taxation: The Role of Constitutional Review in the Development of Tax Laws in Estonia," Ringa Raudla tries to bring together streams of literature – constitutional economics and constitutional politics – by using the perspective of constitutional L&E. The case study demonstrates that the development of tax laws in Estonia has, in important aspects, been influenced by the institutions of constitutional review, which have repeatedly sought to affirm and extend the rights of taxpayers. The author also shows that although according to the strategic interaction models, proposed in the literature on constitutional politics, one would expect a constitutional court to be reluctant to pass rulings that imply large costs for the bud-

get, the Estonian Constitutional Review Chamber has been repeatedly willing to go ahead with costly judgements on tax laws. Further, contrary to the predictions of the rational choice models, the Estonian legislature has deferred to the constitutional court in most cases. Thus, based on the Estonian case study, one can argue that though the strategic interaction models of the constitutional politics literature can provide some insights into the behaviour of courts and legislatures, a more complete survey of their decisions has to take into account to whether the dominant political actors attribute a symbolic role to constitutional review and whether the previous rulings have created path dependencies that make it easier for the constitutional courts to adopt costly decisions and more difficult for the parliament to override such decisions.

The final essay, by Jürgen Backhaus, is based on the keynote address of the conference. Coming from one of the founders and key figures of Law & Economics as a scholarly discipline in Europe – and one to whom the organisers owe much of their exposure to and even interest in Law & Economics –, this is a particularly significant contribution to this issue. Backhaus' essay traces the question whether the key figures in the development of Law & Economics have been both lawyers and economists, or whether they rather were one or the other and the field emerged from close cooperation, partially in order to find out how to institutionally organise Law & Economics studies. As he says, "This question is of course of great importance for the question of how to arrange the study of Law & Economics in the Governance context as well – should it be done by Governance experts who also know Law & Economics, or by lawyers and by economists dealing with Governance issues?" But the importance of the essay for our topic goes well beyond that – by looking closely at a defining moment in the history of Law & Economics, the genesis of the German Civil Code of 1900, which profoundly changed shape due to the interaction of the lawyer Otto v. Gierke and the economist Gustav v. Schmoller, Backhaus shows how empirically-based jurisprudence together with economics were able to ensure the creation of a legal paradigm which would support rather than hinder economic development and practice in the context for which it was designed – with clear lessons for the future of the European Union.

It is worth noting that a number of essays in this issue have been inspired by the methodological approaches outlined by Backhaus (2005b), who makes a distinction between three different kinds of analysis in L&E: positive analysis of legal structures (economic reconstruction of the legal argument), evaluative analysis, and normative economic analysis. The positive analysis (with a focus on reconstructing the structure of a legal argument) tries to illuminate complex legal reasoning that cannot be reduced to one or few organising principles of legal doctrine. (Backhaus 2005b, 465) Such an approach – by employing a different kind of analytical structure, consisting of economic concepts and theories – can provide new insights into legal issues and enhance our understanding of the law or policy in question. (Klevorick 1975; Mackaay 2000) The evaluative approach focuses on analysing the consequences of a particular legal decision or a set of decisions – the consequences here do not have to be only economic, but rather, the evaluative analysis seeks to look at all consequences of an act or policy, regardless of whether it concerns the impact on the economy or on other spheres. The normative analysis, finally, sets out "to explore the

relationship between the various value judgments underlying legal discourse and to indicate where and how they may conflict.” (Backhaus 2005b, 465) If, for example, a particular value judgement is given priority over others, the normative analysis can show to what extent this priority will compromise the attainment of other – maybe more traditional – goals. As the articles in this issue demonstrate, such a categorisation of L&E approaches is also very useful for analysing various topics in Governance. (For a further discussion of these approaches and an example of application, see Raudla 2007)

What unites all articles in one way or another, then, and what is a hallmark of L&E analysis, is the insight that the answer to the Platonic lawmaker’s question mentioned supra, “Do I indeed achieve ... my goal?” (*Nomoi* 744a), is very often in the negative. Correct implementation is never a given, nowhere, and we have known this literally for millennia – and yet, too many governments, agencies, legislatures and of course media and citizenry alike ever so often assume that one just needs a law, an ordinance etc. and the desired effect will follow. Seeing the overarching importance of structured living-together, basic as it is for civilised life, this is literally a vital issue for Governance, because both legitimacy and effectiveness hinge on correct implementation. The L&E approach with its specific slant and mode of inquiry emphasises this problem and thus makes its analysis easier and its prevention, to the extent that this is possible at all, more likely – especially if applied *ex ante*. As we have seen, all essays in this issue illustrate this point, from different L&E perspectives and regarding very different fields and layers of Governance, and so the editors hope indeed that the demonstration of the benefits of L&E Analysis in Governance has been, if not demonstrated, then at least underlined.

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