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LawMacro and the Schism in Law and Economics

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LawMacro, as it is currently practiced, has unmeasured confidence in the ability of government to steer the economy.

THERE IS A SCHISM IN THE CONTEMPORARY SCHOLARSHIP in law and economics. The field that decades ago helped revive the classical liberal tradition for law and lawyers continues to advance its project of studying legal incentives at the level of the individual—but it sidesteps monetary questions, approaching money only as a measuring rod to solve the barter problem. The nascent subfield of law and macroeconomics, or “LawMacro,” on the other hand, centers on monetary regulation—but does so while ditching classical liberal prescriptions and values.

LawMacro combines the macroeconomic and the legal angles to address some of the most pressing questions of today. This is a welcome development. Yet most of its practitioners have concluded that the tradition of law and economics, now downgraded to “LawMicro,” is obsolete at best, and deleterious at worst.

As a result, the two approaches develop in opposite directions. LawMicro focuses on efficiency and innovation, LawMacro on distribution and politics. LawMicro is supply-sided, LawMacro is demand-oriented. LawMicro sees the market as an engine for prosperity, but LawMacro increasingly supports government-lead initiatives—and what’s worse, it often sidesteps the discussion of political incentives, “romanticizing” politics, to allude to a Buchananian allegory.

Monetary matters are the missing link between LawMicro and LawMacro, and present the opportunity for scholars to approach these questions in a way that eschews many of LawMacro’s unhelpful assumptions. If scholars take this opportunity to bridge the gap, it would help reclaim the intellectual legacy of law and economics and provide needed insights for the pressing policy questions.

Law and Economics

By the 1950s, economics had developed a number of theoretical tools to understand individuals’ behavior that could be extended to other fields; it was in jurisprudence that those tools were first applied. The propensity of individuals to maximize their utility is a sufficiently constant human characteristic to be used to predict behavior. That prompted the use of economics to explain law, that is, to make sense of law as a social mechanism that can promote (or hinder) economic efficiency.

It all started with Ronald Coase’s idea that in a world with positive transaction costs (our world) law matters for efficient allocation. Then came Richard Posner’s conjecture that the English Common Law had evolved towards efficiency—for example, by determining that competition was not to be viewed as a tort. Later, as hypothesized, American Common Law judges improved on this monumental legacy. Property rights were

honed to encourage investment, contract law oiled market coordination, and tort law induced internalization of costs and risks.

At the same time, efficiency started to be paired with the virtue of prudence: you achieve the former by pursuing the latter. As such, the economic way of thinking could be employed not only as a descriptive tool but—important for lawyers—also as a normative one, to be used with moderation in concrete situations. A number of practical applications followed suit: corporate law can mitigate agency costs and protect shareholders; bankruptcy law can maximize firm value for the benefit of creditors; contract law can reduce transaction costs; antitrust law can maximize consumer welfare; a well-calibrated intellectual property law can induce innovation. The list goes on.

The field thrived. Law and economics left an indelible mark on a handful of economically inclined lawyers. It then made inroads in academia and legal practice in the United States. Ultimately, it spearheaded a movement that spread around the globe.

Macroeconomics and Jurisprudence

Depending on where one exactly locates the birth of law and economics, the tools of microeconomics can be said to have been applied first to private law (for example, the economic incentives explaining decisions in tort cases) or public law (such as the economic rationale behind the very existence of constitutional law). Economic tools are suitable to both. LawMicro covers essentially every field of law, from traditional Common Law areas to regulation, international law, and more.

But what is the right place for macroeconomics? From among those legal fields historically associated with private law, banking law holds most promise for an application of macroeconomics.



A marginalist approach to LawMacro, on the other hand, holds great promise as a critique of the field's standard assumptions.

The limited amount of attention traditionally devoted in law and economics to banking law approaches banks merely as financial intermediaries: Banks are entities that move funds from surplus to deficit agents. Here, transparency, corporate governance, and even systemic risk are paramount legal concerns that can be suitably complemented with microeconomics. The assumption of money neutrality explains this attitude. Macroeconomics becomes relevant once we approach banks as money-producing agents, payment agents, and (at least in times of distress) treasury-financing agents. Here, interactions with taxation and the Federal Reserve System are the key concerns.

As to the domain of legal fields traditionally associated with public law, monetary law holds promise for the employment of macroeconomics. Monetary law has been out of sight from most traditional law and economics scholars ever since the Volcker Era and the demise of US inflation in the 1980s. With concerns over inflation and deflation looming large, cryptocurrencies rising everywhere, central banks considering the adoption of digital currencies, and (last but not least) unconventional monetary policies well in place, lawyers are now forced to revisit old questions about money and its regulation. That macroeconomic considerations are useful for addressing these questions is beyond doubt.

And of course, there is crossover between banking and monetary law. Quite obviously, the money the banks produce will be governed by monetary law. Furthermore, overly indebted governments typically make use of financial repression mechanisms to depress interest rates, and that often involves banking regulation. (Many older readers may remember the now-repealed Regulation Q, for instance, which used to restrict payment of interest on checking accounts.)

Banking regulation also implicates other areas of private law—such as contract law—that could benefit from the macroeconomic approach.

Usury regulations, now again part of the law and policy debate, probably offer the best example. At the same time, there are issues of monetary law that are not typically housed under banking law. The regulation of crypto and blockchain currencies are a good example. Inflation adjustment of contractual obligations is another. Foreign exchange controls are third one. The list is long.

The Problem with LawMacro

Given that LawMacro has begun to explore these areas of law, why is there a need to reclaim the intellectual legacy of law and economics? Because LawMacro as currently practiced increasingly embraces three unhealthy features. The first is the unmeasured confidence in the ability of government to steer the economy. The second is a certain strand of institutionalism that downplays economic “realities”—that is, each individual’s opportunity set—in the discussion of institutional design.

And the third, at the level of macroeconomics proper, is a flirtation with the theory that the main purpose of money is to serve as a tool for political goals, an approach often referred to as Modern Monetary Theory, or MMT.

The combination of these ideas often manifests in the following assumptions and policy agendas:

There is no reason for monetary scarcity, that is, there are no limits to the amount of money a government, which has monetary sovereignty, can conjure in order to pay for its expenses;

The price level in the economy may be regulated by taxation;

The government, by inflating the money supply is able to generate growth;

Social reality manifests itself in legal formulations. It is not that legal institutions are shaped by social realities, but rather they are an embodiment of those realities;

Since the government has the monopoly of the creation of currency, and the creation of money substitutes by the banking sector is a cause of financial crisis, banks should be forbidding of lending the money they receive as deposits, possibly by the nationalization of the entire bank sector;

The creation of a Central Bank digital currency should be viewed as an opportunity to enhance financial repression.

Here is not the place to discuss these assumptions in great length. Suffice it to say that we reject their validity and we argue that applying them either descriptively or normatively to legal studies will result in mistakes and potentially in catastrophe. The malaise of simultaneous inflation and recession common in the 1970s due to the application of Keynesian economics is just one example of what we may experience if credence is once again given to these ideas.

A marginalist approach to LawMacro, on the other hand, holds great promise as a critique of these assumptions. For example, a marginalist approach to the relation between the money supply and the amount of goods available in the market debunks the claim that there is no rationale for the scarcity of sovereign money. Similarly, it might remind us that, when the rubber meets the road, if individual economic agents cannot make a profit, they will not invest and there will be no economic growth, regardless of how much new money is printed by the government.

An Opening for a New LawMacro

Contrary to the field of microeconomics, where a consensus mainstream was developed, in the field of macroeconomics a consensus is still lacking. Microeconomics evokes intuitive ideas that are easy to grasp: individuals calculate and respond to incentives; they are self-interested and do not normally pass up opportunities to make themselves better off; higher prices tend to increase supply and reduce demand; efficiency results from aggregating everybody's welfare or wealth.

These and other instinctive ideas conform the non-mathematized version of microeconomics mainstream. Finding applications to law is (in hindsight, at least) not so difficult. But in macroeconomics, a “mainstream” is not as potent an idea. The point is not simply that macroeconomics is more complicated—it is—but that theoretical disagreement within high-level macroeconomics is large.

The development of the field of macroeconomics was heavily influenced by Keynesian doctrine. The neoclassical synthesis that forms the (increasingly elusive) mainstream economics has incorporated Keynes’ teachings in a significant way for the last 70 years. However, such synthesis never amounted to a firm consensus among economists, being challenged by the Marxists from the left, the Austrian economists from the right, and the monetarists from within. Internal disarray in macroeconomics represents an opportunity. At the very least, it means that a macroeconomic analysis of law does not need to be “Keynesian”, as one of us [has recently argued](#).

As different schools of thought have incorporated or abandoned some principles, those changes have reshaped the discipline. For the purposes of this essay, let us say that the “marginalists” now comprise, not without divisions among themselves, the Austrians, the Monetarists, the Keynesians and the neo-Keynesians. There are many “marginalists” doing research on macroeconomic topics with limited use of Keynesian tools, even if most of the discipline continues to be influenced by Keynesian concepts.

There is a need to bring together scholars to approach LawMacro from a marginalist economic perspective. Such an approach will point out the flaws and limitations of government intervention and help craft better public policy for our increasingly fraught economic environment.

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