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Legal Foundations of Economic Inequality in the Time Loop of Law and Economics Movement

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ABSTRACT

Keywords

Capitalism
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Legal order
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The role of law in breeding economic inequality has gone unnoticed for an extended period; however, it is yet to be explored. To state and elaborate on the problem, while capitalism has been considered to potentially contribute to the ongoing inequality trends in the world, there needs to be more literature on how the legal order in terms of bolstering capitalism and economic inequalities are enlaced. The research problem is in regards to the extension of choice of legal structure undergirding capitalism correlate with economic inequality. As a limitation, this correlation should not be understood causally, as other underlying potential factors perpetuating economic inequality must exist. This article undertakes to fill the gap by utilizing epistemological and multidisciplinary approaches from the theories and practices of law and economics. Applying semiotic interpretation systems in forming arguments and drawing conclusions in doctrinal legal research. Various views are enabled through the findings because both law and economics are partly subjective and irrational, which reshape the meanings. It found that capitalism as a legal order is established to trace Economic inequality's legal roots. *Therefore*, appalling economic inequalities can co-exist with formal legal equality. Laws can reshape societies, but they serve capital, even when the movement of law and economics is at a crossroads.

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1. Introduction

The primary *raison d'être* of economic analysis of law is maximising social welfare as the most efficient outcome, and the most overarching social goal is economic equality ([Cecot, 2023](#); [Farber, 2003](#); [Granger et al., 2022](#)). Tracing the legal foundations of economic inequality is imperative to state the problem because all processes to redistribute market gains have abysmally faltered ([WID.World, n.d.](#)). As a proportion of GDP across nations, it is statistically noted that the unearned income from capital is rising every financial year. Nevertheless, the

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earned income from wages and salaries is declining ([Piketty, 2014](#)). The critical inquiry of the problem is to fathom the role of legal institutions and legal forms ([Menke, 2015](#)). Economic inequality is a complex that only war, revolution, state collapse, and deadly pandemics can solve ([Allam et al., 2022](#); [Huang, 2023](#); [Murshed, 2020](#); [Polacko, 2021](#); [Van Bavel & Scheffer, 2021](#); [Waitzkin, 2021](#)). Others believe that the rising levels of inequality are what is chosen as a deliberate policy by the operation of laws and regulations ([Stiglitz, 2018](#)).

What structures prevent people from prosperity? Is it a mere flaw or some fundamental defect of the system? People's forbearance for a wicked problem ([Rittel & Webber, 1973](#)), like economic inequality, is puzzling. What makes the impoverished so benevolent towards a few superrich? What led to this delusion? The human mind resists change: is it the fear of the unknown that if they revolt, they might even lose what they have? Or is it a result of steadfast faith in the legal system that people accept as "Because It Is Legal"? ([Mezzina et al., 2022](#)) Public criticism of economic inequality is rarer because it is profoundly ingrained and naturalised into thinking. Some people remain where they are no matter what; some are bound to prosper. This paper evaluates the research question of whether the legal substructure at the foundations of capitalism's laws perpetuates economic inequality.

Capitalism would not exist without legal enforcement ([Smith, 1978](#)). The Literature review explores the roots of capitalism, lying deep in the legal system, as recognised by Smith, Henry Maine, John Stuart Mill, Marx, and many more. However, the term used for market exchanges was "commercial society." ([Smith, 1978](#)), emphasis upon natural law and property (Pierre-Paul), explaining physiocracy and analysing property law with agriculture production (Steven Laurence Kaplan), exposition on labour regulations (Marx), describing the legal struggle:

"The creation of the normal working day is the product of a protracted civil war"
([Marx, 1867](#)).

All theorised the legal foundations of capitalism, although little is there to correlate it with economic inequality. Instead, the conviction was that "commercial society" may enhance equality. The origin of the legal foundations of capitalism may be uncovered in the work of Pierre de Bois-Guibert ([Faccarello, 1999](#)). Through Smith's 'Wealth of Nations.', reforming markets (grain and labour) required conceptualising property and contract laws Field ([Purdy, 2010](#); [Smith, 1978](#)) and developing new regulations and public infrastructures ([Foucault, 2007](#)). Legal changes along these lines were pursued by successive British governments ([Cain, 1997](#)), by the French monarchy, and later by the French Revolution ([Mooers, 1991](#)). Through all these legal and political processes, what was emerging was a market economy. The analytical separation between law and economics was also due to the continuous construction of a market economy ([Foucault, 2008](#)).

The contract and property laws were drafted, removing all formal distinctions based on law ([Commons, 1924](#); [Hale, 1924](#)). The production process was also delegated to the private players, legitimised through the constitution. The constitution distinguished between "government" and "sovereignty" to create political leadership out of individuals. This sovereignty did provide stability to the economic system as rules could not be varied so quickly, whereas the government was to give some flexibility to move things ([Craig et al., 2017](#)). These legal foundations established the economic system of capitalism, underscoring insights from institutional political economy and law and economics ([Maier, 1988](#)). Amid formal legal equality, the sharp edges of fundamental inequality that capitalism keeps are apparent. From the legal foundations of capitalism (John Commons) to legal realism (Hale), the law may stimulate an approach in which markets are not considered abstract ([Klevorick, 1985](#)). Consequently, the state remained impuissant and nonchalant in containing inequality among



juridical equals, and markets continued accelerating the entrenched differences generated by the legal system that protected the privileged asset holders.

This paper initiates its discussion by outlining the methodology that was utilised. First, the discussion elaborates on the separation of government and private actors from sovereignty and the public sphere to comprehend the issue of economic inequality in the legal world. Afterwards, the legal foundations of the law of capitalism are described to figure out the base of capitalism as an economic ideology from a legal perspective. Furthermore, Piketty's inequality is elaborated to connect the understanding of the theory of capitalism and its practicality. From the private parties' point of view, economic inequalities are also outlined to acknowledge their impact on that particular stakeholder. Hence, it can be concluded that law and economics can be at a crossroads, specifically when both co-exist.

2. Research Methods

Legal and economic analysis uses doctrinal legal research by applying semiotic interpretation systems in forming arguments and drawing conclusions ([Aditya & Al Fatih, 2022](#); [Nur, 2022](#); [Yearwood & Newton, 2022](#)). Semiotics is a multidisciplinary field that explores how languages convey meaning and how people interpret those meanings in various contexts. In the context of legal interpretation used in this paper, semiotics examines legal and economic languages employed to convey messages and how those messages are interpreted by individuals or within specific cultural or societal contexts ([Bittar, 2022](#); [Lloyd, 2021](#)). Various views run against findings because law and economics are partly subjective and irrational, reshaping the meanings. What differentiates law from economics is not the subject area, but the method applied. This article attempts to employ an integrated paradigmatic methodology by attaching utility to economics and the objective to the law through content analysis of primary and secondary sources, databases, monographs and historical analysis of trends in law and economics. The triadic relationship of the legal order, economic inequality and capitalism is reconfigured to reach a logical conclusion.

3. Discussion

3.1. Legal Separation of Government from Sovereignty and Private Sphere from Public Sphere

This legal substructure underlies and reinforces the social system that strengthens inequality generating capitalism. It separates the public sphere from the private and the sovereign from the government. The former ideally divided the domains of economics and politico-legal functions, whereas the latter effectively ratified juridical equality on the one hand and, conversely, secured the protection of property rights and private contracts. The former insulates the economic system from direct political control by separating their functions. At the same time, the latter solved the puzzle of creating a political whole out of the juridical equal, discrete individuals of commercial society. The source of all fundamental laws was the sovereign, although the powers of the sovereign delegates to run usual operations to administration ([Jackson & Victor, 2021](#); [Lohnes, 2021](#)).

This separation between direct democracy at the level of sovereignty and representation at the level of government means that the source of ultimate constitutional authority in a democracy – the people – will often be “asleep” (Hobbes) for long spells, with brief constitutional law making when awake. This constitutional separation restricts people from conveniently altering the long-established ingrained legal structure underlying capitalistic order, the persistent cause of inequality $r > g$. The division of public/private attempts to keep

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the economic system free from general control ([Elsässer & Schäfer, 2023](#); [Milner, 2021](#)). Conversely, sovereign/government separation attempts constitutional protection to contracts and property recognised by the sovereign but with limited possibilities to amend. The rise in inequality has been dramatic since the intensification of the proliferation of capitalism in the 1980s. The level of wealth concentration and the pervasive economic inequality are only possible with the legal system's support ([Egidi, 2023](#); [Traber et al., 2022](#)).

Legal institutions like contracts or property rights work because people repose faith in the legal system's legitimacy, even if it incurs an unbearable loss. This authority and legitimacy of law works because of the legal substructure at the foundation of capitalism. The attorneys, trained in wringing and rigging the legal system, protect the wealth concentration by creating a competitive advantage using the capitalistic system's legal foundations ([Goldini, 2021](#); [Miola & Picciotto, 2022](#); [Salomon, 2023](#)). United Nations Development Report recorded income inequality based on the top 10% income share soaring since the 1980s; it was recorded in 2017 that the global top 1% owned more than 33% of the total global wealth, while others at the bottom 50% owned less than 2%. United Nations, Human Development Report 2019 ([UNDP, 2019](#)). The data has been continuously collected, processed and updated; predominantly since the 1980s; in the Western world, western Europe, the U.S., Japan, South Korea, Canada, India, China and other developing countries, there is an exponential rise in Inequality ([Alvaredo et al., 2018](#)).

The claim of how an inbuilt legal substructure generates economic inequality sparks off to carry out an autopsy of the underlying legal institutions. Peculiarly, this inequality is among people with equal legal status, unlike in feudal times ([Jung et al., 2014](#)). Courts in many countries readily use their respective constitutions to promote economic equality, but more is required for structural reforms; over eighty per cent of all constitutions today include socioeconomic rights granting juridical equality, and many courts enforce these rights directly ([Lawrence, 2021](#)). There is a coexistence of economic inequality with the rise of capitalism. It is a historical fact and needs to be named. Did classical political economists like Smith ever contemplate that capitalist societies generate grotesque inequalities? Conversely, it was envisioned that the capitalist order would enhance legal equality by reinforcing equal status between two contracting parties. Did it dissolve vestigial feudal relations ([Rothschild, 1992](#)), and how the answer correlates with rising inequalities.

3.2. Legal Foundations of The Laws of Capitalism

Capital is an asset that creates wealth. All economic systems survive and thrive on the law. The historical analysis of the legal foundations of capital underlines one thing lucidly the core institutions that accord legal protection to capital have endured. What capital is the most pertinent question? ([Piketty, 2014](#)). What is the wealth-generating quality of an asset? These may be property, contract, trust, collateral, corporate law and insolvency and bankruptcy Law. These laws create or protect wealth in the form of capital creation. The law establishes a priority. The law creates priority rights for the asset holders, giving a more substantial right over others; for instance, in an insolvency proceeding, the debtor has fewer assets than the claims against his assets. Secured claims can be separately enforced, whereas unsecured creditors can claim only the remaining assets. In that situation, priority rights matter most, which law and legal institutions carry durability, universality, and convertibility capital assets. Capitalism is more than market exchanges- a market where some assets are placed on legal steroids ([Haskel & Westlake, 2018](#)). These legal forms became the basis of persistent inequalities because of perpetuating wealth concentration. The legal institutions were based on juridical equality. Still, production was delegated to private players, which has been so consistent that there is a whole new personal law to protect and secure those wealth



concentrations. The distribution of output between the owner and worker is a significant legal and policy issue in redistribution.

3.3. Piketty's Inequality ($r>g$)

The present economic system must be understood as a system reinforced by the legal order. This legal ordering is considered foundational to capitalism (Piketty, 2014). The production and distribution aspects are legal issues as well. Piketty analyses three laws of capitalism with extensive empirical data and proves that capitalism generates economic inequality (Piketty, 2014). Nevertheless, while assuming his thesis, the research does not consider the statistical 'laws of capitalism,' like $r>g$, but the legal substructure of the 'laws of capitalism. The empirical ratification contradicts earlier narratives concerning the relationship between capitalistic order, legal order and inequality (Piketty, 2014). The wealth and asset ownership are so skewed that wealth makes a substantial share of economic growth, evidencing a dramatic rise of the superrich, embraced by the legal order (Falconer & Schulman, 2008; Gilens, 2012; Leys, 2003; Parry et al., 2013). The only consolation for those worried about this enormous concentration of power is that, like the rest of us, the superrich will eventually die. Still, Piketty's point is that their fortunes do not (Grewal, 2014). Thomas Piketty's $r>g$ equation proves how inequality is rising because the legal order protects already highly unequally distributed wealth, and the returns to ownership are much higher than income returns. His findings revised the Kuznets U-shaped curve.

3.4. Privatizing Legal Code: Breeding Economic Inequalities

A market economy stands on private law. Supra n. 27. The legal order is not a sideshow but the same cloth from which "capitalism" is cut. The state benefits from it in the form of ascertained avenues to levy taxes. Once the owner of the land, intellectual property, or patent is known, the state can collect taxes for its sustenance. How does capital come into existence? Money and wealth are not the same as capital, which is produced in a process that includes exchanging goods for money and the extraction of surplus from labour. Capital concentration among a few wealthy generates enormous inequality (Marx, 1974). An asset with the proper legal coding turns into capital. Once legally coded, it generates wealth for its holder. This legal coding is a creative process without which wealth concentration would never be so huge. The method of capital monetisation dresses up simple assets and puts them on legal steroids so that they can run faster than other assets. This is how law creates value in assets. Law plays an enormous role in protecting these assets and protecting them for an extended period by putting them under the legal veil. With assistance from expert lawyers, capitalists are using the legal system for private wealth gains, thereby increasing economic inequality. All that would not be possible without legal protection. Wealth would be much more exposed to regular financial crisis cycles without legal protection. The right to contract and property are the foundations of capitalism, but that is not the cause of wealth concentration. The legal concessions or privileges granted to some assets through legal substructure accelerate wealth concentration. The legal foundations of inequality lie beneath these legal substructures (Acemoglu & Robinson, 2015; Frerichs, 2024; Lierse et al., 2022).

Okun's argument that an 'equitable legal system' chooses a valid point on the equality-versus-efficiency frontiers is likely substantially wrong if we currently implement it (Okun, 2015). Economic equality may go along with efficiency. How much does the Law and Economics movement correlate with the history of economic inequality emanating from the rise of "capitalism" from the structure of the legal system and policy? The case for the efficiency of capitalism rests on the theory of the invisible hand, where greed is harnessed to serve a social purpose in a seemingly impersonal and automatic way (Schelle, 1897). The legal decoding of capital reveals Smith's invisible hand as a substitute for reliable legal code- visible even if often hidden from sight (Pistor, 2019). The development of law and economics began

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with the property rights approach in “The Nature of the Firm” (1937) ([Coase, 1937](#)). “The Problem of Social Cost (1960)” ([Coase, 1960](#)), followed by ‘Some Thoughts on the Risk Distribution and the Law of Torts’ (1960) ([Calabresi, 1961](#)), and Posner’s resonated faith in *homo-economicus* ([Posner, 1998](#)), That attempted to establish it as a discipline. Piketty indicates that “capitalism” itself, rather than its ideology, is responsible for ever-expanding inequality. Rousseau remarked that nature maintains no disparity. It is a result of economic and legal systems.

A new phenomenon, co-terminus with the movement of law and economics, is underway for wealth concentration, finance, and investment. The way legislation is avoided, parliament is bypassed, and even courts are not banked upon; the reason given is inefficiency; sometimes, regulation is accepted but is later forgotten. These institutions were imperative to establish capitalism but needed to be more. The ongoing development privatises public justice ([Gaukrodger, 2013](#); [Mills, 2023](#)). The legal structure established capitalism, but it gulped economic equality. Nations must reclaim their sovereignty; they lost it through the processes of conflict of law or choice of law or arbitration. Law and economics must involve law as much as it involves economics.

Efficient outcomes must cohere with equality. Let us not allow efficiency. To replace the laws of the market economy. Let us not replace robust regulatory regimes in the garb of efficiency as that may invite regulatory disaster, widening inequality. A well-designed and functional cohesion of law and economics may lead to efficient institutions and an egalitarian society. The legal system preserved slavery, kept away the right to contract and property from minorities, excluded women from economic participation, and crony capitalism prevailed, which led to rising economic inequality. It is a common experience for business people to violate the contract terms and utilise the law’s loopholes to declare themselves bankrupt. The law makes choices and is all-pervading ([Dacin et al., 2022](#); [Singer, 2018](#)).

Law is the most dominant organ in distributing economic power in society, though this role of law has been largely ignored in the era of capitalism. Instead, in law and economics, it is mulled over that competition results in specific efficient outcomes—and if law interferes with altering those outcomes, it is only an undue intervention. Law and economics must not endeavour to revive the legal ideology of *Lochner v. New York*, where the Supreme Court annulled the ‘Maximum-Hours Law’ for workers at a bakery because it violated principles of “freedom of contract,” favouring the enforcement of property rights and contracts and disfavoring both market regulations and workers’ unions. This case was later struck down when the Court ruled on a ‘Minimum-Wage-Standard.’ Even contracts were signed by the powerful mine operators owning extensive property rights, with impoverished workers on the condition that they did not join a union. It magnified inequalities in economic power. The dissenting opinion by the great Justice Oliver Wendel Holmes is crucial, which later prevailed: ‘overemphasis on economic theory overlooked state constitutions, which regulate citizen’s life, to stop their exploitation.’ ([Bernstein, 2005](#); [Schweber, 2014](#)).

Did the law and economics movement relaunch the *Lochner* Era approach by putting the old wine in a new bottle rather than taking it to an ethical and moral vision? If affirmative, the movement was hijacked by the influential, and it, thereby, enshrouded its activity by surrendering to the powerful: the dismantling of constitutional rights of justice and equality over market forces, diminishing the importance of Worker’s Union, invalidating the welfare provisions, delegitimising socioeconomic structures, all in the name of efficiency. Did the policy prescriptions of Law and Economics bank upon the law as much as it on economics? This movement seeks to endorse the spirit of competition for efficiency and optimal utilisation, whereby the spin-off limits the state’s intervention in market regulation.

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Nevertheless, competition does not occur in nothingness: it is grounded upon laws, rules, regulations, property laws, contracts, and antitrust laws ([Sohoni, 2019](#)).

These are the thresholds of economic coordination, such as contract or property rights, necessary to shape competition to work. Although, they are, in themselves, limits upon competition. To see holistically, state intervention is all-pervading: it either balances economic power through competition or lets it monopolise. What is the movement of law and economics calling an 'intervention'? Given the rising economic inequality and wealth concentration, laws must weaken financial domination rather than intensify it. The movement of law and economics should not be used to defend economic inequality through wealth concentration. The present antitrust framework hand-picks explicit legal rules over others and uses them to define the market. Competition law organises coordination through conventional capitalist firms, the space devoid of equality and democratic decision-making, exacerbated since the resuscitation of law and economics, preferring concentrated wealth ownership, intensifying inequality ([Zac, 2022](#)). We are in the age of the consequences of policies made by the law-and-economics movement, where large firms coordinate and law thumbs-down cooperation by smaller firms. There can be no choice to make no choice: either weaken economic domination or intensify it.

What are the aftereffects when the boundaries of law and economics collapse? The capture of law-making processes over administration. The way legal structure constructed the market economy that swallowed equality, the law and economics movement can be instrumental in its unmaking while preserving the social goals attained through it. Capitalism exists within the law as it cannot survive outside of state support. There is no capitalism outside the regulatory regime established by the state ([Alami et al., 2021, 2022](#); [Rolf & Schindler, 2023](#); [Shaffer, 2022](#)). The state and the markets are co-terminus spaces. This may not be true in theory, but historically, there are no examples other than this being true.

Can the movement from “status to contract” Be defined as social empowerment because economic disparities dramatically replaced the decline in status inequality due to the inherent unequal distribution of property and other community assets? Expecting formal contractual equality to wipe out all inherent societal differences was too much. Capitalism has generated persistent economic inequalities due to inherently privileged positions, some in property laws and in the distribution of capital assets within communities. How have these privileged positions been maintained? Some relatively small variations are found between countries due to the differences in national policies ([Maine, 1861](#)).

It is significant to mull over how the property laws were constituted. The corporate and labour laws were structured and functioned together through contractual exchanges in the market. It might solve the puzzle of how formal contractual equality remains non-conflicting with rising economic inequality. The legal system does not only affect wage or production activities but also profoundly impacts socio-political aspects of the market: dynamics of public and private debt ([Streeck Wolfgang, 2011](#)), regulation of finance ([Lothian, 2015](#)), The constraints placed on democratic control of the economy by international integration, the problem of commodification, and block exchanges, among others ([Lang, 2011](#)). Suppose the housing market does better than the stock market. In that case, wealth inequality falls, mainly because the middle class has housing as the primary portfolio, unlike the top few per cent, whose wealth is concentrated in equity. Although if the stock market does better than housing, wealth inequality rises exponentially, which has been witnessed in India since 1991. Economic policies have massive wealth distributional effects. To say that they are neutral and have no impact on the distributional process needs reconsideration.



4. Conclusion

The assertion by the wealthy that their wealth is the toil of their parents needs to be more accurate as it would only endure with legal coding. Capitalism as a legal order is established to trace Economic inequality's legal roots. Therefore, appalling economic inequalities can co-exist with formal legal equality. As the legal system clenches more power, new disparities emerge. This brief research has travelled full circle: in the beginning, the legal order supported and conceived capitalism, and the market economy was born; eventually, markets decide the laws and keep the governments. At its peak, capitalism is generating prodigious inequalities. It is potentially creating and demolishing legal institutions, even sovereignty.

Laws can reshape societies, but they serve capital. Consequently, even the movement of law and economics is at a crossroads. Posner and Weyl propose to do away with the legal privileges of capitalism by forming “radical markets”. While emphasising efficiency, it should be a proponent of an equitable legal system and distributive market mechanism. They claim the efficient allocation of resources based on a fully competitive market is the path to a just society. It means replacing private property rights with the right to use contingently. The peculiarity is that if capitalism were wholly a façade, it would be defeated far back. The ploy is that while maintaining inequality through wealth concentration, it has managed significant involvement of the exploited to ensure acceptance and allegiance to the prevailing order. It is not difficult to delineate why feudal, despotic, oligarchic states could not contain inequalities, but why did all intellectual imaginations like liberal democracies and constitutions fail to tame it? The wheel must be reinvented repeatedly to regain legal order's control over inequality-generating capitalism.

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