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A European code of capital ?

Interview with Katharina Pistor

by Eric Monnet & Antoine Vauchez

Katharina Pistor has renewed the critique of economic inequality by showing how the institutions of private law form the lock of an unequal economic and social system.

Katharina Pistor, Professor of Comparative Law at Columbia University in New York, has profoundly renewed the critique of economic inequality by looking at contemporary capitalism from the point of view of its "code", i.e. its law. She shows how the institutions of private law (property law, contract law, the law of securities and obligations, etc.) and their continuous expansion are a key vector of "capitalist wealth" – at the same time as they form the lock of an unequal economic and social system, as well as of our collective inability to cope with it within the framework of our democracies. She argues that debt, land and knowledge only become capital – monetizable and profitable – through the intermediary of private law. She uses the metaphor of the "code" to describe how the law transforms goods into private capital. Applied to the European context, this approach proves particularly enlightening. It shows how and to what extent the European Union, and in particular its Single Market Law and economic freedoms of movement, have historically been able to become a key area for the consolidation of this code, notably through the competition and forum shopping among national regulations. But in pointing out what private law is doing to our democracies, she also questions reform strategies in a European Union that has always thought of its transformation in terms of public law. In contrast to the great constitutional big bangs, this invites us to focus our attention on the way in which these same private law institutions could become the lever for greater control and embedding of capital in public and democratic circuits.

***Books and ideas*: How can your work on the code of capital be enlightening for analyzes of the European Union (EU), the way it has developed over the past**

decades and the way it can be reformed? In other words, in what extent does the European project in general has been an important pillar or vehicle for strengthening the code of capital and the various forms of capital that you describe in your book.

Katharina Pistor: I think the EU has evolved in a direction of being more sympathetic and accommodating to coding capital, that is, to allow private actors to employ private law more flexibly for turning simple into capital assets. As I explain in my book, "The Code of Capital", with the help of property rights, collateral law, trust, corporate, bankruptcy, and contract law, virtually any object, promise, or idea, can be turned into a wealth creating asset. But that's not necessarily how it started. The Treaty of Rome defines four types of freedom: free movement of goods, services, capital and persons (both natural and legal persons). So it was not only about capital. The Rome Treaty left private law that is used to code capital with the member states. The idea back in the fifties was that the member states would harmonize their laws before opening up the borders so there would be no race to the bottom. If one can choose between two or more legal systems, one can engage in legal arbitrage by choosing the one that increases private interest. The member states of the EU put the brakes on legal arbitrage by saying for quite some time: "we want to harmonize corporate law first". They tried quite hard but ultimately did not succeed, not only because of lobbying by business interests, but also because of the parochialism of legal professionals in the different member states who cherish their own law and refused to budge. There were also a couple of ideological, or political, issues. For example, the Germans pushed for extending co-determination to other member states, but the UK blocked this. So here you see the direct clash between states – or governments – and different private interests, as well as the importance of lawyers who can become very protective of their turf.

For decades the European Court of Justice waited to see whether the governments would get their act together and harmonize the law. The harmonization of laws is a political project, it can go either way: to advance business interests, or to give more wait to social goals. I think one of the European success stories, especially looking from the other side of the Atlantic – the United States – is consumer protection law. There the EU has managed to harmonize law beyond any other trade bloc. And it is, I think, an example for an anti-dote to the coding capital, that is against the primacy of private laws over public interest.

The shift towards a more sympathetic approach to coding capital came in the 1990s, which coincided with the adoption of the Maastricht Treaty and the commitment to allow the free movement of capital. The shift is also visible in the judgments of the Court of Justice of the European Union. At some point, the court basically said "we've waited long enough, here's the treaty, here are the principles of free movement, and we are now enforcing it". In 1999, there was this famous case *Centros Ltd v Erhvervs- og Selskabsstyrelsen*, which created the first real precedent to say companies can choose the corporate law within the European Union that they want and are not bound by the law where they want to establish their business. This was a Danish couple who wanted to establish a Danish business in Copenhagen but wanted to register the company under English law. The Court was persuaded by arguments that said that the Danish authorities' refusal to recognize the company impeded the free movement of capital. Free movement of persons, including legal persons, and free movement of capital were thus interpreted to include the free movement (or choice) of law.

This shift was not written in stone. I think the institutions of the European Union could have gone either way, that is not necessarily in favor of the predominance of free choice of corporate law that enforce the power of private capital. Fritz Scharpf has talked about negative and positive integration, and there was a lot of positive integration attempting to avoid a competition between legal rules. But the process of positive integration is slow. Moreover, the ideological background changed in the European Union.

***Books and ideas*: Was it only a race to the bottom, choosing the member state law which is more protective of capital, or did it end up in a supranational law for European companies?**

Katharina Pistor: There was an attempt to create a European corporate law that creates the legal foundation for a European company. But the result has been a patchwork. There is such a thing as the "Societas Europaea", but the relevant Eu law does not specify all the details. The details still have to be filled in by the law of the member state, in which the company has its headquarter (which, of course, is a matter of choice). So ultimately, corporate law remains, by and large member state law. In the U.S. since the 1970s, there has been this debate on the competition for corporate law, where Delaware always comes out ahead. Is it a race to the bottom or race to the top? It depends on your perspective. In the U.S., the argument is always pro shareholder and so people conclude that it is a race to the top because competition between state

laws increases the power of shareholders. The empirical evidence in the U.S. indeed suggests that the shareholders benefit from this race. In the EU as well, companies prefer, such Dutch over German law, because it is more amenable to their and their shareholders' interests. The competition between national laws is pro coding capital because it gives resourceful actors the option to pick and choose the law that best serves their interests.

***Books and ideas*: To what extent is the overconstitutionization of EU law by the Court of justice an integral part of the strengthening of the code of capital (through the rise of a European economic constitution)?**

Katharina Pistor: Courts can go either way and we see this in US as well where they can be pro-civil rights or against it. We have an increasing debate about how much a court should be involved in setting the standards. I agree with Joseph Weiler, Dieter Grimm and others who think that the Court of Justice of the EU has played quite a central role in limiting the ability of member states to impose their own rules on private actors from other member states. This is done in the name of a European project which is conceived of as an economic project of free capital movement. I would not say that the EU has a law for coding capital. It does not. But it allows flexibility and choices between national laws, which is one of the mechanisms by which capital can get the upper hand. And companies also push courts to go into this direction because they have the financial resources to bring cases to the court again and again.

***Books and ideas*: Regarding the comparison with the US, you said earlier that the EU was better for consumer protection. Some economists – like Thomas Philippon or Luigi Zingalez – have also argued that the EU has worked better than the US to enforce competition and avoid big monopolies that impose high costs on consumers. Do you think antitrust has indeed worked better in the EU or the increase of large monopolies in the USA can be attributed to other factors?**

Katharina Pistor: I think I agree with this argument, although I should say that I'm not an expert in antitrust law. Until recently, in the United States, there was a kind of arrogant belief, with the idea that the EU just did not get it. In fact, the EU was influenced by US antitrust law, having been the first country to adopt such a law (the Sherman Act) in the late 19th century. But this law was completely watered down under Reagan. Antitrust laws were not enforced because of an ideological shift that said that we should be less interested in the structure of markets than in the welfare of consumers. According to this new doctrine there are no monopoly rents as long as prices for consumers go down. This led to higher concentration of economic power.

But the EU did not go down that rabbit hole. It stuck to a more market structure approach.

***Books and ideas*: If we move to other sub-fields of private law such as intellectual property law, it seems that the EU has been a great promoter of the strengthening of intellectual property law and of the TRIPS (Trade-Related Aspects of Intellectual Property Rights) agreement. To what extent is the EU trapped in its own defense of this "module of capital" which is the intellectual property law and the increasing enclosure of knowledge, as can be seen on the case of the Covid vaccines?**

Katharina Pistor: I think the EU is pushed into this corner also by the industry. When you look at the assets that contributed to the market capitalization of large firms, nowadays it's mostly intellectual property rights, financial assets. It's no longer a bricks and mortar type of production. And, the US has pushed since the 1980s for patenting all kinds of things, even when human innovation is quite marginal, as in biotech, or when the innovation amounts to little more than a filing system, like the software that powers Google's search engine. What is interesting about TRIPS is that the American companies lobbied their European counterparts to push their governments to get TRIPS done. The EU has basically gone with the trend of the times: this was the new frontier, the new capital asset that had to be coded and monetized: it's really about trademarks, patents, copyrights and financial assets. The U.S. was ahead on financial assets and on patents, and the EU felt that it has to participate to keep pace with the competition. And then EU companies were pushed by their US counterparts to lobby at the member state level and in Brussels.

***Books and ideas*: So the EU eventually appears even more zealous than the US?**

Katharina Pistor: This is difficult to say, but one could argue that the nature of the EU sets it up to be more zealous: its bureaucratic nature and its preference for harmonization and standardization means that if and when something is harmonized, all have to dance to the same tune. Interestingly, on this matter, the US has done something similar by creating a special patent court so that the patent lawyers and the industry have one court, not many, to deal with, which usually works in their favor. It's also the competition with the U.S. and the industry's argument that they can't compete on international scale that makes the EU more zealous than it arguably need to be.

Books and ideas: **What is already harmonized and unified at the European scale is monetary policy and – partly – banking supervision (the system of European central banks is in charge of both)? This raises two questions. First, how did it shape the European financial system, not only by law but also through the practice of supernational institutions? Second, there is the question of the accountability of these European institutions in front of the Parliament, either the European parliament and the parliament of member states. How can we increase the democratic legitimacy and accountability of independent supranational institutions such as the European central bank?**

Katharina Pistor: These are big questions. Of course, the standardization of monetary policy had huge effects on the financial system within member states and the EU. And one reason for this is the interaction of money with private law. The problem of the European Central Bank was that it didn't have a financial instrument to conduct monetary policy, that is a unique financial asset (like a Treasury bill in the U.S.) that the central bank can purchase or take as a guarantee when it lends to bank. So the ECB ended up issuing collateral guidelines for the assets private actors use to secure transactions to set monetary policy operations. Thus it relies on private actors to create assets, which the ECB then uses as collateral. Between 2004 ad 2007 ECB started to standardize set of eligible collateral. Then, during the 2008 crisis, it back-track and expanded the list of eligible collateral to offer liquidity to more actors. The ECB also tried to accommodate the differences in the financial structure of different member states. It allowed around 8000 banks to borrow at the ECB. In the U.S., it's a handful of of top dealers with whom the Fed conduct monetary policy operations. The different structure of European banking systems and the singularity of European monetary integration forced the ECB to be quite innovative in developing its arsenal for monetary policy. It also faced critical legal constraints. The Maastricht Treaty says that the ECB cannot buy government debt in the primary market, only in the secondary market. So the system was set up to gear the ECB towards private assets because states didn't want to have indirect fiscal financing. But that has an impact on financial markets who use more public debt as collateral and can use these assets as collateral to borrow from the ECB. In comparison, the Fed (the US central bank) only moved into private assets in 2008 crisis by expanding the asset it accepted for dollar lending.

The second part of your question was on banking supervision and accountability. Banking supervision in the euro used to be decentralized. It was a problem that was revealed in the 2008 crisis and in the sovereign debt crisis in Greece

and elsewhere that followed. There was a distrust in how the member states would regulate their own banking system, especially the countries in crisis. Less attention was paid to how deeply the French and the German banks were exposed to Greek public debt, for example. The focus of the reform efforts was on what was regarded as an unhealthy relationship between banks and the government, where the banks buy government debt and the government bails them out in return. In fact, the problem was much more complex, because bank lenders were not just domestic. Anyhow, now we have centralized bank supervision at least within the monetary union. We train supervisors and give them centralized rules. To some extent, I think it was almost inevitable that an integrated monetary policy requires a standardized banking regulation and supervision.

Regarding accountability, independent agencies pose a democratic dilemma: By relying on independent competition authorities, Supreme courts or central banks, political actors, including legislatures are exempt from responsibility. I think there is an interesting trend of a decline in responsibility of legislatures that is visible in the rise of the power and intervention of independent agencies.

I sympathize with your views that the central bank should be more responsive to democratic oversight and at the very least have questions asked in public forums and need to explain their policies. Monetary policy is not just as a technocratic issue. Everybody understands that monetary policy has major distributional effects. The central bank should be able to justify its choices and not only act like an oracle that influences financial markets behind a veil of technocracy. I think it's important that central banks become more open to having debates and having to justify what they have to do.

***Books and ideas*: You're talking about stronger parliamentary oversight or at least more accountability. But what about more structural reforms of the EU financial system such as a EU Treasury or a European system of credit that may balance the EU system?**

Katharina Pistor: Issuing a common European debt might have an effect at the outset, but when you look now at the trend of the US, you realize that the transformation of financial markets is really shaped by the increasing role of private assets. The sheer volume of private assets that have been created since the early 1970s is just out of proportion. We're saying on one hand that public institutions and states in particular shouldn't indebt themselves so much, but, on the other hand, that we need safe assets. Where do you get safe assets from? In the US, in the 1960s, pension

funds demanded more safe assets and one answer to this was to increase mortgage backed securities (MBS). So now you have a safe asset which is a private asset that doesn't sit on the balance sheet of the government, even though in the US everybody agreed that it was implicitly insured by the government, because these MBS were mostly issued by the Government sponsored enterprises (GSEs), Fanny Mae and Freddie Mac. This fueld the private debt market get, which ultimately caused the 2007-2008 subprime crisis. So, given the volumes involved, unless you tame that beast of privately issued assets a European Treasury alone is unlikely to balance the EU financial system.

***Books and ideas*: So we have gone through a variety of subfields of private law, and I wanted to know whether you considered that there was a sort of imbalance between public interest and private interests entrenched in the EU Constitution.**

Katharina Pistor: The question is always: compared to what? the EU is a special beast and over time the respect for private interests and industries' interests and the attempt to create conditions for private markets has probably increased, although we shouldn't forget that it was set up as an economic union. And the increasing support to private interests – pushing back what states can do – took off not only in Europe but also in other parts of the world. States are still there, but they're in the service of private markets. So in that sense, I think the EU is just part of a general trend.

At the same time, looking at the EU from the US, I always feel that there's still much more potential, or hope, to create countervailing forces because there is a powerful competition authority and there is a court with a fairly steady turnover of judges that allows for fresh perspectives from time to time. You can get to the court from very different angles, bringing different cases from member states. There are also trans-European associations and political movements that can have some sway over policy making. There are powerful private interests, of course, like everywhere else, but I don't think there is a way to fix the system by having a better EU constitution. Constitutions evolve, legal systems evolve in relation to what the prevailing ideologies and the social forces are. The question is not just what is written in ithe constitution, but how it is interpreted. The EU still has much more of an inclination to respect for a diversity of interests such as consumer interest or labor interest than the US or the UK for that matter.

***Books and ideas*: In your book *The Code of Capital*, you explain very well how private law has helped the development of capitalism, economic growth and finance**

but has also created inequalities. These are the two faces of private law. And we encounter similar issues today regarding the protection of the environment. Is private law necessarily pro-market and destructive for the environment, or can it be used to protect the environment? Now we see examples of companies condemned by courts – based on private law – because they hurt the environment (e.g. the Shell case in the Netherlands). So is private law an essential tool for climate activists or a problem for protecting the environment?

Katharina Pistor: Private law is quite malleable and can serve different purposes, depending on who uses it and for what ends. This is the beauty of private law: it empowers private actors to make govern their affairs with one another fairly autonomously. Yet, as Jonathan Levy wrote in his recent book, *Ages of American Capitalism* first there was capitalism and then democracy. In the same way, first there was private law, then there was public law. With the rise of nation states and national legal orders, private law was backed by the state. All legal regimes that I know have simply embraced and many codified the private law that existed before. In addition, states guaranteed the protection of some private rights, such as property, in their constitutions. This made things even more complicated because tweaking property rights is equivalent to expropriation. On top of that, there are international treaties that give even more prominence to property rights, especially of foreign investors in bilateral or multilateral investment treaties. But there are recent examples showing that this can be changed, like when Spain, France and the Netherlands terminated their membership in the Energy Charter treaty that enabled companies in the oil, gas, or coal business, for example, to sue governments that sought to phase out coal and adopt environmentally friendly policies. It shows that governments can still take back power. These are important steps, but I still think we have changing the private law itself and how it operates should be on the agenda as well. There are some measures I would start with, which are relatively simple, technically and politically feasible. First of all, we shouldn't subsidize debt, which means that debt must not be deductible from taxes. Debt means that you have to pay back in the future, which requires economic growth and thus make future changes to the current structure almost impossible. Second, I would end limited liability for shareholders in corporations, at least for investors who invest in assets that knowingly pollute and destroy this planet. It's a legal privilege debate. Of course, investors would say this is expropriation, but one could argue that limited liability is what make investors misprice the environmental risk. Because they don’t bear this risk directly, they don’t price it. As such, limited liability serves as a license to externalize.

Of course, these are only stepping stones. There are no silver bullet; the system is too complicated to be fixed with a single stroke. Many lawyers would agree that the effects of most regulatory interventions can be muted. It just takes them every time a little longer because it gets more complicated. But they can find ways so that their clients avoid the costs of the law without having to sacrifice their ability to use the law to protect their interests. And I think that's also a point where we have to be more insistent on the purpose and the underlying normative goals of the law rather than just the black letter rules. It requires a different reading of the law, both by regulators and judges. There's a whole series of things that we should be doing and I would not start again by imposing more regulation, because I think that these are often only short-to medium-term measures. More generally, I think we need more accountability of private power.

***Books and ideas*: It seems that you suggest essentially private solutions to private law problems. What would then be the role of public law and of constitutional law in rebalancing public and private rights or social and economic rights at the level of the EU?**

Katharina Pistor: It sort of belongs together. At the EU level, you also have to think about how you interpret principles such as the free movement of persons, which is enshrined in treaty (or public) law. If nobody moves, that is, if you just about send your registration papers for establishing a company to a different registration office, I don't think that should be endorsed as free movement. Still, there are lots of things that you can also do in public law and I don't want to say you should only do it in private law. But of course, they belong together, and arguably more not less so. The dichotomy or bifurcation of law into public and private and the different norms that animate them, is a critical source for playing one off against the other. Private law is often treated like the holy cow in our legal system, as what you should not touch. The impetus for policy makers and the public is always to use regulation, to which private actors respond "it's an intervention in markets" that distorts them. What I'm basically saying that we should take a look at the foundation of the market economy, put it on the same normative foundations as (public) constitutions and modify some elements that have been used to counter public policy. So, saying "we will no longer allow you to deduct your liabilities from your taxes" is in fact a change in public law. Changing competition policy is a public policy as well. But for me, the two bulk of the work has to be done in corporate law and with regards to the rights creditors. Strengthening creditor rights has helped fueled an increasingly a debt-ridden economy that is fragile and always on the verge of crisis if not collapse. Governing financial markets is not

just about banking supervision but must include the creation of new financial assets by banks as well as non-bank intermediaries. Right now, public institutions, including the central banks in many countries are accommodating financial markets more than reigning them in. After the failure of the Silicon Valley Bank in march 2023, for example, the U.S. offered deposit insurance for non-insured accounts. The Treasury and the Fed are basically saying when in need "come to us", which I find irresponsible. But I understand that for many people this is less salient because we're so used to this idea: you have a problem, you just fix it with some public intervention, which is always reactive, always comes too late. I suggesting to throw a little bit of sand into the wheels and say "you have not only rights, but also responsibilities. We don't guarantee that you can do what you want and get help whenever you need it."

***Books and ideas*: I have a question of method. How do you see potential reform happening? I mean through crisis, through the role of regional actors such as the EU in pushing for specific agenda. How do you see the sort of mechanism for which it could actually happen?**

Katharina Pistor: I think all of the above. The state is not a unitary actor, and it is also not necessarily on the "right" side. There are different sites where different interest groups within the state or constitutional structures, including the EU, can exert influence. These are all potential battlegrounds for change. There is some need for legislative change, as tax or corporate law as mentioned before. There is also room for litigation strategies to push the courts to hold private actors accountable. You mentioned the Shell case, and these are important cases because courts in the UK and the Netherlands have basically said that the parent company of Shell has a duty of care for ensuring that its subsidiaries don't cause harm to others – even when these subsidiaries operate as independent corporate entities. This legal argument sheds doubt on relying on the formal separation of assets between the parent and its subsidiaries in order to avoid liability – a strategy that corporations have successfully employed for decades. A few cases won't change the world, but they set a new standard; they legitimize change. So if more courts follow, more legislatures might be inclined to say, 'we now normalize this, and we put this interpretation of the duty of case in our law'. With sufficient mobilization of legal and political resources, this can have a snowball effect. For the EU, the main problem might well be that it is so difficult to change anything, because it requires so many potential veto players to go along. In the shadow of political infighting, private actors can take advantage of the flexibility of private law, picking and choosing the laws by which they wish to be governed or

avoid the reach of unwelcome legislation. This is why I would not start with trying to change the EU, certainly not its constitutional structure.

***Books and ideas*: But do you really think the EU is the last starting point as you say? What about for example the case of investment protection and investment tribunals, the EU seems to be playing a role in pushing for stronger protection of public forms of justice and of the right to regulate. Given strong public law traditions of member states, and particularly in Germany or France, don't you think there is still a possibility to the EU to come out with such a reform agenda?**

Katharina Pistor: I meant treaty reform or something like that. But there is room for rethinking the interpretation of EU law by European Court of Justice which could say: "if we allow this private legal arbitrage on core issues in EU law, we are undermining its unity and our own ability to determine its meaning". A similar argument could be made by every sovereign state in the world… Private legal arbitrage, by which I mean the picking and choosing of the law of different states, like from a menu, has given private actors too much power. Similarly, shifting dispute settlement from courts to private arbitration tribunals, many of which are staffed by attorneys from private practice, gives private interests too much influence over determining the interpretation of law. This may be tolerable in disputes among private business, but is not tolerable for matters that have direct bearing on public matters or on weaker parties that lack the bargaining power to refuse to sign mandatory arbitration clauses. So I'm not against public law or public constitutional law, I just think it's not the only site where we can or should fight. Private law has for too long been neglected as a site for political discourse and battle.

Published in *booksandideas*, 31 december 2024.