The Mother of All Subsidies

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Katherina Pistor, The Code of Capital: How Law Creates Wealth and Inequality (2019).

"Capital = Asset + Coding" is the axiom that serves as Katherina Pistor's tool of analysis, to lay bare the role of law in the history of capitalism. An asset can be anything—a plot of ground, a machine, an idea, a debt, a sequence of molecules—but an asset becomes capital when, but only when, it has been "coded," that is, when it has been endowed with specific modules of legal protection: she calls them priority, durability, universality, and convertibility.

Pistor, the Edwin B. Parker Professor of Comparative Law and Director of the Center on Global Legal Transformation at Columbia Law School, laments that "economists … have clung to the notion that capital is a physical input, one of the two factors of production, when in fact, capital has never been about a thing, but always about its legal coding; never just about input and output, but always about the ability to capture and monetize expected returns." (P. 116.) Her book has won awards already, including two "best books" citations from the *Financial Times*. The financial press is taking heed, and legal academics should, too. This wonderful book is destined to inform the difficult way ahead, as global capitalism's second crisis in a dozen years overwhelms us.

Lawyers have enclosed all manner of assets in these four modules of protection. "Priority" determines who has an enforceable claim on an asset, and in what order. "Durability" is the possibility of capital surviving the death of an owner or the dissolution of a partnership or the claims of a creditor or regulator. "Universality" protects the capital owner against all comers, wherever the asset may be, at home or abroad, or nowhere at all. "Convertibility" means that capital, in whatever asset, wherever held, can be exchanged, on demand, for "state money." (P. 3.)

The book exposes the continuity over centuries that connects the feudal estate, and its exotic encoding, to the even more exotic collateral debt obligation and credit default swaps circulating in the run-up to 2008, and to the blockchained private currencies of the moment. We lawyers are the masters of this code. Legislatures and courts are the late-comers who ratify—but rarely disturb—what the lawyers do in service to private capital. It was the English solicitors who enclosed the commons for the landed gentry while shielding their enclosures from the reach of creditors. It was the lawyers too who devised debt instruments for the creditors, and who later, as ingenious "conveyancers," eventually broke open or conveyed-around the code-laid-down. It is the legal code-meisters of our era who have enclosed the digital commons and even segments of the genetic code, converting these raw assets into capital, and then into fabulous private wealth for the few, in the midst of the sinking expectations of the many.

One of many examples: Google owns the data inputed to and generated by the program PageRank —not as a matter of patent (it was Stanford's, and has expired), but as a trade secret, which is not time-limited. It amounts to a lawyer-devised genus of "data-generating patents" (P. 128) unknown to statute. Pistor calls this and like maneuvers "the second enclosure (this time of knowledge rather than land)…We are now in danger of losing access to our own data and to nature's code for the sole purpose of giving select asset holders yet another opportunity to expand their wealth at the expense of the rest." (P. 131.)

Universality and durability are the modules that give capital wings to fly from one jurisdiction to another, as if on "legal steroids," (P. 9) endowing capital with freedoms that not even the wealthiest natural persons can know. "Capital coded in portable law is footloose; gains can be made and pocketed anywhere and the losses can be left wherever they fall." (P. 9.)

The limited-liability corporation is a key invention: corporate investors stake only what they pay for shares. The uniquely anglophone device of the "trust" adds another durability: an asset settled into a trust is shielded from creditors of the settlor, of the beneficiary, and of the trustee.

The corporate form and the trust allow practically limitless subdividing, cloning, and nesting, and enable capital to elude the taxing and regulatory authority of the state. Coding can turn a firm into a "capital-minting operation," in addition to or instead of a business participating in the real economy. (P. 48.)

To illustrate, Pistor performs an autopsy of Lehman Brothers, in its transmogrification from a retail operation in antebellum Montgomery, Alabama, set up by three Bavarian immigrants, to a go-to funding source for clients of Goldman Sachs, to a holding company "with 209 registered subsidiaries in twenty-six jurisdictions" and "hundreds, if not thousands, of special-purpose vehicles, or SPVs, in the form of trusts or limited liability companies" (P. 51) on the verge of its collapse in September 2008, precipitating the Great Recession. Tranched and nested again and again, the underlying assets—in essence only IOUs—became inscrutable. Nobody knew what they were buying and, until the music stopped, nobody cared. The tale has been told elsewhere, yet Pistor's unpacking of the legal devices involved is novel and chilling.

She spotlights the importance of a shift in the choice-of-law rules. The once-dominant "seat" or "real-seat" theory required firms to incorporate in any jurisdiction where they do business, if they wished to enjoy the benefits of doing business there as a corporation. With the ascendance of neoliberalism, real-seat theory was unseated in favor of "incorporation theory," which allows a corporation to incorporate in its favorite jurisdiction and nonetheless to enjoy the advantages of the corporate form everywhere it does business—assuming those places accede, as states practically must to play in a globalized economy. Capital is unwilling to call unless it can bring its favorite corporate law along.

Incorporation theory makes it possible for corporations to choose the tax rate they wish to pay. Pistor cites the case of Apple in Ireland. Apple was booking its EU revenues in low-tax Ireland until the EU—despite its adherence to incorporation theory—stepped in and docked Apple for having taken "illegal state aid." Even so, "tax" and "regulatory arbitrage" and a race to the bottom in labor and environmental standards and corporate tax rates is rampant.

While the internal culture of the big law firm master-coders is restlessly innovative, the external visage of law itself is the opposite. Law presents itself not as an accumulation of clever, contingent, humanly devised advantages, but as an enshrinement of natural entitlements, whose fundamental legitimacy is beyond question. "Choosing the assets" to be encoded is "an exorbitant privilege" accorded to lawyer/coders to the benefit of those who hire them —"exorbitant" because this choice "is tantamount to controlling the levers for the distribution of wealth in society." (P. 19.) This privilege is "the mother of all subsidies" (P. 222), which is all the more valuable for its sheer legality, giving private interests "enormous cognitive sway" over politics and polities. (P. 20.)

Marx and Engels wrote that capitalism constantly revolutionizes the means of production. Pistor shows how neoliberal capitalism has turned away from research and development of productive means, and toward asset-sheltering and debt-minting best done by the "best lawyers." (P. 161.) Despite their "special responsibility for the quality of justice" (MRPC Preamble), lawyers "tend to ignore the external effects of their coding efforts." (P. 166.) The wealth they help create bears less and less relation to the real economy, and skyrocketing inequality leads to popular resentment, alienation, and the widely remarked, ever-growing "democratic deficit." Capital on steroids cannot stop itself.

> The truth is that in a world in which well-coded roving capital faces a diffuse and unorganized public scattered over multiple polities, a social contract is beyond reach,even if capital wanted it for the sake of its own survival. (P. 223.)

Pistor sketches a program for reform, whose "basic task would be to roll back control by current asset holders and their lawyers over the code of capital by limiting the choices at their disposal." (P. 224.) Leading the roll-back is "a

bright-line rule to refrain from offering capital legal privileges over and above the basic modules….” (P. 225.) This will mean limiting capital’s liberty to choose fora and governing law, and refusing enforcement of “purely speculative” contracts. (P. 227.) What else? Abolish the trust? Insist on codetermination in corporate governance? Forbid trading in debt, the asset distinctive of capitalism (77, 200)? She never says what’s “basic” or where the roll-back stops. And how to deal with capital’s push-back?

> Claims that [rolling-back] would deny some actors the opportunity to increase the pie to the benefit of all should be eyed with suspicion, as past experience shows that even big pies are usually devoured in solitude or only by invited guests. (P. 225.)

As for the politics, Pistor hopes that the “persistent incrementalism” (P. 229) that has worked for capital’s encoders might also work for the roll-back needed to restore democratic legitimacy. The alternatives are either a “true revolution” or “the further erosion of law’s legitimacy as a means of social ordering.” (P. 234.) In short: expect some form of noncapitalism (to arrive by increments or by revolution), or—despite its recurrent crises—a persistently incremental neo-feudalism (i.e., more of the steroidal same).

If Justice Holmes was right, that the law is nothing more pretentious than a prediction of what (our heretofore largely irrelevant) judges will do, then we, at our “current conjuncture,” haven’t any idea what the law is.

Editor’s note: For a previous review of *The Code of Capital* see Robert Gordon, Masters of the Code, JOTWELL (September 28, 2020).

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