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1

Empire of Law

It looks like an elephant's head: the line that represents the growth rate and the amount of wealth captured by different income groups globally between 1980 and 2017; fittingly, it is called the "elephant curve."¹ The broad forehead holds 50 percent of the world's population; over the past 35 years they captured a paltry 12 percent of growth in global wealth. From the forehead a curve leads down toward the trunk and from there, steeply up to the raised tip. The trunk is where "the one percent" sit; they hold 27 percent of the new wealth, more than double the amount held by the people clustered together on the elephant's forehead. The valley between the forehead and the trunk is where lower-income families in the advanced Western market economies are bundled together, the "squeezed bottom 90 percent" of these economies.²

It was not meant to be this way. The 1980s witnessed a surge in economic and legal reforms in developed and emerging markets alike that prioritized markets over government in allocating economic resources, a process that was further galvanized by the disappearance of the iron curtain and the collapse of socialism.³ The idea was to create conditions by which everyone would prosper. Individual initiative protected by clear property rights and credible

contract enforcement would, so the argument went, ensure that scarce resources would be allocated to the most efficient owner, and this in turn would increase the pie to the benefit of all. The playing field may not have been leveled, but the prevailing wisdom was that by freeing individuals from the shackles of state tutelage, all would eventually benefit.

Thirty years later, we are not celebrating prosperity for all, but instead are debating whether we have already, or not quite, reached levels of inequality that were last seen before the French Revolution, and this in countries that call themselves democracies, with their commitment to self-governance based on majoritarian, not elite, rule. It is hard to reconcile these aspirations with levels of inequality that smack of the Ancien Régime.

Of course, there has been no shortage of explanations. Marxists point to the exploitation of labor by capitalists.⁴ Globalization skeptics argue that excessive globalization has deprived states of the power to redistribute some of the gains capitalists make through social programs or progressive taxation.⁵ Finally, a novel interpretation holds that in mature economies capital grows faster than the rest of the economy; whoever has amassed wealth in the past, therefore, will expand it further, relative to others.⁶ These are at least partly plausible explanations, but they fail to address the more fundamental question about the genesis of capital:⁷ How is wealth created in the first place? And, relatedly, why does capital often survive economic cycles and shocks that leave so many others adrift, deprived of the gains they had made earlier?

The answer to these questions, I suggest, lies in capital's legal code. Fundamentally, capital is made from two ingredients: an asset, and the legal code. I use the term "asset" broadly to denote any object, claim, skill, or idea, regardless of its form. In their unadulterated appearance, these simple assets are just that: a piece of dirt, a building, a promise to receive payment at a future date, an idea for a new drug, or a string of digital code. With the right legal coding, any of these assets can be turned into capital and thereby increase its propensity to create wealth for its holder(s).

The roster of assets that are coded in law has changed over time and will likely continue to do so. In the past, land, firms, debt, and know-how have all been coded as capital, and as this list suggests, the nature of these assets has changed along the way. Land produces foodstuff and shelter even in the absence of legal coding, but financial instruments and intellectual property rights exist only in law, and digital assets in binary code, for which the code itself *is* the asset. And yet, the legal devices that have been used for coding every one of these assets have remained remarkably constant over time. The most important ones are contract law, property rights, collateral law, trust, corporate, and bankruptcy law. These are the *modules* from which capital is coded. They bestow important attributes on assets and thereby privilege its holder: *Priority*, which ranks competing claims to the same assets; *durability*, which extends priority claims in time; *universality*, which extends them in space; and *convertibility*, which operates as an insurance device that allows holders to convert their private credit claims into state money on demand and thereby protect their nominal value, for only legal tender can be a true store of value, as will be further explained in chapter 4.⁸

Once an asset has been legally coded, it is fit for generating wealth for its holder. The legal coding of capital is an ingenious process without which the world would have never attained the level of wealth that exists today; yet the process itself has been largely hidden from view. Through this book I hope to shed light on how law helps create both wealth and inequality. Tracing the root causes of inequality has become critically important not only because rising levels of inequality threaten the social fabric of our democratic systems, but also because conventional forms of redistribution through taxes have become largely toothless. Indeed, shielding assets from taxes is one of the most sought-after coding strategies that asset holders covet. And lawyers, the code's masters, are paid extraordinary fees to place them beyond the reach of creditors, including the tax authorities, with the help of these states' own laws.⁹

How assets are selected to be legally coded as capital, by whom, and for whose benefit are questions that cut to the core of capital

and the political economy of capitalism. Yet, there are few, if any, answers to these questions in the literature. The reason is that most observers treat law as a sideshow when in fact it is the very cloth from which capital is cut. This book will show how and by whom ordinary assets are turned into capital and will shed light on the process by which lawyers can convert just about any asset into capital. The wealthy often claim special skills, hard work, and the personal sacrifice they themselves or their parents or forefathers have made as justifications for the wealth they hold today. These factors may well have contributed to their fortunes. Yet, without legal coding, most of these fortunes would have been short-lived. Accumulating wealth over long stretches of time requires additional fortification that only a code backed by the coercive powers of a state can offer.

It is often treated as a coincidence that the economic success that separates modern economies from millennia of much lower growth rates and much greater volatility of wealth closely tracks the rise of nation-states that rely on law as their primary means of social ordering.¹⁰ Many commentators herald the advent of private property rights, seen as a critical restraint on state power, as the key explanation for the rise of the West.¹¹ Yet, it may be more accurate to attribute this to the state's willingness to back the private coding of assets in law, and not only property rights in the narrow sense, but also other legal privileges that confer priority, durability, convertibility, and universality on an asset. Indeed, the fact that capital is linked to and dependent on state power is often lost in debates about market economies. Contracts and property rights support free markets, but capitalism requires more—the legal privileging of some assets, which gives their holders a comparative advantage in accumulating wealth over others.¹²

Uncovering the legal structure of capital also helps solve the puzzle Thomas Piketty presented in his seminal book, *Capital in the Twenty-First Century*.¹³ In advanced economies, he showed, the average rate of return on capital exceeds the average rate of economic growth ($r > g$). Piketty did not explain this puzzle, but settled on documenting its remarkable empirical regularity. Yet his own data offer important cues for solving it. In a chapter entitled “The

Metamorphoses of Capital,” Piketty shows that rural land was the most important source of wealth until the early twentieth century.¹⁴ Shares, bonds, and other financial assets as well as urban housing have since replaced it.

The analysis offered in this book will show that the metamorphosis of capital goes hand in hand with grafting the code’s modules onto ever new assets, but also, from time to time, stripping some assets of key legal modules: rural land, the major source of private wealth for centuries, had long benefited from greater durability as compared to other assets, but lost this privilege in the UK and elsewhere in the late nineteenth century. By that time, corporations had become widely used legal modules not only for organizing industry, but as incubators of wealth. The corporate form, together with trust law, is also one of the key legal devices for emitting financial assets, from shares to derivatives. Last but not least, intellectual property rights have been on the rise over the last few decades and account for the lion’s share of the market valuation of many firms today.

Decoding capital and uncovering the legal code that underpins it regardless of its outward appearance reveals that not all assets are equal; the ones with the superior legal coding tend to be “more equal” than others. The gist of this argument has been made before by the late legal historian, Bernard Rudden. He captured the essential role of law in fashioning assets that confer power and wealth on their holders in the following quote:

The traditional concepts of the common law of property were created for and by the ruling classes at a time when the bulk of their capital was land. Nowadays the great wealth lies in stocks, shares, bonds and the like, and is not just movable but mobile, crossing oceans at the touch of a key-pad in the search for a fiscal utopia. (. . .) In terms of legal theory and technique, however, there has been a profound if little discussed evolution by which the concepts originally devised for real property have been detached from their original object, only to survive and flourish as a means of handling abstract value. The feudal calculus lives and breeds, but its habitat is wealth not land.¹⁵

In this book, I will show that the “feudal calculus” is indeed alive and kicking, including in democratically governed societies that pride themselves on guaranteeing everyone equality before the law—only that some can make better use of it than others. It operates through the modules of the legal code of capital, which, in the hands of sophisticated lawyers, can turn an ordinary asset into capital. Not the asset itself, but its legal coding, protects the asset holder from the headwinds of ordinary business cycles and gives his wealth longevity, thereby setting the stage for sustained inequality. Fortunes can be made or lost by altering an asset’s legal coding, by stripping some modules from an asset, or by grafting them onto a different asset. We will see this play out in the rise and decline of landed wealth; the adaptation of legal coding techniques to firms; the conversion of loans into tradable financial assets that can be converted into cash at the doors of central banks; and, finally, in the rise of know-how as capital. For each of these assets, the legal coding ultimately determines their capacity to bestow wealth on their holders. It also provides them with a powerful defense against challengers: “But it’s legal.”

Law’s Guiding Hand

The legal code of capital may be invisible to the casual observer, but that does not make it less real. Some may find it easier to believe in the market’s “invisible hand” immortalized by Adam Smith, than to spend their time decoding capital’s legal structures.¹⁶ And yet, changes in the legal structure have fundamentally altered the conditions for Smith’s invisible hand to do its work. As is well known, Smith argued that the pursuit of individual self-interest will inevitably benefit society. Often ignored is the mechanism that powers the invisible hand. “Every individual,” Smith explained, “endeavours to employ his capital as near home as he can, and consequently as much as he can in the support of domestic industry; provided always that he can thereby obtain the ordinary, or not a great deal less than the ordinary profits of stock.”¹⁷ Why so? Because “he can know better the character and situation of the persons whom he trusts, and if he

should happen to be deceived, *he knows better the laws of the country from which he must seek redress.*¹⁸ Whereas conventional wisdom attributes the operation of the invisible hand to the market, it might just as well be read as a reference to the quality of the rules of the game where business is conducted. The invisible hand does its job under weak institutions; it becomes superfluous once institutions are in place that allow economic agents to enforce their rights and interests anywhere.

Today's entrepreneurs no longer need to seek redress at home, and the fate of their wealth is no longer tied to the communities they left behind. Instead, they can choose among many legal systems the one they prefer, and enjoy its benefits even without physically moving themselves, their business, their goods, or assets to the state that authorized that law. They can code capital as they choose in domestic or foreign law by opting into another country's contract law, or by incorporating their business in a jurisdiction that offers them the greatest benefits in the form of tax rates, regulatory relief, or shareholder benefits. Opting out of one and into a different legal regime leaves only a paper or digital trail but will not compromise the code's power as long as there is at least one state that is willing to back it.

This is so because, since Smith's writing more than two hundred years ago, an empire of law has been built that is made primarily of domestic law but remains only loosely tied to specific states or their citizens. States have actively torn down legal barriers to entry and offered their laws to willing takers and have thereby made it easier for asset holders to pick and choose the law of their liking. Most states recognize foreign law not only for contracts but also for (financial) collateral, corporations, and the assets they issue; they use their coercive powers to enforce it, and they allow domestic parties to opt into foreign law without losing the protections of local courts. The phenomenal expansion of trade, commerce, and finance globally would have been impossible without legal rules that enable asset holders to carry their local rules with them, or, if they prefer, to opt into foreign law. Dislodging the modules of capital from the legal systems that begot them has fostered the creation of wealth

by holders of capital, the ones along the elephant's trunk, but it has also contributed to a highly skewed distribution of wealth for others without access to sophisticated coding strategies.

Realizing the centrality and power of law for coding capital has important implications for understanding the political economy of capitalism. It shifts attention from class identity and class struggle to the question of who has access to and control over the legal code and its masters: the landed elites; the long-distance traders and merchant banks; the shareholders of corporations that own production facilities or simply hold assets behind a corporate veil; the banks who grant loans, issue credit cards, and student loans; and the non-bank financial intermediaries that issue complex financial assets, including asset-backed securities and derivatives. The craftsmanship of their lawyers, the code's masters, explains the adaptability of the code to the ever-changing roster of assets; and the wealth-creating benefits of capital help explain why states have been only too willing to vindicate and enforce innovative legal coding strategies.

With the best lawyers at their service, asset holders can pursue their self-interests with only few constraints. They claim freedom of contract but overlook the fact that in the last instance, their freedoms are guaranteed by *a state*, though not necessarily their home state. Not every state, however, is equally accommodating for coding capital. Two legal systems dominate the world of global capital: English common law and the laws of New York State.¹⁹ It should come as no surprise that these jurisdictions also harbor the leading global financial centers, London and New York City, and all of the top one hundred global law firms. This is where most capital is coded today, especially financial capital, the intangible capital that exists only in law.

The historical precedent for global rule by one or several powers is empire.²⁰ Law's empire has less need for troops; it relies instead on the normative authority of the law, and its most powerful battle cry is "but it is legal." The states these citizens constitute as "we, the people" readily offer their laws to foreign asset holders and lease their courts to enforce foreign law as if it were home-grown, even if this deprives them of tax revenue or the ability to implement the policy preferences of their own citizens.²¹ For the global capitalists,

this is the best of all worlds, because they get to pick and choose the laws that are most favorable to them without having to invest heavily in politics to bend the law their way.

Like most empires of the past, the empire of law is a patchwork; it consists not of a single global law, but of select domestic laws that are knit together by rules, including conflict-of-law rules that ensure the recognition and enforcement of these domestic laws elsewhere, as well as select international treaty law.²² The decentered nature of the law that is used to code global capital has many advantages. It means that global commerce and finance can thrive without a global state or a global law; and it allows those in the know to pick and choose the rules that best suit their or their clients' interests. In this way, the empire of law severs the umbilical cord between the individual's self-interest and social concerns. The legal decoding of capital reveals Smith's invisible hand as a substitute for a reliable legal code—visible even if often hidden from sight, and with a legal infrastructure firmly in place that is global in scope—that is no longer serving its purpose. Effective legal protection almost anywhere allows private self-interest to flourish without the need to return home to benefit from local institutions. Capital coded in portable law is footloose; gains can be made and pocketed anywhere and the losses can be left wherever they fall.

The Enigma of Capital

Capital is a term we use constantly, but its meaning remains obscure.²³ Ask any person on the street and she will probably equate capital with money. But as Marx has explained in the introductory chapter to *Das Kapital*, money and capital are not the same.²⁴ Rather, in his view capital is produced in a process that includes the exchange of goods for money and the extraction of surplus from labor.

In fact, the term capital was in use long before Marx immortalized the concept. The social historian Fernand Braudel traces it back to the thirteenth century, when it was used to denote interchangeably a fund of money, goods, or money rented out for interests,²⁵ at least where this was permissible.²⁶ Definitions abound, even today, as

Geoffrey Hodgson has shown in a careful review of the literature.²⁷ To some, capital is a tangible object, or “physical stuff.”²⁸ To this day, many economists and accountants insist that capital must be tangible; if you can’t touch it, it ain’t capital.²⁹ To others it is one of the two factors of production; or just an accounting variable.³⁰ And to Marxists, capital is at the heart of fraught social relations between labor and its exploiters who own the means of production, which gives them the power to extract surplus from labor. The historiography of capitalism does not offer much clarity either. Some historians confine the “age of capital” to the period of heavy industrialization; others, however, have pushed the concept back in time, to periods of agricultural or commercial capitalism.³¹ Our own post-industrial age has been labeled alternatively the age of financial or global capitalism.

What makes the concepts of capital and capitalism so confusing is that the outward appearance of capital has changed dramatically over time, as have the social relations that underpin it. Against this background, one might even question whether it makes sense to bundle historical epochs that differ so fundamentally from one another under a single rubric of “capitalism.” In this book, I will take the position that we can, indeed that we should do so, but to justify this we need to dig deeper and understand the making of capital itself.

To start with, it is critical to note that capital is not a thing; neither can it be pinned down to a specific period of time, a political regime, or just one set of antagonistic social relations as between the proletariat and the bourgeoisie.³² These manifestations of capital and capitalism have changed dramatically, yet capital’s source code has remained almost unchanged throughout. Many of the legal institutions we still use today to code capital were first invented in the time of feudalism, as Rudden observed in the quote provided earlier in this chapter.

Marx noted already that ordinary objects must undergo some transformation before they can be traded in exchange for money to set in motion a process by which profits are made. The process has been labeled commodification, a necessary but, as we will see, not a sufficient step in the coding of capital, and he also recognized

the possibility of commodifying labor. Karl Polanyi disagreed with Marx about classifying land, labor, or money as commodities. Only items that are “*produced* for the market” qualify as commodities, he argued, and none of these assets are.³³ Polanyi was correct that commodification is man-made, but he erred on the nature of this transformation at the hands of humans: not a physical production process, but legal coding is key. For commodification alone, two of the code’s attributes will do: priority and universality. However, to attain the utmost legal protection, durability or convertibility must be added to the mix. Capitalism, it turns out, is more than just the exchange of goods in a market economy; it is a market economy in which some assets are placed on legal steroids.³⁴

Contrary to Polanyi and many economists today, even humans can be coded as capital. This is at odds with neoclassical accounts that describe the production function as the sum of capital (K) and labor (L), the two factors of production, which together produce goods, or Q .³⁵ This equation treats both K and L as quantities, the price of which is determined by their relative scarcity. It ignores the power of the legal code. In fact, with a little bit of legal engineering, L can easily be turned into K . Many a freelancer, for example, has discovered that she can *capitalize* her labor by establishing a corporate entity, contributing her services to it in kind and taking out dividends as the corporation’s shareholder in lieu of a salary—thereby benefiting from a lower tax rate.³⁶ The only input to this entity is human, but with some legal coding, it has been transformed into capital. Defining capital as non-human is also at odds with the rise of property rights in ideas and know-how, such as patents, copyrights, and trademarks, often collectively referred to as “intellectual property rights.” What else are they but the legal coding of human ingenuity?

Another reason why humans are often excluded from the definition of capital is that they cannot offer themselves as collateral and thereby monetize their own labor.³⁷ But as I have just shown, they can contribute their labor as capital to a firm. Law is malleable, and it is easy to mold human labor as an in-kind contribution. Moreover, when slavery *was* legal, slaves were not only owned; they were widely used as collateral to secure loans—in the United States this

was often done by investors from the Northern, slave-free states, who thereby helped sustain an inhumane system, even as they condemned it in public.³⁸ As a result, when slavery was finally abolished and the formerly enslaved men, women, and children were set free, their former owners lost what to them had been a valuable economic asset.³⁹ Of course, their economic loss pales against the fate their former slaves had suffered at their hands, which at the time was sanctioned by the inhumane recognition and enforcement of property rights in humans.⁴⁰ The point is that the history of slavery illustrates the power (not the morality!) of the legal code in the making and taking of capital, but also of human dignity.

To fully appreciate the versatility of capital, we have to move beyond simple classifications and understand how capital obtains the qualities that distinguish it from other assets. Economists in the “old” institutionalist tradition have come close, but their contributions have largely been forgotten.⁴¹ Thorstein Veblen, for example, suggested that capital is an asset’s “income-yielding capacity.”⁴² And in his seminal book *The Legal Foundations of Capitalism*, John Commons defined capital as “the present value of expected beneficial behavior of other people.”⁴³ In his account, law takes center stage in enhancing the reliability of others’ expected behavior. As he documented, in the late nineteenth century, US courts extended the notion of property rights from the right to use an object at the exclusion of others to protect asset holders’ expectations to future returns. Once this was done, these expectations could not only be taxed; they could be exchanged and re-invested, and violators of these interests, including the state, could be charged with compensation for damages.⁴⁴

Bringing this line of argument to its logical conclusion, Jonathan Levy defines capital as “legal property [that is] assigned a pecuniary value in expectation of a likely future pecuniary income.”⁴⁵ In short, capital is a *legal* quality that helps create and protect wealth. This book will shed light on how exactly the critical legal attributes are grafted onto assets and the work that key legal institutions, the code’s modules, have done for centuries in creating new capital assets.

Once we recognize that capital owes its wealth-creating capacity to its legal coding, we can see that in principle, any asset can

be turned into capital. Viewed in this light, there is nothing new about the “new capitalism.”⁴⁶ Capitalism’s changing face, including its most recent turn to “financialization,” can be explained by the fact that old coding techniques have migrated from real assets, such as land, to what economists like to call legal fictions: assets that are protected by corporate or trust veils, and intangibles that are created in law.⁴⁷

Capital’s Legal Attributes

In law, the term “code” is typically used for voluminous books that compile legal rules. Prominent examples are the big codifications of the nineteenth century, such as the French and German civil and commercial codes.⁴⁸ I use the term to show how certain legal institutions have been combined and recombined in a highly modular fashion to code capital. Looking back, the most important modules that were used for this purpose, but by no means the only ones, were contracts, property, collateral, the law of trusts and corporations, as well as bankruptcy law. How these modules operate will be explored in greater detail in the chapters to come. For now, it is sufficient to understand that these modules bestow critical attributes on an asset and thereby make it fit for wealth creation, namely priority, durability, convertibility, and universality.

Priority rights operate like an ace in a game of cards—ranking claims and privilege over weaker titles. Having priority rights is critical for a creditor when the debtor suffers economic ruin and all her creditors will descend on her assets at once. This is when owners can request their property, and secured creditors are able to pull out the assets they have secured and sell them to recover their loss, whereas the unsecured creditors have to settle for the leftovers. Property rights confer title to an owner and allow her to remove an asset she owns from the pool of assets that are in the possession of a bankrupt debtor, no matter how loudly other creditors might protest. Collateral law works in a similar way. The holder of a mortgage, pledge, or other security interest may not have full title to the asset, but she has a stronger right than creditors without such protection,

i.e., the *unsecured* creditors.⁴⁹ Bankruptcy can therefore be called the acid test for the legal rights that have been created long before bankruptcy loomed.

Hernando de Soto, a life-long advocate for bringing property rights to the poor, has suggested that these rights can turn “dead land” into “life capital,” because owners can mortgage their land or other assets to obtain investment capital.⁵⁰ And yet, this is only half of capital’s full story. Without additional legal safeguards, debtors risk losing their assets to creditors if and when they default on their payments, even if this happens through no fault of their own. History books are filled with cases of debtors who have lost not only their family silver, but their shirts to creditors in times of severe economic downturns. Asset holders who wish to turn their assets into lasting wealth therefore crave not just priority, but also durability.

Durability extends priority claims in time. Legal coding can extend the life span of assets and asset pools, even in the face of competing claimants, by insulating them from too many creditors. As long as it was not allowed to seize all the land of a debtor, even if it had been mortgaged, land could serve as a reliable source of wealth, which could be transferred from generation to generation. Not just any firm, but the ones that are organized as legal entities, can have an indefinite life span; short of putting them to death by liquidation, they can operate forever and incubate wealth for a changing roster of owners or shareholders. Creditors of the corporation itself can seize its assets should it default on a loan; but, as we will see, the corporation’s own shareholders cannot gain access to these assets, and neither can the shareholders’ personal creditors.⁵¹ Because of its ability to shield its assets from all but its direct creditors, even its own shareholders, the corporation has become one of the most enduring institutions of capitalism.

The third attribute is universality, which not only ensures that priority and durability will affect the parties who agreed to be bound by them, but that these attributes will be upheld against anybody, or *erga omnes* in Latin legalese. Universality sheds a crucial light on the nature of capital and its relation to state power. A simple agreement between two parties can exert influence only between the two

contracting parties, but it cannot bind others. It takes a powerful third party to extend priority and durability rights against the world such that others will yield.

Convertibility is the final attribute of capital's code; it gives asset owners an explicit or implicit guarantee to convert their assets into state money when they can no longer find private takers. Convertibility presumes the right to freely transfer an asset. In the past, even simple debt obligations had to be performed by the original parties to the contract. But convertibility adds another dimension to the simple right to transfer (or assign) legal obligations: it gives asset holders access to state money, the only asset that can retain its nominal value (not necessarily its real value, as the history of inflation documents).⁵² The reason is that the money states issue as legal tender is backed by the coercive powers of that state, including the power to unilaterally impose liabilities on others, i.e. its citizens. This is what turns state money into a reliable store of value and explains its unique status among attempts to create money, the private debt that is coded in law, or more recently, the cryptocurrencies that use digits instead.⁵³ For financial assets, convertibility is more important than durability, indeed, is an effective substitute. It allows the holders of these assets to lock in past gains at a time when other market participants no longer value them.

State, Power and Capital

The code of capital is a legal code; it owes its power to law that is backed and enforced by a state. We may negotiate contracts with others and we may treat them as binding, whether or not they would be enforceable in a court of law. We may even find an arbiter to resolve any disputes that might threaten the full implementation of a commitment we made in the past. If the world consisted only of such simple deals, law would be trivial, even superfluous;⁵⁴ and for lawyers, such a world would be rather boring.

Things become more interesting (and more realistic) only in the face of competing claims to the same asset. Individuals buy or lease cars, rent an apartment or mortgage a house, receive salaries, buy

bonds or shares, and deposit money in a bank account. Entrepreneurs buy input, hire employees, rent premises, make investments, enter into contracts for electricity and water, owe taxes, collect money from selling goods, and pay back loans to creditors. As long as every obligation is met and every bill paid as it becomes due, many legal issues remain invisible. They come to the surface with a vengeance, however, when the individual or entity at the center of this web of claims falls behind; when liabilities mount, asset values decline, and it becomes apparent that not all claimants will get what they had contracted for at the outset. When insolvency looms, insisting on contract enforcement is no longer an answer; instead, it is time to decide who gets how much and in what order.

Absent such a decision, the first creditor who arrives on the scene is likely to take it all—a practice that was common before the invention of bankruptcy law. Its purpose was to avoid a run on the debtor's assets, a market failure that in most cases destroys any chance of reorganization or the efficient reallocation of the debtor's assets.⁵⁵ Most bankruptcy codes today impose a simple rank order. Owners can take out their assets, secured creditors can pull the collateral from the pool and sell it to obtain satisfaction, and unsecured creditors get the leftovers on a pro-rata basis.

In the best of worlds, creditors with weaker rights as compared to others would yield voluntarily. Creditors who are in danger of losing, however, may not be so inclined. Enforcing priority rights effectively involves more than finding a solution to a coordination game; someone must stand in for, and, if necessary, execute these rights. In fact, modern economies are built around a complex network of legal rights of different standing that are backed by coercive state power.⁵⁶

When trade and commerce take place primarily within tightly knit communities, formal law enforcement may not be needed. Everybody in that community will know who has better rights; after all, this is how things have always been done. As long as most members of the group continue to abide by established norms, there will be little need for complex legal systems, courts, and enforcement powers. However, when trade and commerce extend beyond the

boundaries of established spheres of exchange where norms and entrenched hierarchies are known to all, a different mode of social ordering becomes necessary, one that is capable of upholding stronger claims even against strangers.⁵⁷ States and state law are examples of such institutions, and they have been critical for the rise of capitalism.

To be sure, law may not always succeed in garnering respect, and states may at times lack the resources to make enforcement credible. In many societies law is not perceived to be legitimate and compliance tends to be weak. Many countries that received their formal legal system by imposition during the era of colonization and imperialism tend to have weaker legal institutions than countries that developed their formal legal institutions internally.⁵⁸ Under such conditions, the modules of the code will not produce lasting wealth effects. Instead, private wealth will be guarded by physical force, stacked in foreign bank accounts, or coded in foreign law with foreign courts standing by to back it.⁵⁹

Law is a powerful social ordering technology; it has been used for centuries to scale social relations beyond close-knit communities and to assure strangers that they can risk transacting with one another to the tune of billions of dollars without ever having to come face to face. This is so because law that is backed by the threat of coercive enforcement increases the likelihood that the commitments that private parties made to one another and the privileges they obtained will be recognized and enforced without regard to pre-existing social ties or competing norms and that these legal claims will even be respected by strangers. What exactly gives law this scaling power? This question has concerned social and legal theorists for generations.⁶⁰ One answer to this question is that law is backed by the coercive powers of a state; another reason is law's capacity to focus collective expectations that minimize deviant behavior and encourage decentralized, private enforcement.

Max Weber explained the power of law by invoking the state's monopoly over the means of coercion.⁶¹ Through its courts, bailiffs, and police forces, states enforce not only their own commands, but also private property rights and the binding commitments private

parties make to one another. This does not mean that state power is omnipresent. As long as the threat of coercive law enforcement is sufficiently credible, voluntary compliance can be achieved without mobilizing it in every case.⁶² Others have argued that systems of law can evolve in the absence of coercive state power.⁶³ People have been governing themselves since long before the emergence of modern nation-states. All it takes for effective self-governance is a central authority that is capable of proclaiming a binding interpretation of rules and principles. With this in place, enforcement can be left to private parties, because they have powerful self-interests to help others to enforce their claims in accordance with known and respected norms, knowing they might need similar support in the future. Private parties may not have sheriffs or prisons at their disposal, but they can shame, shun, and expel members from the group.

This coordination game, however, is likely to work best in settings where all market participants have comparable assets and interests. In capitalist systems, however, not all assets are equal; some asset holders have better rights than others. When the rank order of competing claims is in dispute, relying on others to protect one's own claims now, against a vague promise to reciprocate at some future date, is unlikely to work. The more diverse the assets and the more uneven their distribution, the greater the need for coercive law enforcement, and thus for states and their coercive powers. Herein lies the deeper reason for why states and capital are joined at the hip.

The fact that capital has become global does not refute the argument that state power is central for capitalism. For capital's global mobility is a function of a legal support structure that is ultimately backed by states. Many states have committed themselves under their own domestic law, or in international treaties, to recognize the priority rights that were created under foreign law. They regularly enforce foreign law in their own courts and lend their coercive powers to executing the rulings of foreign courts or arbitration tribunals. This legal infrastructure is the backbone for global capitalism and explains why today's merchants no longer have to venture home to protect their spoils.

An Exorbitant Privilege

The story about capital and its legal code is complicated, as the legal modules that are used are complex and hidden in arcane statutory or case law and the plot frequently develops behind the closed doors of large law firms, with only a rare airing in a court of law or parliament. The legal code confers attributes that greatly enhance the prospects of some assets and their respective owners to amass wealth, relative to others—an exorbitant privilege.⁶⁴ Choosing the assets and grafting onto them the legal attributes of priority, durability, universality, and convertibility is tantamount to controlling the levers for the distribution of wealth in society.

This account contradicts the standard argument that capitalist economies are defined by free markets that allocate scarce resources efficiently and that prices reflect the fundamental value of assets.⁶⁵ Many legal scholars have already drawn attention to the fact that the operation of the market hinges on legal institutions that facilitate price discovery.⁶⁶ I go a step further and argue that the legal coding accounts for the value of assets, and thus for the creation of wealth and its distribution. This should be only too apparent with respect to financial assets and intellectual property rights that do not exist outside the law. However, it is also true for simpler assets that were used as the prototypes for legal coding, such as land or pools of assets held together in firms.

States and state law are central to the coding of capital. States have not only dismantled existing rights and privileges to make room for the power of market forces, as Polanyi has pointed out.⁶⁷ Capital and capitalism would not exist without the coercive powers of states.⁶⁸ States often do not, in fact they need not, control the legal coding process itself. Indeed, at the frontiers where new capital rights are minted day by day in the offices of law firms, states take a back seat. But states provide the legal tools that lawyers use; and they offer their law enforcement apparatus to enforce the capital that lawyers have crafted. Not all coding strategies will go unchallenged, and some of them will be struck down at a future date. Many, however, will never be scrutinized and others will survive the challenge; and

the few that are eventually struck down often have already produced fortunes for their holders.

The ability to graft the code's modules onto an ever-changing roster of assets makes lawyers the true masters of the code of capital. In principle, anybody has access to lawyers and their coding skills, but the market for legal services ensures that only the best-paying clients can hire the most skillful among them. The specifics about how assets are selected for legal coding are rarely scrutinized. The common depictions of law as stable, almost sacrosanct, immunize from the public eye the work that is done more and more in private law firms, and less and less in parliaments or even courtrooms.

The states' willingness to recognize and enforce privately coded capital, indeed to foster it by recognizing innovative coding strategies and the expansion of asset classes that can be legally coded as capital, may seem puzzling. Many a state has fallen for the promise that expanding the legal options for some, including offering them exemptions from general laws and other legal privileges, will enlarge the pie and offer greater prosperity for all. They frequently realize only later that the trickle is often rather small. More important, most of the benefits from capital do not trickle down; they trickle up to capital holders who repatriate their gains or place them behind the legal shields other jurisdictions afford them to protect their wealth from tax and other creditors.⁶⁹

Another explanation is that states themselves have more to gain than to lose from privileging capital by backing the private coding efforts that create it. States benefit from economic growth, because it boosts their tax revenue and allows them to raise debt finance. The fate of governments in democracies in particular has been tied ever more closely to their governments' ability to produce growth. Growth rates, and the rise of stock markets, not the distribution of wealth or indices of human development, have become the standard measures for adjudicating success or failure of elected governments—in itself an indicator of the enormous cognitive sway capital has over politics. Yet, as many states have realized, the power of the tax sword has been blunted by sophisticated legal coding strategies that can hide assets from their reach. Even more generally,

promoting the interests of capital first and foremost boosts private, not necessarily national, wealth and thereby fosters inequality.⁷⁰ To see why this is so, we need to decode the legal structures of capital.

Summary and Outlook

In this introductory chapter, I have outlined the major themes of this book: Capital is coded in law, and, more specifically, in institutions of private law, including property, collateral, trust, corporate, bankruptcy law, and contract law. These are the legal modules that bestow critical legal attributes on the select assets that give them a comparative advantage over others in creating new and protecting old wealth. Once properly coded, capital assets enjoy priority and durability, are convertible into cash, or legal tender, and, critically, these attributes will be enforced *against the world*, thereby attaining universality. This works because states back and, if necessary, coercively enforce the legal code of capital, whether or not they had a direct hand in choosing the coding strategy for the asset in question.

Recognizing that capital is made, and not simply the product of superior skills, shifts attention to the processes by which different assets are slated for legal coding and to the states that endorse relevant legal modules and offer their coercive powers to enforce them. As I will show, this process is both decentralized and, in only seeming contradiction, increasingly global. Private attorneys perform most of the work on behalf of their clients, and states, for their part, offer their own legal systems as a menu from which private parties get to pick and choose. As a result, many polities have lost the ability to control the creation and distribution of wealth.

In the following chapters, I will illustrate this argument by showing how different asset classes have been coded as capital, starting with land (chapter 2) and moving on to firms (chapter 3), debt (chapter 4), and know-how (chapter 5). This survey sets the stage for unpacking the legal order that sustains global capitalism in the absence of a global state or a global legal system (chapter 6) and for exploring the rise of the global legal profession, the masters of the code (chapter 7). While law has been the foremost coding technique

for the past several centuries, it is no longer the only contender for claims across time and space; the digital code has become a close competitor. However, as I will argue in chapter 8, its greatest powers will likely come not from offering an alternative to the legal code, but from using the legal code as a shield to protect private gains.

The questions of access to and the distribution of legal coding powers will be raised throughout the book, but they are taken up more fully in the book's final chapter, entitled "Capital Rules by Law." There I will argue that the coding of capital occurs typically in a much more decentralized fashion than Marxists would have it. Asset holders do not need to capture the state directly, much less win class struggles or revolutions; all they need is the right lawyers on their side who code their assets in law. This highly fragmented way of deciding how wealth is distributed in society raises fundamental political and normative questions. After all, law is the predominant means by which democracies govern themselves; yet the law they furnish is used by private parties, the holders of capital assets and their lawyers, to advance their private interests. As the code of capital has become portable, it has taken over the space that was once occupied by the invisible hand. The creeping erosion of the legitimacy of states and their laws in the face of growing inequality is a direct result of this structural bias that is rooted in the legal code of capital. The increasing threat to law's legitimacy may turn out to be capital's greatest threat yet.

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