

## LAW AND ECONOMICS IN THE RIA WORLD



LAW AND ECONOMICS  
IN THE RIA WORLD

Improving the use of economic  
analysis in public policy and legislation

Andrea RENDA



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*In memory of my father*



## FOREWORD

This book is the result of years of research, consulting, teaching, travelling and sharing ideas with colleagues, friends and students. Given the wide array of memories and anecdotes that populate its pages, I am sure I would have written it very differently when I was 25, and will probably want to rewrite it from scratch when I'm 64. As in Heraclitus' Πάντα ῥεῖ, even if the river is the same, the water will always be new; what's more, I tend to agree with Cratylus, who argued that it is impossible to step into the same river even once. As a matter of fact, even rewriting this book today would probably lead to a different result. The song remains the same, but the mind moves, like in the famous Zen kōan reported by Douglas Hofstadter, in which two monks were arguing about a flag. One said, "The flag is moving." The other said, "The wind is moving." The sixth patriarch, Zeno, happened to be passing by. He told them, "Not the wind, not the flag; mind is moving."

As a son of two professors of human anatomy, specialized *i.a.* in neuropeptides, I always had problems with the basic assumptions of neoclassical economics, which seemed to me too far from reality, and dangerously so. These certainly included the assumptions that income, unlike most goods, features constant marginal returns; and that individual preferences are independent of income and of the context in which they emerge. These two basic tenets – the irrelevance of distributional issues and pure methodological individualism – are heavily challenged in the pages of this work: overcoming them would lead economics – and law and economics along with it – to much higher grounds.

The problem is that the *pars destruens* of behavioral economics has so far been much more convincing than the corresponding *pars construens*: as a matter of fact, it has inflicted a lethal wound to mainstream neoclassical economics, but did not show where to go from there. Truth is that modern neuroscience makes economics even more dismal, by portraying our brain as a lone soldier entrusted with the desperate attempt to reduce complexity, constantly trying to collect all available information that can be found in past experience, external signals, distorted beliefs, anticipated regret, and just a drop of logic – not more than that. This tells us that we are doomed to use proxies in whatever we do. And that we will never be able to fully master the mysterious ways in which humans react to legal rules. I remember a quote my Dad used in his classes on the nervous system: "If the brain were simple enough for us to understand it, we would be too simple to understand it."

This applies also to public authorities, not just to individuals. And it explains why the *ex ante* assessment of the costs and benefits of public policy should be taken as an exercise constrained by the imperfection of our brains: public authorities should be asked to collect and illustrate all available information from past experience, sound scholarly work, external opinions, basic principles and fundamental goals before they decide to intervene; at the same time, they might want to postpone the answer to certain questions, and prioritize certain decisions, just as we do when we just have too much to squeeze in one day. But they cannot be asked to build a crystal ball and predict the future with full certainty, nor they should be required to make their calculations in isolation, such that they would reach the same results under every sky.

Writing this book, I have gradually realized that some social sciences have progressed more than economics in the past few decades. In my opinion, this occurred because economics, unlike these other disciplines, desperately needs to be immediately useful to policy. That's why "we the economists" should learn from what our colleagues in other social sciences can teach us. To paraphrase Bob Dylan in "my back pages", we were much older ten years ago; we are much younger now, and must take action to help policymakers address the huge challenges that they will have to face in the coming years. Even more difficult, we need to reflect further on what does it mean to be "efficient", "fair" and "just", and find new ways of reconciling the three concepts in our approach to public policies. Otherwise we will be forced to accept reality: that we economists are not able to predict crises, we are not helpful in fostering the happiness of the most, and that, when we are particularly smart people prefer to call us philosophers (one easy example: Amartya K. Sen).

Social sciences are like this, after all. The fact that what you are writing about does not exist *in rerum natura* can be overwhelming at times. This reminds me of when I was 22, and I attended one of my first conferences in law and economics in Hamburg, Germany. I sneaked into a room and ended up seating next to a legendary Professor from the University of Manchester, Anthony Ogus, one of the most enlightened fathers of the European Law and Economics movement. When Professor Ogus saw me, he shook my hand and asked me what I was researching on at the time. I said "I am studying fairness". He then smiled, took a while to reflect, and then replied "fairness is a very nice subject... because it doesn't exist!"

My deepest gratitude goes to all those that have directly or indirectly influenced my research over the past years. In the study of law and economics, Roberto Pardolesi and Roger van den Bergh – with whom the first concept of this book was discussed – have taught me how to walk even before I could stand on my own feet. Michael Faure has patiently and quickly read my drafts, and pointed me in the right direction when my mind was drifting apart. Marianne Breijer was of invaluable help during the drafting of this research. In the RIA



world, colleagues and friends such as Claudio Radaelli, Scott Jacobs, Bob Hahn, Colin Kirkpatrick, Jacques Pelkmans have shown me the keys of the kingdom. My girlfriend Rosa, my mother Loredana, my brothers Luca and Carlo, Fiorella, Amy, Franca, Jorge and our good old friends have made it possible by giving my boggling mind a compass, a warm shelter, and many things to be proud of.

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