

INTEGRATING LAW AND ECONOMICS IN INDONESIA

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Abstrak

Penerapan "Hukum dan Ekonomi" telah dimulai sejak 1.500 tahun yang lalu dan telah berulang kali diterapkan. Pada Abad ke-20, Ronald Coase memelopori studi hukum dan ekonomi yang kemudian dielaborasi lebih lanjut oleh Richard Posner dengan terminologi Economic Analysis of Law (EAL). EAL menggunakan metode ekonomi untuk menganalisis tentang bagaimana perubahan pada ranah hukum dapat berpengaruh terhadap distribusi kekayaan masyarakat. Hal tersebut telah memberikan landasan bagi digunakannya pendekatan pasar terhadap proses pengambilan keputusan hukum melalui beberapa teknik seperti Cost Benefit Analysis (CBA), Cost Effective Analysis (CEA), Regulatory Impact Assessment (RIA) dan lainnya. Sebagai salah satu teknik yang paling sering digunakan, CBA mengukur tujuan hukum dengan tujuan akhirnya untuk memaksimalkan manfaat serta meminimalisir biaya. Sarana analisis ini digunakan untuk mencari variabel dalam menunjukkan efisiensi ekonomi. Oleh karena proses penyusunan undang-undang di Indonesia belum memiliki alat analisis yang konkret dan terukur, penggunaan metodologi EAL dalam mekanisme pembuatan peraturan dapat membantu pemerintah dalam menghasilkan peraturan perundang-undangan yang lebih efektif. Pada saat dunia mengalami ketidakpastian selama era globalisasi, sangat penting bagi negara manapun untuk mengintegrasikan hukum dan ekonomi dalam kerangka kerja tata kelola peraturannya guna mencapai tujuan bersama, yaitu memaksimalkan kesejahteraan sosial sebagaimana tertulis dalam Pasal 33 Undang-Undang Dasar Republik Indonesia Tahun 1945.

Kata Kunci: *analisis ekonomi atas hukum, hukum dan ekonomi, hukum dan pembangunan*

Abstract

The application of "Law and Economics" dates back to 1,500 years ago, and has been applied in many eras. In the 20th Century, Ronald Coase, pioneered the study of law and economics which was further elaborated by Richard Posner with a new synonymously interchangeable terminology, Economic Analysis of Law (EAL). EAL uses an economic method to analyze how changes in the law affect the allocation and distribution of wealth in society. This has provided a foundation of a market approach to the legal decision-making process through the use of various techniques including Cost Benefit Analysis (CBA), Cost Effective Analysis (CEA), and Regulatory Impact Assessment (RIA). As one of the most commonly used techniques, CBA quantifies the objectives of the law with an ultimate goal of maximizing benefits and minimizing costs. It is an analytical tool which searches for variables to indicate economic efficiency. As the legislative drafting process in Indonesia lacks a concrete and measured analytical tool, embedding the law and economics methodology within the regulatory making mechanism can provide more effective laws and regulations. As the world experiences uncertainties during the globalization era, it is imperative for any country to integrate law and economics in the regulatory governance framework to reach a common goal: the maximization of social welfare as enshrined in Article 33 of the 1945 Indonesian Constitution.

Keywords: economic analysis of law, law and economics, law and development

A. Introduction

Indonesia: famously known as an archipelago comprised of more than 17,400 islands. It is the fourth most populous country in the world inhabited by over 261 million people. Indonesia shares borders with Papua New Guinea, Timor Leste, and Malaysia; and it is a member of ASEAN and the G-20 major economies.

Dating back to the 7th Century, the Indonesian archipelago was a significant trading region for China and India. With a history of more than 350 years under Dutch colonial rule, Indonesia was able to gain its independence after the World War II ended in 1945.

The multiplicity of Indonesia's ethnic groups, languages, and religions is united under the nation's philosophy of "Pancasila" which refers to the five basic principles of believing in the divinity of God, a just and civilized humanity, unity, democracy, and social justice. Despite the diversity of cultures, beliefs, and languages, the philosophy has been the nation's foundation that has led Indonesia to be the 16th largest economy in the world.¹

Just as it was possible for the hundreds of communities in Indonesia to unite, it is also logical to believe that the different academic sciences in Indonesia can also unite and continue the dream of its founding fathers to maximize the welfare of Indonesia's society through sustained economic development. With this hope, it should be possible to blend two major academic sciences—law and economics – for the benefit of Indonesian society.

In reference to the above, the blend of 'law and economics' is elaborated in this paper as a means of reaching the same goal of Chapter XIV Article 33 in Indonesia's 1945 Constitution: social welfare maximization.

"Law and economics" basically refers to the application of microeconomic analysis to legal problems. Dating back to the 1500s, this application has been a part of the non neo-classical approach to "law and economics" in Germany. This approach has been a part of the German Historical School of Economics, and has encompassed topics focussing on governance and public policy (*Staatwissenschaften*). Thus, non-neoclassical approaches have been used for the analysis of legal, administrative, and governance issues.

According to Hilaire McCoubrey and Nigel D. White, an economic approach to law is an improved model from the "father of utilitarianism", Jeremy Bentham. Bentham's

¹ Daniel Fitzpatrick, "Culture, Ideology and Human Rights: The Case of Indonesia's Code for Criminal Procedure", *Indonesia Law and Society*, ed. Tim Lindsey (Singapore: The Federation Press, 2008), p. 499

utilitarianism was described as a telecific calculus, referring to the concept of “the greatest happiness to the greatest number,” which has a similar meaning to the common good.⁴

According to a political philosopher, Tim Mulgan, the basic ideas of utilitarianism can also be found in the works of the "father of economics," Adam Smith, on society welfare. In relation to formulating laws, the ideology of utilitarianism is used as the basis to maximize happiness of the people.⁵

To integrate a complete ideology of utilitarianism, Bentham followed the philosophy of Adam Smith regarding a free market and believed that people should have the freedom to decide for themselves regarding what to buy and what to produce. According to Alain Marciano, Adam Smith and Jeremy Bentham were both founders of political economic philosophy. Although the two philosophers came from two different sciences, they had one similar goal: welfare maximization of society.⁶

Throughout history, it has been shown that legal issues have economic dimensions.⁷ Conducting an analysis with an economic approach most often involves assumptions. One such assumption is that each individual is a rational maximizer of his/her satisfactions. The economic assumption is to believe that the rationality and motivation of human beings lead to human behavior. Because people are rationally self-interested beings, their actions are reflections of what they value.

After a 400 – year journey of converging law and economics in the European countries, the concept reached the U.S. in 1949. The year marked the time when attempts were made to analyze law with an economic theory. It started at the University of Chicago under a research program on antitrust regulations called the “Antitrust Project”. The purpose of this research project was to understand how legal rules influence the economy.⁸

In 1960, the Journal of Law and Economics published an article entitled “The Problem of the Social Cost” by Ronald Coase from the University of Chicago. Coase was a pioneer in the study of law and economics, and his article was about laws and regulations, and how they affected the economy.⁹

In 1977, Richard Posner published his first edition of the book, *Economic Analysis of Law*, and made the concept “law and economics” interchangeable with “economic analysis of

⁴ Hilaire McCoubrey, *Legal Theory* (Hampshire and New York: Palgrave Macmillan, 1999), p. 276-277

⁵ Tim Mulgan, *Understanding Utilitarianism* (Stocksfield: Acumen, 2007), p. 1

⁶ Alain Marciano, *Law and Economics: A Reader* (London and New York: Routledge, 2009), p. viii

⁷ *Ibid.*, p. 1

⁸ *Law and Economics: A Reader*, Ed. Alain Marciano (London and New York: Routledge, 2009), p. 3

⁹ *Ibid.*, p. 4

law” (EAL). He defined economics as “the science of human choice in a world in which resources are limited in relation to human wants, explores and tests the implications of the assumption that man is a rational maximizer of his ends in life, his satisfactions, and his self-interests.”¹⁰ Many people may not realize that the economic system consists of the very same people who are found in the legal, social, and political system. Therefore, their behaviors will be a general reflection of the entire system they live in.

There have been numerous prominent figures in “law and economics,” such as the U.S. Court of Appeals for the Second Circuit judges, Learned Hand, Andrei Shleifer, and Guido Calabresi; the U.S. Court of Appeals for the Seventh Circuit judges, Frank Easterbrook and Richard Posner; and scholars, such as Ronald Coase, Gary Becker, Robert Cooter, Henry Manne, William Landes, and A. Mitchell Polinsky.

EAL also developed in various directions from the application of game theory to legal problems. Other developments have been the incorporation of behavioral economics, and the increasing use of statistical and econometric models.

In the study of economics, economists use a tool called the “measuring rod of money”¹¹ which provides the ability to make an analysis with precision. As money is an important determinant of human behavior in modern societies, an analysis through money has considerable explanatory power, and the data is usually available and accessible. This makes it easier to examine a hypothesis.¹² Using an economic method to analyze law is to explore how changes in the law effect the allocation and distribution of wealth in society. In turn, the analysis tries to find the influence of the economic system on law.¹³

In a free-market oriented economy, legal decision making has become vital. EAL has provided the foundation for a market approach to the legal decision-making process. Richard Posner stated,

The economic science as a selected science that was made by rational actors who had self-interests in a world where resources are limited; the modern microeconomic analysis is that rational actors will try to maximize their wealth from the limited availability of resources.¹⁴

¹⁰ Richard A. Posner, *Economic Analysis of Law* (New York: Wolters Kluwer & Business, Aspen Publisher, 2011), p. 3

¹¹ Alain Marciano, *Op.Cit.*, p. 12

¹² *Ibid.*, p. 12-13

¹³ *Ibid.*, p. 18

¹⁴ Richard A. Posner, *Op. Cit.*, p. 44

Based on the assumption that a rational individual will maximize his or her own satisfaction, economic science is applied into the field of law.

Posner further mentioned that in philosophy, the word rationality is the exercise of reason. Rationality is how people reach a conclusion efficiently and spontaneously. The rational decision is not just reasoned, but it is also considered optimal for achieving a goal or solving a problem.¹⁵

As self-interests exist in each human being, an effective legal system is required. The effectiveness refers to an efficient legal system benefitting both market participants and the economy as a whole. Thus, the principles of law have a direct correlation with the economic value of moral principles; such as trustworthiness, consideration for others, charity, neighborliness, hard work, and avoidance of negligence and coercion.¹⁶

The theory behind Posner's EAL is efficiency on the allocation of resources. He defined efficiency as "allocation of resources in which value is maximized." He stated that, "many of the doctrines and institutions of the legal system are best understood and explained as efforts to promote the efficient allocations of resources." Based on this statement, Posner developed his ideology of efficiency to what he referred as the wealth maximization theory of justice, as he stated, "the most common meaning of justice is efficiency"¹⁷ in which the ultimate direct moral goal is wealth maximization.¹⁸ Posner described that wealth maximization is an ethic of productivity and social cooperation¹⁹ which can only be achieved through mutual efforts by society members and government officials chosen to carry out public service duties.²⁰

When Posner elaborated his efficiency theory, a mathematical formulation was found. The formulation used a prediction or assumption to guide how people will respond to legal rules. According to Posner, "economics has somewhat replaced justice as the dominant basis for the critique of law."²¹ This is because EAL offers a methodology and terminologies which justice lacked for many years, and provides actual legal choices. The most important

¹⁵ *Ibid.*, p. 4

¹⁶ *Ibid.*, p. 339

¹⁷ Nicholas Mercuro, Steven G. Medema, *Economics and The Law: From Posner to Post-Modernism* (Princeton: Princeton University Press, 1997), p. 59-60.

¹⁸ Richard A. Posner, *The Problems of Jurisprudence*, (Cambridge, Massachusetts and London: Harvard University Press, 1990), p. 382

¹⁹ *Ibid.*, p. 391

²⁰ Nicholas Mercuro, Steven G. Medema, *Op.Cit.*, p. 58

²¹ Richard A. Posner, *The Problems of Jurisprudence, Op. Cit.*, p. 425

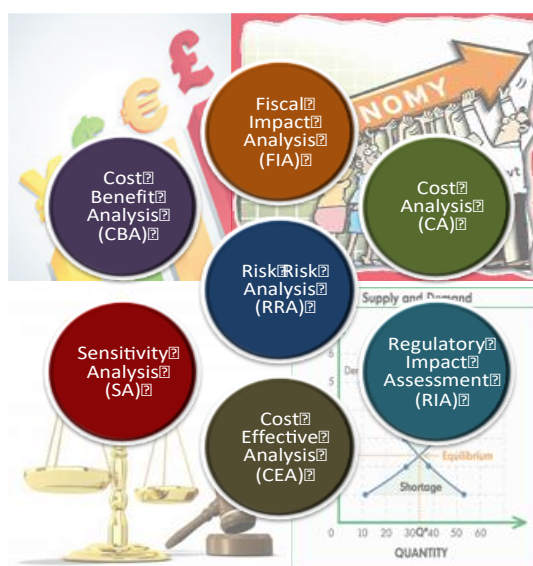
principle of EAL is to ask the following questions: (1) how much it will cost?; (2) who pays?; and (3) who ought to decide both questions?

As a result, law in the 21st century has not only been cultivated into an independent science, but has developed into a multi-dimensional science in various fields; such as history, philosophy, psychology, sociology, politics, religion, and economics.²²

B. Discussion

B. 1. Economics and Legislation

As the law and economics methodology applies economic theory to the legal practice to promote efficiency, legislation can be used as a tool to improve economic conditions in the society. The regulatory making process can utilize various techniques, such as Cost Benefit Analysis (CBA), Cost Effective Analysis (CEA), and Regulatory Impact Assessment (RIA), dependent upon the topics raised. These techniques are illustrated below:



Picture 1. Tools for Economic Analysis of Law

In order to analyze the impact of legislations in the society, these EAL's techniques rest on both qualitative and quantitative considerations. The quantitative examples may include estimates of licensing and reporting costs, reduction of loan and profitability, which have direct and indirect effects on economic growth.²³ Based on this belief, one of the most common techniques, such as CBA, has an ultimate objective of evaluating the law's costs and

²² Nicholas Mercurio, Steven G. Medema, *Op.Cit.*, p. 12-13

²³ Richard A. Posner, *Economic Analysis of Law*, *Op. Cit.*, p. 512

benefits..²⁴ As an analytical tool, CBA covers comprehensive matters while searching for variables to indicate economic efficiency. CBA quantifies the objectives of the law, and its ultimate goal is maximization of benefits and minimization of costs. Thus, the underlying ideology of CBA is the measure of quantification which is used as a decisional tool routinely applied by the executive branch as can be found in the US system through Executive Order 12866 and the Office of Management and Budget Circular A-4 in which regulatory agencies are required to perform CBA in their regulatory making process. Additionally, these requirements are based on the Paperwork Reduction Act of 1980 and Regulatory Flexibility Act of 1980 for the financial regulators, and Riegle Community Development Regulatory Improvement Act for financial regulations in the banking system.

Mathew Adler and Eric Posner provided a technical definition of maximization and stated, “it captures all that needs to be captured for being able to choose systematically and cogently through pairwise comparisons.”²⁵ The virtue of CBA is that it enables the analyst or decision maker to look at the situation globally, and provides hints at the consequences of decision maker’s actions and evaluates a government action by comparing the “future” project with the “status quo” project.

As stipulated in the Law No. 12 of 2011 Concerning the Formulation of Laws and Regulations, legislations must consider their effectiveness in the society based on philosophy, sociology, and judiciary. However, the parameter on the science of “economics” has not been explicitly embedded into the regulatory making process; thus, a concrete economic analysis of proposed legislations is seldom implemented.

B. 2. Globalization and Market Failure

It has been observed throughout history that market failure can cause catastrophic consequences in the entire financial system. When market failures occur, regulatory framework structures can be a vital contributing factor. According to Jerry Evensky, a market resembles a game. In this game, all participants ask two common questions: “What will the rules of our game be?” and “What should my strategy be?” The participants ask questions about the rules because rules of the game define the constitution of the game. Any breach of

²⁴ *Ibid.*, p.512

²⁵ Matthew D. Adler, Eric A. Posner, *Cost-Benefit Analysis: Legal, Economic, and Philosophical Perspectives*, (Chicago, London: The University of Chicago Press, 2001), p. 104

the rules or constitution will enable self-interested participants to focus on *rule manipulation*. Such manipulation would lead to a breakdown of the entire game

According to Robert W. Kolb, “the global financial market is increasingly interlinked, resulting in an extensively interconnected system.”²⁷ Globalization is “the unintended result of the actions of billions of individuals from all parts of the world over the course of time.”²⁸ Various market instruments are available for anyone in any nation to use. Other than money, there are instant electronic links with global guarantees and cross-border capital flows across nations. Through technology, one person is able to move funds to any part of the world with or without any human contact. Capital moves across the globe not by days, not by minutes, not even by seconds, but instantaneously.

According to Edmund Conway, there are five elements contributing to globalization:²⁹

1. Free Trade: The lifting of major barriers and tariffs on imports and exports;
2. Outsourcing: Cheaper production of goods and services at overseas locations;
3. Containerization: The shipment of goods at cheaper costs and improved time;
4. Liberalization: Markets worldwide opening up with free flows of capital;
5. Legal Harmonization: Laws aligning among countries across the world.

Posner stated that, “capitalism is actually a system of a regulated market.” Without government regulations, a capitalistic economy would be unable to operate. The view was simple: in the absence of legal order, markets will not grow, and economies will fail. Therefore, the rule of law is inevitable with sustained growth. In fact, law must be built into the economic system prior to any economic development. This statement refers back to the aforementioned analogy between the terms market and game, through the two famous questions by market participants: “What are the rules of the game?” and “What should my strategy be?” Without the existence of the rule of law, no system is workable.³⁰

Global financial market players comprise various types of institutions located in all areas of the world. If financial panic is stimulated, a contagion usually reverberates into a

²⁷ Robert W. Kolb, *Lessons from the Financial Crisis: Causes, Consequences and Our Economic Future* (New Jersey: John Wiley & Sons, Inc., 2011), p. 331

²⁸ Robert E. Wright, *Bailouts: Public Money, Private Profit* (New York: Columbia University Press, 2010), p. 28

²⁹ *Ibid.*, p. 163-164

³⁰ Jeffrey Friedman, *What Caused The Financial Crisis* (Philadelphia: University of Pennsylvania Press: 2011), p. 293-294

currency crisis from one country to another. According to Paul Krugman, contagion effects could trigger a crisis in places with unexplained fundamental reasons.³¹

Robert Kolb also mentioned that a systemic risk can occur due to a spillover effect from an initial shock. Direct causes may not be involved, and may not be the triggering factor.³² Failures of large financial or non-financial firms can generate severe losses. Uncertainty is then created in other sectors that are potentially subject to the same shock. Schinasi described systemic risk as,³³

The risk that a certain event will trigger a loss of economic value or confidence in the financial system that potentially result to significant harmful effects on the real economy. The danger of systemic risk events is that they are usually sudden and unexpected. The effects of systemic events include disruptions of the payment system credit flows, and destruction of asset values. Economic shocks usually follow and can also lead to negative externalities with severe disruptions in the entire financial system.

Systemic risk normally associates itself with a contagious loss of confidence spreading to all parts of the financial system beyond the original location of the shock.³⁴ One of the most destructive causes of systemic risk is market failure.³⁵ Other elements causing systemic risk include when innovative financial products are traded in the global investment community. These innovative products have the ability to cause a significant increase in the number of institutional and individual investors participating in the global financial market.³⁶ As a result, the financial market will be increasingly prone to systemic risk problems. Therefore, systemic disturbances can occur or originate throughout the market linkages. This brings about a subject on financial crises.

Since the 1600s, crises involved banking collapses, stock market collapses, and deep economic crises. Between 1870-2010, there was a total of 79 major banking crises in 14 developed countries; such as U.S., Canada, Australia, Denmark, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, and U.K. Out of the 79 major crises, there were five considered to be global financial crises as follows:³⁷ 1) the crash of 1873; 2) Baring-related crisis in the early 1890s; 3) the U.S. panic in 1907; 4) the Great Depression in the 1930s; and 5) the financial crisis of 2007.³⁸

³¹ Paul Krugman, *Currency Crisis* (Chicago and London: The University of Chicago Press, 2000), p. 47-50

³² Robert W. Kolb, *Op. Cit.*, p. 463-464

³³ *Ibid.*, p. 339

³⁴ *Ibid.*, p. 339

³⁵ *Ibid.*, p. 339-340

³⁶ *Ibid.*, p. 392

³⁷ *Ibid.*, p. 12

³⁸ *Ibid.*, p. 4

According to Robert E. Wright, there were also crises tied to real-estate and banking that occurred in Finland, France, Japan, Malaysia, Norway, Spain, Sweden, U.S., and Venezuela. During the 1980s, real estate losses were associated with banking problems in Argentina, Chile, Columbia, Ghana, Malaysia, Spain, U.S., and Yugoslavia. All of the mentioned crises had different causes from different sectors at different times across the globe.

B. 3. Law and Economics in Administrative Law

The history of financial crisis corresponds to the "law and economics movement" in the world. The correlation shows there is a definite connection between rule making and the economy. Because the purpose of jurisprudence is to analyze law and to identify the significance of the law for the society, it seeks the meaning of a particular rule and how it relates to law and the entire legal system. More significantly, a particular law can trigger a domino effect within an entire economy.

John Commons stated, "Economy influences law as the global economic system brings forth new challenges and complexities which require a legal change that has the ability to facilitate the evolution of the global market."³⁹

The perceptions of Commons statements describe the basic ideology of EAL. Any type of legal change should be the product of how law influences the economy, and how economy influences the law.

The liberalization movement in the early 1980s resulted in massive economic growth, but also economic decline. Due to the frequencies of financial crises, Administrative Law in the US, for example, experienced newfound challenges in adjusting to the globalization era. Giulio Napolitano in his publication, *The Role of the State in (and after) the Financial Crisis: New Challenges for Administrative Law*, stated that, "the State has a new economic role that will have a new political accountability model."⁴⁰ This resulted to a biggest rise of the Administrative Law system in history. The U.S. has shown its expansion of the Regulatory State with an economic and social dimension. In the European countries, the government began nationalizing banks and establishing economic programs in various financial markets.

³⁹ Nicholas Mercurio, Steven G. Medema, *Op. Cit.*, p. 101-102

⁴⁰ Giulio Napolitano, *The Role of The State in (And After) The Financial Crisis: New Challenges for Administrative Law* (US: Yale Law School, May 2009), p. 2

The financial crisis basically gave the legitimacy, command, and control system to the public. Institutions were not dismantled, and the State rescued troubled institutions.⁴¹

In the age of globalization, Administrative Law adjusted itself and focussed on economic progressiveness. In the last few decades, the State passed acts and statutes to stabilize financial institutions to restore confidence in the financial market. Measures were implemented to address the liquidity crisis of financial intermediaries, create a better institutional infrastructure, and guarantee the accountability of the State during bailout operations.⁴² Thus, the Administrative Law has considered the significance of discretionary authority within the government and independent regulatory institutions. Mark Elliott once stated,⁴³

Discretionary power is the inevitable concomitant of an interventionist state; such power is one of the principal instruments by which such intervention occurs. This follows because it is clearly impossible for Parliament to make legislative provision for each and every situation which may arise in the course of the ongoing implementation of policy.

Elliott also mentioned, “while legislation may set out the general policy and establish the central principles and criteria by reference to which the policy is to be operated, the existence of discretion is inevitable.”⁴⁴

The role of the State has expanded over the last hundred years. Thus, the use of discretionary power has exploded through various forms.

The principle of Administrative Law has proven that it is not an immovable rule. The Parliament intends the power to be exercised only by the decision maker specified in the legislation. Elliott stressed the fact that once discretion is exercised, the decision is justifiably legitimate. If the Parliament has specified that a particular agency has the right to make the decision, then the will of the Parliament must prevail. This is based on the ideology that Parliament is sovereign. The policies of the decision maker should be legitimate because the decision makers, who were designated in the legislation, were chosen because of its institutional ability and expertise. The objective of discretionary power is that the decision maker is given full authority to respond to a particular situation.⁴⁵

⁴¹ *Ibid.*, p. 2

⁴² *Ibid.*, p. 4

⁴³ Mark Elliott, *Administrative Law: Text and Materials*, Ed. Jack Beatson and Martin Matthews, 4th ed., (New York: Oxford University Press, 2011), p. 111

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*, p. 167-168

According to Tom Bingham, “when the legislative has enacted statutory regulations to a specific officer or an institution to make a particular decision, the Parliament does not empower anyone else.”⁴⁶ The global financial crisis entails complexities that have evolved in the financial market. The government is faced with daily challenges of keeping up with the rapid changes of the financial market. Sudden developments can occur at anytime, anywhere from any sector, or any country of the global market.

In addition, economic emergencies do not only change the role of the State and its relationship with the markets, but also the organization of the State and the constitutional justification of the three branches of government. Due to the nature of economy and financial market, sudden choices and decisions have to be made requiring a wide margin of discretion to the decision maker. The discretion is exercised by officials or institutions that have been chosen based on their trustworthiness.

In the U.S., Administrative Law has granted “legal protection” for the Secretary through the Economic Emergency Stabilization Act of 2008 (EESA). In this Act, any decision of the Secretary was committed to agency discretion and was non-reviewable by any court of law or administrative agency.⁴⁷

In support of the legislative body, the Administrative Court condones the new economic role of the State. Administrative judges have the responsibility to protect various interests without slowing down or paralyzing the urgent and necessary decisions to be taken. Administrative Law has become the “backbone of protection both for the recipients of these decisions and for the entire economic system.”⁴⁸

According to Jerry Evensky, “Law is a part of an evolving simultaneous system of institutions and individuals.”⁴⁹ In the age of globalization, these institutions and individuals have created the most integrated and complex global financial market with extensive cross-border operation.

With the complexities that have evolved in today’s society, the need for integrating the two sciences of law and economics has become increasingly crucial for decision makers in all levels of the government.

⁴⁶ Tom Bingham, *The Rule of Law* (London: Penguin Books, 2010), p. 60-61

⁴⁷ *Ibid.*

⁴⁸ *Ibid.*, p. 23-24

⁴⁹ Jerry Evensky, *Op.Cit.*, p. 82-83

B. 4. Law and Economics in Indonesia

As mentioned in the previous section, Administrative Law worldwide is experiencing new challenges due to the profound economic role of the State.⁵⁰ In order for Indonesia to be sustainable, there is a need to improve the legal system as it relates to the regulatory making mechanism embedding the law and economics methodology.

In order to implement EAL, an explicit insertion of the science of “economics” into the Law No. 12 of 2011 Concerning the Formulation of Laws and Regulations is required. The insertion can be based on Chapter II, Article 5, letter (d) and Article 6, Paragraph (2) which stipulate the ability to include other norms or principles; Chapter V, Article 57, Sections (1) and (2) which explains the technical requirements of an academic research paper; and Attachment 1, Point (2) which stipulates that legislations must be based on the foundations of philosophy, sociology, and judiciary. Insertions to the mentioned points can be done through Article 5, letter (d) by adding “economics”; Article 6, Paragraph (2) by adding “economic law”; and Attachment 1, Point 2 by adding “economic basis” which will all justify the insertion of EAL techniques, such as CBA and RIA, as stipulated in the Cabinet Secretary Regulation No. 1 of 2018 and Presidential Instruction No. 7 of 2017. The element of economics is therefore further justified in Chapter XIV, Article 33, of Indonesia’s 1945 Constitution. A diagram on the insertion of EAL in the Law No. 12 of 2011 is illustrated below:

⁵⁰ Giulio Napolitano, *Op. Cit.*, p. 2

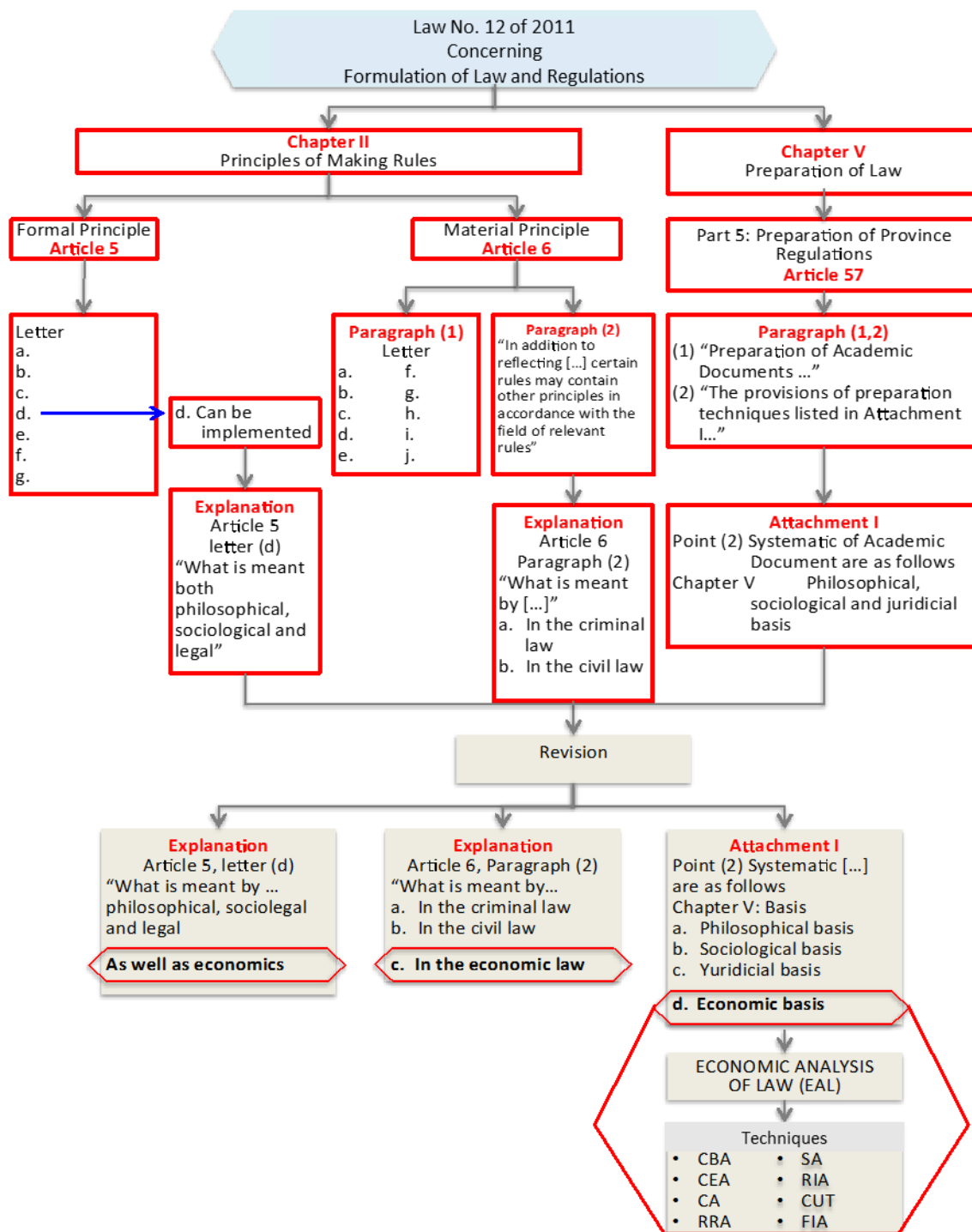


Diagram 1. Law No. 12 of 2011 and Economic Analysis of Law

As in the U.S., the President of R.I. can also establish a regulatory oversight body (ROB) consisting qualified and expert economists and legal scholars to apply economic analysis of legislations, rules, and policies to ensure that the net benefits exceed the costs of the Administration's courses of action. The ROB can provide the analytical framework for the formulation of laws to indicate social welfare maximization.

C. Conclusion

Throughout the 400 years of financial crisis, the financial market has shown its ability to generate maximum growth not through hardcore laws, but through national and international ethical codes of conduct.⁵¹ Clear and explicit laws together with a self-disciplined market culture will lead to an efficient and productive globalized financial market, resulting in social welfare maximization. Financial markets are, by their nature, resilient when they are not strictly confined by compliance, but by ethics.

EAL methodology can be used to determine efficiency and impacts showing benefits outweighing the costs; thus, providing social welfare maximization. This can be implemented as stipulated in the Presidential Instruction No. 7 Year 2017 in which all decision makers must execute an impact analysis using CBA or RIA in their regulatory making mechanism. Regulatory design requires an adequate economic analysis estimating both quantitative and qualitative social costs and benefits.

As the world experiences uncertainties during the globalization era, it is imperative for any country to integrate the sciences of law and economics in regulatory governance framework to reach a common goal: social welfare maximization.

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⁵¹ Abayomi A. Alawode and Mohammed Al Sade, "What is Financial Stability?", *Central Bank of Bahrain: Financial Stability Paper Series No. 1, March 2008*, p. 5-6

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