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COMMENT

INTELLECTUAL HISTORY AS LEGAL ANALYSIS

Yoram Margalioth†

The world's GDP per capita has grown significantly since World War II, but the distribution of wealth across countries has been extremely unequal.¹ As William J. Baumol first noted, two clusters formed: one around wealth and one around poverty.² The wealthy countries converged.³ While a number of developing countries, most notably China and India,⁴ also seem to be on the path to prosperity, other countries, home to more than one billion people, seem doomed to their poverty cluster.⁵

Economists have found that even after controlling for differences in resources, including physical and human capital, large differences in GDP per capita across countries remain.⁶ This has led them to think that the existence of differences in the quality of institutions across countries explains the persistent divergence in income per capita.⁷ Their theory's main premise is that institutions influence the form and rate of technological progress, which is the engine of sustained economic growth, and shape the incentives of economic and political agents, which are the bread and butter of economics. Because institutions are more difficult to change than economic policies, economists can treat them as state variables that explain the differences in growth rates across countries.⁸

This theory has one problem: implementation. Studies of the economic effects of institutions “remain at a very aggregate level of gen-

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¹ See, e.g., ELHANAN HELPMAN, *THE MYSTERY OF ECONOMIC GROWTH* 7 (2004).

² See William J. Baumol, *Productivity Growth, Convergence, and Welfare: What the Long-Run Data Show*, 76 AM. ECON. REV. 1072, 1072 (1986).

³ See *id.*

⁴ See *International Macroeconomic Data Set*, U.S. DEP'T OF AGRIC. (Jan. 19, 2011), <http://www.ers.usda.gov/Data/Macroeconomics/#HistoricalMacroTables>.

⁵ See, e.g., PAUL COLLIER, *THE BOTTOM BILLION: WHY THE POOREST COUNTRIES ARE FAILING AND WHAT CAN BE DONE ABOUT IT* 3–4 (2007).

⁶ Elhanan Helpman, *Introduction to INSTITUTIONS AND ECONOMIC PERFORMANCE* 1, 1 (Elhanan Helpman ed., 2008).

⁷ See DANI RODRIK, *ONE ECONOMICS, MANY RECIPES: GLOBALIZATION, INSTITUTIONS, AND ECONOMIC GROWTH* 51 (2007) (“In the long run, the main thing that ensures convergence with the living standards of advanced countries is the acquisition of high-quality institutions.”).

⁸ Helpman, *supra* note 6, at 13.

erality and do not provide much policy guidance.”⁹ What we know is that institutions are necessary to protect property rights to attract investments; enforce contracts to allow the existence of markets; impose taxes to finance the provision of public goods; regulate product, labor, and financial markets to curb fraud, anticompetitive behavior, and moral hazards; provide macroeconomic stabilization to control inflation and unemployment; create some kind of a judicial mechanism to resolve conflicts; and provide social insurance to foster social cohesion and allow individuals to take economic risks.¹⁰

All of these functions can be provided through diverse institutional forms.¹¹ Indeed, significant differences in institutional arrangements exist amongst countries with sustained economic growth. Plausibly, developing countries can gain from the experience of developed countries in building their institutions, but the design of institutions should be bottom-up, relying on local knowledge of the specific country’s economy and social norms. Similarly, the introduction to a collection of recent articles on growth economics, economic history, and political science concludes, “As is evident from reading these chapters, despite the great progress that has been made, the resulting cumulative knowledge cannot yet effectively be used to design social, political, and economic institutions that will best serve societies with varying features. However, the way is being paved toward this goal.”¹²

Chantal Thomas’s *Law and Neoclassical Economic Development in Theory and Practice: Toward an Institutionalist Critique of Institutionalism*¹³ explores this goal in three parts. Part I offers an original, provocative, intellectual history of the rise of institutional theory.¹⁴ Part II criticizes the application of institutional theory to practice, along the lines mentioned above, and offers an original criticism of an influential paper on causality.¹⁵ In part III, Thomas offers a general explanation

⁹ RODRIK, *supra* note 7, at 51.

¹⁰ For further elaboration of these claims, see JONATHAN GRUBER, *PUBLIC FINANCE AND PUBLIC POLICY* (2d ed. 2007); GARETH D. MYLES, *PUBLIC ECONOMICS* (1995); HARVEY S. ROSEN, *PUBLIC FINANCE* (6th ed. 2002); JOSEPH E. STIGLITZ, *ECONOMICS OF THE PUBLIC SECTOR* (3d ed. 2000).

¹¹ For example, private property was not legally recognized in the 1990s in China, and even today, the court system is not independent. Nevertheless, investors’ property rights were well protected through the following mechanism: investments typically took place in enterprises that were partly owned by local governments. By letting the Chinese government hold residual rights in the investment, the investors benefited from the government’s expectation of future profits, which protected them against its desire to expropriate the investment. See RODRIK, *supra* note 7, at 188–89.

¹² Helpman, *supra* note 6, at 13.

¹³ Chantal Thomas, *Law and Neoclassical Economic Development in Theory and Practice: Toward an Institutionalist Critique of Institutionalism*, 96 CORNELL L. REV. 967 (2011).

¹⁴ See *id.* at 973–1001.

¹⁵ See *id.* at 1002–18.

for the persistence of some of the implementation problems and suggests some structural improvements.¹⁶

I will compare Thomas's account with the conventional one and try to understand its implications. I will then briefly discuss parts II and III and try to answer the question raised by the conference: What is the future of legal theory? Thomas's essay suits this task well, as evidenced by its title: Thomas treats law separately from economic development and from institutions, thereby questioning the relationship between legal and economic theories.¹⁷ Law itself ("the rule of law"), of course, remains a major part of what Thomas refers to in her discussion of institutions.¹⁸

I

INTELLECTUAL HISTORY

The Washington Consensus, articulated in 1990, was meant to synthesize the reforms that most economists in the World Bank, the International Monetary Fund (IMF), the U.S. Treasury, and some of Washington's think tanks believed were necessary for sustained economic growth.¹⁹ It emphasized the importance of privatization, fiscal discipline, trade and financial liberalization, and price stability, and it is associated with "market fundamentalism"—the view that markets solve economic problems by themselves and that government intervention is destructive.²⁰

¹⁶ See *id.* at 1018–23.

¹⁷ Development, international trade, economic growth, political economy, and economic history are all separate fields of expertise in economics. They occasionally overlap, and some scholars specialize in more than one of these fields, but in their scholarly work, these scholars usually contribute to each field separately. For how the faculty in the Economics Department at Harvard define their fields of expertise, see *Faculty Directory*, HARVARD UNIV. DEP'T OF ECON., <http://www.economics.harvard.edu/faculty> (last visited Mar. 8, 2011). Legal academics do not seem to make such distinctions, and legal scholars writing in these fields seem to engage in all of the above and possibly more, often within the same paper.

¹⁸ See Thomas, *supra* note 13, at 988–89.

¹⁹ THE WORLD BANK, *ECONOMIC GROWTH IN THE 1990S: LEARNING FROM A DECADE OF REFORM* xi (2005) [hereinafter *ECONOMIC GROWTH IN THE 1990S*]; see also John Williamson, *What Washington Means by Policy Reform*, in *LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED?* 7, 7–20 (John Williamson ed., 1990) (discussing proposed reforms under the Washington Consensus). John Williamson was the economist who coined the term "Washington Consensus" in a background paper prepared in 1989. See John Williamson, *A Short History of the Washington Consensus*, in *THE WASHINGTON CONSENSUS RECONSIDERED: TOWARDS A NEW GLOBAL GOVERNANCE* 14, 14 (Narcís Serra & Joseph E. Stiglitz eds., 2008) [hereinafter Williamson, *A Short History of the Washington Consensus*].

²⁰ See JOSEPH E. STIGLITZ, *THE ROARING NINETIES: A NEW HISTORY OF THE WORLD'S MOST PROSPEROUS DECADE* 229–30 (2003); Narcís Serra et al., *Introduction to THE WASHINGTON CONSENSUS RECONSIDERED: TOWARDS A NEW GLOBAL GOVERNANCE*, *supra* note 19, at 3, 3.

The experience of the last two decades has proved the Consensus wrong. Countries that followed these suggestions most closely, such as those in Latin America and in Sub-Saharan Africa, either crashed or failed to take off. On the other hand, countries that violated most of the tenets of the Washington Consensus, such as China and India, have experienced unprecedented growth rates in the past two decades.²¹ A large body of scholarship in the first decade of the twenty-first century has explored what went wrong and what can be learned from the Washington Consensus.

According to the conventional account, the Washington Consensus predated the theory that institutions were important for economic development and ignored institutions in its policy blueprint.²² To put it in Rodrik's words:

Most of the items in [John] Williamson's original list were relatively simple policy changes (liberalize trade, eliminate currency overvaluation, reduce fiscal deficits, and so on) that did not require deep-seated institutional changes. Williamson did include "property rights" in his list, but that was the last item on the list and came almost as an afterthought.²³

Moreover, accounting for the importance of institutions would have been opposed to its market fundamentalism approach. The Washington Consensus was a reaction to the development policies of earlier decades that advocated for government intervention to correct market failures. Slow growth in many developing countries in the 1980s, especially in Latin America, created a pendulum effect that called for minimal government intervention.²⁴ According to Stiglitz

The Washington Consensus policies often assumed the worst about the nature and capability of *all* governments, . . . arguing that it was better simply to rely on markets *by themselves*. This resulted in a strong bias against basing policy advice on an analysis of what inter-

²¹ See RODRIK, *supra* note 7, at 55 ("If Latin America were booming today and China and India were stagnating, we would have an easier time fitting the world to our policy framework."); see also *International Macroeconomic Data Set*, *supra* note 4 (showing growth rates for countries in Latin America and Sub-Saharan Africa, as well as for China and India).

²² See Dani Rodrik, *Goodbye Washington Consensus, Hello Washington Confusion? A Review of the World Bank's Economic Growth in the 1990s: Learning from a Decade of Reform*, 44 J. ECON. LIT. 973, 978 (2006).

²³ *Id.*

²⁴ See ECONOMIC GROWTH IN THE 1990s, *supra* note 19 ("What for many countries had been the 'lost decade' of the 1980s made it evident that government interference in the economy—through price controls, foreign exchange rationing, distorted trade regimes, repressed financial markets, and state ownership of commercial enterprises—wasted resources and impeded growth. Hence, the logic went, rolling back the state would lead developing countries to sustained growth.").

ventions are appropriate in what contexts, or building the institutions or capacity of states to intervene effectively.²⁵

In part I of *Law and Neoclassical Development in Theory and Practice*, Thomas provides a different account of that history.²⁶ She perceives the theory of institutions as going hand in hand with market fundamentalism.²⁷ She argues that while chronologically “macro-economics” was the first stage of the Washington Consensus and “governance” was the second stage, on the theory level, they were equal.²⁸ According to her account, the neoclassical movement was merely waiting for the politically appropriate moment to consolidate its agenda.²⁹ In the appendix, she places “Good Governance” (the theory of institutions) and “Structural Adjustment” (market fundamentalism) together.³⁰

Anne Krueger, whose name appears in parentheses under “Structural Adjustment” in Thomas’s appendix, is a plausible link between the two.³¹ Krueger was the World Bank’s chief economist from 1982 to 1986.³² She was known for her academic work on rent seeking, and according to Stiglitz, she “saw government as the problem.”³³ In 2004, when the World Bank and the IMF were trying to learn from the failure of the Washington Consensus, Krueger gave a speech in which she argued that the reason the Washington Consensus failed was not that it was wrong but that it did not go far enough. She believed it should have been supplemented with institutional reform.³⁴

What is especially original in Thomas’s account of the history is her argument that the only reason that the Washington Consensus did not include institutional reforms was an obstacle in the form of a question of legal interpretation.³⁵ According to Thomas, advocating institutional reforms would have been interpreted as violating a prohibition in the World Bank’s charter against interference in the “political affairs” of borrower states.³⁶ This obstacle was removed around 1990.³⁷ According to Thomas, removing this obstacle was possible

²⁵ Joseph E. Stiglitz, *Is There a Post-Washington Consensus Consensus?*, in *THE WASHINGTON CONSENSUS RECONSIDERED: TOWARDS A NEW GLOBAL GOVERNANCE*, *supra* note 19, at 41, 46.

²⁶ See Thomas, *supra* note 13, at 937–1001.

²⁷ See *id.* at 970, 973–91.

²⁸ See *id.* at 970–71, 973–1001.

²⁹ See *id.* at 970–71.

³⁰ See *id.* Appendix.

³¹ See *id.*

³² *Anne Osborn Krueger*, WIKIPEDIA, http://en.wikipedia.org/wiki/Anne_Osborn_Krueger (last visited Mar. 8, 2011).

³³ JOSEPH E. STIGLITZ, *GLOBALIZATION AND ITS DISCONTENTS* 13 (2002).

³⁴ See Rodrik, *supra* note 22, at 977.

³⁵ See Thomas, *supra* note 13, at 970–71, 991–93.

³⁶ See *id.*

³⁷ See *id.*

due to geopolitical changes, such as the end of the Cold War, that strengthened the power of the United States and, in Thomas's words, provided "political momentum [for] development agencies [to seek] broad-based changes in the basic commitments of economic policy by the beneficiary government, a position consistent with neoclassicism."³⁸

Thomas's account of the history contradicts the story told by Williamson, who coined the term "Washington Consensus."³⁹ Williamson argued that when he prepared the list of ten reforms that constituted the Washington Consensus, he did not believe that the "'neoliberal' innovations" of the Reagan Administration and Thatcher's government had "survived the demise of the former," with the exception of privatization.⁴⁰ This does not necessarily mean that Thomas is wrong. Williamson may have been unaware of the politics that took place above his head, and, moreover, that his superiors did not share his view that neoliberalism had died.

What are the implications of Thomas's unconventional account of the history of the institutional theory? Thomas argues that since the late 1990s, development discourse has started to accommodate another perspective, which is built on a strong belief in the private market but sees an important role for the government.⁴¹ However, "[a]s of yet," according to Thomas, "the practical influence of these more moderate approaches, and their theoretical distinctness from neoclassicism, still appear debatable."⁴²

It seems that the reason Thomas is unsure about the practical influence of the more moderate views is her disbelief in the conventional narrative, which states that the World Bank made a mistake, admitted it, and has been trying to learn from it and come up with better development policies, including through a new focus on institutions.⁴³ According to Thomas's story, the Bank's new emphasis on institutions is not the outcome of learning from past mistakes but the implementation of more or less the same neoclassical ideology.⁴⁴ Thomas argues that the "learning process" by which practitioners realized their desired reforms "were ineffective without appropriate institutions and laws" was "bounded by the theoretical constraints of

³⁸ *Id.* at 992.

³⁹ *See supra* note 19.

⁴⁰ Williamson, *A Short History of the Washington Consensus*, *supra* note 19, at 15–16.

⁴¹ *See* Thomas, *supra* note 13, at 985–90.

⁴² *Id.* at 989.

⁴³ *See e.g.*, ECONOMIC GROWTH IN THE 1990s, *supra* note 19. Rodrik described this publication as "a genuinely interesting document: it represents a mea culpa as well as a way forward." Rodrik, *supra* note 22, at 986.

⁴⁴ *See* Thomas, *supra* note 13, at 970.

neoclassicism.”⁴⁵ Thomas suggests that portentous world events provided the opportunity for the neoclassical movement to expand its influence; accordingly, Thomas sees Krueger’s view as representing the true ideology of the Bank and the theory of institutions as simply a more rigorous implementation of neoclassical policy.⁴⁶

II

THE ENDOGENEITY PROBLEM

The theory that countries with better institutions will attract greater investments in physical and human capital, spur innovation, and use these factors more efficiently to achieve economic growth than countries with worse institutions seems highly intuitive. Anecdotal evidence, such as the divergent paths of North and South Korea and East and West Germany, might also support this view. Nevertheless, it is theoretically possible that causality goes in the opposite direction, namely, that rich economies choose or can afford better institutions or that good institutions and high per capita income are correlated through other factors.⁴⁷

Thomas argues that a close examination of the economic literature reveals that, in assuming that institutions are responsible for economic growth, all authors rely on one seminal paper by Daron Acemoglu, Simon Johnson, and James Robinson (AJR) that allegedly found a source of exogenous variation in institutions that allowed testing the theory that good institutions lead to high per capita income.⁴⁸ AJR “propose[d] a theory of institutional differences among countries colonized by Europeans.”⁴⁹ They found strong correlations among (a) per capita income and existing institutions; (b) existing institutions and institutions in 1900; and (c) mortality rates of soldiers, bishops, and sailors stationed in the colonies between the seventeenth and nineteenth centuries.⁵⁰

AJR argued that the (potential) settler mortality rates were a major determinant of settlements.⁵¹ In places where the disease environment was favorable to European settlement, Europeans migrated and settled, replicating European institutions with a strong emphasis on private property and checks against government power.⁵² In places where mortality rates were high, in contrast, Europeans did not settle

⁴⁵ *Id.* (footnote omitted).

⁴⁶ *See id.* at 971, 991–94.

⁴⁷ *See* RODRIK, *supra* note 7, at 185–86.

⁴⁸ *See* Thomas, *supra* note 13, at 1012–15.

⁴⁹ *See* Daron Acemoglu, Simon Johnson & James A. Robinson, *The Colonial Origins of Comparative Development: An Empirical Investigation*, 91 *AM. ECON. REV.* 1369, 1370 (2001).

⁵⁰ *See id.* at 1370–71, 1395.

⁵¹ *See id.* at 1373–74.

⁵² *See id.* at 1374.

but set up “extractive states,” which provided no protection for private property, to facilitate the transfer of as much of the resources of the colony as possible to the European colonizer.⁵³

AJR viewed mortality rates as a possible source of exogenous variation proving that the causal direction was from institutions to high per capita income.⁵⁴ They found the relationship to be robust when controlling for latitude, climate, current disease environment, religion, natural resources, soil quality, ethnolinguistic fragmentation, and current racial composition.⁵⁵

Thomas, however, makes an excellent point that many other factors could establish alternative causal relationships to the one that AJR asserted.⁵⁶ She notes, for example, that the amount of investment capital and technology that the settlers brought with them could also explain the variation.⁵⁷ AJR’s theory is intuitive, but it does not rule out the possibility that institutional quality is endogenous to income levels or that both are correlated through a third (unknown) factor.

III

IMPLEMENTATION DIFFICULTIES

Thomas argues that the rule of law is too vague a concept to provide any clear policy.⁵⁸ She further argues that the use of the term “property rights” is problematic because it is too simplistic.⁵⁹ Thomas then argues that the way the development literature currently discusses property rights reflects only one substantive neoclassical vision, without acknowledging other views (with the exception of Amartya Sen’s) and without sufficiently acknowledging their susceptibility to negative externalities.⁶⁰

There are numerous critics of the one-size-fits-all approach. Thomas cites articles, written by economists who worked with development agencies in Latin America, that describe how this approach nevertheless persists.⁶¹ Moreover, programs that were supposed to strengthen the rule of law inappropriately copied laws, lacked self-assessment, and were therefore misguided or manipulated by interest groups.

⁵³ See *id.* at 1370, 1375.

⁵⁴ See *id.* at 1395.

⁵⁵ See *id.* at 1388–95.

⁵⁶ See Thomas, *supra* note 13, at 1014.

⁵⁷ See *id.*

⁵⁸ See *id.* at 1003–05.

⁵⁹ See *id.* at 1005.

⁶⁰ See *id.* at 1005–07.

⁶¹ See *id.* at 1006–07, 1014–17.

In part III, Thomas suggests a general explanation for the persistence of these failures.⁶² She argues that the institutions of development policy suffer from the same problems they are supposed to cure, such as imperfect information, unequal bargaining power, and subjective models that would preclude individuals from perceiving institutional inefficiencies.⁶³

Thomas, therefore, calls for an “institutionalist analysis of institutionalism.”⁶⁴ In particular, she suggests improving program design by implementing mechanisms of evaluation and knowledge building by the development agencies themselves, with greater emphasis on hiring locals to do the research and the consulting work.⁶⁵ Finally, she acknowledges the inevitability that donor countries’ national interests would affect development policy, but she calls on the professional corps to establish normative pressure as a counterweight.⁶⁶

It is difficult to pin down what makes Thomas’s essay “legal” scholarship. The central theme of the paper, which is the intellectual history of institutional theory, could have been written by an economic historian.⁶⁷ Her discussion of the vagueness of the rule of law or the complexity of property rights did not require legal skills, but maybe only a legal academic would feel confident enough to make such arguments.⁶⁸ Additionally, her discussion of the interpretation of the prohibition in the World Bank’s charter against interference in the “political affairs” of borrower states is clearly a legal matter.⁶⁹ However, the essay only mentioned this; it did not pursue a legal analysis.⁷⁰ Parts II and III raise the causality argument and discuss policy implementation issues; none of them is uniquely legal.⁷¹

I think that what makes the paper legal scholarship is its inherently interdisciplinary character. Thomas does not limit herself to one specific field of expertise. The topic of institutions cuts across

⁶² See *id.* at 1018–23.

⁶³ See *id.* at 1019.

⁶⁴ See *id.*

⁶⁵ See *id.* at 1018–20.

⁶⁶ See *id.*

⁶⁷ Historians or political scientists specializing in economic history could also have written the central theme of Thomas’s essay. Specifically, Thomas mentions that the first part of the paper was influenced by David Scott, an anthropologist. See Thomas, *supra* note 13, at 971 n.22. Clearly, an economist specializing in the field of development could also discuss the change in development policies, but the type of analysis, or perhaps merely the style of analysis, performed in the first part of her essay is different from development-economics scholarship and would fit into the category of economic history. See *id.* at 973–1001.

⁶⁸ See *id.* at 1002–07.

⁶⁹ See *id.* at 970–71, 992–94.

⁷⁰ See *id.*

⁷¹ See, e.g., RODRIK, *supra* note 7, at 184–92 (discussing these issues outside of a legal context).

many fields and requires the integration of various areas in the social sciences. Nonlegal academics might be unable to provide a combination of a detailed big-picture analysis that addresses both theory and practice, such as the one provided in Thomas's essay, unless they collaborated with colleagues from other fields. Legal academics, on the other hand, would simply research whatever they thought was necessary to get to the bottom of things, using common sense to compensate for an occasional lack of specific expertise.