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0521677572 - The New Law and Economic Development: A Critical Appraisal

Edited by David M. Trubek and Alvaro Santos

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# 1 INTRODUCTION: THE THIRD MOMENT IN LAW AND DEVELOPMENT THEORY AND THE EMERGENCE OF A NEW CRITICAL PRACTICE

*David M. Trubek and Alvaro Santos*

The study of the relationship between law and economic development goes back at least to the nineteenth century. It is a question that attracted the attention of classical thinkers like Marx and Weber. And there were some early efforts to craft policy in this area; for example, under the Raj, some English Utilitarians tried to put Jeremy Bentham's ideas about law and economic progress into practice in India. But it was only after World War II that systematic and organized efforts to reform legal systems became part of the practice of international development agencies.

Initially, development agencies turned to law as an instrument for state policy aimed at generating economic growth. Starting in the 1980s, interest in the role of law in economic development grew, but it was an interest in law more as a framework for market activity than as an instrument of state power. This book argues that, starting in the mid-1990s, development practitioners approached law in a fundamentally new way – as a correction for market failures and as a constitutive part of “development” itself. As a result, “the rule of law” has become significant not only as a tool of development policy, but as an objective for development policy in its own right.

This book charts the history of this growing interest in the legal field, explores the shifting rationales behind development policy initiatives, and explores in detail the newest – and most surprising – of these rationales. To do that, we trace the history of a body of ideas about law and economic development that have been employed not just by academics but also by development practitioners responsible for allocating funds and designing projects. In this introduction, we refer to that body of ideas as *law and development doctrine*. Although this doctrine has academic roots in economic and legal theory, it is a practical working tool of development agencies.

This is not a static body of thought. Views on the relationship between law and development, and thus on the nature of legal assistance efforts, change over time. As ideas change and practices evolve, older ideas are challenged

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and a new vision crystallizes. As a result, there have been several different versions of law and development doctrine since the 1950s. In this introduction, we use the term “Moment” to refer to a period in which law and development doctrine has crystallized into an orthodoxy that is relatively comprehensive and widely accepted. While the authors in this collection employ different terms to refer to such “Moments” of crystallization, all agree that there have been three primary forms of orthodox law and development doctrine since World War II.

The first such Moment emerged during the 1950s and 1960s. Development policy focused on the role of the state in managing the economy and transforming traditional societies. Development practitioners assumed that law could be used as a tool for economic management and a lever for social change. Initially, these assumptions were largely tacit but eventually a body of theory and doctrine emerged. First Moment doctrine stressed the importance of law as an instrument for effective state intervention in the economy. It helped guide a small number of law reform projects in a few parts of the world.

In the 1980s, however, law moved to the center of development policy making and the scope of the reform effort expanded exponentially. This renewed interest in law was heavily influenced by the emergence of neoliberal ideas about development. Neoliberal thinkers stressed the primary role of markets in economic growth. As development policymakers sought to transform command and *dirigiste* economies into market systems, and integrate developing nations into the world economy, they began to see law as an important arena for policy.

Like the previous period, this was not a turn to law in general, but to a particular vision of law and its role in the economy. The particular vision of this period, however, could hardly have been more distinct from that which came before. Rather than an instrument for state policy, law was understood as the foundation for market relations and as a *limit* on the state. Of course, new laws would be needed to dismantle state controls. But, consistent with the dominant economic theory that working markets were both necessary and sufficient for growth, the primary role assigned to legal institutions was one of a foundation for market relations.

Attention shifted from the establishment of an administrative state to the core institutions of private law, the role of the judiciary in protecting business against the intrusions of government, and the need to change local laws to facilitate integration into the world economy. Not much attention was paid to regulatory law. When it was, regulation was often presented as an unnecessary intrusion on the market. Neoliberal law and development thought focused primarily on the law of the market: relatively little concern was shown for law as a guarantor of political and civil rights or as protector of the weak and disadvantaged.

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This neoliberal turn led to the Second Moment in law and development doctrine and to a remarkable expansion of the assistance effort. The first law and development efforts were small in scale, involving a few projects mostly in Africa and Latin America. The neoliberal era ushered in a massive increase in the level of investment and the scale of projects. Investments by bilateral and multilateral agencies as well as by private foundations reached into the billions. “Law and development” became big business.

The results of the neoliberal Second Moment have been analyzed and critiqued from many points of view. In this book we recapitulate and expand on some of these analyses. But the real focus of the volume is on the description, analysis, and critique of the Third and current Moment. We argue that a major shift in law and development doctrine is going on today. In the 1990s and the early years of this century, changes have occurred in development economics, assistance policy and practice, and legal thought. Neoliberal ideas have been revised and additional elements added to the definition of development. In this context, mainstream law and development doctrine has changed. This change has influenced and been influenced by shifts in development policy more generally.

This book had its origins in a consensus among the authors that emerged during a conference on “Law and Economic Development: Critiques and Beyond” held at Harvard Law School in 2003.<sup>1</sup> All of us have been studying the relationship between law and economic development, some for many years. As we prepared for the 2003 event, we all realized that a significant shift had occurred in this field during the 1990s. We gave the shift different names, we offered somewhat different explanations for the changes, and we held differing views about the possible relationship between changes in theory and changes in practice. But we all saw that something important was taking place.

We thought this shift might presage the emergence of a new paradigm and the inauguration of the Third Moment in Law and Development. Some thought that a basic change had occurred; others were not sure that the neoliberal era had really ended. Was there a new paradigm, or simply a chastened form of neoliberalism? We decided to pool our efforts to better understand this shift. The group met several times over the following year.<sup>2</sup> This volume is the result.

**“LAW AND DEVELOPMENT” DOCTRINE AS THE NODE OF THREE DISCIPLINARY FIELDS**

“Law and development doctrine” orients and explains the current practices of those who seek to change legal systems in the name of development,

<sup>1</sup> The conference was sponsored by the Harvard Law School European Law Research Center.

<sup>2</sup> The group met at the University of Wisconsin in October, 2003, and at Cornell University and the University of Toronto in April, 2004.

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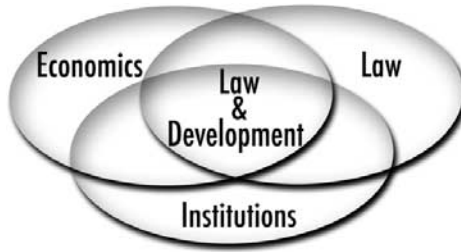
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however defined. This doctrine is more than a detailed blueprint and less than a robust theory. Our thesis is that at any point in time, the doctrine can best be understood if it is seen as the intersection of current ideas in the spheres of economic theory, legal ideas, and the policies and practices of development institutions.

These spheres are analytically separable but practically intertwined. They influence each other in complex and reciprocal ways. Both the theory and the practice of law and development are shaped by, and at the same time shape, the spheres of economic theory, legal theory, and institutional practice. The book does not suggest a relation of causality between these various spheres. Our goal is to disentangle the separate spheres, understand how each has changed in recent years, study how they have interacted, and chart the multiple dynamics of influence.



As the chart shows, law and development doctrine emerges from the intersection of economics, law, and institutional practice. Economics influences the practices and policies of the development agencies but these policies and practices may also be taken into account in shaping economic theory. So there is an area of overlap between institutional practice and economic theory. But the shape of this space is also constituted by the world of legal ideas: when economic theory and institutional practice turn to law, they must take their ideas about law from the realm of legal thought. Law and development doctrine, then, crystallizes when all three of these sources come together.

The analysis of the spheres and their interaction in the following chapters helps us chart recent changes and understand the emergence of a new vocabulary and an increasingly dominant way of thinking about development. The resulting maps are an effective guide for understanding and contesting current mainstream thought and practice.

Our authors suggest many reasons why a new law and development mainstream vision is emerging. These include changes within the field of development economics, reactions to failures of the neoliberal Moment, changing policies and practices of the World Bank and other development agencies, developments within legal theory in the center, and the spread of a new legal consciousness to the periphery.

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One of the recurring themes in this volume is the complex relationship between changes in development economics and practices and changes at any point in time in ideas about law's role in development. All the authors recognize the relationship between these bodies of ideas. They may not agree on the exact nature of this relationship but all acknowledge that at given points in time ideas from the several spheres seem to fit together and a new Moment begins.

**THE FIRST TWO MOMENTS IN LAW AND DEVELOPMENT**

We can think of the First Moment as "Law and the Developmental State." The developmental state was based on a series of assumptions that included the idea that import substitution in the internal market is the engine of growth; scarce savings must be directed to key investment areas; the private sector is too weak to provide "take-off" to self-sustaining growth; and "traditional sectors" will resist change. Foreign capital may help but it is scarce and possibly exploitative. As a result, in order to secure self-sustaining growth, the national state should create plans, reallocate surplus, combat resistance, invest and manage key sectors, and control foreign capital.

The primary use of law in the developmental state is as a tool to remove "traditional" barriers and change economic behavior. Laws are needed to create the formal structure for macroeconomic control. Legislation can translate policy goals into action by channeling economic behavior in accordance with national plans. The law is needed to create the framework for operation of an efficient governmental bureaucracy and the governance of public sector corporations. Legal rules are needed to manage complex exchange controls and import regulations.

Law and development doctrine and practice in the First Moment followed from this vision. The focus was on modernizing regulation and the legal profession. Emphasis was placed on public law and transplanting regulatory laws from advanced states. It was important to strengthen the legal capacity of state agencies and state corporations and modernize the legal profession by encouraging pragmatic, policy-oriented lawyering. Because modernization was thought to come about primarily through university training, a great deal of emphasis was placed on the reform of legal education.

The Second Moment might be called "Law and the Neoliberal Market." The development policy of the neoliberal market was based on the view that the best way to achieve growth was by getting prices right, promoting fiscal discipline, removing distortions created by state intervention, promoting free trade, and encouraging foreign investment.

The vision of law in the Second Moment was as an instrument to foster private transactions. In the Second Moment, law and development doctrine placed its emphasis on private law in order to protect property and facilitate

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contractual exchange. It sought to use the law to place strict limits on state intervention and ensure equal treatment for foreign capital.

Second Moment legal reforms were designed to strengthen the rights of property and ensure that contracts would be enforceable. Emphasis was placed on the role of the judiciary both as a way to restrain the state and to facilitate markets. It was thought that an independent judiciary using formalistic methods would provide fidelity to the law and predictability. The model was thought to be universal: markets were markets, and the same legal foundations would be needed and could operate anywhere.

#### THE TRANSITION TO THE PRESENT: THE CRITIQUE OF NEOLIBERALISM AND THE EMERGENCE OF NEW PRINCIPLES FOR DEVELOPMENT POLICY

As the last century came to an end, reactions to the neoliberal program in development economics grew stronger. Many developing and transition countries that had adopted these policies experienced severe economic crises. When it became clear that neoliberal policies were not delivering the growth that had been promised, the voices of skeptical economists became louder, and confidence in the so-called Washington Consensus that codified neoliberal policies began to erode.

The devastating experience with market-shock therapy in Russia, the severe economic emergency experienced by a number of Latin American countries, and the Asian financial crisis made clear that markets do not create the conditions for their own success. People recognized that unrestricted markets were often inefficient and that state intervention was necessary to correct such market failures as transaction costs or information asymmetries. Critics charged neoliberal policymakers for not having paid attention to existing local institutions and to timing of reforms. They noted that transplanted laws, thought to reflect best practices, often did not take hold, or produced results diametrically opposite from what was intended. They emphasized that success of economic policies could not be disentangled from local context and from concern with sequencing and pacing of reforms.

Another set of critiques questioned the exclusive focus on economic growth that had dominated development thinking. One set of critics noted that growth did not necessarily lead to poverty reduction. Others questioned the very idea that “development” should be seen exclusively as a matter of economic growth and poverty alleviation.

These critiques have led to two distinct lines of new ideas about development: the recognition of the limits of markets and the expansion of the definition of development. Mainstream development thinkers continue to stress the importance of markets as the main mechanism for production and distribution of resources in societies and as the main leverage for economic

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growth. But they now also recognize that there may be significant market failures, which could justify state intervention. Development economists no longer insist on “deregulation” of internal markets, but rather focus on introducing “appropriate regulation.” Similarly, they have come to qualify their faith in open international borders and unrestricted flows of capital and goods. While the faith in free trade is still robust, it has been qualified by recognition that countries need to pace the liberalization of their borders.

Second, there is an appeal for a reconceptualization of development that would decenter the focus on economic growth. Advocates of this view argue that development policies should broaden their scope in the pursuit of human development, of which income is only an aspect, and equal consideration should be paid to political, social, and legal development. Taken together, these multiple aspects of development aim at promoting development as *freedom*: the goal is to enhance people’s capabilities and to enable individuals to lead the life they choose to live. These objectives have been captured in the promotion of a “Comprehensive Development Framework” and in the incorporation of a social agenda in policy recommendations.

In addition to these two major efforts to rethink development, other changes occurred as academics and practitioners reflected on the limits of the neoliberal model. Thus, more stress is being put on the need to consider local institutions and to avoid one size fits all approaches. Also, there is more attention to local participation in the design and implementation of economic reforms so that local groups take “ownership” of reforms and projects. Finally, there has been a renewed interest in establishing social safety nets and focusing policy more explicitly on poverty reduction.

The new attention to the limits of markets, the effort to define development as freedom not just growth, the stress on the local, the interest in participation, and the focus on poverty reduction have helped set in motion new thinking about law and have ushered in a new Moment in law and development doctrine.

**THE THIRD MOMENT IN LAW AND DEVELOPMENT THEORY: AN EMERGING PARADIGM?**

As the critique of neoliberal policies took shape and new visions of development policy emerged, people interested in the role of law started to rethink Law and Development doctrine. As a result, a new set of ideas about law have appeared and gained support, allowing us to speak of a Third Moment in Law and Development. Unlike the first two, however, this Moment is still in a formative phase. While the basic outlines of a new vision have become clear, some aspects are still contested.

This new “paradigm” contains a mix of different ideas for development policy. These include the idea that markets can fail and compensatory



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intervention is necessary, as well as the idea that “development” means more than economic growth and must be redefined to include “human freedom.” While Third Moment doctrine embraces these broad notions, each encompasses a great range of options with very different implications for policy. Take “market failure” as a rationale for intervention. This can be construed very broadly, allowing wide scope for government intervention, or very narrowly. Similarly, while everyone is committed to including human rights in development, there is room for very different interpretations of what that might mean. For some, human rights might mean limiting state action while others might deploy a more expansive notion. The same terminology of human rights can be used to promote the interests of oppressed minorities and holders of property.

These two key ideas are not only subject to very different interpretations; they may also be deployed in ways that make them incompatible. A vision of development that embraces human flourishing as its benchmark certainly goes beyond a purely economic conception of development. Those pursuing a holistic vision of development may choose policies that sacrifice long-term growth results to avoid a decrease in or promote an increase of people’s capabilities and freedom. In contrast, those supporting a wealth maximization yardstick for development may opt for policies having a prospect for long-term growth results at the expense of investing in people’s capabilities.

Another feature that marks the Third Moment as more unsettled than the prior two periods of orthodoxy is the simultaneous presence of critique. At the same time that these new conceptions of development are taking root, a new set of critiques is also being developed. The critiques, including those presented in this book, include some of the concerns raised during the Second Moment. But the new critique adds elements unique to the present because it looks closely at the new elements of doctrine that have appeared in this Third Moment.

In addition to delineating the Third Moment vision, the authors in this book articulate a critique of this emerging orthodoxy. They use different terminologies but all agree that a new form of development doctrine is emerging.<sup>3</sup> They see that the new doctrine accepts the use of law not only to create and protect markets, but also to curb market excess, support the social, and provide direct relief to the poor. They believe that while Third Moment doctrine continues the neoliberal project of private law development, the new vision also seeks to construct an appropriate framework for regulation of economic behavior.

<sup>3</sup> All but one of the chapters focus on the description and analysis of the Third Moment although many do this in the light of a history of earlier periods. They give different names to, and different accounts of, the new orthodoxy and take different approaches to the emerging critique. For example, in describing mainstream theory David Kennedy refers to “chastened neoliberalism” while Trubek calls it “Rule of Law II,” Rittich talks about the “incorporation of the social,” Newton speaks of the “post Moment,” and Santos identifies it with the World Bank’s Comprehensive Development Framework.



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The authors note that the judiciary remains a central actor and judicial reform still is a major focus of development assistance. But they see that there are subtle differences in the role ascribed to judges in Third Moment doctrine. Now judges not only have to protect property rights and be sure contracts are enforced; they also have to be sure they interpret regulatory law correctly, protect a wider range of human rights, and contribute to poverty reduction. As a result, they cannot rely exclusively on formalist reasoning but must also deploy consequentialist thought. And since the judiciary is now linked to poverty reduction and the social, it is important to provide access to justice for those most in need.

Finally, there is some recognition that one size does not fit all. As the agencies gain more experience and the tasks ascribed to law become more complex, they at least say they are willing to accommodate local conditions and national diversities.

### Legal ideas: The Third Moment and the history of legal thought

The progress from the First to the Third Moment in law and development not only moves law to the center of development policy making; it also changes the rationale for legal development assistance. Up to now, the rationale for such assistance has been instrumental. Proponents argued that in one way or another law was a tool to bring about development, and development meant economic growth. But in the current era, the concept of development has been expanded to include law reform as an *end in itself*. Third Moment development thinkers have not rejected instrumental arguments; they still think that law is important to constitute markets and implement a host of policies. But they also see legal institutions as part of what is meant by development, so that legal reform is now justified whether or not it can be tied directly to growth.

To understand the current Moment in thinking about “law and development,” we must first look at developments within the sphere of legal theory. And to do that, we must first go back a long way in time. That is the role of Duncan Kennedy’s chapter on the globalization of legal consciousness.

Kennedy’s chapter provides a sweeping history of law and legal thought from the mid-nineteenth century to the present. He shows how several times in that period a dominant set of ideas about law and its relation to economy and society emerged and was gradually diffused around the world. He identifies three such sets of ideas or “globalizations”: the first one going approximately from 1850 to 1914, the second from 1900 to 1968, and the third from 1945 to 2000.

The first of these modes or globalizations is classical legal thought, which consolidates nineteenth-century liberal ideas about law in a market society. It stresses the importance of individual autonomy and sees the primary role of law being protection of property and free transactions. Classical legal thought

embraces legal formalism – the deduction of legal results within a coherent and autonomous legal order.

The second globalization was based on the idea of law as means to an end, an instrument to pursue social goals. In this mode, social law emerges to supplement market relations. Laws are consciously designed to achieve social ends. To pursue social welfare, law's domain expands into areas previously left to the market or the will of the parties. Because law is a means to achieve such ends, legal thought must embrace consequentialist analysis.

Duncan Kennedy's analysis helps us understand the past of law and development doctrine. The First Moment in Law and Development embraced the core ideas of social law and consequentialism while the Second or neoliberal Moment was an effort to revive the free market ideas of classical legal thought. But it also helps illuminate the present. For in his chapter Duncan Kennedy sketches a third mode of legal reasoning. He describes this third mode as an amalgam of the prior modes of legal consciousness, which incorporates two separate elements: *policy analysis* and *public law neoformalism*.

Policy analysis involves balancing the competing considerations and conflicting interests present in complex legal problems and finding a supposedly rational solution. In this mode, judges are expected to make decisions by assessing consequential outcomes out of conflicting considerations. Neoformalism, on the other hand, involves purportedly deductive reasoning by reference to rights and principles in foundational texts like treaties and constitutions. Policy analysis draws from ideas of the second globalization of legal thought while new formalism relies on ideas developed in the initial one.

This mode of legal thought emerged after World War II and has gradually diffused around the world. Many factors may account for this diffusion: Duncan Kennedy lists a number of them, including the spread of constitutional courts, the role of transnational law firms and transnational legal NGOs, the incorporation of this mode of thought in the work of international organizations, the global reach of U.S. courts, and the emergence of a transnational legal elite.

The rise of this mode of thought is a key element in the emergence of the Third Moment. Because this mode of consciousness includes attention to the social and to consequentialism, it served as one foundation for the critique of the neoliberal revival of classical legal thought and as a building block for a new form of doctrine. As it was widely diffused already, it provided cultural support for legal projects built around Third Moment premises.

### Economic ideas

The current Moment is to a great extent the result of the acknowledged failures of neoliberalism. Of course, voices on the left have pointed to the limits of neoliberalism from the very beginning. But voices from within the original mainstream have been far more influential in defining the current Moment.