5 Law, Economy, and Globalization: Max Weber and How International Financial Institutions Understand Law

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The global spread of neoliberalism suggests that Adam Smith now reigns supreme in the world of economic ideas. During the 1980s and 1990s, advanced and developing economies alike embraced privatization, deregulation, balanced budgets, and market liberalization, sometimes for domestic political reasons and sometimes at the insistence of international financial institutions (IFIs; Fourcade-Gourinchas and Babb 2002; Stiglitz 2002). Socialism, the historical alternative to capitalism, disappeared as countries in eastern and central Europe, the former Soviet Union, and China shifted to market economies. What remains are a variety of capitalisms (Hall and Soskice 2000) and developing countries, which seek capitalist economies. Market principles have been embraced not only by individual countries but also by the major organizations charged with managing the international economy and encouraging economic development. The International Monetary Fund (IMF) and the World Bank, for example, put much more trust in the invisible hand of the market than in the visible hands of the state.

Yet Adam Smith's dominance in shaping economic policy will probably not last, for how neoliberals regard law shows the growing relevance of Max Weber. Market enthusiasts now recognize the importance of the "rule of law" (e.g., Wolf 2004: 61,233). Adam Smith famously celebrated the virtues of markets and noted the importance of government in providing the law and order that markets require (Smith 1976, II: 231–2). Max Weber thought

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much more deeply about the connections between law and capitalism, and indeed many IFIs have discovered that legal institutions are a critical part of the foundation for markets. In part, they draw on neoinstitutional economists like Douglass North (1981, 1990). The neoliberalism of the IMF is already well-known (see, e.g., Stiglitz 2002), so in this essay we will consider its implicit neo-Weberianism as well. Similarly, by the 1980s the World Bank had concluded that the best strategy for combating world poverty was to encourage market-based economic growth, and it considered which institutions support markets and how law affects market growth. Careful reflection on the connections between law and markets is particularly timely given the global spread of capitalism and the global pursuit of rule of law.

As part of an expanding portfolio of concerns, many IFIs now consider law to be within their policy ambit. Corporate bankruptcy or insolvency law has been of particular interest. As private corporations operating in markets have become the primary engines of economic activity, countries have devised rules to govern what happens when those firms fail. If capitalism means hard budget constraints, bankruptcy law is the legal instrument that gives bite to those constraints. It dissolves or reorganizes corporations, offering a basis for organizational death and transfiguration. Starting in the early 1990s, bankruptcy law has been of interest to many global institutions, including the IMF, the World Bank, the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), and the United Nations (UN) Commission on International Trade Law (UNCITRAL). Until 2005 and the UN General Assembly's adoption of UNCITRAL's Legislative Guide on Insolvency, none of these institutions managed to monopolize thinking about bankruptcy law or to pull bankruptcy law within its organizational jurisdiction. Analyses, diagnoses, recommendations, and solutions proliferated as a global conversation about this law unfolded. These reached a climax within the UN, which effectively settled institutional rivalries for the time being.[1]

Here, we follow this policy conversation and use it to trace out implicit and explicit understandings about the connection between law and capitalism. The conversation is not merely academic, to be sure, because of how it shapes policy. The IMF, for example, attaches many strings to the money it lends a troubled country as part its financial rescue package (the "loan conditionalities," see Babb and Buira 2004), and these strings now often include bankruptcy law reform. The World Bank's 2002 *World Development Report* included a chapter-length discussion of judicial systems, and the Bank has

become very interested in bolstering the capacity and competence of courts. More generally, however, ideas play a critical role in shaping the kinds of alternatives among which policy makers choose, so it is important to understand their creation and promulgation (Campbell 2002).

We begin by reviewing Weber's arguments about the connection between predictable law and capitalism and the role of experts in legal rationalization. We shall next consider contemporary arguments made by IFIs about the virtues of legal predictability and transparency for capitalist markets. In many respects, these arguments reproduce some of Weber's ideas, although he is not cited. The arguments derive from neoinstitutional economics combined with practical experience. Whatever consensus there is about predictability and transparency, however, there is less agreement on how best to create them, or what the IFIs should do. It is one thing to say that rules should be predictable, and quite another to specify what they should predictably do, or whether predictability can be legislated. In addition, IFIs are considering rules in a multijurisdictional context where, in principle, each country sets its own rules. Legal pluralism complicates the situation because it means that the decision to embrace a particular rule depends not only on whether the rule has beneficial consequences (e.g., leads to more investment and economic growth) but also on whether the rule is perceived to be *legitimate*. A fuller appreciation of Weber would move the policy discussion forward and could give IFIs greater analytical purchase on the problems they face regarding law's relation to markets.

Fortunately, because the IFIs have been very interested in the specific rules that govern corporate bankruptcy, we have more than just abstract principle or philosophy to work with, and so consider the different policy proposals and interventions pursued by IFIs. These recently culminated during an intense deliberative period in which many different ideas about corporate bankruptcy law have been proposed. Although economics as a discipline has come to appreciate the importance of institutions (e.g., North 1981, 1990), the debate was largely ignited by two major events: the 1989/90 wave of transitions from command to market economies and the 1997/98 Asian financial crisis.

Weber on Predictability, Law, and Capitalism

Weber's arguments on this issue are well known in sociology and relatively easy to summarize (Swedberg 1998: 82, 90, 99, 104–5). Modern capitalism has specific institutional presuppositions that include calculable law, rational

capital accounting, freedom from irrational limitations, rational technology, free labor, and the commercialization of economic life (Weber 1981: 276–77). Capitalism requires law that can be: ". . . counted upon, like a machine" (Weber 1981: 342–43); it needs a legal system that is ". . . calculable in accordance with rational rules" (Weber 1978: 337). Hence, those who construct legal-commercial relationships (forming a corporation, borrowing money, signing a contract) know with a high degree of certainty what those relationships will entail. Because so much activity in a modern economy consists of the creation and exchange of formal property rights, the legal aspects of market activity are central.

Legal predictability contributes to rationality in that decision makers are able to know what consequences they face, and so can choose the best alternative. Rational capital accounting, the most general of the presuppositions, involves monetary valuation of assets and liabilities to measure the profitability of economic activity (Weber 1978: 91). Similarly, calculable law ensures that the *legal* consequences of economic action are also ascertainable *ex ante*.[2] As an example, Weber discusses England's patent law of 1623, the "first rational patent law" (Weber 1981: 312), and argues that the intellectual property rights it enshrined helped to spur innovation and entrepreneurship. He also notes that since medieval businessmen could not tolerate the magical formalism of Germanic law or the unpredictability of trial-by-ordeal (Weber 1981: 340–41), whenever possible they avoided unpredictable legal systems. This may help explain the origins of the *lex mercatoria,* although it does not account for the general emergence of calculable law (Swedberg 1998: 105).

The long-term trend in the West has been toward formally rational law. This "rationalization" process was neither inevitable nor self-sustaining, however. Most famously, Weber faced a problem in that England was the first capitalist economy even though common law was not very rational in a strictly formal sense (it relied on judge-made law and an unwritten constitution). According to Swedberg (1998: 106), however, Weber distinguished between formal legal rationality and calculability, and although England lacked the former it had no shortage of the latter (see Harris 2000). Weber also argued that economic rationalization led to legal rationalization (e.g., Weber 1978: 883), but the effect was only partial and indirect (Weber 1978: 654–655,892). For Weber, the strongest push for legal rationalization came from the legal specialists and professionals who have shaped law into a set of formal rules that as much as possible are complete, consistent, and logically interconnected

(Weber 1978: 776, 811). Legal rationalization has been propelled primarily by expert legal specialists, with the support of those who favor legal predictability (e.g., capitalists).

The term *presupposition* suggests that calculable law is a necessary but not sufficient condition for modern capitalism. One could have calculable law without capitalism, but not vice versa. Thus, those interested in encouraging capitalist economic growth might draw the neo-Weberian lesson that legal reform is a useful development strategy: Is law in a given country sufficiently "calculable" or "predictable"? If not, then the legal system needs improvement. Weber in effect provides an institutional prescription for calculable law. It includes formal substantive and procedural law, bureaucratically organized courts staffed by autonomous career judges, and a skilled profession. Coincidentally, it is precisely this institutional framework that the IFIs have adopted for insolvency systems, but with one additional element that Weber omitted—out-of-court procedures that operate in the "shadow of the law."

Predictable Bankruptcy Law and Unpredictable Bankruptcy

Corporate bankruptcy is one of the hallmarks of a market economy. Competition among firms means that some succeed whereas others fail, and bankruptcy law provides a way to deal with failure. If incorporation and contract are two key features that a commercial legal system offers to a market economy (Swedberg 1998: 100–102), then bankruptcy calls both the existence of a firm and the sanctity of its contractual obligations into question. Whether liquidated or reorganized, bankrupt firms fail to keep most of their legal promises. This means that bankruptcy injects considerable uncertainty into economic relationships and produces further financial losses. Bankruptcy severs the nexus of contracts at the heart of a firm.

Modern corporate bankruptcy laws typically allow for both liquidation and reorganization, although law can favor one over the other. For example, a country with a "debtor friendly" bankruptcy law will prefer corporate reorganization over liquidation. A bankrupt firm may simply close down, lay off all employees, and distribute the assets to creditors, or the firm can be reorganized so that it can return to profitable operation. Procedurally, corporate bankruptcy law determines when financially troubled companies can seek legal protection from their creditors, who may initiate proceedings, what pow-

ers corporate management retain after initiation, how much prior contractual obligations can be altered or negated, who has priority in the distribution of assets, and the procedures for corporate reorganization.

In *liquidation,* the assets of an insolvent firm aren't sufficient to repay all the creditors, so the main problem is to share the shortfall among competing claimants and distribute the assets accordingly. Creditors cannot be sure how much of the money loaned to an insolvent debtor will be recovered, but they all want to see other creditors bear the brunt of the shortfall. For a *reorganization* to work, serious corporate surgery is usually required: Labor and loan contracts need to be renegotiated to reduce wages and debts, unprofitable divisions will be closed down, onerous executory contracts terminated, and so on. The main problem for reorganization is to devise a viable rescue plan, and then put someone competent in charge to execute it (one contentious issue is whether current management should remain). Again, creditors, customers, suppliers, and other stakeholders don't know, *ex ante,* how their relationships to the reorganized firm are going to change. For both liquidation and reorganization, timing matters. In liquidations, proceedings need to begin before too much of the creditors' money is lost, and successful reorganizations need to start before the firm's situation becomes completely hopeless.

Bankruptcy law deals with market failure and its complications in an orderly fashion. Ironically, bankruptcy law is intended to manage, as predictably as possible, one critical, consequential, and inevitable form of economic uncertainty. Thus, the Weberian issue of certainty is at the very heart of bankruptcy law. With the growing importance of markets, the economic and social significance of bankruptcy law can only increase.

Certainty is not the only important issue with which bankruptcy law grapples. The distributional problem that corporate liquidation poses is one that engenders conflict among competing claimants: There isn't enough money, so who is to suffer? Do some claimants deserve more? Corporate reorganization raises politically salient issues such as employment and economic growth: Giving firms a second chance may help preserve jobs and maintain productive capacity, but it risks impairing the contractual claims and property rights of creditors and may give incompetent managers an undeserved second chance. Overly generous reorganization provisions can relax the hard budget constraints that distinguish capitalism from socialism. As we will see, the consensus in favor of certain, predictable law doesn't by itself go very far in settling the other important issues that bankruptcy poses.

Neo-Weberianism and the IFIs

Sociologists are familiar with Weber's analysis, but economists are mostly not, and however much the IFIs use academic research when thinking about law, there is almost no mention of Weber.[3] Yet the use of neo-Weberian language is striking. For instance, consider the World Bank's centerpiece document on insolvency law: "Transparency, accountability and predictability are fundamental to sound credit relationships" (World Bank 2001: 2), and elsewhere, "Effective insolvency systems include rules that are reasonably predictable, transparent and hold all parties duly accountable throughout the process. There is no substitute for clear law. A predictable law promotes stability in commercial transactions, fosters lending and investment at lower risk premiums, and promotes consensual resolutions of disputes . . ." (World Bank 2001: 25). An earlier draft document was even blunter: "What is therefore required is a clear, predictable and transparent insolvency process which affords the creditor a reliable means of calculating the consequences in the event that insolvency actually occurs. The attribute of certainty is a vital one in terms of a creditor's ability to assess and to manage risk" (World Bank 1999: 5).

Following the Asian Financial Crisis, the ADB asserted that there is a "need for certainty or predictability in commercial affairs," and also a "need for transparency" (Asian Development Bank 2000: 26). Such needs could be met by predictable law. The EBRD deals with eastern and central Europe, but it also focuses on insolvency law and has criticized the region on the grounds that "the level of [legal] predictability and transparency across the entire region is woefully low" (Uttamchandani 2004: 455). The IMF asserted that one overall object of insolvency law was "the allocation of risk among participants in a market economy in a predictable, equitable, and transparent manner" (IMF 1999: 5). Following its successful negotiation of a Model Cross-Border Insolvency Law, UNCITRAL underscored the dangers of unpredictable law: "The soundness and credibility of insolvency laws and practices are central to the efforts of Governments and regulators to enhance the operation of the global financial system. Inefficient, antiquated or poorly designed insolvency laws and practices whose outcomes are uncertain, capricious, unfair or parochial threaten the benefits of globalization" (UNCITRAL 1999:2).

International financial institutions now recognize the importance of predictable, calculable law for markets. In some respects, they are revisiting the 1960s law-and-development movement (Tamanaha 1995, Ginsburg 2000), but

with lessons drawn from the shift from socialism to capitalism and the Asian Financial Crisis. Both of these experiences forced policymakers to reorient their thinking. In dealing with the transition economies, IFIs had to consider how to get the basic building blocks of a market economy to function effectively. The Asian Crisis served as a stiff reminder that even highly successful market economies (e.g., high growth, high investment, low inflation, etc.) could still get into very serious trouble. Both the short-term diagnosis and treatment (e.g., the bailout loans and conditionalities) and the longer-term analyses put some blame on East Asian legal systems.

Recognition of law still didn't solve the problem of how to create predictable, calculable law. Western advisors to transition economies, for example, soon realized that much more is required than just writing clear, self-evident laws. Furthermore, although contemporary capitalism is global, the commercial laws that undergird it are not. National laws vary from one jurisdiction to another, and the ability to pass their own laws is a prerogative that nations are extremely reluctant to surrender. Even if the IMF or World Bank could devise one "best" bankruptcy law, it would be unrealistic to suppose that other countries would simply adopt it. Developing countries with a colonial past are especially sensitive about importing laws from former colonizers, and so even laws that are "technically" superior may be politically problematic.

Global Institutions and Corporate Insolvency

During the 1990s, IFIs realized that bankruptcy law was important and that unpredictable laws hurt economic development. However, they disagreed over how to proceed from this point of consensus. In addition to differences over the content of law, there were several reform strategies (Halliday and Carruthers 2005). One is to devise abstract principles on which all can agree, and then to allow individual countries to interpret them in a manner suitable to their own situation. This approach makes it easier to get consensus, but will result in more varied outcomes because different jurisdictions make different interpretations. Another strategy is to set standards for different aspects of bankruptcy law and to urge countries to meet those standards. This ensures a minimal degree of quality, but allows jurisdictions to go beyond those standards. Standards are harder to agree upon than abstract principles, but when successfully implemented they produce less legal variability.

Yet another strategy involves a model law. Here the challenge is to negotiate a law on which all can agree. A model law constrains the options available

to a country and results in more legal uniformity. Finally, because a number of extant insolvency laws are known to function well, another strategy would be to identify one country's law as the "best" and disseminate it. Obviously, such an option would resolve the issue of whether a particular law "worked," but it raises the problem of whether laws can simply be transplanted from one place to another, as well as the more intractable problem of whose law to transplant. In cases of importation of laws, there is also the issue of whether too much obvious deference by one state to the laws of another will be politically acceptable.

In addition to these possibilities is the important matter of how much to coordinate with the other IFIs in creating predictable law. Along with recognition of the importance of bankruptcy law came the realization that it constituted new and valuable "policy turf" and that it was advantageous to claim that turf. However much cooperation was appropriate, competition always threatened to break out. Finally, the IFIs could stress diagnosis, prescription, or both. That is, they could describe existing situations, or they could offer advice on how to solve problems, or they could do both.

Different organizations went in different directions, and only recently did a *modus vivendi* emerge. The EBRD, for example, made corporate bankruptcy law a priority for transition economies (Bernstein 2002: 3–4). Along with some other areas (e.g., secured transactions, capital markets, corporate governance, etc.), bankruptcy law was identified as having an especially big impact on national investment. In the past, the EBRD regularly conducted a Legal Indicator Survey to rate countries (Uttamchandani 2004: 454). The process of public assessment and benchmarking was intended to let countries know where problems existed. It set up comparisons with other transition economies and let interested parties such as investors know about the problems, all of which created pressure for reform.

The EBRD devised principles (*Core Principles for an Insolvency Law Regime,* see http://www.ebrd.com/country/sector/law/index.htm) about what an Insolvency Law Regime (ILR) should do, for example, "The ILR should at all times promote economy, transparency and speedy resolution." From its Legal Indicator Survey and these general standards, the EBRD derived specific diagnostic standards that it uses to evaluate countries both on their formal insolvency laws and on implementation. These standards are used for private consultations between the Bank and national authorities, and they are integrated into EBRD lending algorithms.

The EBRD publishes country assessments that allow for comparisons across countries and between a country and the general standards, but also underscore the connection between the rule of law and the transition to a market economy. For example, the 2005 assessment of Kazakhstan (http://www.ebrd.com/country/sector/law/cla/kaza.pdf) provides a systematic assessment of Kazakh commercial law, including both its "extensiveness" (the quality of law on the books) and "effectiveness" (how well it is implemented). It includes a chart illustrating the correlation between institutionalization of the rule of law and progress toward a market economy. Similar reports have been done for other countries such as Russia, Croatia, and Azerbaijan.

The EBRD produces summary documents such as *Transition Reports* and *Law in Transition* to report on annual progress so that a country's current status can be judged (e.g., Uttamchandani, Harmer, Cooper, and Ronen-Mevorach 2005). Even countries with deplorable legal systems receive some praise if there is movement in the right direction. The bank also uses its technical assistance program to fund projects supporting the development of legal capacity, predictability, and noncorruption.

Like the EBRD, the ADB is a regional development bank, and after the Asian Financial Crisis it became very interested in corporate insolvency law (ADB 1999: 7). By coincidence, the ADB had just published a study of the role of law in Asian economic development (Pistor and Wellons 1998). This is one of the few IFI documents that directly engages Weber's ideas on law and the economy, but it concludes that there is no simple relationship between the two because so many East Asian economies enjoyed dramatic economic growth even though their legal systems were problematic (Pistor and Wellons 1998: 3, 5, 26). In the rush to respond to the Asian Financial Crisis, the ADB later produced a series of less nuanced analyses, and Weber disappeared from view. But faith in the importance of legal predictability continued.

Under the auspices of the Regional Technical Assistance for Insolvency Law Reform (RETA 5795), the ADB undertook diagnoses and technical assistance in countries whose insolvency legal systems were deemed deficient. The premise behind the program was that Asian insolvency law was out of date and needed more predictability. The ADB commissioned a series of country studies, but also developed general standards: "There are a number of common, almost universal, elements associated with the creation and operation of corporations which suggest that laws concerning their financial stability and viability should be similar or should contain common identifiable basic

elements" (ADB 2000: 25). The ADB was sensitive to the charge that it was engendering legal homogeneity, and it recognized that insolvency laws were quite varied (ADB 1999: 9). Nevertheless, it believed there were underlying principles and sought to articulate them.

Consider the first Good Practice Standard: "An insolvency law regime should clearly distinguish between, on the one hand, personal or individual bankruptcy and, on the other, corporate bankruptcy" (ADB 2000: 28). This seems uncontroversial, although the next standard is not: "All corporations, both private and state-owned (with the possible exception of banking and insurance corporations), should be subject to the same insolvency law regime" (ADB 2000: 29). The second suggests that the hard budget constraints enacted through bankruptcy law should be applied generally, possibly excluding only banks and insurance companies. This standard pointedly notes that public ownership per se should not spare a firm from bankruptcy. Its rigorous application would be consequential in countries with many state-owned enterprises.

The ADB lays out a series of Good Practice Standards and then determines each country's compliance with each standard: Countries apply, apply in part, or do not apply a particular standard. No attempt is made to rank standards by importance, and there is no finer-grained classification. The entire exercise obviously helps put legal reform on the agenda by calling attention to insolvency law, and it provides a detailed evaluation for each country about where the problems lie and how that country compares with international standards. The ADB also recognizes some of the unique features that East Asia possesses. First, Asian countries traditionally do not rely on the legal system to help organize the economy (ADB 2000: 75; Pistor and Wellons 1998: 5). Many of the biggest companies are essentially family firms, and so firm governance builds on a nexus of kinship, not on a nexus of contracts. This often means that legal institutions are underdeveloped and unable to play a big role in governing economic relationships. In addition, cultural attitudes in many Asian countries steer away from formal dispute resolution methods (ADB 2000: 78); the preference is to solve problems informally and privately. Because so much of bankruptcy law is about the management of conflict, people are discouraged from using law.

The ADB and EBRD have a regional focus that undoubtedly simplifies the challenges they face. By contrast, the IMF and World Bank must take a global perspective. The World Bank attends to the long-term needs of developing economies, whereas the IMF focuses on the short-term financial situation of

its entire membership. Both became very interested in corporate bankruptcy law during the 1990s.

Although it considered bankruptcy law in the context of national financial development (World Bank 1989), the Bank's attention to insolvency law was largely provoked by the Asian Financial Crisis, combined with a growing appreciation of the importance of economic institutions. The Bank quickly sought a leadership role and, led by Gordon Johnson, it pitched its efforts at the highest level. The title of one of the early background documents (1999) reveals these ambitions: *Building Effective Insolvency Systems: Toward Principles and Guidelines*. Two years later, the Bank published its *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* (2001). The latter lists 35 principles applicable to national insolvency systems, and it repeatedly underscores the virtues of predictability and transparency. It recognizes that the principles will have to be "adapted" to the realities of developing economies, and so there will be some measure of legal variability.

The World Bank goes further than does the ADB by applying the assessment methodology of the World Bank and IMF to insolvency law through the mechanism of Review of Standards and Codes (ROSC). ROSCs are diagnostic instruments that the Bank and Fund use to appraise a country's conformity with global standards. Of a similar level of detail to the EBRD current diagnostic instrument, the World Bank/IMF ROSC goes through each major area of substantive law and institutions and rates whether a country conforms. These appraisals inform both annual Article IV evaluations of country members by the IMF and technical assistance and lending decisions.

Although there is no automatic penalty for failure to comply with the Bank's principles or their specification in the ROSCs, the Bank and Fund still retain the ultimate sanction of loan conditionality for countries in financial crisis. The Bank also relies on market forces to do its work. The Bank's principles argue that emerging market economies without effective insolvency systems will have a harder time attracting investment (World Bank 2001: 17). In other words, the World Bank doesn't need to rely on coercion because, it believes, the world's capital market will function as an enforcer: Capital will naturally flow to countries with superior legal systems. The Bank's principles offer a kind of road map to effective insolvency systems, but in the long run capital mobility will lead countries in the same direction any way.

The Asian Financial Crisis also brought the IMF's attention to bankruptcy law. Over time, the IMF's central mission has evolved to the point where its bailout loans come with a number of different strings attached. These strings

(*conditionalities*) reflect IMF understandings of what is needed to solve a country's problems. As Babb and Buira (2004) note, the IMF worried about inflation and balanced budgets in the 1960s. During the 1980s this interest expanded to make sure countries did not default on their external loans, and later to encompass market reforms and other parts of the neoliberal package. Most recently, measures against terrorism have been embraced by the IMF (at the behest of the U.S. Treasury Department). In general, the IMF has gone from insisting on macroeconomic adjustment to structural adjustment and institutional change as a loan condition. Borrowing countries no longer just worry about balanced budgets and inflation: They also have to institute policy changes. After the Asian Financial Crisis, legal reform became part of IMF conditionalities.

In the short run, the IMF's new concern about insolvency law was reflected in its loans to Thailand, South Korea, and Indonesia. The various letters of intent stipulated specific changes in corporate bankruptcy law (e.g., Government of Indonesia 1998), and particularly in the case of Indonesia, the IMF soon learned that the creation of predictable law was not a straightforward matter. After seeing a new and transparent insolvency law adopted by Indonesia, the IMF (and foreign investors) witnessed a number of surprising court rulings that demonstrated that predictable law involves much more than clearly written law on the books (Halliday and Carruthers 2005). Unfortunately, the IMF's orientation and competencies are geared toward short-term problems, and this makes it ill-suited to longer-term tasks like building effective institutions.

In addition to short-term interventions, the IMF also developed an overarching framework within which to put the specific deals it hurriedly negotiated, and this resulted in the so-called Blue Book (IMF 1999). Given that the IMF is in the business of responding to crises, the link to insolvency law lay in the IMF's perception that financial crises are made much worse without effective and predictable insolvency procedures (IMF 1999: 1). In the absence of such procedures, the IMF believes, financial crises are both deeper and harder to fix.

Unlike the World Bank, the IMF did not lay out principles. Rather, it simply articulated the key issues for insolvency law. It did not presume either to describe existing systems or to propose general standards (IMF 1999: 1). For the IMF Legal Department, the objectives of insolvency law are twofold: "the allocation of risk among participants in a market economy in a predictable, equitable, and transparent manner," and "to protect and maximize value

for the benefit of all interested parties and the economy in general" (IMF 1999: 5). To achieve these objectives, insolvency systems need a legal framework that sets out various rights and obligations and an institutional framework to implement those rights and obligations effectively. The Blue Book acknowledges the importance of a well-functioning, independent judicial system in supporting both elements, but it says nothing about how to create such a judiciary (IMF 1999: 3, 78). Most of the document consists of discussions of the key issues of substantive bankruptcy law, with summary conclusions about each issue.

The EBRD, ADB, World Bank, and IMF each encountered insolvency law at about the same time. All four had ample technical expertise and experience in financial affairs, but none had obvious jurisdiction over this particular issue. Each organization proceeded in a slightly different direction from the common premise that insolvency law should be predictable and calculable. They have been mindful of one another's efforts, acting at times like rivals and interlocutors. The ADB and EBRD systematically evaluated the laws of their member countries and have offered technical assistance to encourage legal reform. The World Bank and IMF have evaluated closely the laws of a small set of countries who were in severe financial difficulty and have linked their assessments to loan conditionalities. Increasingly they backed up their principles with precise diagnostic instruments, to the extent that all four institutions now have in place detailed mechanisms for appraising a country's insolvency system.

Behind each approach lay a series of conferences, deliberations, and meetings that brought together a small number of international experts, practitioners, and academics. Representatives from the International Bar Association (Committee J) and the International Association of Restructuring, Insolvency and Bankruptcy Professionals (INSOL) usually participated, as well. Although each organization took a distinctive approach, collectively they drew on the same small pool of high-level lawyers and accounting experts.[4] There was very little direct input either from the corporations that go bankrupt, or from the employees or creditors who suffer the consequences of bankruptcy. Nor did politicians or legislators participate. Experts and professionals overwhelmingly dominated the discussions.

The final organization we discuss, UNCITRAL, is the smallest of the group. It has, however, been the most ambitious in trying to fashion something both integrative and concrete. Unlike the others, its strengths are legal

rather than financial or economic, and it is the most "democratic" and "legislative" organization among the group. This gives it an important measure of legitimacy that the others do not possess, and it can bestow its legitimacy onto the legal products it creates. Furthermore, UNCITRAL could build upon prior success.

UNCITRAL was founded in 1966 by the UN General Assembly to harmonize laws and reduce barriers to international trade. UNCITRAL shared with others an unquestioned faith in the importance of legal certainty and predictability (UNCITRAL 2000). It is now composed of sixty member states elected by the General Assembly to represent the various regions and economic and legal systems of the world. Formal proceedings are essentially governed by "the sense of the meeting," unlike governance in the IMF or World Bank (where countries have votes weighted by the size of their financial contribution, thus empowering rich countries). Starting in 1999, in response to an Australian proposal that built on UNCITRAL's successful negotiation of a Model Cross-Border Insolvency Law, UNCITRAL's Working Group on Insolvency was revived to develop a legislative guide. A guide presents legislators with a set of broad principles to govern insolvency law and then proceeds through the main substantive topics of a national bankruptcy law, in each case laying out the goals, discussing the merits of major alternatives, and proposing recommendations. The legislative guide offers much more flexibility than do model laws because it lowers the bar of agreement from a single model standard to alternative recommendations. These are offered at differing levels of specificity, depending on the consensus reached in the working group and Commission. Although a legislative guide will not produce the degree of legal standardization of a multilateral treaty or a model law, it does harmonize legal systems around common principles and a limited number of alternatives.

Over several years, the UNCITRAL working group successfully negotiated a *Legislative Guide on Insolvency Law.* It was adopted in 2004 and is intended to help countries write new insolvency laws. It is not intended specifically for countries undergoing a financial crisis, and it does not distinguish between developed or developing economies, or between market and transition economies. The model law is available for all: "The Legislative Guide does not provide a single set of model solutions to address the issues central to an effective and efficient insolvency law, but assists the reader to evaluate different approaches available and to choose the one most suitable in the national or local context" (UNCITRAL 2005: 2). The *Guide* presents a menu of legal

alternatives and invites the country to choose what seems best. Besides the official States members of the Commission, the meetings were attended by observers from other countries and organizations. The latter included the IMF, World Bank, ADB, EBRD, INSOL, the International Bar Association, the American Bar Association, and the International Insolvency Institute, who were active participants in both the formal sessions and some of the expert sessions held between working group meetings. Thus, in addition to creating their own products, the IMF, World Bank, ADB, and EBRD participated in the UNCITRAL process.

Like the others, UNCITRAL underscored the importance of legal certainty: "An insolvency law should be transparent and predictable . . . Unpredictable application of the insolvency law has the potential to undermine not only the confidence of all participants in insolvency proceedings, but also their willingness to make credit and other investment decisions prior to insolvency" (UNCITRAL 2005: 13). Among other things, uncertain law lowers investment and raises interest rates. The *Guide* argues for countries to protect insolvency proceedings from domestic political or social influences and suggests that whatever priorities and distributions the insolvency process enshrines should preserve foremost the sanctity of prebankruptcy contracts (UNCITRAL 2005: 13). Insolvency should be a legal process that unfolds in an independent court system. In addition to detailed recommendations, alternatives, and accompanying commentary, the *Guide* acknowledges the importance of a supporting institutional framework for the proper implementation of laws. It also notes that extralegal institutions are really beyond the purview of UNCITRAL, whatever their importance.

It seems surprising that UNCITRAL was able to involve the IMF, World Bank, ADB, and EBRD, which all had their own approach to bankruptcy law and still create consensus around a global standard. In fact, the involvement of international organizations in the UNCITRAL effort depended on legitimacy (Halliday and Carruthers 2005). Although the IFIs could justify their efforts through their own pragmatic expertise and that of their expert panels and consultations, the IMF and World Bank in particular had a legitimation problem. On the one hand, both organizations are manifestly unrepresentative in their decision making because the wealthy countries contribute more money and consequently get more voting rights. Similarly, they rely on experts recruited disproportionately from advanced countries. On the other hand, because the World Bank and IMF have used coercion, via conditionalities, to

compel domestic reform, they engender a domestic political backlash. Global standards promulgated by these organizations are almost always resisted by national legislators. Regional banks, such as the EBRD and ADB, attract less opprobrium, but their scope is only regional.

The IFIs recognized the value of UNCITRAL as an authoritative venue that combined representation with expertise and in which deals could be negotiated. As a creation of the UN General Assembly, UNCITRAL had a mandate and legitimacy that none of the others could match. The voting system gave each country, rich or poor, one vote, and UNCITRAL did not use financial leverage to give countries unwelcome advice. For these reasons, the others found it useful to work through UNCITRAL, knowing that the consent of individual countries would be necessary anyway because they were the ones that would have to alter their own insolvency systems.

In fact, the convergence of the world's norm-making institutions on insolvency yielded more than even UNCITRAL initially anticipated. Whereas the IFIs gained the legitimacy of a UN deliberative body, UNCITRAL gained IFI financial leverage and the capacity to monitor the world's legal systems. UNCITRAL has, in effect, negotiated with the World Bank and the IMF to incorporate the principal recommendations of the *Legislative Guide* into the ROSCs that are used by the IFIs to evaluate national insolvency systems. In this way UNCITRAL gains a significant mechanism for enforcement of its global norms.

Neo-Weberianism and IFIs

Thus far we have shown unquestioned agreement among the major IFIs that certain, predictable law is necessary for a modern market economy. The sudden interest in law may seem surprising coming from organizations that hitherto focused overwhelmingly on financial and economic affairs, but events of the 1990s forced them to broaden their horizons and consider the legal framework for markets. We have also explained how this overall understanding has been applied to the particular case of corporate insolvency law.

Ideas about legal predictability came from different sources. World Bank thinking reflected somewhat the influence of neoinstitutional economists like Douglass North, who stress the importance of predictable property rights for long-term economic growth (North 1981). A review of the World Bank's annual *World Development Report* shows no sign of Weber's influence, however, and very little of North throughout the 1980s (he isn't even in the bibliog-

raphy). The 1989 report did cite North and the law-and-economics scholar Richard Posner in a discussion of national financial systems where the Bank stressed the need for "clear legal rules" (World Bank 1989: 85). North is discussed again in several of the reports published after the Asian Financial Crisis, although Posner is not. Evidently, the World Bank became aware of North's arguments starting in the late 1980s, but it was the Financial Crisis that forced the Bank to engage his ideas more thoroughly.[5] By contrast, the IMF seems not to have drawn upon neoinstitutional economics or other scholarly literatures, but instead learned about law from the practical experiences of lawyers and bankers. Their informants reported that unpredictable law was a problem in East Asia, and the IMF quickly incorporated that claim into its postcrisis diagnosis and prescription.

One ADB-sponsored study (Pistor and Wellons 1998) mentioned Weber's work, but almost immediately after publication the crisis hit and Weber disappeared from view. Postcrisis ADB literature doesn't cite North, either. The EBRD's *Law in Transition* publication began in 1992. No social science scholarship on law was discussed in the early years of the journal, although the focus was very much on commercial law in transition economies. Even the Autumn/Winter 1996 edition of *Law in Transition,* which highlighted the impact of law on investment (and analyzed the new Czech bankruptcy law), said nothing about why the EBRD believed calculable law to be important (EBRD 1996: 1–2).

Whatever the sources of these ideas, the evidence suggests the real limits of the neo-Weberian consensus. Agreement that predictable law is good does not by itself create predictable law, and the problem of how to enact such law has clearly been a challenge. Coordination in a multicountry, multiorganizational issue area would by itself be difficult even if all agreed on how to proceed. Furthermore, "predictability" is not a characteristic that distinguishes one particular law, for there are many predictable insolvency laws. Which version of predictable law to choose raises numerous political issues that straightforward insistence on predictability per se cannot resolve.

The inadvertent rediscovery of Weber's discussion of legal predictability necessarily leaves out important portions of his analysis. Were the IFIs to undertake a thoroughgoing exposition of his work,[6] two aspects of Weber's historical analysis of law and capitalism would seem especially relevant. First, predictable law is largely the handiwork of legal professionals and specialists. The production of formally rational law both reflects and reinforces their expertise. Second, such expert production is supported by a separate social

group, capitalists, who benefit from the predictability that such law offers. These two points raise issues that have not been fully considered by today's IFIs even as they focus on insolvency law.

The first point suggests that the creation of predictable law must involve the domestic courts and legal profession, that is, legal specialists. It is not something that can be produced by fiat through a bilateral agreement between an international organization and a national government. Although new law on the books is a tangible and public result that pleases politicians and can satisfy loan conditionalities, law and society scholars have long appreciated the difference between formal law and law-in-action. Legal predictability resides in law-in-action, not legal texts per se. Predictability in implementation necessarily depends on those who implement law, that is, the lawyers, judges, and other participants within a country's legal system. The failure to create such a system, or opposition from key professions, can render reforms ineffective (Halliday and Carruthers 2004; Halliday and Carruthers 2002). Moreover, different professions may disagree over what insolvency system best serves their own interests. Jurisdictional conflicts between lawyers and accountants, for instance, can occur not only within countries (Carruthers and Halliday 1998) but in global norm-making. IFIs understandably relied on international legal experts to produce standards and models for corporate insolvency law. This was only a first step, however, and if the IFIs want national laws to function predictably, then they will have to consider legal institutions as well as legal texts.

Several IFIs have shown some reluctance to add legal institutions to their list of responsibilities. Although the UNCITRAL, IMF, and ADB standards all acknowledge the importance of institutions, it is only the World Bank's *Principles* that elaborated them in any detail. In practice, the IMF, World Bank, and ADB have been actively involved in institution building as an element of technical assistance or as a component of their structural adjustment programs, but those attempts have been recent and not always successful.[7] Pushing reform from the outside risks impugning national sovereignty. Hence, working through UNCITRAL seemed an attractive route: Through a quasi-legislative process, the *Legislative Guide* could earn the support of individual member countries. In addition, because it was still up to nations whether to adopt the model law, they were not being "forced" to do so by foreign organizations—at least not directly. Indirectly, it is likely that the IMF and World Bank will point countries to the *Legislative Guide* in order to remedy problems that the

ROSCs reveal. Even if a country does adopt the law, however, the formal text still has to be interpreted and implemented by a domestic legal system, and this can be done creatively and variably. Whether legal reform comes through adoption of the UNCITRAL *Guide,* or on the basis of some other organization's principles or standards, the interests and capacities of domestic legal systems will determine how predictable new insolvency law can be.

The second point is perhaps more fundamental, for it raises the issue of who seeks predictability in the first place and whether predictability can be obtained through legal means. What constituency favors predictable law? In the IFI argument, it is stated as a bald and simple fact that investors (capitalists) require predictable law. But Weber's historical discussion raises doubts about such a simple assertion. Predictability is useful for some groups, under particular conditions. It may not be necessary or even desirable under all circumstances. For example, it is clear that although in 1997 and 1998 the IMF and World Bank discovered the inadequate state of East Asian insolvency laws, foreign investors had nevertheless poured money into the region for decades. Either investors were astonishingly ignorant of the true state of East Asian law, or they were able to tolerate more legal unpredictability than the IFIs gave them credit for. The ongoing inflow of capital into China, despite the manifest shortcomings of its commercial laws, again casts doubt on the idea that investors *require* legal certainty (Carothers 2003: 6, Huang 2003). Investors may, under certain circumstances, find legal uncertainty tolerable or unproblematic. Perhaps they can live with it if the rates of return are sufficient high, or it may be that they are able to devise functional substitutes and work around unpredictable law (Macaulay 1963).

Investors' need for legal predictability should be a matter for empirical investigation rather than assumption. It is also important to consider who benefits from legal *uncertainty.* A legal system that truly operates like a machine is one that affords little discretion or importance to lawyers and judges. They act like cogs and transmission belts and derive neither prestige nor power from their position. If their professional judgments are to matter, then legal rules cannot be completely deterministic or predictable. The legal profession itself may not wish to make law too certain.

Legal predictability can also pit locals against foreigners. Unpredictable law often means that extralegal considerations (politics, patronage, family ties, etc.) affect legal outcomes, and these are usually better understood by local elites than by international investors. Foreigners are more apt to miss

or overlook the informal social networks that can shape implementation and are certainly less likely to be embedded in such networks. Legal predictability, understood as a situation where the literal meaning of legal text determines how law in action unfolds, puts foreign investors and domestic actors on the same basis and doesn't privilege local knowledge or social networks. Thus, domestic interests can oppose calculable law because it undermines one of their advantages.

Locals and foreigners may also differ over how much importance to give law in the first place. The ADB proposed a cultural argument in recognizing that business elites in East Asia generally avoided the formal legal system as a way to solve problems. Asian culture values informal methods and quiet diplomacy. Because corporate insolvency necessarily involves many overt conflicts, there may be widespread resistance to IFI attempts to ensure that the restructuring or closure of troubled corporations happens in the courts.

Conclusion

It is now clear how much Max Weber can add to Adam Smith. The neoliberal agenda strongly dominates international policy making, and those who embrace it have learned that markets are not self-sustaining. Markets require institutional supports, and here IFIs recognize the importance of law. Their conception of law is too simplistic, however, consisting of a mantra-like repetition of the idea that markets require calculable law.

The process of bankruptcy is an inevitable part of a competitive market economy. Some firms do well and others poorly, and eventually the poor performers fail outright. At this point, corporate bankruptcy law disposes of the failed firm. Bankruptcy adds uncertainty to the economy because it means that economic actors can disappear or be radically transformed. Whether a firm is liquidated or reorganized, bankruptcy also means that the contractual relationships that firms enter into can be severed, violated, or transformed.

Bankruptcy law deals with the economic uncertainty that corporate failure creates. Perhaps that is why organizations so wedded to the idea that capitalism requires certainty stressed the importance of predictable bankruptcy law. Even if bankruptcy inevitably created additional market uncertainty, then at least the law that enacted bankruptcy should be predictable. Yet this conviction still leaves matters very incomplete, for it is still not clear how to create legal predictability and who will help to create such predictability. Weber is

convenient if one wants to cite briefly a famous sociologist on the importance of legal predictability, but he can be positively illuminating if used more fully to consider these unresolved questions about predictability.

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Notes to Chapter Five

1. This paper is based on (a) extensive fieldwork within each of the institutions discussed here, most notably UNCITRAL; (b) hundreds of interviews with leaders in the global movement to develop a universal standard for insolvency law; and (c) public and private documents from all institutions.

2. Legal norms ". . . convey to an individual certain calculable chances of having economic goods available or of acquiring them under certain conditions in the future" (Weber 1978: 315).

3. Pistor and Wellons's (1998) ADB-sponsored survey is very much the exception.

4. For example, of the six consultants for the IMF Blue Book, Manfred Balz is now General Counsel of Deutsche Telekom. He was a principal architect of the Russian insolvency law, a principal drafter of the new German insolvency law, and a former chairman of the Group on Bankruptcy of the European Union Council. Balz was also a member of the World Bank's Task Force on the Insolvency Initiative and consulted with the IMF on the Cambodian and Korean reforms. Jay Westbrook, Professor of Law at the University of Texas, was on the World Bank Task Force and was the Reporter on the American Law Institute's cross-border insolvency laws for the North American Free Trade Agreement. Ronald Harmer, an Australian lawyer and former president of INSOL, is a delegate to the UNCITRAL Working Group and a consultant who developed, with Neil Cooper, another former INSOL president and active member of the UNCITRAL Working Group, the diagnostic instrument of the EBRD.

5. North is a primary source for neoinstitutional economics (1981) and seems unaware of Weber's arguments about legal predictability.

6. Consider that one of the top IMF officials centrally involved in creating the Blue Book admitted to the authors of never having even heard of Max Weber.

7. For example, IMF Legal Department traditionally did the Fund's legal work but did not advise on things like development policy or structural adjustment loans until the mid-1990s.