

# THE LOGIC OF DISCIPLINE

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*Abstract.* This is the draft first chapter of a book titled *The Limits of Discipline: Global Capitalism and the Architecture of Government*, under contract with Oxford University Press. It argues that governmental reform in many sectors has been driven by a design philosophy which I call the logic of discipline. This logic is applied with the aim of restricting popular control over governmental functions that are critical to the operation of a globalized economy. It combines a deep skepticism about the reliability of democratic institutions with a naive faith in the capacity to effect significant systemic change through statutory or constitutional reform. The chapter surveys governmental reforms that are built on the logic of discipline. It questions the desirability and sustainability of this program of governmental redesign, especially after the onset of the global financial crisis.

## 1. THE LOGIC OF DISCIPLINE

This is a book about an era in governmental reform that spanned thirty years. I will call it the era of liberalization. It began, roughly, in 1978-1980, with the advent of market reforms in China, led by Deng Xiaoping; the election of British Prime Minister Margaret Thatcher, and her subsequent assault on the British planned economy; and the election of US President Ronald Reagan, and his own program of economic deregulation. Economic liberalization was at first a revolutionary doctrine, but after three decades it became an orthodoxy, promoted by center-left politicians (Democratic President William Clinton and Labour Prime Minister Tony Blair, for example) as well as those on the right. This epoch ended in 2007-2008, as the consequence of a global financial crisis that threatened to plunge the world into depression. This is not to say that the crisis threatened to unravel all of the policy changes of the preceding three decades. However, faith in the ideas that had propelled reform was shattered.

This era will be remembered as one in which markets were liberated and the role of government was constrained. Major businesses that were once operated as government enterprises -- airlines, electricity and telephone companies, mining and steel manufacturers, among others -- were sold to private investors. Government regulations that limited competition within major industries were pruned and sometimes completely eliminated. Barriers to international trade (such as tariffs on imports, as well as rules designed to discriminate against foreign goods) were reduced, as were constraints on international investment. All of these policy changes led a dramatic transformation in the structure of the global economy. In some advanced economies, the relative power of

different sectors shifted: for example, finance boomed while manufacturing declined. The cross-border flow of goods, services, and money exploded.

In this era, the market reigned over the state. Markets were booming; they were dynamic; they were hotbeds of innovation. A vast amount of intellectual energy was dedicated to the challenges of organizing new methods of commerce: devising new financial instruments, new mechanisms for matching buyers and sellers, and new methods of organizing globally-dispersed production chains. Government, by contrast, seemed to have a more limited assignment: to get out of the way. We agreed that the main goal in the public sector was to have less of it, and the main tactical question was how government could make an orderly retreat by trimming or abandoning its now-redundant appendages.

Or so we sometimes thought. In fact, governmental reform was more complicated than a simple exercise in downsizing. In many critical areas, policymakers felt compelled to invent new ways of performing basic governmental functions. Sometimes they were looking for institutional arrangements that would promote key parts of the pro-market creed (such as the need for sound money and fiscal discipline). Sometimes they were trying to reduce the adverse effects that followed from early market-oriented reforms -- for example, by creating new regulatory agencies to check the misbehavior of privatized utilities. And sometimes policymakers were responding to the pressures of the new globalized economy -- by expanding ports so that they could handle the boom in trade, or modifying their judicial systems to reassure foreign investors.

We can combine these various efforts at governmental reform and say that, taken together, they constituted a distinctive program of state renovation. This program was

not aimed simply at dismantling or shrinking the state. Rather, it was a program aimed at rebuilding government so that it would complement a liberalized and globalized economy. We will examine many of these reforms throughout this book. And we will find that each of these reform projects had more in common than the shared objective of making the global economy run smoothly. They also shared a design philosophy that I will call *the logic of discipline*.

The logic of discipline is a way of thinking about the organization of governmental functions which I will argue has been applied in many different ways over the past three decades. Briefly, the logic has two components. The first is justificatory: that is, it consists of an argument about character of government's problems, and the objectives of reform. This argument usually begins with an expression of deep skepticism about the merits of conventional methods of democratic governance, which are thought to produce policies that are shortsighted, unstable, or skewed to serve the selfish concerns of powerful voting blocs, well-organized special interests, and the bureaucracy itself. The argument ends with a call for governmental reform that will promote policies that are farsighted, consistent, and crafted to serve the general interest. (For convenience, I will call this last attribute the virtue of public-spiritedness.)

Allied to this argument about the need for reform is a second argument, concerned with tactics -- that is, about the best way of changing governmental processes to promote the virtues of farsightedness, consistency, and public-spiritedness. The tactical argument says that it is important to remove certain critical functions so that they put outside the sphere of ordinary politics. The task is one of depoliticization: that is, establishing "some sort of area of separation between politicians and certain policy

fields," so that a designated group of specialists can make decisions that would otherwise be politically impracticable. The best way of depoliticizing functions, it is thought, is to change constitutional or statute law so that the autonomy of these specialist decisionmakers is formally acknowledged.<sup>1</sup>

Here is an example of the logic of discipline at work. As we shall see in Chapter Two, one of the most important governmental reforms of the last three decades has been the reorganization of central banks, which are responsible for setting monetary policy. Previously many central banks were under the control of finance ministers, who are members of popularly elected governments and accountable to popularly elected legislatures. Under these old arrangements, it has been argued, central banks faced pressure to stimulate short-term economic activity, despite the long-term inflationary effects, and also pressure to fiddle with monetary policy too frequently. The virtues of farsightedness and consistency in policy were ignored. In many countries, the prescription was to adopt laws that recognize the formal independence of central banks, so that central bankers could make decisions about monetary policy that are sound but politically inexpedient. Here was a case for reform that was predicated on an argument about the underlying problem (myopia and instability) and an argument about the appropriate remedy (legislative change, to secure autonomy).

Central banking was hardly the only area in which the logic of discipline was deployed, as we shall see in subsequent chapters. The same reasoning applied in fiscal policy -- that is, the business of taxing and spending. Here, the attempt was made to bolster the power of Treasury bureaucrats, with the aim of curbing the impulse to over-spending; and similarly, to increase the independence of tax collectors, so they could get

on with the politically unpopular business of raising revenue. Laws were also adopted to promote the autonomy of ports and airports, so they could expand their operations to accommodate the boom in international trade and travel. This was again justified as a way of discouraging interference by politicians who (it was argued) lacked business judgment, cared little about operational efficiency, and suffered from an unhealthy habit of poaching revenues from shippers and airlines to fund politically popular programs elsewhere.

The abysmal state of public infrastructure -- roads, bridges, schools, hospitals, and so on -- was said to provide further evidence of the shortsightedness of politicians. There are many votes to be gained by building new roads and buildings, but few votes in maintaining them in following decades. The remedy (it was argued) is to delegate the function of infrastructure development to private consortia, and to provide legal guarantees that politicians will not try to interfere in their work. Similarly, if investors in critical utilities (electricity, telecommunications, or water) are worried about political manipulation of regulations that determine profitability, the remedy is to create independent regulatory agencies, structured much like independent central banks. If foreign investors are worried that national courts might bend to political pressure and refuse to uphold contracts, then the remedy is to sign treaties that create new quasi-courts that are buffered from the influence of politicians and voters.

The people who advocated reform in each of these areas were sometimes unaware that similar arguments in favor of reform were being made elsewhere. Advocates for port reform did not know that they were echoing the case for central bank independence, and proponents of independent regulatory agencies usually did not see that there was a

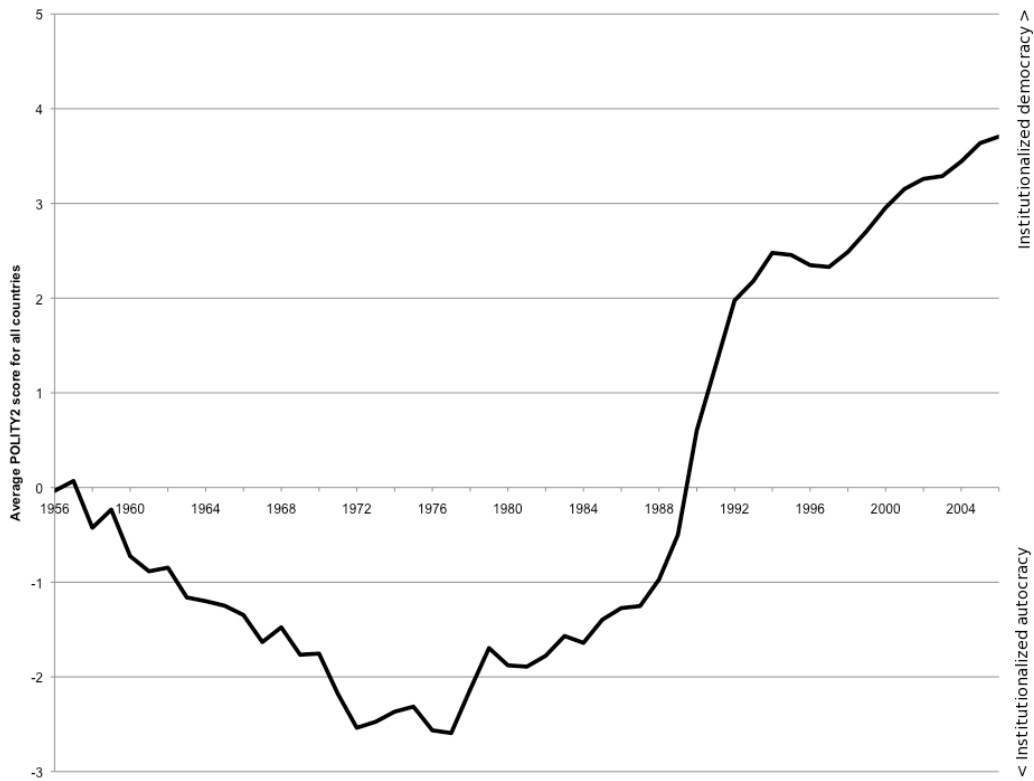
comparable argument for the "autonomization" of tax collectors. But there was a common thread that connected all of these reform campaigns. It was the logic of discipline: skepticism about the performance of democratic processes, combined with faith in the curative power of legal reform.

#### SOVEREIGNTY OR DISCIPLINE?

It might seem odd to claim that a major theme of governmental reform across the last three decades was built on skepticism about democratic processes, and a desire to buffer technocrats from the influence of politicians, voters, and interest groups. This seems to be at odds with the widely accepted view that the era of liberalization was also one of democratization -- that is, of a time in which principle of popular sovereignty was firmly entrenched.

There is a great deal of evidence that would bolster this alternative point of view. In the last three decades we witnessed the collapse of authoritarian regimes in Latin America, South Korea, the Philippines and Indonesia; the end of apartheid government in South Africa and one-party rule in Mexico; the collapse of the Soviet Union, and the integration of many of its former satellite states into the European Union. The 1990s were hailed as a decade in which democracy enjoyed an "unabashed victory" over rival forms of government. Crude quantitative measures showed the powerful swing toward democratic systems of governance (Fig. 1.1. For convenience, details about all figures are provided in the Appendix.). Students of public opinion reported a global surge in popular support for democracy as the ideal form of government. At a World Forum on Democracy held in Warsaw in 2000, representatives of one hundred governments

affirmed that it is "the will of the people [that is] the basis of the authority of government." "At long last," said the US State Department on the eve of the Warsaw meeting, "democracy is triumphant."<sup>2</sup>



**Fig. 1.1 The Polity IV measure of democratization, 1954-2004.**

Indeed, one could argue that a considerable amount of governmental reform over the last three decades was actually occupied with the task of giving effect to the proposition that "the will of the people" should guide governments' behavior. New democracies were given aid and advice on running fair elections. Parliamentarians were told how to organize legislative processes so that executives could be held properly accountable. A panoply of watchdog agencies were created help legislators: audit offices

to scrutinize revenue and spending; ombudsmen to receive complaints about bureaucratic misconduct; and commissions to investigate corruption and human rights abuses.<sup>3</sup>

Many nations also shifted power downward, so that governments would be responsive to local needs. "Decentralization was so widely adopted," says Merilee S. Grindle, "that it amounted to a structural revolution in the distribution of public responsibilities and authority in a large number of countries." Local leaders were now elected, where once they had been appointed. They were given substantial responsibilities such as education and economic development, and also the power to levy taxes for local projects. Decentralization, it was hoped, would allow more people a role in policymaking, increase accountability, and entrench the democratic virtues in everyday life.<sup>4</sup>

Governments were in the throes of a "transparency revolution" as well. Laws to reduce governmental secrecy spread quickly around the globe. Between 1980 and 2007, over sixty countries adopted laws roughly modeled on the U.S. Freedom of Information Act, which gave citizens the right to ask for internal documents prepared by public officials. The right to information was closely linked to the democratization project, as the Supreme Court of India explained: "Where a society has chosen to accept democracy as its creedal faith, it is elementary that its citizens ought to know what their government is doing. . . . It is only if people know how government is functioning that they can fulfill the role which democracy assigns to them." Other mechanisms were also used to increase openness, such as laws to discourage corruption by compelling disclosure of property owned by senior officials, and laws to protect employees who reveal information about waste and misconduct.<sup>5</sup>

"Citizens and organizations have become increasingly vocal in recent years," a 2001 report by the Organization for Economic Cooperation and Development (OECD) warned. "Governments are under pressure to relate to citizens in new ways." Several new democracies adopted administrative procedure laws that compel bureaucracies to allow public comment before rules are issued. More adventurous jurisdictions experimented with citizen assemblies, citizen juries and deliberative polls -- experiments in which randomly selected samples of "ordinary citizens" meet to debate government policy -- to address major questions such as reform of electoral systems and (in Australia) the removal of a head of state. In the developing world, citizens were encouraged to collaborate with watchdog agencies in "participatory audits" of government bureaucracies.<sup>6</sup>

Citizens also challenged the state's monopoly over provision of critical services. "The relationship between state and citizen has changed," British Prime Minister Tony Blair told his Labour party supporters in 2004. "People have grown up. They want to make their own life choices." The idea of creating options in the fields of elementary and secondary education, healthcare, and pension provision acquired increasing popularity. This shift in policy was said to be propelled by demographic change. "Today's young people," Andrei Cherny argued in 2000, "[have] a central unifying ethic all their own: that of *choice* . . . [They were] born at a time when they had more choices to make with fewer restrictions than ever before in history and bred with an overwhelming desire to make these decisions for themselves in every part of their lives."<sup>7</sup>

Here, then, was a bundle of institutional reforms, all broadly adopted, and promoted in the name of popular sovereignty. They advanced the democratic virtues --

participation, transparency, accountability, responsiveness. And in addition to this they built upon a deep skepticism about the trustworthiness of old governing elites -- including political executives and legislators, senior bureaucrats, and experts within government agencies. It was widely argued that we had entered a new populist era, in which "the wisdom of crowds", rather than the special knowledge of elites, deserved celebration. "Groups are remarkably intelligent," said James Surowiecki in 2004, "and often smarter than the smartest people in them. . . . There's no reason to believe that crowds would be wise in most situation but suddenly become doltish in the political arena." <sup>8</sup>

Indeed, populist rhetoric became so commonplace by the end of this era that it alarmed some observers. In 2007 Andrew Keen lamented the rise of the "the cult of the noble amateur", which he thought was encouraged by the leveling effect of information technologies and marked by extreme hostility toward any claims of expertise. The challenge of governance, said John Lukacs in 2005, now arose from a virulent new form of populism, unchecked by the institutions that traditionally assured reason and justice in public affairs. This was held to be a problem outside the developed world as well. "India is no longer a constitutional democracy but a *populist* one," said Ramachandra Guha, regretting "the decline of Parliament and of reasoned public discourse in general." <sup>9</sup>

Anyone who wants to make a case for the logic of discipline must confront this daunting body of evidence, all of which tends to support the view that the prevailing winds favored a contrary dogma, the logic of sovereignty, rooted in distrust of governing elites. In fact, we are not really obliged to subscribe only to one view or the other. It would be more accurate to say that the two logics operated simultaneously, and often in opposition to one another; and that the consequence was to produce a system of

governance in which the principle of popular sovereignty was broadly affirmed, even as certain functions were subjected to the process of depoliticization. In some instances, too, attempts to pursue the logic of discipline were compromised precisely because of the failure to anticipate the strength of an opposing movement dedicated to the advancement of sovereignty.

The critical beginning point is a recognition that the renaissance of democratic values in the last decades of the twentieth century was always countered by an equally robust skepticism about the efficacy of liberal democratic systems. The nadir for the major liberal democracies came in the mid-1970s. All of the major democracies were struggling, unsuccessfully, to reverse stagnant economies, and several were also struggling to contain pressures for the recognition of minority populations, and problems of domestic and international terrorism. The United States itself had been traumatized by a string of political assassinations, a sharp rise in domestic terrorism and crime, and a constitutional crisis that ended with the resignation of its President.

"Liberal democracy is in serious trouble," Scotty Reston wrote in 1975. Reston was an editor and columnist for the *New York Times*, and one of the most influential journalists in the world in the early 1970s. "We are living in a time of widespread doubt about the capacity of free societies to deal with the economic, political, and philosophical problems of the age . . . There is a kind of counter-revolution against liberal democracy now going on in the world."<sup>10</sup>

This was a grim assessment of the state of liberal democracy. But it was affirmed in the same year in an expansive report by three prominent political scientists -- Samuel Huntington, Michel Crozier and Joji Watanuki. (The report's cover had an ominous

picture of a waving flag caught in a sniper's hair sight.) "The crisis of democracy," as they called it, was in an odd way the product of its success. Traditionally, the effective operation of democratic political systems depended on "apathy and non-involvement" on the part of many individuals and groups. In the preceding decades, however, a resurgence of faith in democratic and egalitarian ideals had stirred many of these marginalized individuals and groups to action. "The democratic expansion of political participation," Huntington and his co-authors concluded, had "generated a breakdown of traditional means of social control, a delegitimation of political and other forms of authority, and an overload of demands on government, exceeding its capacity to respond." The "overload thesis", as it came to be known, gained popularity among conservative thinkers as a explanation of the malaise of the 1970s.<sup>11</sup>

While conservative political scientists such as Huntington led an assault on one flank of the liberal democratic state, conservative economists mounted a charge on another. Their method consisted largely of asking what sort of behavior would be expected if individuals in the public sector -- politicians, bureaucrats, interest groups and voters -- were assumed to behave just like individuals in the market place -- that is, with an acute sense of their own self-interest and a sharp understanding of how the game (the business of governing) should be played to improve their position. ("The basic behavioral postulate," says Dennis Mueller, "is that man is an egoistic, rational, utility maximizer.") The body of scholarly work that applied economists' tools to problems of governance became known as Public Choice theory, and it gained a wide readership in the 1970s and early 1980s.<sup>12</sup>

The Public Choice perspective on political action was rarely flattering. Politicians, it was assumed, are fixated narrowly on maximizing votes in the next election, rather than the pursuit of broad programs or ideologies. To win elections, politicians must cater to voters who are themselves fixated on their material interests, but vary in their ability to protect those interests. It is typically easier to mobilize a small number of individuals, each of whom are sharply affected by government policy, than to mobilize a large number of individuals who are mildly affected. The result is that politicians give disproportionate to the well-organized few. To deliver on their promises, politicians must rely on government agencies. But the bureaucrats who lead these agencies are themselves preoccupied with maximizing their budgets and perquisites, and often collude with their agency's clients to pressure politicians for more money than they really need.<sup>13</sup>

The Public Choice diagnosis proceeded from different premises than that of conservative political scientists -- looking at the motivations of players within the system, rather than broad societal transformations -- but in the end produced a similarly bleak view of the predicament of liberal democracies. The governmental system was myopic -- largely because of the fixation of politicians on elections. It was biased toward constant expansion, because of pressure from organized interests and pandering by elected leaders. And it was ossified, because of resistance from powerful bureaucrats and the political influence of their clients. Public Choice theorists were not inclined to use the political scientists' terms, but their view was also one in which liberal democracies wrestled with problems of overload and declining "governability."

The two camps also agreed that the best way of restoring the health of liberal democracy was to impose firm checks against the destructive tendencies that were inherent within it. If Huntington and his colleagues were right in concluding that "an excess of democracy means a deficit in governability," then the survival of the political order clearly required "more self-restraint on the part of all groups," -- or, in the alternative, the establishment of "limits to the indefinite extension of political democracy." Public Choice theorists, meanwhile, also favored similar constraints -- such as new constitutional rules to limit spending and taxing, so that government budgets would not be left "adrift in the sea of democratic politics." Some "external and superior rule" is necessary, James Buchanan argued, "to forestall the persistent demands for an increased flow of public spending benefits." Constraints were also needed to control self-aggrandizement by bureaucrats and public service unions, and minimize "political micro-management" aimed at distributing patronage to powerful constituencies.<sup>14</sup>

It is clear, therefore, that enthusiasm for popular sovereignty in the last quarter of the twentieth century was hardly unabashed. There was, at the same time, a sharp appreciation of the perceived dangers of unconstrained sovereignty -- of what we might call the "systemic risks" inherent in the liberal democratic system of governance. The collision of these two viewpoints produced a new understanding of how liberal democracies should be constructed if they were to avoid problems of ungovernability. It was still possible, therefore, to say (as the US Department did in 2000), that democracy had finally "triumphed" in the last quarter of the twentieth century. But our understanding of what democracy *meant* also shifted significantly in those years.

The formula, briefly, was sovereignty within limits. Mechanisms for participation and oversight of the state could be improved, but at the same time the sphere within which public opinion had a direct effect on the content of policy would be reduced. This was most obviously true with regard to state intervention in the economy. Government's role in economic affairs was now understood to be strictly confined. It might set a "framework" for the operation of a capitalist economy. But it no longer operated major industries such as steel, energy or transport -- the sectors that politicians of the left had once called the "commanding heights" of a planned economy. Nor did it regulate other sectors rigorously. Economic intervention was understood to be forbidden territory; the scope of state action was thus constrained.<sup>15</sup>

There is also a second way in which sovereignty is limited. Even within the state apparatus itself, constraints are imposed. There are certain things which (it is hoped) will be put above popular influence. For example, we establish rules that will force discipline in spending, and strengthen Treasury departments to enforce those rules. We create depoliticized organizations to control monetary policy; independent agencies to administer what is left of the regulatory function; autonomous organizations to collect revenue and run our ports and airports; private consortia to provide basic infrastructure; and new international quasi-courts to enforce trade and investment rules. These reforms repudiate the language of popular sovereignty. They involve the imposition of limits on choice; the empowerment of new technocracies; and a deliberate buffering of certain arms of the state from the mechanisms that provide voice to popular opinion.

The way in the influence of popular sovereignty is constrained is not indiscriminate. The aspects of governmental activity that I have just described have

something in common. In one way or another they all relate to tasks that must be performed properly if a nation is to survive, and thrive, in a globalized economy. A nation that cannot maintain discipline in fiscal and monetary policy will lose the confidence of globalized financial markets. A nation that cannot demonstrate its impartiality in regulating businesses, or in adjudicating trade and investment disputes, will find itself unable to lure foreign investment. A nations whose ports and airports are decrepit cannot participate in the global trade of goods and services.

One study of recent governmental reform in the United Kingdom observes that the Labour government in power since 1997 "has been unable to explain why depoliticization has been accepted as a legitimate model of governance in some sectors but not others. This has resulted in a typically British patchwork of asymmetrical depoliticization." But it is neither a patchwork nor unique to the United Kingdom. The logic of discipline is most likely to applied to those aspects of government whose performance is critical to the smooth functioning of globalized markets. (We might say, in an inversion of the socialist phrase, that the logic is applied to the "commanding heights" of the state structure itself.) If this test is not met, the logic of discipline is less likely to be applied, and reforms that are wholly antithetical to the logic of discipline might be pursued. In education and healthcare, for example, recent reforms have often been concerned with the extension of political control over service delivery, and weakening of the power of professionals within those domains -- a program of politicization, rather than depoliticization.<sup>16</sup>

In the United States, it is often argued that the national government is "bifurcated" -- that is, it is essentially two discrete systems combined in one government. The

conventional way of thinking about this split is to suggest that there is one part that deals with domestic policy, in which policy influence is broadly diffused; and another part, dealing with foreign and defense policy, in which power is concentrated in the hands of the President and the national security apparatus. The latter area is "deliberately shielded from the effects of democratic debate," Eric Alterman argues, "with virtually no institutionalized democratic participation."<sup>17</sup>

The analogy will be clear. The advance of global capitalism has had a comparable effect on the administrative structures of many national governments. In a sense, all governments are now divided: there are certain tasks, essential to the operation of globalized markets, that are organized in distinctive ways, so that they will be buffered from popular influence or the vagaries of judgment by political leaders.

#### THE LIMITS OF DISCIPLINE

The preceding discussion might create the impression that there is a neat settlement about the way in which government should be organized in the era of global capitalism. This is not the case. The question of how government should be structured, and where the logic of discipline should be applied, is the subject of ongoing political debate. Or perhaps we should say debates; because there is not one single grand argument about the need for discipline. There are, instead, a series of arguments about the need for reform in a particular sector, or about the need to preserve reforms already undertaken. In each sector we can find different stakeholders advancing the same logic. Financial institutions apply it in the field of monetary policy; Treasury officials and international lenders apply it in the field of fiscal policy; shippers and airlines apply it in

the field of transportation; private utilities apply it in the field of regulation and investment protection; and so on. The logic of discipline is advanced by powerful interests in the areas that matter most to them.

Similarly, we should not overstate the coherence of the rhetoric that is deployed by advocates of discipline in different fields. My argument is that there are strong substantive commonalities in the way that reform is justified. But the commonalities often go unrecognized by the stakeholders themselves, and certainly none would refer to a "logic of discipline" itself. Arguments about reform are usually messy. Elsewhere I have argued that the process of building such arguments is one of *bricolage*, that involves the cobbling together of already-familiar ideas in order to bolster the case for some new reform.<sup>18</sup>

And there is certainly ample material for *bricolage* here. Arguments about the dangers of amateurism in government go back to Plato's *Republic*. (See the epigraph to this book.) The Progressive movement in the United States in the early years of the twentieth century was also concerned with the depoliticization of core governmental functions, especially in local government, although Progressives would not have phrased it in this way. And many constitutional democracies rely on autonomous bodies to monitor elections, safeguard human rights, and assure the rule of law. So the case for constraints on sovereignty is not unfamiliar. The challenge for the stakeholders I described earlier was to make the case for similar limitations in the field of economic affairs. And they were required to do this in the face of stiff resistance from other individuals and organizations who felt empowered by the apparent renaissance of democratic values in the waning years of the last century.<sup>19</sup>

In short, the campaign for discipline has not been a monolith: it has been dispersed in structure and often varied in form of argument. Moreover it has often failed to accomplish its goals. A major aim of this book is to examine the instances in which the logic of discipline has been defeated, or compromised, or discredited, or rendered irrelevant by changed economic conditions. While thinking about the setbacks which advocates for discipline have encountered, it is useful to break recent history into two periods. We can say something about the troubles that the campaign for discipline encountered *before* the advent of the global economic crisis, whose beginning we can put roughly in the summer of 2007. And we can say something about the distinct set of troubles that the campaign for discipline encountered during the crisis itself.

Before 2007, advocates of discipline had learned something about the limits of a reform strategy that put heavy emphasis on the reform of governmental systems through legal change. I said earlier that the logic of discipline contained a tactical argument which said that the best way to promote the virtues of of farsightedness, consistency, and public-spiritedness was to impose constraints on democratic processes, either by foreclosing certain choices entirely (as balanced-budget rules do) or by transferring authority over certain choices to specialists who are protected from political interference. We shall see that these constraints were often contained in new statutes (such as those assuring the autonomy of independent regulators), or in constitutional amendments, or in contracts or treaties. Advocates of discipline had great faith in the ability to reform governmental processes through the adoption or modification of legal instruments.

Many of these advocates described themselves as "institutionalists." In adopting this label, they meant to convey the message that they understood the critical importance

of "governing institutions" to long-run economic development. Before the 1990s many development specialists, particularly those affiliated with major organizations like the World Bank, paid little attention to the way in which the design of state institutions affected economic growth. But this changed in the 1990s. The World Bank in particular developed an enthusiasm for the improvement of "institutional capability" in poorer nations. This shift was encouraged by scholarly work such as that done by the economist Douglass North, who emphasized the way in which institutions influenced economic performance.<sup>20</sup>

However, there was a critical difference between North and the groups that were engaged in the campaign for discipline. North defined the term "institution" broadly, to include informal constraints such as norms of behavior, codes of conduct, and conventions that are "part of the heritage we call culture." Many other scholarly proponents of the "new institutionalism" (as it came to be known) took a similarly broad view of what an institution is. A skeptical view about the possibility of institutional change flowed naturally from this broad definition. "Formal rules may change overnight," North warned in 1990, but "informal constraints embodied in customs, traditions and codes of conduct are much more impervious to deliberate policies."<sup>21</sup>

Advocates of discipline purported to march under the banner of "new institutionalism" but often took a much narrower view of their assignment. They were concerned with the formal-legal aspects of governance: constitutions, treaties, laws and contracts. They were not much concerned with "informal constraints" on behavior. And because they had a reduced view of what institutions were, they took a relatively upbeat

view about the ease with which institutions could be changed. For reasons that will shortly become obvious, I will call this *naïve institutionalism*.<sup>22</sup>

Naïve institutionalism had advantages for three key constituencies: advocates of reform, target governments, and a certain range of scholars interested in studying the effects of reform. For proponents of reform, a formal-legal approach had the advantage of efficiency and simplicity. Legal reforms can be communicated easily from one country to another, and adoption can be a quick process, if executives and legislators are properly motivated. Governance reform becomes a matter of "technology transfer" from richer to poorer countries. By contrast, any reform approach that takes informal constraints seriously is bound to require more time for assessing the particular conditions of a particular country, and is more likely to require the invention of a tailor-made remedy that involves a long-term commitment of effort to execution. Reformers who face time and resource constraints are unlikely to find this an appealing prospect. Hence the reversion to naïve institutionalism, which offers the promise of change in the "short to medium-term perspective."<sup>23</sup>

Formal-legal changes are also observed more easily than changes to informal constraints. This, too, has advantages for reform advocates, who may face pressure within their own bureaucracies to demonstrate success in advancing reform. For the same reason, target governments will also emphasize formal-legal changes if their primary purpose is to signal to other governments, or investors, that they are serious about reform. Finally, observability creates temptations for scholars interested in undertaking studies of the ways in which reforms are diffused among countries, or the impact of reforms. Scholars may recognize the limitations of formal-legal reform: but as

we will see, there is an overwhelming temptation to focus on easily measured phenomena.

Despite its attractions, there was ample evidence even before the era of liberalization that a strategy of reform that emphasized only the formal-legal aspects of governance was unlikely to succeed. In the United States, an extensive scholarly literature was produced in the 1970s to explain why the legislative initiatives of the Great Society era failed to produce significant social change: the prevailing theme was that good intentions expressed in law can easily be defeated in the "implementation phase" by powerful political, bureaucratic and socio-economic forces. In the same period, the US legal community undertook a substantial campaign to "modernize" the legal systems of poorer countries by exporting techniques of legal education, legal practice, and judicial administration. The program was bolstered by money provided by the US government, which was eager to build alliances with developing states during the Cold War. By the mid-1970s, however, this reform program was widely regarded as a failure, flawed by a lack of understanding of political, economic and social conditions in the targeted countries.<sup>24</sup>

The advocates of discipline, largely unaware of this history, were doomed to repeat it. As we shall see, attempts at formal-legal transformation were often affected by political or socio-cultural factors whose power had not been appreciated by advocates of reform. In rare instances these factors actually favored reform, providing a buttress that went unacknowledged in subsequent analyses of the reform process. More often, however, these factors frustrated reform, or defeated it entirely.

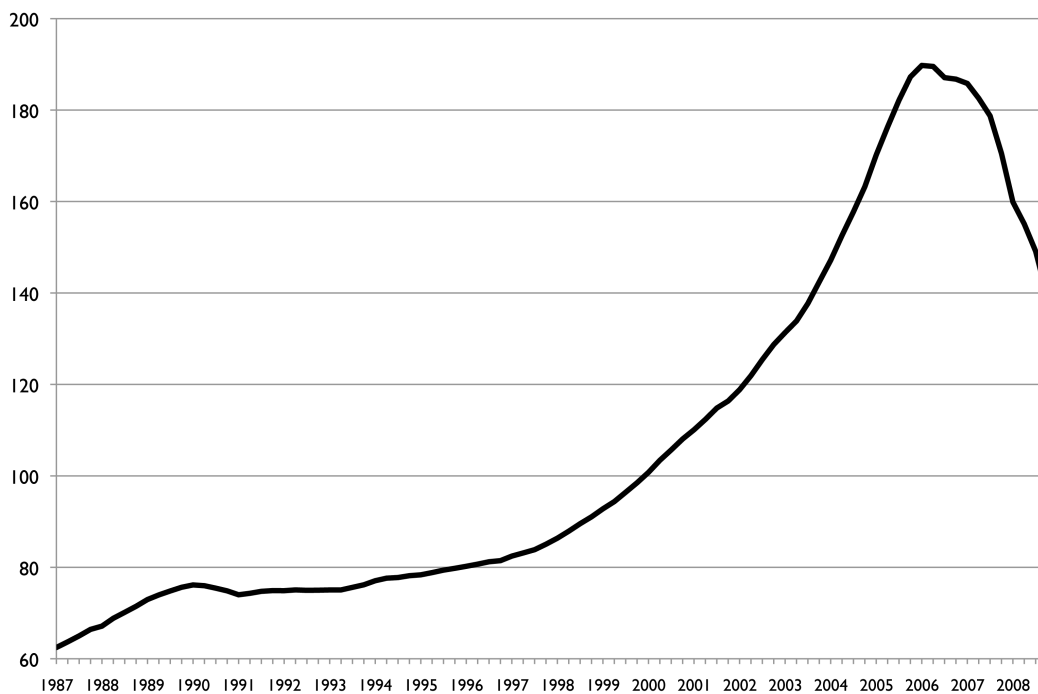
*Ex post* analyses of failed reforms rarely defined these factors with precision. The usual tactic was to throw combine them into a residual category of considerations that appeared to affect the prospects for institutional reform, sometimes labelled as "the political and cultural context" or "the wider framework for governance." But this residual category was clearly important, and by the mid-2000's many development specialists seemed ready to abandon a narrow, formal-legal conception of reform. "Merely adopting some other country's laws and formal regulations is no guarantee of achieving the same institutional performance," a chastened World Bank report concluded in 2005. "[W]e need to get away from formulae and the search for elusive 'best practices' . . . [and acquire] a better understanding of non-economic factors -- history, culture, and politics -- in economic growth processes." A 2008 Bank report agreed, in language that would have been familiar to a student of the Great Society reforms thirty years earlier: "Policy design and implementation is a complex, multi-directional, fragmented and unpredictable process."<sup>25</sup>

## EFFECT OF THE CRISIS

Before August 2007, it could still be argued that the logic of discipline had the benefit of favorable headwinds, even if particular efforts at the imposition of discipline were often encountering "problems of implementation." The case for discipline still had tremendous power: the engine of economic globalization appeared to be running smoothly, and skepticism about the competence and rationality of governments relative to markets was still broadly shared. In two short years the conventional wisdom has reversed completely. Global commerce has collapsed, along with faith in the power in

markets. The role of the state has expanded substantially. And in many of the areas that we will canvass in this book, the campaign for discipline has suffered substantial setbacks.

We must briefly describe the arc of the global economic crisis. It is now agreed that the United States, and some other major economies, experienced a substantial bubble in the housing market that started roughly in 1995, expanded even more rapidly after 2001, and burst after 2006 (See Chart 1.1). A combination of factors contributed to the bubble. Low interest rates made it possible for home buyers to make larger offers to home sellers. At the same time, lenders became less rigorous in deciding whether prospective buyers were qualified for mortgages. Bubble psychology drove lenders and buyers: if prices were always increasing, there was little risk involved in approving bigger mortgage loans, or bidding extravagantly on property.



**Fig. 1.2 The Case-Shiller US Home Price Index, 1986-2008.**

There was more than bubble psychology at work, however. The business of mortgage lending had itself been transformed in ways that encouraged inflation in housing prices. Many lenders were less discriminate because they quickly sold mortgages to third parties, who pooled these mortgages to create new assets, known as mortgage-backed securities. Securities like these became popular investments for a range of loosely regulated financial institutions. These investor institutions were themselves highly leveraged: they took advantage of low interest rates to borrow trillions of dollars that could be invested in these securities, and thereby channelled into mortgage lending. Executives in these financial institutions were motivated by salary schemes that encouraged them to maximize short-term profits with scant regard to cumulative long-term risks. They were abetted by credit rating agencies who understated the riskiness of the securities in which financial institutions were investing, partly because they were paid by the institutions that were selling the securities; and also by insurers who sold the investing institutions cheap protection against losses that it was assumed would never be incurred.<sup>26</sup>

Only three years ago, all of the statements in the preceding paragraph would have been regarded as careless provocations. That they are now taken as commonplace is evidence of the scale of the crisis that was triggered by the bursting of the housing bubble. Overbuilding and an unexpected rise in interest rates led to a decline in house prices and wave of defaults on lower quality mortgages. This, in turn, raises doubts about the value of mortgage-based securities and other instruments connected to them. Financing schemes were so complex that financial institutions could not be sure whether their business partners were still solvent, and lending between financial institutions seized

up, pushing weaker institutions into insolvency. The panic spread globally because of the tight interconnection of financial markets. By 2009, it was estimated that financial institutions had lost almost four trillion dollars. Major firms were dissolved or taken into state ownership.

The collapse in house prices meant that American households were poorer than they had imagined they had been. Households became poorer still when the stock market collapsed in October 2008. The net worth of US households declined twenty percent, or thirteen trillion dollars, in just eighteen months. Distressed financial institutions also tightened their lending to households and businesses. For all of these reasons, spending for consumption or investment purposes declined sharply. The interconnection of markets meant that the effect of reduced spending was again globalized, and by 2009 the world economy had fallen into its deepest recession in modern history. Central bankers and finance ministers were taking extraordinary measures to stimulate demand and avert a full-scale depression.

In many ways, the economic crisis has upended the logic of discipline. Consider, for example, the role of central banks. Dozens of central banks were given structural independence over the last two decades, on the argument that this was only way of assuring that monetary policy would be firmly anti-inflationary. Only a few years ago, this reform was hailed as a great success. But it can now be argued that central bank independence was a sort of Maginot Line: a massive structure that was heavily fortified to resist the wrong threat. Independence entrenched a doctrine about the role of central banks that involved a blindness to systemic vulnerabilities and the dangers raised by asset bubbles. When a financial crisis did occur, central bankers were caught flatfooted, and

quickly compromised the show of independence, collaborating closely with elected leaders to avoid a collapse of the financial sector.

The campaign for discipline was compromised in other respects as well. The appeal of independent regulatory agencies waned as they, too, began to look like mechanisms for entrenching flawed policies. The virtues of fiscal discipline were quickly forgotten as it became clear the financial sector required trillions of dollars in loans, guarantees and capital injections to avoid collapse, while the broader economy required trillions more in stimulus to compensate for the decline in consumption and investment. The case for creating autonomous ports and airports weakened as trade and travel collapsed: the problem for these ports and airports was now under-utilization, not congestion. Similarly, the argument for private investment in infrastructure collapsed as investors themselves, unable to refinance their debts, abandoned the field. And the urgency of establishing safeguards to reassure investors in less stable regions diminished as those investors retreated to safer markets.

Recall that the case for discipline had been predicated on an argument that democratic political processes were prone to three vices: myopia, instability, and selfishness. The policies that were usually produced by unconstrained democratic systems, it was alleged, paid scant regard to long-term consequences; were liable to change unpredictably over time; and usually involved an unhealthy expansion of governmental functions to appease well-organized special interests. The presumption was that a free market would not be prone to the same vices. The economic crisis has disproved this thoroughly. It arose because of a breakdown of discipline within the financial sector itself.

The crisis also showed that the case for discipline within the public sector was contingent on the assumption that the financial sector itself would not require aid from government. When the financial sector itself became distressed, the logic of discipline in monetary and fiscal policy was quickly put aside. The logic of discipline, it now appears, always applied with a large asterisk -- an unspoken qualification that it would be suspended when required by the needs of capital.

Is the logic of discipline dead? It is too soon to say. We can imagine, for example, a scenario only a few years down the road when the case for discipline is revived. At that time, governments may be struggling with the inflationary and budgetary effects of policies adopted during the crisis, and arguments may again be made about the virtues of central bank independence and firm fiscal rules. We might return to normalcy, as that condition was defined in the era of liberalization. But this is not a certain outcome. The logic of discipline might be so firmly discredited that it will be politically impossible for elected leaders to apply it in practice. We might insist that it is that markets, rather than governments, are prone to myopia, instability, and greed, and therefore in need of discipline.

This would be a complete turnabout, but it would not be unprecedented. In his *General Theory*, published in 1936, John Maynard Keynes argued that it was the state, rather than the market, that was better able to take the long view in matters of economic management. By the end of the Second World War it was "highly respectable doctrine" that strict controls had to be imposed on capital, rather than governments, precisely because of its erratic behavior. The logic of discipline was invoked against markets, rather than electorates. In the era of liberalization, the logic was turned on its head. But

the economic crisis suggests the need for another recalibration. Even if the institutional substructure built during the era of liberalization is not completely dismantled, enthusiasm for extending the logic of disciplined democracy will certainly be tempered.<sup>27</sup>

## NOTES

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<sup>2</sup> Francis Fukuyama, "The End of History?," *National Interest* 16, no. Summer (1989): 3-16, Hans-Dieter Klingemann, "Mapping Political Support in the 1990s: A Global Analysis," in *Critical Citizens: Global Support for Democratic Governance*, ed. Pippa Norris, (New York: Oxford University Press, 1999), 31-56, 42-46, U.S. Department of State, "From the Editors," *Issues of Democracy* 5, no. 1 (2000): 2-3, 2.

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<sup>4</sup> Merilee S. Grindle, *Going Local: Decentralization, Democratization, and the Promise of Good Governance* (Princeton, NJ: Princeton University Press, 2007), 4.

<sup>5</sup> Ann Florini, *The Right to Know: Transparency for an Open World* (New York: Columbia University Press, 2007), 348, David Banisar, *Freedom of Information around the World 2006* (Washington, DC: [freedominfo.org](http://freedominfo.org), July, 2006), M. Amir-Ul Islam, *Right to Know Is Right to Liberty* (Dhaka, Bangladesh: Legal Education and Training Institute, 1999), Richard Calland and Guy Dehn, eds., *Whistleblowing around the World* (Capetown, South Africa: Open Democracy Advice Centre, 2004).

<sup>6</sup> OECD, *Citizens as Partners* (Paris: Organization for Economic Cooperation and Development, 2001), 8, Éric Montpetit, "Public Consultations in Policy Network Environments: The Case of Assisted Reproductive Technology Policy in Government," *Canadian Public Policy* 29, no. 1 (2003): 95-110, 96, Bruce A. Ackerman and James S. Fishkin, *Deliberation Day* (New Haven: Yale University Press, 2004), United Nations, *Auditing for Social Change: A Strategy for Citizen Engagement in Public Sector Accountability* (New York: UN Department of Economic and Social Affairs, 2007), 6.

<sup>7</sup> Tony Blair, *Speech to the Labour Party Conference* (London: Office of the Prime Minister, September 27, 2004), Tony Blair, *Speech to the Labour Party Conference* (London: Office of the Prime Minister, September 27, 2005), Andrei Cherny, *The Next Deal: The Future of Public Life in the Information Age* (New York, NY: Basic Books, 2000), 37 and 50.

<sup>8</sup> James Surowiecki, *The Wisdom of Crowds* (New York: Doubleday, 2004), xiii and 270. See also: Thomas Frank, *One Market under God* (New York, NY: Anchor Books, 2001), 29, Fareed Zakaria, *The Future of Freedom: Illiberal Democracy at Home and Abroad*, 1st ed. (New York: W.W. Norton & Co., 2003), Chapter 9.

<sup>9</sup> Andrew Keen, *The Cult of the Amateur: How Today's Internet Is Killing Our Culture*, 1st ed. (New York: Doubleday, 2007), 35-63, John Lukacs, *Democracy and Populism: Fear and Hatred* (New Haven: Yale University Press, 2005), Ramachandra Guha, *India after Gandhi: The History of the World's Largest Democracy*, 1st Ecco ed. (New York: Ecco, 2007), 690-691. Emphasis in original.

<sup>10</sup> James Reston, "The Crisis of Democracy," *New York Times*, March 3, 1974, James Reston, "The Crisis of Democracy," *New York Times*, June 29, 1975.

<sup>11</sup> Michel Crozier, Samuel P. Huntington, and Joji Watanuki, *The Crisis of Democracy: Report on the Governability of Democracies to the Trilateral Commission* (New York, NY: New York University Press, 1975), 8, 114-115, 161-164. For other expressions of the "overload" thesis, see: Anthony King, "Overload: Problems of Governing in the 1970s," *Political Studies* 23 (1975): 284-296, Richard Rose, *Challenge to Governance: Studies in Overloaded Politics* (Beverly Hills: Sage Publications, 1980), Samuel P. Huntington, *American Politics: The Promise of Disharmony* (Cambridge, MA: Belknap Press, 1981), Anthony Birch, "Overload, Ungovernability and Delegation," *British Journal of Political Science* 14, no. 2 (1984): 135-160.

<sup>12</sup> Dennis Mueller, *Public Choice III* (New York: Cambridge University Press, 2003), 1-2. Public Choice also gained the distinction of becoming the only academic theory that spawned a situation comedy, Britain's *Yes Minister*.

<sup>13</sup> James M. Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (Ann Arbor, MI: University of Michigan Press, 1962), Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, MA: Harvard University Press, 1971), William Niskanen, "The Peculiar Economics of Bureaucracy," *American Economic Review* 58, no. 2 (1968): 293-305, Gary S. Becker, "A Theory of Competition among Pressure Groups for Political Support," *Quarterly Journal of Economics* 98, no. 3 (1983): 371-400.

<sup>14</sup> Crozier, Huntington, and Watanuki, *The Crisis of Democracy: Report on the Governability of Democracies to the Trilateral Commission*, 113-115, James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977), 125-126, Herman Schwartz, "Public Choice Theory and Public Choices: Bureaucrats and State Reorganization in Australia, Denmark, New Zealand and Sweden," *Administration and Society* 26, no. 1 (1994): 48-77, 56.

<sup>15</sup> Daniel Yergin and Joseph Stanislaw, *The Commanding Heights* (New York, NY: Simon & Schuster, 1998).

<sup>16</sup> Flinders, *Delegated Governance and the British State: Walking without Order*, 264. Peter Burnham, "The Politics of Economic Management in the 1990s," *New Political Economy* 4, no. 1 (1999): 37-54.

<sup>17</sup> Theodore Draper, *A Very Thin Line: The Iran-Contra Affairs* (New York, NY: Hill and Wang, 1991), 580-598, Deborah Pearlstein, *Form and Function in the National Security Constitution* (Princeton, NJ: Princeton University Program in Law and Public Affairs, 2008), Aaron B. Wildavsky, *The Presidency* (Boston: Little Brown, 1969), 230-245, Aaron B. Wildavsky, *The Beleaguered Presidency* (New Brunswick, NJ: Transaction Publishers, 1991), 29, Eric Alterman, *Who Speaks for America? Why Democracy Matters in Foreign Policy* (Ithaca, NY: Cornell University Press, 1998), 4.

<sup>18</sup> Alasdair Roberts, "The Rhetorical Problems of the Management Expert" (Harvard University, 1994), 14.

<sup>19</sup> On Progressivism, see: Robert H. Wiebe, *The Search for Order, 1877-1920* (Westport, Conn.: Greenwood Press, 1980). A survey of the role of autonomous bodies in monitoring elections and protecting basic rights is provided in: Bruce A. Ackerman, "The New Separation of Powers," *Harvard Law Review* 113, no. 3 (2000): 633-729.

<sup>20</sup> World Bank, *World Development Report 1997: The State in a Changing World. Summary* (Washington, DC: World Bank, May 1998, 1997).} Douglass C. North, *Institutions, Institutional Change, and Economic Performance, The Political Economy of Institutions and Decisions* (New York: Cambridge University Press, 1990).

<sup>21</sup> North, *Institutions, Institutional Change, and Economic Performance*, 4, 6 and 36-37. For other broad definitions of "institution", and related statements about the difficulties of institutional change, see: Peter A. Hall, *Governing the Economy: The Politics of State Intervention in Britain and France* (New York: Oxford University Press, 1986), 19, John L. Campbell, *Institutional Change and Globalization* (Princeton, N.J.: Princeton University Press, 2004), 19, Ronald Jepperson, "Institutions, Institutional Effects, and Institutionalism," in *The New Institutionalism in Organizational Analysis*, ed. Walter Powell and Paul DiMaggio, (Chicago: University of Chicago Press, 1991), 143-163, 145, Paul Pierson, *Politics in Time: History, Institutions, and Social Analysis* (Princeton, NJ: Princeton University Press, 2004), Chapter 1.

<sup>22</sup> This attitude was not entirely new. The same formal-legal approach typified political science in its early years, but was largely repudiated in the modern era: James A. Bill and Robert L. Hardgrave, *Comparative Politics: The Quest for Theory* (Washington, DC: University Press of America, 1981), Chapter 1, Marian D. Irish, "Advance of the Discipline?," *Journal of Politics* 30, no. 2 (1968): 291-310, 298.

<sup>23</sup> Per Molander, "Budgeting Procedures and Democratic Ideals," *Journal of Public Policy* 21, no. 1 (2001): 23-52, 23.

<sup>24</sup> Eugene Bardach, *The Implementation Game: What Happens after a Bill Becomes a Law* (Cambridge, MA: MIT Press, 1977), Jeffrey L. Pressman and Aaron B. Wildavsky, *Implementation: How Great Expectations in Washington Are Dashed in Oakland*, 3rd ed. (Berkeley: University of California Press, 1984), Francis Snyder, "The Failure of Law and Development," *Wisconsin Law Review* 1982, no. 3 (1982): 373-396, Curtis J. Milhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal About Legal Systems and Economic Development around the World* (Chicago, IL: University of Chicago Press, 2008), 207-212, Daniel Berkowitz, Katharina Pistor, and Jean-François Richard, "The Transplant Effect," *American Journal of Comparative Law* 51, no. 2 (2003): 163-203.

<sup>25</sup> World Bank, *Economic Growth in the 1990s: Learning from a Decade of Reform* (Washington, DC: World Bank, 2005), xiii, 5, World Bank, *The Political Economy of Reform: Issues and Implications for Policy Dialogue and Development Operations* (Washington, DC: Social Development Department, 2008), vii, Dani Rodrik, *One Economics, Many Recipes: Globalization, Institutions, and Economic Growth* (Princeton, NJ: Princeton University Press, 2007), 163-166, Howard Stein, *Beyond the World Bank Agenda: An Institutional Approach to Development* (Chicago, IL: University of Chicago Press, 2008), 105-106 and 125-128.

<sup>26</sup> Brief summaries of the unfolding economic crisis are provided by: Olivier Blanchard, *The Crisis: Basic Mechanisms, and Appropriate Policies*, WP/09/80 (Washington, DC: International Monetary Fund, April, 2009), International Monetary Fund, *World Economic Outlook* (Washington, DC: International Monetary Fund, April 22, 2009), High Level Group on Financial Supervision in the EU, *Report* (Brussels: European Commission, February 25, 2009), 1-12, Financial Services Authority, *The Turner Review: A Regulatory Response to the Global Financial Crisis* (London: Financial Services Authority, March, 2009), 11-28. The following paragraphs draw on these summaries.

<sup>27</sup> John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York, NY,: Harcourt, Brace, 1936), Arthur Bloomfield, "Postwar Control of International Capital Movements," *American Economic Review* 36, no. 2 (1946): 687-709, 688.