

ROUTLEDGE LAW IN ASIA

Law and Development in Asia

Edited by
Gerald Paul McAlinn
and Caslav Pejovic



Law and Development in Asia

This book fills a gap in the literature by presenting a comprehensive overview of the key issues relating to law and development in Asia. Over recent decades, experts in law and development have produced multiple theories on law and development, none of which were derived from close study of Asian countries, and none of which fit very well with the existing evidence of how law actually functioned in these countries during periods of rapid economic development. The book discusses the different models of law and development, including both the developmental state model of the 1960s and the neo-liberal model of the 1980s, and shows how development has worked out in practice in relation to these models in a range of Asian countries, including Japan, Korea, China, Thailand, Singapore, India and Mongolia. Particular themes examined include constitutionalism, judicial and legal reform; labour law; the growing importance of private rights; foreign investment and the international law of development. Reflecting the complexity of Asian law and society, both those who believe in an “Asian Way” which is radically different from law and development in other parts of the world, as well as those who believe the arc of law and development is essentially universal, will find support in this book.

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Preface

This book grows out of a conference held at Kyushu University in 2008, entitled “Law and Development at a Crossroads: Asian Alternatives to Universal Schemes?” As the title suggests, the central theme of the conference was whether it can be said there is an Asian alternative to universal approaches to law and development. The materials contained in this book strongly suggest that Asia writ large presents examples of both convergence and divergence with universal approaches. Those who believe there is an “Asian Way” and that it is radically different from law and development in other parts of the world will find support in the chapters of this book. Likewise, those who believe that the arc of law and development is essentially universal will find material to point in that direction as well. The book may not answer this ultimate question, but this only serves to reflect the rich complexity of Asian law and society.

The Rule of Law, as well as the degree to which law per se has played a key role in Asian development, is a central theme of the chapters in this book. Various theories of law and development ranging from neo-liberalism to legal transfer are discussed and analysed in context. The chapters of this book also represent wide geographical coverage dealing with issues of law and development in Japan, Korea, Taiwan, China, Thailand, India, Mongolia, and Singapore.

This book is divided into two major sections: “Law and development orthodox: Asian challenges”; and “Special topics: institutions and areas of law”. Setting the stage for the debate that forms the core of this book is a short introductory chapter written by David Trubek. He begins by reminding readers of the role legal reform has historically played in both the economic and social development of nations. It was not until the twentieth century, however, that systematic legal reform projects began to take shape as central vehicles for driving development. Trubek identifies three major themes springing up in the second half of the twentieth century. First, law as an instrument to foster economic and social change in developing states. Second, law as a barrier to economic development insofar as “bad” law could impede development. Third, law as a framework for private decision-making, emphasizing the recognition of the critical role to be played by private actors as contrasted with state-led initiatives.

Trubek observes that a specialized academic field of law and development has failed to materialize, notwithstanding strong academic interest. This he

attributes to the mixed record of legal reform in the context of development as well as to the tension between the use of law by developing states and the growing belief that deregulation (and privatization) possibly held the answers to rapid development. He concludes by advancing four basic propositions to guide law and development studies into the twenty-first century, namely, that (1) Law should facilitate experimentation and innovation; (2) Law is increasingly affected by global forces; (3) Law itself is part of development; and (4) Law and development policy should be evidence-based. As Trubek rightly argues, these four propositions have already gained traction in the field and are being adopted by academics, law and policy makers, and judges alike.

The introduction by Trubek leads nicely into the first six chapters of the book, beginning with a chapter entitled “Law and development orthodoxies and the Northeast Asian experience” by John Ohnesorge. He begins his analysis by recognizing that the many theories of law and development did not reflect the prevailing situation in Japan, South Korea, and Taiwan. For this reason, they were never tested empirically against the clear and apparent success of the Northeast Asian development story. Ohnesorge queries why the Northeast Asia experience was so neglected by law and development theorists and advances some possible reasons for this oversight. Ohnesorge addresses this imbalance by reviewing the major theories of law and development and then measuring them against the reality of Northeast Asia. He then argues persuasively for a new theory of law and development based on inductive reasoning, to wit, by studying examples of success and failure it is possible to draw reasonable inferences regarding the role and function of law in development.

The next chapter, entitled “The resurgence of the right to development,” by Muthucumaraswamy Sornarajah notes the decline of the right to development in the last decade of the twentieth century in the face of neo-liberal economics. Sornarajah points to the UN Millennium Goals, which seek to address the problems of dire poverty in many countries of the lesser-developed world. He contends that it is a resurgence of recognition for the right of development that is most likely to see developing countries actually achieve the Millennium Goals. He predicts that strong leadership by large emerging economies such as India, China, and Brazil can now tilt the balance of power into a better state of equilibrium with the developed economies of the world.

Tom Ginsburg follows with a chapter called “Japanese law and Asian development.” His basic contention is that Japanese legal influence was transferred to Korea and Taiwan, placing those countries on a path to high growth. Ginsburg identifies three main elements of what he refers to as the “Northeast Asian legal complex.” The first is a semi-autonomous judiciary, meaning a judicial system organized hierarchically with effective top-down control and a limited capacity such that litigation rates could be kept relatively low. The second factor is a small private bar that sought to protect its monopoly rents and had no incentive to challenge state control. Finally, the administrative law regime had the effect of insulating state management of the economy from judicial review. These three factors combined to promote stability and reliable bureaucratic governance.

Ginsburg then successfully demonstrates how Japan was able to transfer this recipe for development to its former colonies, Korea and Taiwan.

The next chapter, “The success of law and development in China: is China the latest Asian development state?” by Connie Carter, asserts that law has been an important factor in China’s move to a market economy, even though China does not conform to Western notions of “rule of law” or democratic principles of governance. She poses some provocative questions based on the Chinese model, such as does China’s success prove that development can occur without observing the rule of law, and if development is ultimately concerned with freedom to choose then what choices must China make to ensure stability and equity between the countryside and the cities? Carter tracks the role of law through a number of China’s developmental periods before concluding that China has, in many respects, followed the Asian development state model. The country continues to face many problems but Carter seems confident that the commitment to building a harmonious society will address many of the inequalities.

Andrew Harding takes on the recent problems of Thailand in his chapter entitled “The politics of law and development in Thailand: seeking Rousseau, and finding Hobbes.” His concern is with the emergence of the so-called “third moment” in the history of law and development, i.e., one where development is defined broadly to include not only economic, but also, political and social considerations. He presents a historical perspective on law and development in the context of an absolute monarchy. This is followed by an analysis of constitutionalism in Thailand and, to a degree, its undoing by corruption under the Thaksin regime. Still, Thailand enjoyed strong economic growth as well as being able to recover from the global financial crisis. This he attributes not so much to the rule of law as to the nature of the Asian developmental state that offers stability and predictability as its hallmarks.

The final chapter of the first section is “Law and development, FDI, and the rule of law in post-Soviet Central Asia: the case of Mongolia,” by Sukhbarat Sumiya. He presents a case study of Mongolia as it emerged at the end of Soviet domination. His approach is to examine the relationship between law and foreign direct investment. Mongolia, as Sumiya notes, had no recent history of either a market economy or multi-party democracy on which to draw after having existed for over 70 years under a single-party, central planning system of government. He concludes his argument by contending that, while the rule of law has a definite role in development, the need for state involvement cannot be denied.

With the theoretical issues of law and development being explained and explored in the Asian context, the second section of the book turns to a number of specific topics and themes that were identified in the first section.

The second section leads off with a chapter by Arun Thiruvengadam and Michael Ewing-Chow entitled “Echoes of *Through the Looking Glass*: comparing judicial reforms in Singapore and India.” The authors present the debates with respect to the success of judicial institutions within the fields of law and development and comparative constitutional law. The focus for Singapore is the Malik Report, which concluded that Singapore had “one of the most efficient,

effective judicial systems in Asia,” and its deficiencies in terms of measuring the overall effectiveness of the Singaporean judicial system. Contrasted with Singapore, the authors offer an analysis the state of the judiciary in India. While the Singapore system is duly praised for its efficiency, it is sometimes criticized for an apparent lack of independence from other state political institutions. Indian courts, on the other hand, have been praised for rendering bold judgments in support of individual rights at the same time they are plagued by gross delays and systemic inefficiencies. The authors use the two countries to present a thought-provoking treatment of the oft time conflicting values of efficiency and justice.

Caslav Pejovic’s chapter on “Japanese long-term employment: between social norms and economic rationale” looks at law and development in Japan from the perspective of employment law. He points to the role of “life-time employment” as one of the essential elements of the Japanese economic model. The chapter traces the roots of the life-time employment system and demonstrates how the courts played a major role in its establishment. The system is supported by cultural, economic, and corporate control rationales that combined to provide the stability and work-force reliability needed for Japanese industry to regain its footing after the end of the war. Economic conditions, however, have changed in Japan and the model is under pressure in the face of the need for Japanese companies to maintain global competitiveness. Pejovic demonstrates that models, which may be highly effective at one point in a nation’s development, can have detrimental effects if they are not flexible enough to adapt to changing conditions.

The next chapter returns the reader to China and a discussion by Shin-ichi Ago of the “Non-economic criteria in the formulation of the world trade regime: from social clause to CSR.” He considers why developing nations wish to join the WTO regime at the same time as exploring some of the pitfalls of the global regime identified by protesters and developing nations alike. He warns that the universal application of trade rules can have a potentially devastating effect on economically weak developing countries. One of the more interesting aspects of the chapter is the author’s consideration of the role of corporate social responsibility (CSR) as a source of legal obligation. While CSR is not widely accepted as constituting a legal duty, it has clearly made its way into the various trade regimes and is now a part of international trade law.

Steven Van Uytsel contributes a chapter regarding “China’s antimonopoly law and recurrence to standards.” He uses competition law as a window into national policy and economic development. Van Uytsel warns that the provisions of the Chinese Antimonopoly Law allow for broad discretion, which he warns could give rise to market distortion as a result of lobbying aimed at protectionism. The focus of the chapter is on the provisions of the AML dealing with concentrations. He succeeds in linking the development of competition law and policy to economic liberalization, including the review of various economic development strategies such as infant industry protection, the advancement of “national champion” industries or companies, facilitation of R&D, and incentivizing foreign

investment as a means of enhancing capital infusion and intellectual property induction. The chapter concludes by confirming a widely held suspicion that China has demonstrated a willingness to use the discretion built into the AML to favor local industry over foreign investors.

The penultimate chapter by Gerald McAlinn entitled “The privatization of investor–state dispute resolution” approaches an important issue relating to FDI and development. It has been frequently said, but not conclusively proven, that foreign investors demand legal infrastructure in the form of dispute resolution institutions that is predictable and fair. Naturally, a foreign investor will be reluctant to submit an investment dispute to the national courts of the host country. Until relatively recently, this meant that foreign investors were forced to seek recourse through the channels of diplomatic protection. The inherently political nature of diplomatic protection, however, made this an unattractive alternative. Taking a page from the growth of alternative dispute resolution in the national law of developed states, the World Bank succeeded in having 144 nations sign on to the International Convention on the Settlement of Investment Disputes between States and Nationals of other States, or the Washington Convention as it is known. Many bilateral and multilateral investment treaties now embody ADR as the method of resolving foreign investment disputes thereby removing to a fair degree both the public and the political element.

Finally, Lawan Thanadsillapakul contributes a chapter entitled “Thailand and legal development.” Her work argues for ways in which Thailand can benefit from the global trend of trade liberalization by enhancing the interaction of institutions, law, economic policy, and market function. She emphasizes the criticality of being successful in this as all countries in Asia, including Thailand, are increasingly forced to deal with the issues of Asian regionalism and rapid economic integration. Lawan examines Thailand’s policy with respect to entering into free trade agreements and analyzes the nation’s negotiation strategy. She concludes by predicting that Thailand will have to strengthen its legal and institutional framework to meet the needs of a changing global and regional economy.

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Introduction

Law and development in the twenty-first century

*David M. Trubek*¹

The idea that a nation's legal system affects its economic and social prospects can be traced back as far as the eighteenth century. And as early as the nineteenth century the discourse about law reform often took account of the economic impact of specific measures. But it was only in the twentieth century that an effort was made to create an academic discipline to study the relationship between law and development and governments and international institutions concerned with development began to organize systematic legal reform projects.

Law and development in the twentieth century

The 1960s marked the beginning of support for systematic reform efforts by international development agencies and the first effort to create an academic "field" for the study of law and development. The pace of support for systemic reform picked up in the 1980s and academic study increased. In the second half of the twentieth century, we saw the emergence of several theories, each of which spawned reform efforts. Three major themes can be identified:

- 1 **Law can be an instrument to be used by developmental states to foster change:** The first law and development movement stressed the need for change in economic and social relations and expressed hope that new laws could induce such change. This body of thought drew on modernization theory and the view—widely held by economists around mid-century—that a strong state was needed to manage the economy and transform society. Law, in this view, could serve as a positive instrument of change, offering incentives for people and institutions that are "modern" and promote growth, and disincentives for those who resist change and cling to traditional values.
- 2 **Law may be a barrier to economic development:** From the beginning, even those who had a positive view of law understood that the wrong kind of legal rules and practices could reduce incentives for investment and increase the cost of innovation. Concern about the negative impact of law grew in importance towards the end of the century as development agencies lost faith in state intervention and began to put more stress on the role of markets and on the need for deregulation.

- 3 **Law should be a framework to facilitate private decision-making:** As development economics turned away from a belief in state-led initiatives, more and more emphasis was placed on the role of law as a framework within which private actors would make economic decisions. Scholars stressed that, to function properly, markets require a complex infrastructure of institutions and rules, including legal rules such as the law of contract and property. They also depend on the ability of legal professionals and judges to ensure that the laws are effective. Markets may also require regulations, like anti-trust and securities law. Much of the interest in legal transplants and in judicial reform for development, which made up the bulk of international support for law reform in the late twentieth century, was based on the importance of creating such a neutral framework.

The legacy of the twentieth century is a complex one. First, the hoped-for academic field of law and development never materialized. Academic interest has increased and several disciplines besides law have taken up the topic, but nothing like a “field” exists. Second, the experience of reform was mixed as best: Some projects failed and some transplanted laws did not “take.” Third, there are conflicts among the several ideas that dominated the period. There are tensions between the idea of the use of law by a strong developmental state on the one hand and a deregulatory push on the other; between law as an instrument to change behavior and law as a neutral framework; between deregulation and the need to create new institutions. All these issues continue to be debated in the academy and in practice and no consensus has emerged.

Law and development today

Thus, as we enter the twenty-first century, we are faced with unresolved issues and unfinished tasks. We have yet to reconcile tensions among the ideas of the twentieth century and create a systematic body of knowledge that can serve as a reliable guide to reform efforts. And we can begin to glimpse new ideas and new phenomena that need to be studied and absorbed, including the following:

- 1 **Law should facilitate experimentation and innovation:** Twentieth century law and development experts assumed that the path to development was known and the challenge was to create instruments and institutions that would help move nations down that path. For those who saw law as an instrument of state control, knowledge about the path forward would be provided by state planners and the law would implement the plan. Those who rejected planning thought that unrestricted markets would make the optimal economic choices so that right way to foster development was to create markets and let them alone. However, in the twenty-first century many are coming to believe that neither planners nor markets working alone can find the optimal path. Rather, strategies must evolve and investment choices

must be made through public–private partnerships and processes of iterative experimentation. These processes require new forms of governance and law. In such “experimentalist” developmental states, law can neither be a simple tool for direct state invention, nor merely a neutral framework for private decisions. Rather, the law should seek to establish partnerships between public and private sectors and institutionalize a process of mutual search for innovative solutions and optimal developmental paths.

- 2 **Law is increasingly affected by global forces:** Twenty-first century law and development must deal with the growing impact of global forces on the law. There are three major forces at work. The first is the availability of global models such as the formulae for law and development promoted by the World Bank. Whether or not a country receives funding from the Bank, the models it promotes have an influence on national thinking. Second, national lawmakers must take account of the role law plays in determining national competitiveness. The more a country’s development strategy depends on foreign investment, the more its laws will be subject to scrutiny by foreign investors who will compare the legal environment for development in various nations before deciding where to invest. Today, investors have many options and law becomes an important factor in the effort to attract capital. The third global force is the growth of transnational law. Increasingly, a nation’s legal order is affected by norms originating outside of its borders. Whether they are norms of regional bodies like NAFTA or Mercosur or global institutions like the WTO, national legal orders are subject to constraints from other levels of governance.
- 3 **Law itself is part of development:** All the major ideas about law and development in the twentieth century saw law as a *means* to some other goal, whether it is economic growth or social protection. But recently scholars have argued that the existence of “the Rule of Law” is a goal in itself, a necessary part of the process of empowerment and capability-enhancement that constitutes “development.” This means that legal protection for constitutional values and human rights, including economic and social rights, must form part of the law and development agenda along with economic law and judicial reform.
- 4 **Law and development policy should be evidence-based:** We need to get beyond abstract debates and develop empirical evidence concerning what works and what doesn’t work. There is very little empirical work of any kind on the role of law in developing countries yet the whole law and development enterprise requires such knowledge. Developing countries need to make a quantum leap in their capacity for socio-legal research. That will include developing tools to diagnose problems and measure the results of reforms. The creation of cross-country legal indicators by agencies like the World Bank is a reflection of the search for such tools. But this process is still in its infancy and there are questions about some of the indices being used and the policies derived from them. Indicators can be misleading if they rely only on the formal written law, not the law as it is actually applied,

or are drawn from user surveys that are not truly representative. Moreover, even when the data reflected in the indicator is accurate, sometimes policy makers make questionable leaps from the data by proposing reforms that are either inappropriate or beyond the capacity of the government to carry out.

Because they recognize that law is an important resource for development, many countries are now encouraging systematic research on the role of law in development and are seeking to take into account the lessons of the twentieth century and the challenges of the twenty-first. Governments, academics, judges, and leaders of the bar in places like Brazil, China, and India have taken up the challenge of building a body of knowledge about law and development appropriate for our times. New law schools, like those at FGV in Brazil and similar schools in China and India, are developing research and training programs on law and development. Success in building more comprehensive knowledge and more robust reform efforts will require close cooperation among governments, the private sector, international agencies, and universities in the North and South.

Note

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Part I

**Law and development
orthodoxy**

Asian challenges

1 Law and development orthodoxies and the Northeast Asian experience

*John K.M. Ohnesorge*¹

Introduction

The law and development community² has produced over recent decades a series of theories on law and development, none of which were derived from close study of Japan, South Korea and Taiwan, and none of which fit very well the existing evidence of how law actually did function in these countries during rapid economic development. Not surprisingly, there has also been a general failure to test the specific claims of these theories empirically against the Northeast Asian development success story.

Why does the world need a theory of law and development? Beyond our normal interest in understanding law's relation to social life, international financial institutions (IFIs) such as the World Bank, the International Monetary Fund (IMF), and the Asian Development Bank devote enormous resources to programs advocating change in the legal systems of countries under their influence. Likewise, law and development initiatives play an important role in the work of major bilateral development assistance providers such as the United States Agency for International Development (USAID), Germany's *Gemeinschaft für technische Zusammenarbeit* (GTZ), and the Japan International Cooperation Agency (JICA). More importantly, these initiatives affect the lives of billions of people in developing countries, since even governments that maintain a high degree of sovereign autonomy, such as those of China and India, can be affected by the ideas, ideologies and policies that emanate from the World Bank or other law and development actors. And while the typical initiative targets the legal system of a poor country, or one that is transitioning from a planned to a market economy, it is important to remember that South Korea was among the world's largest economies and a member of the OECD and has engaged in law and development activities of its own, when, as a result of the Asian Financial Crisis and Korea's resulting need for international assistance, its legal system became the target of IMF, World Bank and United States pressure.

It is fair to date the current mode of law and development activities to the 1960s, when primarily Western governments, institutions, and academics became involved with the legal systems of many developing and newly-independent countries.³ The world has also come to recognize Northeast Asia's

economic miracle over a similar period, and the region's outstanding economic performance became the subject of extensive analysis and debate by students of economic development from various disciplines. At the same time, Northeast Asia's legal systems have also attracted much research, resulting in a rich Western language literature on the topic. Surprisingly, however, Northeast Asia's legal systems have been largely overlooked as potential sources of knowledge concerning the fundamental questions of law and economic development, and despite ventures by some scholars of Northeast Asian law into law and development debates, scholarship on Northeast Asian law has played an insignificant role in the theoretical literature on law and development.

This lack of interest would not be a problem if Northeast Asia's economies were neither exceptionally good nor exceptionally bad, and thus insignificant for the questions the field of law and development seeks to answer. But Northeast Asia's economies are the best examples we have of sustained, equitably distributed, industrialization and development. Given that indisputable record of economic and social success, and given that literature on Northeast Asian legal systems is widely available, the failure to place Northeast Asia at the core of law and development theorizing seems impossible to justify. This chapter addresses that discrepancy. The dominant law and development orthodoxies of the last few decades will be examined through the widely accepted assessments of how Northeast Asia's legal orders functioned during the region's high growth decades. To the extent these orthodoxies cannot accommodate the Northeast Asian experience, they are deeply inadequate.

This chapter will also articulate a positive vision of what the study of Northeast Asian law can contribute to law and development, offering a new approach to law and development activities informed by Northeast Asia's experience. As the debate over a viable and cohesive theory of law and development is waged, law and development projects underway throughout the world continue, with or without the intellectual underpinnings of a theory. This bureaucratic imperative likely explains why these efforts often appear to repeat mistakes of the past, seemingly immune to a long tradition of insightful academic critique. As a matter of bureaucratic practice, if not of logic, it may therefore take a coherent intellectual framework that could be adopted for these ongoing projects; thus this essay offers that framework for understanding law and economic development that builds upon the Northeast Asian experience.

This proposed approach is novel because it incorporates explicitly the functioning of law and legal institutions during the Northeast Asian "miracle" era. More importantly, however, the approach offered here abandons the central assumption of all the orthodoxies it seeks to replace, which is that legal rules and institutions have clearly defined functions, and that the role of law and development efforts is to get client countries to adopt specific legal reforms that will reliably produce intended social outcomes. Instead of drawing on Northeast Asia to create yet another set of law and development prescriptions for implementation by developing countries, the Northeast Asian experience will be used here as evidence that the proper role of law and development assistance is both more

modest and more demanding. More modest because it involves the admission of uncertainty and competing goals in the functioning of legal rules and institutions, yet more demanding in that it recognizes the top-down, formalist logic of existing orthodoxies is insufficient, and must be replaced by continued monitoring, learning-by-doing, and re-examination of both means and ends.

The top-down formalist logic orthodoxies can be rejected because they simply do not allow for adaptation to a broader social matrix which determines economic performance, of which law and legality make up only a part. This broader matrix includes non-legal factors such as education levels, demographics, natural resource endowments, geographical location, technology levels, domestic political institutions, social and cultural norms and practices, and international politics and economics. A country's policy choices with respect to these factors will often be reflected in positive law, of course, so social or economic reforms almost invariably involve legal change. Law and development activities seek to put the functioning of legal systems at the center of the development equation. Because so many non-legal factors are clearly relevant to a country's economic performance, however, and because these factors, like legal system performance, tend to be difficult to isolate, quantify and study scientifically, the best we can probably hope for in constructing law and development theory will be theory that will help structure and guide inquiry.

The best way to generate such theory is inductively, studying recent history's examples of both economic success and economic failure, and then drawing defensible inferences based upon what can be observed about the law's function in these episodes.⁴ While studying failures can aid any understanding of law and development, studying only a country that has a weak legal system *and* a weak economy, such as Russia in the early to mid-1990s, encourages the confusion of correlation with causation. In law and development studies, this could mean blaming a lack of economic development on a weak legal system, when in fact causation might run the other way. Moreover, studying those countries that developed most successfully should help prevent a repeat of Max Weber's "England problem," that England, the birthplace of modern capitalism, had a legal system that did not really fit the formal-rational ideal type that Weber thought was so important to modern capitalism.⁵ Today's law and development orthodoxies tend to replace Weber's Germanic bias with an Anglo-American bias, but run the risk of replicating his basic mistake if they do not deal explicitly with Northeast Asia, where the vast scholarship the region's economic success is also well-suited to test law and development theories empirically.

There are several factors that make Northeast Asia an especially appropriate region to which this inductive, empirical approach could be applied. First and foremost is "the miracle" that Japan, then later South Korea and Taiwan, are the premier development success stories of the twentieth century.⁶ Japan's economy is, at the time of writing, now the world's second largest, while Taiwan and Korea rank among the top 25. With respect to technology, within the space of a few decades, Japan, and later Taiwan and Korea, moved from technological backwardness to close to world frontiers in many fields. Social indicators also

show remarkable progress, as health care, life spans, education levels, and diet have all improved significantly. One of the most striking aspects of these achievements is that they have been shared comparatively equally, so that Northeast Asian societies do not display the vast disparities between rich and poor that often accompany rapid economic expansions.

In addition, although observers often focus on the similarities among Japan, South Korea and Taiwan, as successful modernizers, as examples of export-led growth, or as “developmental states,”⁷ there is also a great deal of diversity among the three in areas that likely matter for development. Post-war Japan has been a democracy, for example, while Taiwan and Korea were both authoritarian for large parts of their high-growth periods. And despite the fact that Taiwan and Korea were both colonies of Japan, as a result of differing colonial policies and other historical factors, their post-World War II histories have differed substantially.⁸ Important differences can be seen with respect to foreign investment, to state ownership of industry, in patterns of private ownership of industry, and in defense expenditures.⁹ The pattern of broad similarities with relatively discrete differences which Northeast Asia offers should facilitate useful and empirically based theorizing.¹⁰

The orthodoxies of law and development

Discussions of law and development orthodoxies typically begin with what David Trubek and Marc Galanter dubbed “liberal legality,” the approach associated with modernization theory of the 1950s and 1960s.¹¹ That orthodoxy was largely spent by the early 1970s, as the broader modernization ethos succumbed to realities such as the Vietnam War and the extent to which “modern” Western societies did not themselves fit the model, and as funding for law and development activities dried up. The critics of modernization theory did not succeed in providing an alternative law and development orthodoxy, but they did produce two influential bodies of work, dependency theory and the world systems approach, which will also be discussed here.

The second commonly recognized era of law and development began around 1989, with fall of the Berlin Wall and the subsequent collapse of the Soviet Union. Much had changed in the economics academy since the 1970s, and the new law and development orthodoxy that developed was a neoliberal Rule of Law orthodoxy associated with what has been termed the “Washington Consensus.”¹² While this intellectual history is generally accepted, a complete picture must now include two more recent proto-orthodoxies, which are quite distinctive, and which might be seen as contending for dominance. One of these, termed here the “comprehensive development Rule of Law,” can be associated with trends within the World Bank under President James Wolfensohn, while the other, termed here the “legal origins” approach, has its origins in the writings of financial economists originally interested in legal systems and financial system performance.¹³ None of these orthodoxies fares well when examined in light of the Northeast Asian experience of law and economic development.

Law and development in the era of modernization

The modernization orthodoxy was not concerned only with economic development, but saw development as a process by which “traditional” or “backwards” societies would transform along a host of dimensions to become “modern.” Scholars from a range of disciplines shared the modernization ethos, indeed interdisciplinarity was a fundamental to the goal of developing a total theory of society, so they naturally produced traditional-modern schemas based upon their disciplinary concerns.¹⁴

The specifically legal dimension of the modernization ethos shared important elements of the general modernization approach. Law reform was not simply about economic development, it was about helping Third World countries develop “modern legal systems.” A modern legal system, like a modern society for modernization theorists more generally, was supposed to be the ultimate stage in a more or less universal process of societal evolution, but at the same time bore a striking resemblance to an idealized vision of the contemporary United States legal system. This idealized picture directly reflected the normative commitments of America’s moderate, liberal elite, who at that time could claim to represent an ideological consensus in a way that seems fantastic now.¹⁵ In addition, the elements of liberal legality were distinct yet mutually reinforcing, so that one could have faith that assisting in the modernization of one institution or body of law would have salutary spillover effects on the whole system. For example, one might believe in the priority of economic growth over other aspects of development, as some modernization scholars did, but even if one did not, as Trubek and Galanter pointed out, one could still assist in economic law reform with confidence that the “seamless web” nature of the legal system would result in better performance on non-economic dimensions as well.

What were the specific elements of this idealized “modern” legal system circa the 1960s? Law was to be the instrument by which reformist Third World governments would bring about social change in the direction of socially responsible capitalism and pluralist democracy. This view entailed both a faith that Third World states were committed to the public interest, and a faith that law could be made potent and predictable enough to serve this social engineering function. Beyond this view, law and development efforts focused on legal education. This included an assumption that increasing the number of lawyers in a society marked progress towards the rule of law, a debatable notion that still persists in the field. As Trubek has argued recently, the modern, instrumental conception of law seemed to require an attack on four distinct manifestations of legal formalism: formalism in judicial reasoning, formalism in law making, formalism in the way legal professions understood the function of the lawyer, and importantly, formalism in the way law was taught.¹⁶

In addition to programs to introduce specific statutory or institutional changes, therefore, reforming legal education became an important fulcrum for gaining leverage to reorient entire legal cultures, in other words, toward Americanization.¹⁷ Americanizing legal education would help cure Third World lawyers of

their penchant for formalism, turning them from Weberian automatons into pragmatic problem solvers. The idea that “Americanizing” legal education would solve this problem was misguided, as law schools would not teach the practical experience nor provide the opportunity for participation.¹⁸

Development assistance was predominantly bilateral during the modernization era, rather than flowing through international organizations such as the United Nations or the international financial institutions, which generated space for the political interference that was part of modernization’s approach.¹⁹ But despite the fact that the bilateral nature of the law and development programs meant no international law limits on potential political implications, the Cold War context provided recipient governments with at least a partial shield against unwelcome political interference, turning to the Soviets.²⁰ With the collapse of the socialist world, developing countries have no way to “enforce” the non-political interference norm, and this fact, together with the rise of new institutional economics, meant that even the IFIs no longer had to take the norm very seriously.²¹

Dependency and world systems theory: modernization’s discontents

The decline of the modernization ethos is a complex story that played out differently across regions and academic fields, but one primary dissatisfaction with the approach was its trust that the Third World state was representing the public interest, defined as socially responsible economic development and pluralist democratic governance.²² This perspective highlights an important parallelism between attacks on modernization theory from the Left and the Right, and links them both to contemporaneous developments in the United States. By the 1970s, neoclassical economists interested in development issues argued that state intervention was inefficient and an excuse for rent-seeking by government functionaries, while the economic attack on regulation being developed by conservative, free-market economists in the United States.²³ The Left, meanwhile, argued that the Third World state was captured by international capital, in league with local comprador elites, a charge that shares much with the contemporaneous claims from the American Left that United States regulatory agencies were captured by the industries they were supposed to be regulating in the public interest.²⁴

The modernization approach had seen integration into the international economic order as basically benign and desirable, though its focus on state-supported industrialization certainly reflected doubt that Ricardian comparative advantage alone would enrich developing countries. While this doubt was in the air in the 1940s, it became formalized around 1950 in the Prebisch–Singer thesis, which holds that over the long term, the terms of trade favor manufactures over commodities, so that for a developing country simply to rely on its comparative advantage to export commodities while importing manufactured goods would be a losing proposition.²⁵ But while modernization theory counted on the nation state to play the necessary, interventionist role of fostering industrialization, the dependency theories that followed doubted that the international forces which

consign nations to the periphery will allow Third World states to play such a constructive role. These forces, which include international commodity markets, the interests of multinational corporations, as well as the interests of Third World comprador elites, will instead conspire to maintain and enforce the international division of labor captured in the core–periphery image.

From this approach, there is little sense in modernization’s strategy of replicating within developing countries the institutions of “modern” societies since modernization was never based on internal characteristics but was instead achieved through the exploitation of poor countries. Focusing, à la Weber, Parsons, and their followers, on the internal characteristics of developing countries to explain why they are poor is just a form of blaming the victim; even if a developing country succeeded in replicating modern institutions internally, this would not change the country’s place in the international order.²⁶

While there clearly was an orthodoxy of law and development that corresponded to modernization theory, it is not surprising that no such orthodoxy can be linked to dependency and world systems, which arose in critical reaction to modernization theory. Dependency and world systems, as facets of a broader collapse of modernization thinking, clearly affected some involved in law and development activities.²⁷ However, these approaches imparted a deep skepticism towards legal development assistance targeted at domestic legal systems. Some in the law and development community influenced by the dependency critique retained an interest in law reform, but turned their attention from national law reforms to reforming the international legal order, a movement associated with the New International Economic Order movement of the 1970s.²⁸ It was in this way that some law reform advocates maintained a link with development economics as some in that field also turned their attention to reforming the international economic system.

The Washington Consensus Rule of Law

The next real orthodoxy that arose following the demise of the modernization movement was the Rule of Law orthodoxy associated with the Washington Consensus and the energetic neoliberalism of the 1990s. This was the orthodoxy developed to frame and justify the massive law and development agenda that grew out of the collapse of the Soviet Union, and which accompanied the economic globalization of the 1990s, and was also the heir to the Right’s critique of the modernization orthodoxy. Reference to economist Douglass North’s designation of law as an “institution” with important economic implications²⁹ helped justify legal reform initiatives that went far beyond the scope of prior IFI initiatives, and the Rule of Law became the umbrella concept used to rhetorically unify a wide range of legal development initiatives.³⁰

While economic thinking about development generally had moved on after the demise of modernization, much of it towards free-market solutions, some in the direction of the dependency critique, it was some time before a new law and development orthodoxy arose. Prior to the rise of “new institutional economics”

(NIE), mainstream economics tended not to think much about private law, essentially assuming smoothly functioning legal systems as the background for theorizing about markets.³¹ Described very simply, NIE refers to the branch of economics that concerns itself with the ways that economic behavior, whether by individuals or by firms, is affected by the institutional setting in which actors find themselves. As neoclassical economics came to dominate development thinking, attention naturally enough shifted away from the “process” or “systemic” concerns important to the modernization era, such as building modern government institutions and ensuring that legal systems could effectively transmit government policies, to a substantive concern with free markets and limited government.

Two separate currents seem to have converged in the late 1980s to bring law and legal institutions back into the development picture. One was the increasing influence of NIE, which brings institutional structures and processes, explicitly including law, back into economic theorizing. The second was the fall of the Berlin Wall and the collapse of the socialist world, which had two effects. First, it quite suddenly presented the development community with the problem of how to nurture market economies in Eastern and Central Europe, the Baltics and Central Asia, where legal systems were geared to socialist rather than capitalist economics, and second, it left developing countries with nowhere to turn for assistance except the United States-dominated West, in which views on economics and the role of the state in society had taken a strong turn towards the market.³²

Testing the orthodoxies against Northeast Asia

None of the theoretical approaches to law and development proceeded empirically from the study of Northeast Asia, nor do any of them fare very well when their claims are tested against Northeast Asia as a case study.

Modernization (and its discontents) meet Northeast Asia

Turning to the modernization approach of the 1960s, what do we find if we examine its claims through the lens of the Northeast Asian experience? Looking at the performance of Northeast Asia’s legal systems over the past several decades, there is no doubt that legal instrumentalism was ever-present, in authoritarian South Korea and Taiwan, as well as in democratic Japan. Governing elites saw law as a tool with which to control their societies, and with which to exert political control over their judiciaries that sometimes extended even to decisions.³³ Northeast Asia thus took the instrumentalism of modernization’s “liberal legality” one step further: even in Japan, where judicial independence was best institutionalized, individual judges were sometimes disciplined for particular decisions that displeased their superiors within the judicial bureaucracy.³⁴ Those cases were highly publicized, so any judge would have known of the possibility of punishment in case he decided “wrongly” according to those above.

Law thus did not achieve the degree of autonomy called for even in the instrumental vision of liberal legality, and certainly not the level called for in later Rule of Law orthodoxies.

What about other aspects of modernization? During their highest growth decades all of the countries in Northeast Asia limited the numbers of fully licensed lawyers to a tiny fraction of what an American would consider normal.³⁵ No doubt the existing lawyers tended to favor this protectionism, but in authoritarian Taiwan and Korea one would not expect the legal professions to have sufficient political clout to obtain such a privileged position unless it happened to also benefit the political leadership, in which lawyers did not generally play a central role. In Korea and Taiwan, then, the extreme paucity of lawyers seems best explained as resulting from political choices to limit lawyers' social role and influence, while in the case of Japan the private interests of the Bar or of industry probably played a bigger role. In any case, though, lawyers in Northeast Asia even now have not become the free-ranging problem solvers of the modernization model, greasing the wheels of commerce one moment, protecting citizens from arbitrary state action the next. It is fair to say that neither they nor the judiciaries ever transcended the limited, formalist mode of that earlier period.

Judicial formalism in Taiwan and Korea should be understood in the context of political authoritarianism, in which assertions of power by the judiciary could be career-ending, or perhaps worse; in the early 1970s, for example, a Seoul National University law professor, who had recently returned from a lengthy stay at Harvard, was murdered by Korea's Central Intelligence Agency. In such an environment, formalist reasoning probably feels like the safest course to the judge. And in cases where the law is obviously in doubt, or which involve obviously political concerns, formalism offers a refuge that the practices of open-ended policy analysis and the balancing of interests do not. Perhaps contributing to the continued formalism in Northeast Asia's legal professions and judiciaries was the fact that legal education in Northeast Asia remained highly formalist, centered on learning the provisions of the fundamental statutes, and their interrelations with one another. Yet this continued formalism coincided with not only rapid economic growth, but also with dramatic improvements in broader "modernization" indices such as rising education levels and improving life expectancies.

Having satisfied ourselves that Northeast Asia got the best of the liberal legality and modernization theory, we should now ask ourselves why Northeast Asian societies now seem bent on finally establishing long absent pillars of the so-called modern legal systems. Beginning around 1990, the countries of Northeast Asia have entered into a multi-pronged effort at legal reform that seems driven by something very much like the modernization ethos. Starting with legal education, Japan, South Korea and Taiwan are all in the process of introducing "American-style" law schools.³⁶ Japan has gone the furthest to date, licensing over 70 graduate-level "law schools," nearly all of which are located at universities which also have existing undergraduate and graduate law faculties.³⁷ South Korea opened 25 graduate level law schools in 2009, and Taiwan is actively

studying the situation. Though the motives will obviously vary, a stated purpose of these initiatives is to improve legal education by getting away from the abstract, doctrinal teaching that has characterized undergraduate legal education in the region, as in the civil law world generally (according to the American view). For example, to become more practically-oriented the new schools in Japan are experimenting with clinical legal education and inviting practitioners and judges to teach, and this more practical education is supposed to turn out lawyers closer to the pragmatic problem-solvers of the modernization model.³⁸ Getting students to pay attention to this new, practical curriculum requires changing the national bar exams, which Japan and Korea are both pursuing.

Coming in tandem with the creation of the new schools are moves to raise passing rates on national bar exams, so that the graduates of these new schools should enjoy a much greater chance of actually joining the bar than undergraduate law majors previously had under the quota passage system. While in the case of Korea it might be possible to achieve high passage rates for new law school graduates without increasing the total admitted to the bar per year by limiting the number of new schools and students, the Judicial Reform Commission's proposal along these lines was immediately criticized for abandoning real reform in the face of protectionist pressures from the legal establishment.³⁹ An increase in the size of the Japanese bar is much more certain. Having already allowed over 70 new graduate law schools to open, Japan will not be able to reach the high passage rates that were originally part of its new law school plan unless the annual quota is increased substantially.

With more lawyers, the story goes, societies will become more law governed, and more oriented towards the assertion of rights via litigation, i.e., more "rule of law."⁴⁰ Reforming legal education should also hypothetically address judicial formalism, at least in the long term, though to expedite the process Japan and Korea are also planning to introduce lay participation in some areas of adjudication, interjecting potentially counter-formalist forces into the process.⁴¹

All these new, practically oriented lawyers have to have something to do, and rather than wait to see whether they can create demand for their own services, governments in the region have simultaneously been engaged in a series of law reforms that depend upon increased private litigation. Specifically, all three countries have, over the past 10 to 15 years, amended their corporate and administrative law regimes to encourage, respectively, litigation by corporate shareholders against management, and by private parties against government agencies.⁴² Like civilian legal systems in Europe, for example, those of North-east Asia have not relied heavily on such "private" enforcement to achieve systemic goals such as constraining corporate management or government agencies. In keeping with the current trend, however, shareholder litigation is being actively encouraged by various technical fixes to procedural rules and corporate statutes.⁴³ Administrative litigation is being encouraged by the enactment of general administrative procedure statutes, which include some citizen participation in rulemaking, information disclosure laws, amendments to "administrative litigation" statutes and the creation of dedicated administrative courts or

benches.⁴⁴ In doing so they are opting to move towards modernization's focus on enlisting private interest, channeled through private litigation, in the public task of regulating corporate and government bureaucracies.

Moreover, these societies are moving in a direction that may have represented the consensus view of legal modernity *c.* 1970, but which, in the United States at least, has become very much contested terrain. Shareholder litigation as actually practiced in the United States is under constant attack from academics, politicians and even newspaper columnists, as is the "adversarial legalism" of America's regulatory culture, and the idea of administrative law plaintiffs functioning as "private attorneys general."⁴⁵ If we actually look at how shareholder and administrative litigation function in the United States, which as Trubek and Galanter pointed out in 1974 is exactly what the modernization ethos biases us against, we might ask whether the "modern" United States system has resulted in better performance by either corporate management or by administrative agencies than that achieved in Northeast Asia.

What this all suggests is a different possible validation of modernization thinking, that there is a logic of convergence that drives national legal systems towards a common set of characteristics.⁴⁶ But this is not a simple economic logic, like some contemporary convergence arguments. Rather, the logic of this convergence seems to be more cultural, in the sense of being driven by the spread around the globe of a set of common ideals with respect to the performance of national legal systems.⁴⁷ The reason this trend matters for law and development is that it is in full force at the time when Northeast Asian governments are themselves becoming active purveyors of legal development assistance.⁴⁸ One might have hoped that as Northeast Asian governments entered the law and development business themselves they would base their advice on realistic appraisals of how various areas of law functioned when they were developing countries. This seems not to be the case, however, as the law and development efforts of Japan and Korea do not appear to offer much more nuance than the current international mainstream, and do not seem to be based on realistic self-assessment.⁴⁹ Korea, for example, has joined the effort to convince developing countries of the great benefits of active competition policy despite the fact that Korea did not even have a competition law on the books until 1980, after roughly 20 years of high-speed growth.⁵⁰

If modernization theory does not hold up well when confronted with the Northeast Asian experience, however, its chief antagonists, the dependency and world systems approaches, do not fare all that much better. At one level, the Northeast Asian experience can serve as Exhibit A for those seeking to demonstrate the fallacies of these approaches.⁵¹ As a descriptive matter, Northeast Asian states, beginning with Japan in the late nineteenth century and followed by Taiwan and Korea after 1950, were not consigned by the world capitalist system to permanent membership in the periphery. Rather, while the world capitalist system was in full force the three all moved from the periphery to either the core (Japan), or close to it (Korea, Taiwan). This suggests that even if the categories of periphery, semi-periphery, and core capture basic descriptive truths

about the world, to deny that their borders are permeable, at least under some conditions, is overly deterministic. In addition, if the developmental state theorists are correct, then dependency theory's specific distrust of the Third World state, one of its critiques of the modernization school, must be tempered. Furthermore, Northeast Asia's climb up the world systems hierarchy did not merely coincide with a global economy; rather there is near universal agreement that engaging in world markets was key to their achievements. Thus, if a prescriptive aspect of dependency and world systems approaches is that the global capitalist order produces the categories of the world system and that countries should therefore "de-link" from the international system in some systematic way, the Northeast Asian experience can again provide a counter story.⁵² In fact, while one would have to search long and hard to find a country that has moved up the hierarchy by religiously following a free-market, free-trade orthodoxy, it would be equally hard to find lasting success among countries that have taken the de-linking advice of the dependency school very seriously. In any case, however, in our post-WTO, globalizing world, de-linking hardly seems possible or normatively attractive to developing country policy makers.⁵³

If one looks a bit deeper, however, one finds substantial points of connection between dependency theory and the Northeast Asian experience. First, many Northeast Asians would agree that the world actually *is* divided between the "haves," who command the industrial, technological, financial and military heights, and the "have nots." Furthermore, as inheritors of proud cultures and histories, many Northeast Asians seem to have shared with dependency theorists the notion that they were among the "have nots" largely as a result of imperialism. Although this mindset sees the possibility of movement up the world systems ladder, it rejects the idea of de-linking, and in fact sees the possibility of progress only in aggressive engagement with the global economy; to many observers it is essentially mercantilist rather than liberal. The global economic order is treated with caution, and while widespread import substitution was of limited duration in Northeast Asia, a concern for self-reliance was reflected in the creation of elaborate mechanisms to channel and moderate connections with the international economy.⁵⁴ Because while Northeast Asian governments behaved as if the levels of the international economic order were upwardly permeable, they also behaved as if they were downwardly permeable, if international economic forces were left unmediated. Northeast Asian economic development may present a "challenge to dependency theory," in economist Alice Amsden's phrase from an early essay on Taiwan, but that challenge is based on a different set of solutions more than on a different diagnosis of the essential problem facing poor countries.⁵⁵ Friedrich List's nationalist prescriptions for late-industrializing Germany, and his critique of the cosmopolitan free-trade advocated by Adam Smith, bears a much closer resemblance to Northeast Asian trade practices than do the prescriptions of dependency theory.⁵⁶

Northeast Asia and the neoliberal Rule of Law

How do the claims of the neoliberal Rule of Law orthodoxy fare when compared with the Northeast Asian experience? Not very well, it turns out. First, on the level of private law and private property rights, the Northeast Asian experience provides good reason to think that constitutional law protecting property rights is not crucial to the overall development picture. Despite the fact that development was basically privately led, the dictators who oversaw development in Korea and Taiwan were unconstrained by constitutional law in any direct sense, showing it not to be necessary even to the relatively equitable economic growth. Clearly a political commitment to capitalism is enough, both for local entrepreneurs and for foreign investors, as China is demonstrating once again. Property rights absolutism in the United States is a political agenda that is simply not reflected in constitutional law, as the Supreme Court's "regulatory takings" jurisprudence and eminent domain decision, *Kelo v. City of New London*, show. In *Kelo* the majority of the Court extended its century-long generous interpretation of "public use" under the Fifth Amendment, facilitating the taking of property by government via eminent domain. This is not to suggest that property rights in the United States are an illusion, or that developing countries shouldn't have constitutional law and judicial review to protect them. But whether a country is a dictatorship, like Korea and Taiwan were in their high-growth eras, or a democracy, like the United States and post-World War II Japan, the idea that law and development activities can lead to the locking in of "rules of the game" protecting private property from the state is fanciful, and perhaps downright dangerous.

The story with administrative law is much the same, with even democratic Japan contradicting the orthodoxy in important ways. All three countries maintained extensive regulatory screening systems to modulate cross-border flows of technology and capital, and the bureaucracies responsible for these screens had a great deal of discretion to operate them free from the fear of judicial challenge.⁵⁷

These screening mechanisms the Northeast Asian governments erected between their economies and the international economy drove the industrial policy debate of the 1980s as well as the developmental state tradition in economics and political science, and it is no coincidence that the tendency of Northeast Asian administrators to rely on unwritten suggestions instead of formal dispositions, in domestic and international trade issues, became the aspect of Northeast Asian administrative law that really interested the West.

Finally, if one examines the specific legal fields that loom large in the orthodoxy, areas such as insolvency law, competition law, or corporate law, it is not hard to show how the roles claimed for them in the orthodoxy do not match the roles they played in Northeast Asian economic development. The most glaring example is intellectual property (IP) law, which in Northeast Asia has failed, and continues to fail to varying degrees, to live up to the demands that mainstream law and development literature would place on developing countries. At very least this shows that protection of foreign intellectual property plays an uncertain role in economic development, and depending upon whether domestic IP holders

used the legal system to protect their interests during the high growth era, it may be that even the importance of IP law for domestic purposes should be reexamined. Formal insolvency regimes were relatively little used, and competition law was notoriously unsuccessful as a tool for combating cartels.⁵⁸ Although Japan's Fair Trade Commission is now undertaking a high-profile attack on a bid-rigging cartel among specialized bridge building firms,⁵⁹ this cartel existed for over 40 years, and was so little concerned with the law that it published and distributed rule books to relevant employees from member companies.⁶⁰ And while modern corporate law completely penetrated these economies in the sense that the important firms were organized and operated as corporations, the reality was far from the model.

In Taiwan the most important corporations were either controlled by families or by the Party-state apparatus of the Kuomintang, while in Korea the important corporations were virtually all family or state controlled.⁶¹ Minority shareholder rights existed on paper, of course, but judicial enforcement of those rights did not play a serious role in corporate governance.⁶² Even in Japan, where corporate law mattered more to the reality of corporate governance, shareholders exercised control mainly through large, relatively stable holdings, not through threat of litigation to enforce their legal rights.⁶³

Legal origins and Northeast Asia's development

As noted above, although the neoliberal rule of law vision remains part of the picture, the center of gravity in the law and development world has shifted in the direction of two very different proto-orthodoxies, the legal origins and the comprehensive development approaches. As with the modernization and Neoliberal rule of law orthodoxies, it is instructive to compare the claims of these approaches with the Northeast Asian experience. Turning to the legal origins approach first, the Northeast Asian countries were all fundamentally civil law regimes. Whatever advantage can be proven for the common law through the use of statistical models, having a civil law system cannot be much of a handicap. But even though these were all basically civil law systems, they were also all hybrids to one degree or another as the result of different legal transplants and approaches, including those legal norms taken from the U.S., so coding them as one or the other for cross-country statistical comparison presents serious problems.

Turning to more specific issues, Northeast Asian corporations have succeeded under very different models of corporate governance, in none of which did corporate law provide extensive protections for minority shareholder rights. The prototypical corporation in Taiwan and Korea was dominated by controlling shareholders, with no separation of ownership and control. These owners were in turn checked by a variety of forces, including the competition of product markets, the exit option enjoyed by shareholders, and interventionist governments controlling the banks from which they borrowed. Legal rights of minority shareholders were inconsequential. The dominant pattern in Japan was different,

with ownership and management separated, but with monitoring of management again provided largely through forces other than minority shareholder rights to sue management. Given the central role corporations have played in Northeast Asian economic development, it is hard to argue for the importance of minority shareholder rights on development grounds, unless one is already assuming the superiority of stylized Anglo-American capitalism, which of course faces its own Northeast Asia problem.

Other policy prescriptions one might draw from the legal organs literature fare little better. The deep and liquid financial markets that the early law and finance studies associated with Common Law jurisdictions can be efficient allocators of capital, but bank-centered financial systems are clearly compatible with successful economic development. Likewise activist, interventionist governments can clearly go hand in hand with astounding economic development, even if they can also be prone to red-tape and rent seeking. Finally, judicial independence hardly thrived during Northeast Asia's most rapid economic development. Like other elements of the legal origins policy package, the argument for judicial independence seems to rely on background assumptions about the superiority of a stylized Anglo-American political economic tradition, assumptions which Northeast Asia's economic miracle should call into question.

It is telling that in its eight pages the references section of *Doing Business 2004: Understanding Regulation* contains not a single reference to scholarship on Northeast Asian economic development in any field, let alone scholarship on the role of law in Northeast Asian development.⁶⁴ Whether the selection bias was outcome driven, or due to some morbid tendency to study failure, it is glaring considering Northeast Asia's dramatic success.

Comprehensive development and Northeast Asia

The comprehensive development approach has much to commend it, at least to those who share its underlying assumption that having a decent society involves more than just "getting the rights right," and the approach may help insulate law and development projects from criticism, at least from the Left. But a clear-eyed look at Northeast Asia's experience suggests that the approach is either wrong, or succeeds only through redefining development in a way that risks the ethnocentrism of the modernization approach. We have seen how Northeast Asian legal systems failed important aspects of the neoliberal Rule of Law orthodoxy, but comprehensive development fares even worse.

Labor rights in Northeast Asia, for example, have long been criticized by local and foreign observers, and the Korean case is particularly interesting for being criticized by both the Left and the Right.⁶⁵ The Left claimed, accurately, that the government cooperated with business in using illegal means to suppress independent unions, trying to instead coerce a system of company (not trade) unions, which would all belong to the docile, government-approved national peak union.⁶⁶ Business groups, meanwhile, complained that Korean labor markets were insufficiently flexible because of the protections the law provided

to individual workers. To give but one example, Korea, like Japan, does not allow at-will termination, a provision that particularly baffled American investors.⁶⁷ Perhaps the simplest way to understand Korean labor regulation is as paternalist, meaning that it rejected a free-market model by including comparatively rigid protections for those worker interests that it recognized, but at the same time also discouraged labor from organizing in ways that would allow it to become a political force in its own right, participating in the definition of its interests.⁶⁸ It seems likely that replicating Japan's labor situation was the goal of this system, as after the 1950s Japan enjoyed relative labor peace, while also keeping labor's role in setting the terms of the overall political economy comparatively limited.⁶⁹ Particularly in Korea and Taiwan, the state did not stop with merely legal means to enforce this regime, but also resorted to illegal measures to keep labor under control.⁷⁰

With respect to civil and political rights, social justice, sustainable development, access to justice, or the other add-ons that differentiate the comprehensive development approach from the neoliberal rule of law orthodoxy, Northeast Asia fared little better during its high-growth decades, and not everything has changed. In the spirit of comprehensive development, the World Economic Forum "has begun to explicitly incorporate in its measures of competitiveness aspects of gender equality. . . . Countries which do not capitalize in the full potential of one half of their societies are misallocating their human resources and compromising their competitive potential."⁷¹

While it is hard to disagree with the proposition that misallocating its resources makes a country less competitive, the fact that Korea ranked 54th out of 58 countries in the WEF's 2005 gender equality study, while Japan came in at 38th, suggests that the subjugation of women in Northeast Asia has not been a significant drag on their economies, though that is no reason not to treat it as a very serious human rights problem.⁷² One might argue that keeping women at home working without wages helped to enable rapid development because governments did not need to provide decent social safety nets, though this would not be compatible with the idea of equitable development. The World Economic Forum invoked the idea of "misallocating resources" in its argument for gender equality because it evokes the apolitical, technocratic authority of economics, but the claim is highly questionable. Women have obviously played enormously important roles in Northeast Asian economic development, but if we claim that those roles resulted in the "misallocation of resources" then it seems that what we have done is to turn resource allocation into a normative question, and then answered it by asserting our own values. That is not the answer to the problems of law and development.

The same argument applies to civil and political rights more generally, which were severely curtailed in Korea and Taiwan for decades, with martial law, restrictions on the press, restrictions on travel, and quasi-police state measures to penetrate all levels of society.⁷³ Social safety nets were very thin by Western standards,⁷⁴ and to the extent that "sustainable" development means environmental protection and forcing manufacturers to internalize the costs of the

pollution they produce, growth was prioritized over sustainability.⁷⁵ Nor was access to justice ever given much emphasis in Northeast Asia, as the formal legal system remained relatively distant from the lives of ordinary citizens. Legal professions were intentionally kept tiny compared to general populations, as were judiciaries, and while other law-related professions and non-judicial dispute settlement took up some of the unmet demand, nobody has ever argued that Northeast Asian citizenries were given easy access to their formal legal systems.

One can say, therefore, that if the claim is that economic development requires the “comprehensive development Rule of Law”, then the claim is simply wrong. The record, in fact, better supports the older economy-first arguments that it is the suppression of individual rights and democracy that is somehow positively related to economic development, and that rights and democracy will come later. Whatever its other faults, that argument at least benefits from an obvious correlation in the Northeast Asia experience, where growth did come before democracy and social advances, whereas the comprehensive development approach is directly contradicted. It may be, though, that the Rule of Law vision is now an end in itself, no longer a means to an end.⁷⁶ But then there is a circularity problem: if we define “development” to include right/value X, then a legal system that enshrines and effectively protects right/value X is going to be a prerequisite to development. This is problematic on several grounds, however, some of which have been raised already.

First of all, Northeast Asian societies, despite not conforming to any of the law and development orthodoxies, are highly successful societies in many respects. In fact it often seems to be Northeast Asia’s successes, whether in building cars, in life expectancy, or in education, that raise international standards and thus push us to do better. Thus there is something deeply ethnocentric about any attempt to build a comprehensive socio-legal model to be sold to today’s developing countries that does not take Northeast Asia seriously. Furthermore, given that law and legal systems are intensely political, there are good reasons to be skeptical about ever-expanding definitions of their tasks by law and development practitioners, especially from the IFIs. Any law and development approach is going to be political, and law and development orthodoxies inevitably involve normative pictures of how their creators wish the world were. But limiting the objective to some measure of economic performance seems less imperialistic than an open-ended mandate to remake societies. And even though law and development practitioners can always fall back on the formal excuse that they are simply doing what’s been requested by the local government, if a legal field is at all contested in a society, an invitation from the current regime will very likely just mean siding with the winner in very political local debates.⁷⁷ This is not only playing in local politics in everything but the most formalist sense, but it also means that reforms pushed through in this way will very likely lack the true local ownership that would give them real stability.

A new approach to law and development from the Northeast Asian practice

Criticism of law and development orthodoxies is important, both as a way to challenge existing approaches, and as an exercise that can encourage critical thinking about relationships between law, economics, politics and social life. But when new bursts of law and development activity come it often seems as if criticism of the last round, if noted at all, has had limited impact. It seems clear, for example, that Trubek's and Galanter's attack on the assumptions of the first law and development movement has had a more lasting effect on legal thought, through its contributions to the Critical Legal Studies and Law and Society movements, than it has on the law and development agenda as such.

In the marketplace of law and development ideas, there seems to be a very real need for clear prescriptions that affirm the importance of legal system performance to economic development, yet do so in language that is technocratic rather than overtly political, while also conforming to the positive view of law held by donor countries. Thus, there are structural reasons why the law and development industry will remain impervious to criticism by counter-example if the counter-examples cannot be packaged into some sort of coherent alternative program.

Legal "failures" in Northeast Asia as the basis for an alternative approach to legal development assistance

If we look at all the ways in which Northeast Asia's legal systems during the development experience fail to meet the claims of the law and development orthodoxies, we are confronted with quite a catalogue of failures. Legal systems in high-growth Northeast Asia failed in many ways to move beyond formalist thinking, failed to put judiciaries and problem-solving lawyers at the center of the governance process, failed to serve as convenient fora for private litigation to enforce property and contract rights, failed to protect minority shareholder rights, failed to take intellectual property rights, competition law, or insolvency law very seriously, and failed to legalize state-private sector relations through constitutional and administrative law. This creates a serious problem if, like each of the law and development orthodoxies discussed here, one wants to claim that any particular legal system attribute is really necessary for development. But if one seeks instead to develop a theory of law and development inductively, by looking at how law actually functioned in Northeast Asia during high-speed economic growth, these failures disappear, replaced by ranges of performance amenable to functional analysis in ways that the failures view is not.

Northeast Asian legal instrumentalism and the compartmentalization of law

With respect to legal instrumentalism, Northeast Asia's experience establishes a couple of facts. First, instrumentalism beyond the American liberal legality norm

associated with the modernization orthodoxy is perfectly compatible with rapid economic growth. But even if one defines development more broadly, as under the modernization and comprehensive development approaches, the Japanese experience shows that a thoroughly modern society can allow a degree of legal instrumentalism beyond even the modernization model, accomplished through constraining judges to decide individual cases according to the norms of the bureaucracies within which they work.⁷⁸ The result for Japan has been that the judiciary has not become an active participant in the overall governance system to anything like the degree federal courts are in the United States. But, as has become very clear now in the United States, the idea of a non-political consensus on the independence of our judiciaries, federal as well as state, was one of those attractive fictions from a less polarized era.⁷⁹ While this might have disappointed the law and development practitioners of the 1960s, as it has disappointed many critics of Japanese public law, it would probably not have disappointed the Americans who drafted the Japanese constitution during the occupation era, whose New Deal sensibilities about judicial versus executive and legislative power were more like those that have prevailed in Japan.

Finally, if we remain uncomfortable with legal instrumentalism in the Third World, or at home, it is worth asking whether legal reform programs can be presented in a truly non-instrumental way. This is an attractive idea, which recurs in places like the “credible commitments” literature, as it adopts a pre-Legal Realist faith in the ability of constitutional text and institutional arrangements to insulate property from politics. But from the jaded perspective of 2009 when this chapter was written, it is hard to imagine how this ever could have been persuasive to Third World elites: “We’re here to help you make your legal system into an effective tool to reorder your society, but don’t try this yourself because law is not a tool.”

Legal education, legal professions, and the social role of the formal

Several other aspects of Northeast Asia’s legal systems that contradict claims of the law and development orthodoxies can be understood as relating to the general role of law and the formal legal systems during the high-growth periods. As we have seen, legal education remained far too doctrinal and formal to satisfy the modernizers of the 1960s, while local bars were kept tiny because governments set very low quotas of those allowed to pass the licensing exams in any given year. Governments also kept their judiciaries very small by international standards, but being a judge was attractive enough as a career option to guarantee that very capable people staffed the bench. While the judges who staffed these judiciaries were on the whole highly competent, however, they were subjected to supervision and control by superiors who held fundamentally conservative, pro-development political views, and who believed in a restrained role for the judiciary in the governance system.

Undergraduate law departments were numerous, however, turning out thousands of law-trained graduates each year who had no hope of becoming fully

licensed lawyers, but who instead went into government service, worked in corporate legal departments, or worked in one of the law-related professions such as notaries. Small bars helped guarantee that legal services necessary to access the formal system would be expensive, despite the fact that many people received training in law. Furthermore, access to the formal system was discouraged by professional rules concerning legal fee arrangements, procedural rules concerning such things as the posting of court costs, and the fact that litigation consisted not of trials in the United States sense, but of a series of hearings that could drag on for years even in simple cases. While recent developments suggest that many in Northeast Asia are no longer satisfied with this long-standing settlement, the question is whether it might have played any positive role in the development process.

One possibility has to do with the allocation of scarce resources. A possible virtue of this arrangement is that it helped guarantee that law would be “potent” in that it permeated the internal workings of both government bureaucracies and business organizations, a desire that will probably accompany any law and development effort. It is arguable that this potency was achieved at a relative bargain price, however. Providing undergraduate legal education through lecturing to large classes was comparatively cheap, with more labor-intensive training reserved for those very few who had passed the bar exam and would staff the formal system, either as judges, lawyers or prosecutors.

The system’s approach to the judiciary might also be seen as a rational approach to the potency problem in conditions of limited resources. Because the systems generally discouraged both private and public law litigation, it was possible to spend relatively little on the judiciaries, yet still have them produce coherent, technically competent adjudication in those comparatively few cases that they decided.⁸⁰ Furthermore, while many would object to the control that could be exercised within these systems with respect to the decisions of individual judges, one effect of that control was to maintain and enforce a relatively limited role for law and the courts in the broader political economy. If we engage in a comparative institutional analysis, considering the courts alongside the other organs of government, it certainly seems plausible that from a purely economic point of view the judiciary should be limited in its ability to define its own role in governance. Of course the body doing the controlling could let the individual case decision stand, then act politically to limit the undesired extension of law, but that might be difficult. If the decision is on constitutional grounds even an authoritarian political system may feel constrained in its ability to change the constitution, or if, as Haley argues was the case in Japan, the controlling body is the head of the judicial bureaucracy rather than a political branch, then that body may have no legal statutory authority, and may prefer to keep the political branches away from its domain.⁸¹ The style of legality it produced, however, was more constrained than would be produced by the more “modern” ideal type of large and competitive bars, larger and less disciplined judiciaries, and greater incentives to litigate.

Contract and property rights enforcement

It would be extreme to suggest that a modern market economy could function without law to define property and contract rights, and without courts available to adjudicate disputes that will inevitably arise as market actors transact based upon these rights. Unfortunately, however, the law and development literature too often speaks of judicial dispute settlement in binary terms: it is either available to enforce contracts and property rights, or it is weak, corrupt, ineffective, or something equally repugnant. A better way to look at the issue would be to start with the view that any functioning legal system will again present a trade-off, or continuum, with respect to its attractiveness to litigants. A legal system that makes it too easy to resort to litigation will destroy a certain number of beneficial business relationships that are under stress, but that might be salvaged by the parties were litigation a less attractive alternative. In other words, judicial dispute settlement may “crowd out” private dispute settlement at a cost to the economy. A legal system that makes private litigation entirely implausible, on the other hand, would leave enforcement of contracts to the parties, and property rights to the criminal law.

Northeast Asia’s legal systems have been consistently described as comparatively unfriendly to litigation, a characteristic that was partly responsible for relatively low litigation rates and a reliance on non-judicial settlement of business disputes. While it may be that this approach hindered economic development, or was simply irrelevant, it is at least possible that they settled closer to the ideal point on the continuum than the United States, for example. In any case, this experience demonstrates that one ought to ask whether a legal system creates roughly appropriate incentives to private litigation, yet this question seems absent from much law and development writing.

Putting substance over form in legal technical assistance

Now that these historical failings of Northeast Asian legality have been recast as trade-offs on a series of policy continua, is it possible to forge from it something that can contribute positively to the law and development literature, rather than serving simply as material for critique? The answer is yes, but to do so it will be helpful to see mainstream law and development literature as overly influenced by Max Weber, for whom the “formal” in formal legal rationality meant that legal reasoning referred only to the internal logic of the legal system itself, not to “substantive” value systems or ideologies. In his view, this resulted in a high degree of autonomy for law, and maximized the predictability of legal outcomes to private actors. Substantive rationality, on the other hand, prevailed when non-legal value systems, such as Confucianism, informed the reasoning of legal decision makers.⁸² Although not exactly reproducing Weber’s ideal-types, each of the law and development orthodoxies discussed here betrays its own variant of formalist thinking which renders it incompatible with the Northeast Asian experience.

The modernization orthodoxy has been criticized for formalist assumptions about law, though more important was the formalism in its idea that modernized legal institutions, staffed by modernized people, would produce reliably modern outcomes, with “modern” meaning outcomes that essentially conformed to mid-twentieth century American ideals. The formalism inherent in the Washington Consensus rule of law orthodoxy shares some of the aspects of its predecessor, in the idea that “getting the rights right” is the key to thriving markets, for example, but also takes a much more formalist approach to law itself, thus calling for something much closer to Weber’s formal legal rationality. While property rights were obviously important in the market economies of Northeast Asia, given the diminished role for litigation as the “enforcer” of property rights as well as the noted tendency towards informality in contracting behavior and in organizational form, it is clear that the relationship between the written law and the behavior of economic actors was far more complex than the orthodoxy.

The legal origins proto-orthodoxy is prone to similarly formalist tendencies, as it radically overestimates the closeness of the fit between formal rules and structures and real economic behavior. Finally, like the modernization approach, the comprehensive development approach assumes that the social outcomes it desires will be obtained if the specific legal rules and institutions it supports will perform the functions assigned to them in the theory.

The organizations that do law and development work are staffed by people who need generally applicable frameworks that they can apply around the world, and frameworks of that sort are prone to formalism. It is not simply the need for generally applicable ideas that is the problem, however, but the fact that the actual substantive results, the societal ends which law and development activities should be serving, become secondary to the task of creating the legal rules and institutions which the various orthodoxies claim produce those outcomes. In the words of one long-time World Bank law reform practitioner: “[t]he conventional approach sees legal and judicial reform as an intrinsic good, based on the belief that once legal concepts and institutions of a particular model are established, positive development outcomes will follow—economic, social and political.”⁸³

What is needed, then, is not a new orthodoxy based on what we think happened in Northeast Asia, but a new approach to law and development. That new approach would reject the existing practice, in which successive models are presented as the solutions to the development problem, an inescapably formalist approach. Rather than presenting yet another model, the new approach would generate legal technical assistance that would consist of presenting legal reform issues *as we actually think about them ourselves*, as ridden with tradeoffs, so that where a legal system falls on a particular dimension is important, not some abstraction. The presentation would include such evidence as we have about how successful economies have approached these tradeoffs, and it would be through these appraisals that Northeast Asia’s experience could make an enormous contribution. And because individual legal fields are very often related, the approach would include such evidence as we have of the ways that choices about one area of law or legal institution might affect others. Even if one thought, despite

Northeast Asia's experience, that developing countries should aim for a high level of functioning in all the areas of law contained in the chart, above, in a world of limited resources that is not a realistic possibility. Thus another important contribution of the approach outlined here is that it could be used to help prioritize among various reform possibilities. For example, countries with relatively clean, competent bureaucracies might decide not to devote as many resources to administrative law reform, while countries with strong science education and a desire to foster domestic industry, such as China today, might choose to postpone heavy investment in intellectual property protection until such protection is demanded by local IP owners.

In a macro sense, what the Northeast Asian experience suggests is that if the goal is economic development, then the legal system should as a whole operate in a mode more similar to Weber's *substantive* rationality, rather than to his formal rationality, with the "substance" provided by a commitment to industrialization and economic growth. This does not mean copying the specific policy decisions of Northeast Asian economies, because that would constitute yet another questionable orthodoxy. It would mean, however, approaching the legal system as a tool that should be operated to achieve rapid economic development, which would tend to shift the focus from rules and institutions to outcomes. Such outcomes might be controversial, in the sense of favoring accumulation over redistribution, management over shareholders, and industrialization over the environment, but perhaps not. At least these important distributional questions would be out in the open, rather than being clouded by rhetoric.

What changes would be required under this new approach? The most important would be for law and development activities to move up a level of engagement, to focus on providing options, instead of providing answers. To do this, it would be very useful to take a team approach to staffing law and development projects, with teams to include both common law and civilian lawyers, but also lawyers from successful developing countries. It would also be crucial for legal assistance providers to abandon the idea that their job includes pursuing some broader agenda, such as maintaining the international financial system or the WTO. There is a tendency to want all good things to go together, to want what is good for any particular developing country to also be good for the rest of the world. It is clear from the Northeast Asian experience that sometimes countries benefit from behaving strategically in their interactions with the world, however, so if we really want to help them we should focus on their particular development concerns, and let someone else worry about maintaining the international economic order.

Even if strategic behavior is never actually helpful, however, it seems that economic nationalism has played an important role in Northeast Asia's success. Most developing countries are too insignificant economically for a bit of nationalism to endanger the world economy, and the big countries such as China can largely ignore legal assistance efforts that they think are not in their interests. The world should encourage developing country governments to be concerned, first and foremost, about national development, even at the expense of their

trading partners or the international economic order. Finally, legal assistance practitioners would need to be able to separate themselves from their own national experience, to be open to the fact that something might be useful to a developing country even though their own country has moved away from that practice. This rejects simple best practices approaches, which assume all countries of the world have essentially the same needs, in which case there might actually be a set of non-controversial, apolitical, scientifically-verifiable “best practices.” Best practice for a developing country today might be the Korean corporate governance in the 1970s, for example, not Korean corporate law as of 2005, let alone United States corporate law.

Moving up a level of generality and adopting a “substantive rationality” approach would also help ameliorate the “legal transplant” problem that has bedeviled law and development activities from the beginning. Outsiders would be out of the business of advocating particular rules with particular results in mind, so the problem of rules not transplanting with the intended functional results would disappear. And while outsiders would still advocate for basic institutions such as courts, securities regulators, patent offices or antitrust authorities, it would be recognized that such institutions can play a variety of roles even in successful market economies, and certainly during development. The question then becomes whether the various institutions are functioning so as to support or to impede economic growth, not whether they have been effectively “transplanted.” New rules and institutions will often not function as anticipated, and while being aware of the transplant problem is useful, the new model’s “substantive rationality” calls for continuous monitoring and adjustment, rather than unrealistic expectations followed by followed by exasperation.⁸⁴

Putting this approach into practice would place serious demands on those involved, because a substantive rationality approach would require accurate and continuing monitoring of affected legal systems, to see whether the goals of particular areas of law were being met, and to facilitate intelligent adjustments if not. Adjustment would necessarily involve learning by doing, not by rote, or by hectoring. If donor governments or organizations want to place conditions on their law and development assistance, the appropriate conditions should also become “substantive” rather than formal, being based not on whether the new rule or institutions exist on paper, but on whether the recipient government was taking seriously the task of monitoring and adjusting the new legal rules or institutions so as to facilitate economic growth. Because one of the dimensions along which all legal systems fluctuate involves the twin concerns of stability, to facilitate private planning, and flexibility, to allow necessary change, the processes by which adjustments would be made would also be open to evaluation.

This would also help solve the intractable problem of political interference by allowing the local political process to take responsibility for making the decisions that will affect where the legal system will land on the various continua. Law and development orthodoxies contain within them political choices, and offering an empirically-based menu of options, rather than yet another orthodoxy, puts the choices up front, for all to see.

Given the fact that law and development orthodoxies cannot seem to make sense of the Northeast Asian development miracle, there is reason to doubt that just getting the right set of rules in place is ever going to be the answer. Moreover, unless local politics can be permanently suppressed, a method that crams down a set of rules or institutions over the objection of a significant opposition cannot achieve “ownership,” but is likely to be either subverted in implementation, or reversed when political fortunes change.

Conclusion

Until perhaps very recently Northeast Asia’s legal systems have conformed to none of the orthodoxies of law and development, yet these were the systems in place as their societies underwent the most successful episodes of economic development in modern history. This is obviously a problem with the ways in which the theories have been produced, which have not included careful study of Northeast Asia. Yet what is needed is not a new orthodoxy, in which whatever we think Northeast Asia did would be reduced to a template, to be imposed on today’s developing countries. Rather, what is needed is a new approach that learns from Northeast Asia, but that also recognizes the limits of the ways in which past law and development orthodoxies were used.

This chapter sets out the foundations of a framework to inform the work of law and development providers. But can providers adopt the approach suggested here, to help developing countries orient their legal systems toward a substantively rational emphasis as outlined above? One precondition would be that the IFIs adopt a perspective that allows them to advance the interests of particular developing countries even if those interests conflict with interests of developed countries, or of the international community. The points at which Northeast Asia’s legal systems settled on the performance continua discussed above have been problematic from the perspective of foreigners wanting to participate in their economies, and the globalization of investment and finance only makes this worse.

At present the dominant mindset seems to be that there can be no conflict between local and foreign interests because foreign interests represent the market, so their wishes become the benchmark for proper market economy regulation. With something as technical as economic law reform, however, it seems likely that there will be many specifics that can be handled so as to promote local investment and industrialization that will not matter much to foreign actors. The IFIs must at least be able to focus on what’s best for individual developing countries when looking at these factors. If they and other law and development practitioners can get that far, then they should try to encourage developing countries to orient their legal systems towards assisting economic development in a substantively rational way. This will raise a host of practical problems, but at least these problems will be visible.

While current law and development scholarship supports reliance on formal models, such an approach only obscures necessary policy choices in favor of a

focus on formal rules and institutions, and the success rate of such approaches has not been high. The problem begins when models are built that purport to explain law's role in economic development, but that ignore the functioning of law in the Northeast Asian miracle. The difficulties continue when the implementation of law reform projects is overtaken by a formalist logic which assumes that if certain reforms are enacted the desired results will follow. Projects thereby become self-referential, judging themselves based on how they have changed the legal system, rather than on how they have affected social reality.

Notes

- 1 Professor of Law and Director, East Asian Legal Studies Center, University of Wisconsin Law School. I would like to thank Bill Alford, Marc Galanter, Don Clarke, Bryant Garth, Terry Halliday, Chuck Irish, Neil Komesar, Chang Hee Lee, Yoshi Matsuura, Veronica Taylor, David Trubek and Frank Upham for their comments and suggestions. I would like to thank participants in workshops at Tsinghua University in Beijing, Seoul National University, Korea University, Chuo University, Doshisha University, Hokkaido University, Cornell Law School's conference on Japanese law and participants in the panel at the 2004 Annual Meeting of the Law and Society Association. Much of this paper was written while a visiting researcher at Nagoya University's Center for Asian Legal Exchange (CALE), and I particularly want to thank CALE for their support.
- 2 The law and development community consists largely of academics and development practitioners who focus on the socio-economic role of law in supporting development, variously defined. Academic participants have come largely from social science and law faculties in Europe and the United States, while practitioners have come from international financial institutions such as the World Bank, and from national development aid bureaucracies such as USAID. The idea of "law and development" as a field at the intersection of economic thought, legal thought, and development agency practices is developed in David M. Trubek and Alvaro Santos, eds., *The New Law and Economic Development* (2006).
- 3 Though rarely mentioned now in Western discussions of law and development, the socialist world had its own version of law and development, supporting the spread of socialist legal institutions, for example from the Soviet Union to China in the 1950s. Western and socialist law and development initiatives were parallel aspects of the larger Cold War contest for global influence.
- 4 For an application of this approach to the task of developing theory about economic development more generally, see Alice H. Amsden, *The Rise of "The Rest": Challenges to the West from Late-Industrializing Countries* 290 (2001) ("Models that are inductive use concrete cases of industrial expansion rather than abstract hypotheses to explain growth and guide policy making"). Economist Dani Rodrik has applied a similar approach in his work on the role of government in East Asian development. See, Dani Rodrik, "Getting Interventions Right: How South Korea and Taiwan Grew Rich," National Bureau of Economic Research Working Paper No. 4964 (December, 1994). For an insightful example from the era of modernization theory, see Alexander Gershenkron, "The Modernization of Entrepreneurship," in *Modernization: The Dynamics of Growth* 246 (Myron Weiner, ed., 1966).
- 5 On Weber's "England Problem," see David M. Trubek, "Max Weber on Law and the Rise of Capitalism," 1972 *Wisc. L. Rev.* 720.
- 6 World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (1993). Japan's success came earliest, beginning in the decades around the turn of the twentieth century.

eth century, when Japan was transformed from a relatively isolated, largely agricultural economy into an industrial power capable of challenging Western military power in Asia, and of striking fear into Western manufacturers. After its industrial base was devastated in World War II, Japan experienced a second “miracle” during the 1950s, 1960s and 1970s, as its economy quickly returned to its pre-war levels, then maintained growth rates that made Japan one of the world’s richest societies by the 1980s. Taiwan and South Korea experienced the dark side of Japan’s initial economic development, as they both were colonized by Japan, and remained under Japanese rule until 1945. Though some see this period of Japanese colonial rule as not entirely negative with respect to post-independence economic development, the Korean and Taiwan ‘miracles’ are normally seen as beginning around 1960, and lasting until sometime in the 1980s. An important strain of economics scholarship criticizes the “miracle” label on the ground that all, or nearly all, of Northeast Asia’s economic growth can be explained using normal tools of economic analysis. See, Alwyin Young and Paul Krugman, “The Myth of Asia’s Miracle,” *Foreign Affairs* (1994). While this may be true, it begs the comparative question of why Northeast Asian economies were able to do what so many others could not.

- 7 See, e.g., Robert Wade, *Governing the Market* (1990). Kreuger, Bagwati, e.g.
- 8 Japan’s political policies towards Korea were harsher and more ambitious than those towards Taiwan, at times calling for Korea to be incorporated into Japan proper, and for Korean culture to be essentially eradicated. Taiwan, by contrast, was treated much more like a “normal” colony. Japan’s economic policies towards the two colonies differed as well, with Taiwan remaining a largely unindustrialized exporter of agricultural products to Japan, while Korea, particularly the northern regions, became fairly heavy industrialized. Taiwan ended up being ruled by the Nationalist government that had substantial experience in China prior to fleeing to Taiwan in the late 1940s, as it was losing the Chinese civil war to Mao Zedong and the communists. Korea, in contrast, was under United States military rule until 1948, after which formal authority was turned over to a newly established political system dominated by United States protégée Syngman Rhee, who won the first presidential election.
- 9 Policies toward foreign investment have varied among the three, as have levels. Foreign direct investment played a much greater role in Taiwan than in Korea or Japan. Since the Financial Crisis, however, Korea has taken a much more liberal stance toward foreign investment in terms of form, ownership levels and economic sectors, with the result that foreign investment in the economy has exploded. Foreign investment in Japan has also increased, as Japan’s slump has contributed to the unwinding of stable shareholding relationships that discouraged certain forms of foreign investment, and has reduced the value of various assets to the point that they are attractive to foreign buyers. Japan’s economy was characterized by little direct state ownership, while the level in Korea was higher, and the level in Taiwan was higher yet. For a discussion of the differences between Taiwan and Korea, see Alice H. Amsden, “Big Business and Urban Congestion in Taiwan: The Origins of Small Enterprise and Regionally Decentralized Industry (Respectively),” 19 *World Development* 1121 (1991). Most of the large private firms in Korea and Taiwan have been family controlled, while this has not been the case in Japan. Stijn Claessens, Simeon Djankov, and Larry H.P. Lang, “Who Controls East Asian Corporations?” World Bank Policy Research Working Paper 2054 (1999). Not surprisingly, Korea has the highest per capita defense spending of the three.
- 10 For studies of Northeast Asia examining specific differences against relatively common background conditions, see, Hun Joon Park, “Small Business in Korea, Japan, and Taiwan: Dirigiste Coalition Politics and Financial Policies Compared,” 41 *Asian Survey* 846 (2001) [comparing different policies towards small and medium enterprises]; Richard Whitley, *Business Systems in East Asia* (1994) (comparing business structures in Japan, Korea, Taiwan and Hong Kong); John K.M. Ohnesorge,

- “States, Industrial Policies & Antidumping Enforcement in Japan, South Korea and Taiwan,” 3 *Buffalo J. Int’l. L.* 289 (1996–97) (comparing antidumping practices in Japan, Korea and Taiwan); Gary G. Hamilton and Nicole Woolsey Biggart, “Market, Culture, and Authority: A Comparative Analysis of Management and Organization in the Far East,” 94 *American Sociological Review*, Supplement S52 (1988) (examining different outcomes with respect to enterprise organization, despite relatively similar background conditions).
- 11 David M. Trubek and Marc Galanter, “Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States,” *Wisconsin Law Review* 1062 (1974). A useful recent introduction to modernization theory is Nils Gilman, *Mandarins of the Future: Modernization Theory in Cold War America* (2003).
 - 12 John K.M. Ohnesorge, “The Rule of Law, Economic Development, and the Developmental States of Northeast Asia,” in *Law and Economic Development in East and Southeast Asia* (Christoph Antons, ed., 2003). On the origins of the “Washington consensus” concept, see John Williamson, “From Reform Agenda to Damaged Brand Name: A Short History of the Washington Consensus and Suggestions for What to Do Next,” *Finance & Development*, 10, (September, 2003).
 - 13 See, John K.M. Ohnesorge, “China’s Economic Transition and the New Legal Origins Literature,” 14 *China Economic Review* 485 (2003). This literature is also referred to as the “law and finance” literature, and sometimes as the “law matters” literature.
 - 14 See, Gilman, *supra* note 11 at 77–79 (discussing interdisciplinary aspects of modernization initiatives at Harvard, Yale, and Chicago, and tracing interdisciplinary focus to Talcott Parson’s search for a unified theory of social action in which the role of neo-classical economics would be limited.)
 - 15 Even if real at the time, that consensus papered over disagreements that had existed before, and have since resurfaced to dominate American politics. For example, the American political Right’s current project of enlisting fundamentalist Christians and Catholics, on religious grounds, against the federal judiciary represents the sort of ideological warfare that should have been long discarded in the legal culture of a “modern” society, though of course it would have been perfectly understandable to the Left of the New Deal and prior generations. Likewise, the recent revival of the old battle against teaching evolution in the public schools, certainly best explained as a result of people’s religious beliefs, suggests that the post-ideology “modernization” consensus was exceptional, rather than a final, higher stage of social evolution.
 - 16 David M. Trubek, “The ‘Rule of Law’ in Development Assistance: Past, Present, and Future,” in Trubek and Santos, eds., 74, 76 (2003).
 - 17 In the words of AID General Counsel Thomas Farmer in 1966, “[t]he explanation (for the woeful performance of developing country lawyers) seems to lie first of all in the nature of their legal education—a system generally based on foreign models more responsive to conditions in Europe than to the distinctive needs of the developing societies.” Address by Thomas L. Farmer, General Counsel, Agency for International Development, Department of State, before the Council of the Section of International and Comparative Law, American Bar Association, Montreal, Canada, August 7, 1966; published in Vol. 112, Part 19, Congressional Record 25449–25450 (1966) (quoted in Franz Ballmann, *Legal Technical Assistance of the International Monetary Fund to Member Countries Through Economic Development Legislation*, 3 *J.L. & Econ. Dev.* 197, 202 (1968).
 - 18 *Id.*
 - 19 Trubek, “The ‘Rule of Law’ in Development Assistance,” *supra* note 16, at 75. The International Monetary Fund was involved in legal technical assistance by the late-1960s, however, though at that point the IMF was less demanding of its borrowers. See, Ballman, *supra* note 17. As for the choice between the United Nations and institutions such as the World Bank or the IMF, some suggest that developed countries

- shifted the development agenda away from the UN and to the IFIs because they were easier to influence. See, John Toye, "Changing Perspectives in Development Economics," in *Rethinking Development Economics* 21, 32 (Ha-Joon Chang, ed., 2003).
- 20 For many modernization theorists, the Soviet Union did in fact constitute a modern society, as it appeared to be highly industrialized and urbanized, with a government that had succeeded in penetrating the society to mobilize the populace. See, Gilman, *supra* note 11, at 148–149.
 - 21 See Francois Gianviti, "Evolving Role and Challenges for the International Monetary Fund," 35 *International Law* 1371, 1374 (2001) (discussing the broad language and interpretive power of the IMF) and Robert C. Effros, "The World Bank in a Changing World: The Role of Legal Construction," 35 *International Law* 1341, 1345–1347 (2001) (evaluating Dr. Sihata's view of law and development).
 - 22 For an example from the field of law and development, see Henry J. Steiner and Trubek M. Trubek, "Brazil—All Power to the Generals," 49 *Foreign Affairs* 464 (1970–71).
 - 23 See, e.g., George Stigler, "The Theory of Economic Regulation," 2(1) *Bell Journal of Economics and Management Science* 3 (1971); Thomas W. Merrill, "Capture Theory and the Courts: 1967–1983," 72 *Chicago Kent Law Rev.* 1039 (1996–97).
 - 24 Toye, *supra* note 19, at 30–31; Merrill, *supra* note 23.
 - 25 John Toye and Richard Toye, "The Origins and Interpretation of the Prebisch-Singer Thesis," 35 *History of Political Economy* 437, 440–441, 437–438 (2003).
 - 26 The institutional approach of Douglass North, for example, would be open to the same critique. See Douglass North, *Institutions, Institutional Change, and Economic Performance* (1990) (providing an analysis of the nature and role of institutions which has become widely cited in law and development literature); Jonathan Conly, *Comments on Douglass North's "Understanding the Process of Economic Change"* (Forum Series on the Role of Institutions in Promoting Economic Growth, Mercatus Center of George Mason University) 2 (June 24, 2003); Douglass C. North, "Institutions," *J. Econ. Perspectives*, Winter 1991, at 97, 97 ("Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights)").
 - 27 Trubek and Galanter, *supra* note 11, at 1063. See also, James A. Gardner, *Legal Imperialism: American Lawyers and Foreign Aid in Latin America* (1980); Francis Snyder, "Law and Development in the Light of Dependency Theory," 14 *Law & Soc. Rev.* 723 (1980).
 - 28 Scott Newton, "The Dialectics of Law and Development," in Trubek and Santos, *supra* note 2, at 174, 182–187 (discussing the "Commonwealth school" that arose, informed by dependency theory, in reaction to the modernization orthodoxy).
 - 29 See, Douglass North, *Institutions, Institutional Change, and Economic Performance* (1990), a book which came to be widely cited in the law and development literature.
 - 30 Upham, *infra* note 32; Ohnesorge, *supra* note 12.
 - 31 Ronald Coase, "The New Institutional Economics," 88(2) *American Economic Review* 72 (1998); Douglass C. North, "Institutions and Economic Theory," 36 *American Economist* 3 (1992).
 - 32 See, e.g., Cheryl W. Gray, In Search of Owners: Privatization and Corporate Governance in Developing Economies, 11 *World Bank Research Observer* 179, 181 (1996):

[Formerly socialist economies must] establish the institutions of a private market economy. Socialism either crippled or reoriented these institutions to reflect the goals of central planners. Legal frameworks defining property rights, private contract regimes, fiduciary liability, dispute resolution mechanisms, and rules of entry and exit for private firms atrophied. Courts lost much, if not all, of their independence as well as their role as adjudicators of commercial disputes and enforcers of

commercial laws. Banks lost their independent monitoring role over firms and became instead passive funnels for channeling state funds. “Watchdog” institutions that provide critical information for markets to function, such as credit-rating and consumer protection services, accounting and legal professions, and independent journalism, had neither reason nor permission to exist. Finally, socialism inhibited (indeed, often classified as illegal) the development of basic norms and ethics of market conduct and fiduciary responsibility on which so much behavior in advanced market economies implicitly rests. These laws, organizations, professions, and commercial norms must now be rebuilt, sometimes from scratch.

Countries wanting to reform within a basically socialist order might turn to China, but China has not shown great interest in exporting its law reform experience, and countries in Southeast Asia such as Vietnam tend to be ambivalent about Chinese influence.

- 32 On Japan, see Frank K. Upham, “Political Lackeys or Faithful Public Servants? Two Views of the Japanese Judiciary,” 30 *Law and Social Inquiry* 421 (2005) (reviewing contending explanations of how Japanese judges are controlled). On Taiwan, see Hsiao-Ming Wang and Leanne Fiftal Alarid, “Judicial Sentencing Decisions in Taiwanese Economic Crimes: Consequences of Swift Justice,” *Law & Society Review* (2001):

By law, judges in Taiwan, like their American counterparts, should make their judgment independently. However, the promotion and transfer of Taiwanese judges are controlled by the Judicial Yuan, the highest authority of judicial administration in Taiwan. Hence, this chain of command may impact judicial decisionmaking.

On Korea see, Dae-kyu Yoon, (1990). *Law and Political Authority in South Korea*.

- 34 Upham, *supra* note 32.
- 35 Korea, for example, had only 811 lawyers in private practice in 1977. Kyong Hwan Ahn, “The Growth of the Bar and the Changes in the Lawyer’s Role: Korea’s Dilemma,” in Philip S.C. Lewis, ed., *Law and Technology in the Pacific Community* 119 (1994).
- 36 A special issue of the *Wisconsin International Law Journal* contains papers on legal education reform in Taiwan, Korea and Japan, 24(1) *Wisconsin International Law Journal* (2006).
- 37 Sixty-eight were licensed to open in April, 2004, and four more were licensed to open in April, 2005.
- 38 Lawrence Repeta, “Omiya Law School and the All Day Clinic,” 25 *Waseda Bulletin of Comparative Law* 39 (2006); Peter A. Joy, Shigeo Miyagawa, Takao Suami, and Charles D. Weisselberg, “Building Clinical Legal Education Programs in a Country without a Tradition of Graduate Professional Legal Education,” 13 *Clinical L. Rev.* 417 (2006).
- 39 Korea, which licenses approximately 1,200 new lawyers per year, is reportedly aiming for an 80 percent passage rate for graduates of the new law schools, but is contemplating in the range of 150 students at each of the eight to ten schools (Hae-in Shin, “American-style Law School Plan Causes Controversy,” *Korea Herald*, May 19, 2005), in which case no dramatic increase in the total number passing the exam should be necessary; “Editorial: Bigger Quotas Needed at New ‘Law Schools’,” *Hankyoreh Shinmun*, April 23, 2005.
- 40 Katsumi Yoshida, “Legal Education Reforms in Japan,” 24 *Wisconsin International Law Journal* 209, 214–216.
- 41 Using the term “jury” is potentially misleading given differences between these proposed institutions and the Anglo-American ideal type. They are also not modeled

- exactly on Germany's "lay assessors," however, so using the English translation of the civil law's main example of lay participation would also be misleading. On Korea, see, Kim, Jong-moon, "Reform Panel Sees Juries in Place by 2007," *JoongAng Daily*, May 18, 2005, p. 1, col. 6; Chi-hyoung Cho, "Judicial Reform: Proposed Civil Participation in Criminal Justice Process," *Korea Herald*, May 31, 2005. On Japan, see, Kent Anderson and Mark Nolan, "Lay Participation in the Japanese Justice System," 37 *Vanderbilt Journal of Transnational Law* 935 (2004).
- 42 For more specifics on these reforms, see John K.M. Ohnesorge, *Politics, Ideology, and Legal System Reform* (forthcoming) [hereinafter Ohnesorge, *Politics*]. On administrative law reforms, see John K.M. Ohnesorge, "Western Administrative Law in Northeast Asia: A Comparativist's History," unpublished S.J.D. dissertation, Harvard Law School, 2002; Tom Ginsburg, "Dismantling the 'Developmental State'? Administrative Procedure Reform in Japan and Korea," 49 *American Journal of Comparative Law* 585 (2001).
- 43 Ohnesorge, *Politics*, supra note 42; Joongi Kim, "Recent Amendments to the Korean Commercial Code," 21 *U. Penn. J. Int'l Econ. L.* 273 (2000); Joongi Kim, "The Next Stage of Reforms: Korean Corporate Governance in the Post-Asian Financial Crisis Era," 1 *Asian Journal of Comparative Law* 44 (2006); Curtis Milhaupt, "Nonprofit Organizations as Investor Protection: Economic Theory, and Evidence from East Asia," 29 *Yale J. Int'l L.* 169, 185 (2004); Dae Hwan Chung, "Introduction to South Korea's New Securities-Related Class Action," 30 *J. Corp. L.* 165 (2004).
- 44 John K.M. Ohnesorge, "Chinese Administrative Law in the Northeast Asian Mirror" (forthcoming, *Journal of Transnational Law and Contemporary Problems*, 2007); Ohnesorge, *Politics*, supra note 42; Tom Ginsburg, "Dismantling the 'Developmental State'? Administrative Procedure Reform in Japan and Korea," 49 *American Journal of Comparative Law* 585 (2001).
- 45 See Roberta Romano, "The Shareholder Suit: Litigation Without Foundation?" 7 *J.L. Econ. & Org.* 55 (1991); George F. Will, "Bull Market in Innuendo," *Washington Post*, June 12, 2005, at B09 [defending President Bush's nomination of Representative Christopher Cox to chair the Securities and Exchange Commission]. During the 1990s Congress enacted two statutes to constrain shareholder litigation, the Private Securities Litigation Reform Act, Pub. L. No. 104-67 (1995), and the Securities Litigation Uniform Standards Act, Pub. L. No. 105-353 (1998). For an overview of the movement to constrain shareholder litigation, see Michael A. Collora and David M. Osborne, "Class-Action Reforms Spur Derivative Claims," *National Law Journal*, February 15, 1999. See also Robert A. Kagan, *Adversarial Legalism: The American Way of Law* (2001); Jerry L. Mashaw and David L. Harfst, *The Struggle for Auto Safety* (1990). In the federal courts, the battle has played out in the domain of standing doctrine, with critics of the private attorney general model, led by Justice Scalia, seeking to limit the ability of Congress to expand standing via "citizen suit" provisions. *Friends of the Earth, Inc. v. Laidlaw Environmental Services (TOC), Inc.*, 528 United States 167 (2000), was a clear defeat for Scalia, but he and his allies have been fighting this battle since the 1980s, and there is no reason to think they will give up now, especially since Bush appointees Roberts and Alito have joined the Court. For an overview, see Buzbee, William W., "The Story of *Laidlaw*, Standing and Citizen Enforcement," Emory University School of Law, Public Law & Legal Theory Research Paper Series, no. 05-13. For a resounding defense of the idea, see May, James R., "Now More Than Ever: Trends in Environmental Citizen Suits at 30," 10 *Widener Law Review* 1 (2003).
- 46 On convergence assumptions in modernization theory, see Ian Weinberg, "The Problem of Convergence of Industrial Societies," 11(1) *Comparative Studies in Society and History* 9 (1969).
- 47 Lawrence M. Friedman, *The Republic of Choice: Law, Authority, and Culture* (1990).
- 48 See Ginsburg supra note 42 (on law and development initiative of Japan and Korea).

- 49 Veronica L. Taylor, "New Markets, New Commodity: Japanese Legal Technical Assistance," 23 *Wis. Int'l L.J.* 251 (2005).
- 50 Joseph Seon Hur, "Capacity Building and Technical Assistance in the Area of Competition Policy: Korea's Experiences and Suggestions," presentation to the OECD Global Forum on Competition, February 14, 2002, available at <http://ftc.go.kr/data/hwp/20020214.doc>.
- 51 See, e.g., Richard E. Barrett and Martin King Whyte, "Dependency Theory and Taiwan: Analysis of a Deviant Case," 87 *American Journal of Sociology* 1064 (1982); Alice H. Amsden, "Taiwan's Economic History: A Case of Etatism and a Challenge to Dependency Theory," 5 *Mod. China* 341 (1979) (arguing that the economic history of Taiwan contradicts dependency theory).
- 52 For a de-linking argument, see Samir Amin, *Delinking: Towards a Polycentric World* (Michael Wolfers, trans., 1990).
- 53 International financial markets are a different story, however. See, Russell Mardon, "The State and the Effective Control of Foreign Capital: The Case of South Korea," 43 *World Politics* 111 (1990); Robert Wade, "East Asian Financial Systems as a Challenge to Economics: Lessons from Taiwan," 27(4) *California Management Review* 106 (Summer, 1985).
- 54 Appeals to self-reliance are of course used to justify simple interest-group protectionism, but particularly in the case of South Korea, the drive for national technological competence seems clearly in part based on national concerns for self-reliance.
- 55 Amsden, *supra* note 51.
- 56 Richard Samuels, Rich Nation, Strong Army (1994); Ohnesorge, *States, Industrial Policies, and Anti-Dumping Enforcement in Japan, South Korea and Taiwan*, *supra* note 10.
- 57 Kung-Chung Liu, "Legal Environment for Technology Transfer in Taiwan," 36 *International Lawyer* 1145 (2002); F.L. Hartman, "Japanese Foreign Investment Regulation: Semantics and Reality," 18 *New York Law Forum* 355 (1972-73); Russell Mardon, "The State and the Effective Control of Foreign Capital: The Case of South Korea," 43(1) *World Politics* 111 (1990).
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2 The resurgence of the right to development

*Muthucumaraswamy Sornarajah**

Introduction

The right to development was in decline in the last decade of the twentieth century, which saw the dominance of neo-liberal economics. Joseph Stiglitz described this decade as the “roaring nineties”.¹ The subtitle of his book by that name—“Why We are Paying for the Greediest Decade in History”—is less flattering of the decade. In this context, as the decade of greed was drawing to its close, the United Nations announced its Millennium Goals,² conscious of the need to draw attention to the plight of the poor, but at the same time aware that in the climate of greed that characterized movements in the financial world, aspirational statements were all that could be hoped for. There is a long wish-list of noble objectives but the means of achieving them are not stated with any confidence.

The Millennium Goals stand in marked contrast to the more assertive right to development that was expressed by the developing countries much earlier and it is the revival of the right to development that would provide the best means of ensuring that the Millennium Goals are achieved. At the time the Goals were proclaimed, they constituted at least an awareness of the problems of the world by the leaders of the international community who, however, were unable to devise any meaningful ways of solving the problems they had identified except through the channelling of meagre aid towards some of the objectives.³

Events since then have moved fast. A financial crisis has gripped the world and the prospect for aid and assistance has become distant. With it, the possibility of meagre aid, even of the kind that was contemplated in the Gleneagles agreement, and other such measures will become a mirage. The aspirational goals, however well intentioned when formulated, seem distant and the target date of 2015 is fast approaching. In this context, the existing alternative plan of asserting a right to development, which was formulated in 1986 and is the result of an agenda that the developing states had set out remains an alternative in terms of international law. Its viability is all the greater since events have shown that there is a need to erase the international law that had been built up during the events that led to the financial calamities and characterised the period with war and violence. There is a need to make a fresh beginning through building on

moral foundations that were in abeyance during the period of greed. These conditions led to the formulation of the Millennium Goals in an apologetic and muted fashion to assuage moral sentiments outraged by the inability of the international community to address the pressing problems of the vast amount of humanity.

It is time for the developing world to turn to more activist measures rather than to address pressing problems through placatory means that indicate prescriptions of the soft law that are never realised. It is best to return to the right to development, which the developing world advocated as an activist measure to restructure the economic order just prior to the advent of the philosophy of greed.

The right to development saw its genesis in the movement of the developing world towards a New International Economic Order, which also suffered an eclipse during the “roaring nineties”. The efforts that the developing world sought to make towards restructuring the world so that issues of poverty and economic development could take the centre-stage of international law became side-tracked by the equally energetic pronouncement that, with the ending of the Cold War and the dissolution of the Soviet Union, the consequent triumph of democracy and its economic counterpart—the free market—must be the bases on which the world should be restructured. This triumphalism had the effect of international law being put to use instrumentally to create institutions and rules which catered to the creation of a neo-liberal order based on the preferences of the single hegemonic power that had emerged in the new world order.⁴

At the political level, it resulted similarly in international law being geared to achieve the neo-conservative vision of spreading democracy and the will of the hegemonic power throughout the world. With the opportune fact that globalisation was also taking place around the same time, the emerging solitary hegemonic power was well placed to ensure that the integrating processes of globalisation enabled it to shape a new order through international law that coincided with its own vision of the world organised on the basis of the twin principles of democracy and the free market. Centred around philosophies of the free market, individualism and the spread of democracy, the vigorous promotion of this new order released forces that diverted international law from its moorings in the search for global justice towards the achievement of political and economic objectives favoured by the hegemonic power. The resulting situation privileged groups that were able to manoeuvre in a world dominated by individualistic merit, the free market, an absence of state intervention to correct market failures and a reduction in social networks to promote welfare.

Neo-conservatism, as the political aspect of the doctrine is described, enabled an unrestrained use of force to enhance the position of power. In the context of terrorist activities following the attack on the World Trade Center in New York on 11 September 2001, the advocacy of broad doctrines justifying resort to force became feasible. The consequent overstretch in power in the unilateral invasions of Iraq and Afghanistan has resulted in the enervation of hegemonic power. Neo-liberalism, the economic counterpart of the preferred doctrine, emphasised the accumulation of wealth without government control, enabling the free market

forces as capable of regulating the domestic and global markets. It resulted in avenues for the making of free money without effort through schemes cooked up by financial wizards, leading ultimately to a global financial crisis.⁵ The integration of the world through the process of globalisation has made the crisis widespread. These processes took place in a world lured into complacency that there was but one solution to bring prosperity and that was through the prescriptions of neo-liberalism that enabled the frenzy of uncontrolled capitalism.

International law began to be seen as instrumental in the achievement of this new order. It became the means through which the precepts of neo-conservatism and neo-liberalism could be translated into rules that could be enforced or thrust upon the rest. Many within the international law academy furthered the instrumental use of international law in order to facilitate the change towards the principles of neo-conservatism and neo-liberalism.⁶ The moorings of international law in the search for global justice were diverted to the cause of serving the interests of the privileged few. The law was inspired, to paraphrase Mahatma Gandhi, not by need but by greed.⁷ The dean of a major law school spoke of “lost lawyers”.⁸ More specifically, Philip Allott wrote, having regard to international law:

a perverted, anti-social, anti-human worldview has allowed the holders of public power to treat social injustice and human suffering on a global scale as if it were beyond human responsibility and beyond the judgment of our fundamental values and ideals, and the holders of public power have imagined an international legal system which enacts and enforces such a worldview. And peoples of the world have simply had to acquiesce in and to live with the consequences of this disgraceful perversion of theory and practice.⁹

At the millennium, when the Millennium Goals were announced, the field was heavily occupied by models of law that were totally inconsistent with the goals of eradicating poverty. Those announcing the Millennium Goals did not have the wherewithal to confront the models of law that had already been put in place. They had to take comfort in the articulation of high-sounding phrases that meant very little in terms of capability to deliver a vision of change. This international law had already entrenched within it norms that enabled liberalisation of flows of capital and foreign investment and norms that justified the unilateral use of force in the pursuit of narrow interests. Neo-liberalism had powerful financial institutions—the World Bank and the International Monetary Fund—to give it backing. An important new institution—the World Trade Organization—was created. It sought to liberalise international trade, open up the services sector and give protection to intellectual property.

With the entrenchment of this international law on greed, the possibility of poverty eradication and the other noble ideals of the Millennium Goal receded into the distance. They remain as mere visions of good men and women incapable of meaningful fulfilment due to the fact that the only medium through which such fulfilment could be achieved—international law—had been occupied by

norms that sought to benefit the few at the cost of suffering to the many. They were formulated as prescriptions not as forceful statements that could displace the stronger norms that sought to further the objectives of the newer philosophies that had taken hold. The issue that arises is whether the neo-conservative and neo-liberal models can be dismantled with sufficient speed so that the goals of poverty eradication and development could be achieved. The fact that the Millennium Goals were expressed and stand in opposition to the instrumental norms that were being put in place creates space for the existence of ideas that counter these instrumental norms. To that extent, the Millennium Goals serve an important purpose. That purpose will be enhanced as disenchantment sets in with the twin philosophies of neo-conservatism and neo-liberalism.

The endless violence unleashed in the name of controlling terrorism and the pursuit of greed practised on the international markets has brought about a disillusion that has manifested itself in demonstrations against the institutions and governments representing the neo-conservative order. The most significant manifestation of this change is the election of President Obama in the United States. Whether change is brought about remains to be seen but what is most important is that the American people also yearn for change from the policies adopted in the immediate past, as do people elsewhere in the world.

The financial crisis has added momentum to this need. The measures adopted to deal with the crisis have involved massive state interference of the type that socialist governments take, including massive “nationalisations” of private banks that were reminiscent of socialist take-overs of private business. Heavy controls were thereafter instituted on banking practices. These events predicate change on the part of governments. More importantly, people around the world clamour for change, knowing that the cycle initiated by neo-conservatism has ended in disaster. Since policies were implemented through the mechanism of international law, it is obvious that the international law rules that were generated have to undergo a change.

It would appear that the people of the world are increasingly unwilling to condone the perversion of justice that is involved in the making of international law a slave to power. This is reflected in the international law academy as well. At least in some academic quarters, there is a disillusion with the trends that were emerging within international law. Within the developing world, this disenchantment was deep, provoking counter-analysis of trends in international law.¹⁰ But, as importantly, there were forces released within the developed world that sought to be as contemptuous of the wide divide that was being created within the societies of the rich world to such an extent that the Third World was identified as existing within the developed states.¹¹ New players, such as non-governmental organisations, emerged to take up single issues such as poverty and human rights. Though approaching the trends from different angles, they challenged the existing prescriptions that the hegemonic powers had assigned as the objectives that international law had to achieve.

The most promising channel for the collective expression of these views is through the second coming of the right to development in international law.

The neo-liberal views and the realist efforts at the displacement of an international law based on normative standards had eclipsed the earlier efforts at fashioning a right to development. But, as disenchantment sets in with these trends, there will be a reversion to the ethical and normative standards that inspired the first formulation of the right to development, which was a contribution largely of the developing world to deal with problems which afflicted it after the period of decolonisation. These efforts went into eclipse with the rise of neo-liberal thinking. It is for this reason that the reversion to the roots of legitimacy in international law could be led by the second coming of the right to development assumes significance.

As will be shown, this second coming receives greater impetus because it is no longer a movement of the developing world but is supported by people disenchanted with the events that transpired during the ascendancy of neo-liberalism both on the economic and the political fronts. The hope for the achievement of the Millennium Goals lies in the coalescing of this new coming of the right to development with the aims that are contained in the Goals. In this way, the interaction between the ideas generated and the consensus created will lead to the more meaningful articulation of norms that would be capable of implementing the Goals. The Millennium Goals themselves will move out of an aspirational phase into a phase in which they could have some sanctioning force within the international system.

This chapter first reviews the right to development and its achievements in its first phase of emergence. It points out that despite assessments of its demise, the new international economic order (NIEO) had contributed substantial norms to the law both domestic and international, which were never effaced as a result of the rise of neo-liberalism. They remained in hibernation, capable of being revived when the time was opportune. It then deals with the decade of the 1990s and the rise of instrumental international law designed to establish the hegemonic agenda. The facets of this instrumental international law and its success, particularly in the area of international investment law are assessed. International investment law is chosen so that a concrete illustration could be given of the thesis that is advanced. The thesis could be demonstrated with other areas of international law, such as the law on international trade, international environmental law or the law on the use of force, which have been subjected to similar changes.¹² The next part analyses the second coming of the right to development and argues that this time around, the right to development is supported by stronger forces. The final part surveys the impact of this second coming in the area of the international law on foreign investment, an area of concern to development, and indicates that there would be similar destabilisation of the norms created in instrumental law during the last decade and a half that will occur in the other fields of international law.

The conservation of the first coming of the right to development

Contrary to the view that the right to development suffered a complete reversal in the 1990s with the emergence of neo-liberal views, the advances towards its realisation remained entrenched in the domestic laws, constitutions and contractual practices of most of the developing states, which had subscribed to the NIEO norms in the period after decolonisation. The aim of the NIEO was the recapture of economic sovereignty and the restructuring of the existing economic structure of the world. In this aim, the NIEO was merely asserting a principle that international law always recognised but confined to the states of the former imperial system. The thrust of the NIEO was to state the obvious fact that the principle should be extended to all independent states in the post-colonial period.

The second aim may not have been realised but the first aim was. The course of events have brought about a change in the second aim as well, for many of the larger developing countries have emerged as strong economies with enough clout to affect the course of economic events. China, India and Brazil have acquired such capacity. They give leadership to other developing nations to effect changes or resist the imposition of neo-liberal norms.¹³

The notion of permanent sovereignty over natural resources and the ideas of economic sovereignty contained in such instruments as the Charter of Economic Rights and Duties of States came to be stated at three distinct levels. They were articulated at the international level through a series of General Assembly Resolutions constituting the package of NIEO norms. At the second level, they are contained in the constitutions of the developing countries as well as their domestic laws, such as the foreign investment or mining laws. At the third level, they are reflected in the contract practices of the developing states. Thus, the production sharing agreement in the oil sector and the contract of work in the mining sector reflect principles of the NIEO at the micro-level.¹⁴ Their uniformity around the developing world indicates that the practice owes much to the thinking that underlay the NIEO in that they seek to assert host state control over important economic sectors and preserve the ownership of natural resources to the benefit of the people of the states.

The extent of the success of these norms should be assessed in the context of their interaction at these three levels. The fact that they may have suffered an eclipse at the international level may not mean that they have been affected at the other levels.¹⁵ Even when the NIEO norms were dormant at the international level, the practices based on them at the other two levels remained vibrant. When the eclipse ends at the international level, they will resurface at all three levels with great force. They remain unchallenged as propositions of international law as they reside on foundations that developed states do not contest as these states have employed them through history and cannot deny them to developing states.¹⁶ It would be incredible for a developed state like the United States to contest that its natural resources do not fall under its sovereignty. It is a self-evident proposition which needed assertion in the immediate post-colonial phase

simply because imperial control ensured that natural resources of the colonies benefited the metropolitan states.

This practice of states asserted and confirmed what was expressed at the international level by the developing states through General Assembly resolutions. Developed country international lawyers had dismissed these prescriptions as at best weak sources of international law as they were couched in documents generated by the General Assembly which had only recommendatory powers under the Charter. They were regarded as *lex ferenda* having no present legal significance.¹⁷ Yet, what stood against them were the individual opinions of a cluster of academics or arbitrators often stating their views in academic journals or uncontested arbitrations. It is fascinating to look back and contemplate how international law could have elevated the opinions of single individuals expressed in uncontested arbitrations or in academic journals to a higher plane than the collective voices of states representing the large majority of mankind on the basis of subtleties such as the formulation of the powers of the General Assembly in the United Nations Charter. Such subterfuges are what have irked developing country international lawyers in suspecting the legitimacy of the law that is described in many texts on the subject. International law is hampered by the baggage of subterfuge that it has carried down the ages exposing it to the charge that it lacks legitimacy for many of its rules are founded on what is expedient for those states in power than what is just for the rest of mankind. The argument that the NIEO was totally eclipsed smacks of the same attempt at subterfuge.

Quite apart from the fact that its norms are contained in solemnly expressed legal documents supported by a large majority of states and are therefore entitled to be viewed as a collective *opinio juris* of these states, the vision of the NIEO, formulated in international documents passed into the law and the constitutional documents of the developing states. The doctrine of permanent sovereignty over natural resources, regarded as *lex ferenda* by many developed country international lawyers provides the best example.¹⁸ It is stated in a large number of the constitutions of the developing states.¹⁹ The formula used is similar. It encapsulates the idea that the natural resources belong to the people and that the state is merely the guardian of the natural resources so that its transfer to others is potentially defeasible if the interests of the people in the exploitation of the resources changes. The idea is further entrenched in the domestic law by the fact that the monopoly over the exploitation of these resources are vested in state corporations with elaborate legal mechanisms which regulate the divestiture of control over such natural resources.

This is a universal pattern in resource producing countries. Does it not then amount to practice that supports an articulated norm of international law? At the micro-level, particularly in the oil industry but also in other sectors, contracts such as production sharing contracts and build, operate and transfer contracts ensure that even as to transactions the state actor continues to have control over the operations of the foreign party in the transaction. These contracts now contain choice of law clauses that exclude the application of any other law than

the law of the host state in which the resource exploitation occurs. Licenses are required by domestic laws which carefully prescribe conditions under which resource exploitation takes place. These practices being a continuing phenomenon, it would be incredible to argue that the principles of the NIEO have lapsed or that they never had any effect on the law except as rhetorical devices.

Such views were formulated by developed country international lawyers in the hope that the NIEO could be wished away but, given the fact that its principles are well entrenched in the domestic legal systems of most developed states, it is futile to argue that they have no significance. They have severely dented existing techniques in international law which sought to transnationalise internal arrangements especially in the resources sector by subjecting them to external control through processes of internationalisation. These NIEO principles were encapsulated in the notion of the right to development which again asserted the right of a state to fashion its own economic agenda.

There were other principles stated in the NIEO such as the payment of just prices for resources and commodities exported to the industrialised world and access to markets. More minute areas such as the bringing about of a code of restrictive business practices so that multinational corporations could not carve out or insulate world markets and codes on transfer of technology to the developing world were proposed. But, the drafts met with opposition and never came to pass.²⁰

Neo-liberalism and the dismantling of the right to development

The end of the Cold War and the trumpeting of the triumph of capitalism accompanied by the processes of globalisation enabled the neo-liberal visions of the developed world to dominate the course of international law during the last decade of the twentieth century. The preceding sovereign debt crisis and the denial of aid that was in the package of the neo-liberal policies that were adopted also required the developing states to adopt stances that were required to secure access to a share of economic progress. Developing countries had to compete for the investment capital of the multinational corporations, the only funds now available along with the former socialist East European countries which were converting to market capitalism. In that context, there was no alternative for developing states but to flow along with the major trends that were taking place.

The grip of deterministic theories on the thinking of experts especially in the area of international relations contributed to the fashioning of an instrumental international law. Realist perceptions that international law cannot restrain nations with power but could only serve as instruments for their dictates surfaced.²¹ The view was that in a globalised world there was no alternative but to liberalise markets and then political liberalisation must follow as a matter of course. Besides, the hegemonic power desired the reconstruction of the world order in terms of neo-liberalism. American policy even during the Cold War years was dictated by an economic dimension which viewed a liberal economic

order as indispensable to world peace. Now that the Cold War was over, there was a return to the vision with a triumphant fervour under a new theoretical guise.

Democratic capitalism was an inevitable outcome of this process. The view was that in a world driven by trade, there would be recognition of the need for harmony. In the light of such ideological reasoning, the instrumental role of international law was to accelerate the trends that conduce to economic and political liberalisation. There were evident trends towards such an instrumental use of international law.

These trends included the setting up of the World Trade Organization (WTO) with its different instruments transgressing beyond the traditional areas of international trade into areas of intellectual property, investment, services, agriculture and other related areas. A feature of the WTO was to adopt strong rules, announced as replacing the rules of power with rules of law in international trade. But, the rules of law were undoubtedly made by the states with power to privilege interests of those with power. The rules were to be enforced by the strongest dispute settlement mechanism yet evolved in international law.

Once this trend had been initiated, there were arguments that emerged which sought to redesign major aspects of international law and development in the context of the emerging WTO law. It was suggested that a constitutional order could be created through the adoption of this process. The decisions of the Dispute Settlement Board together with the constituent documents of the WTO would be the foundations on which such an order could be built. Such a project could have been maintained only because it was based on a distinct economic and political philosophy espoused by the single hegemonic power and its allies.²² The ensuing rules of the international trade system were cast in the moulds preferred by the hegemonic power. The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) reflected many of the rules of American law on intellectual property and was driven by the interests of the large pharmaceutical companies of the United States.²³ The rules on services emphasised the liberalisation of rules permitting the services sectors dominated by the major American firms to traverse the world.²⁴

In agriculture, the reluctance of the United States to reduce subsidies to its farmers displayed that protectionist interests were retained when it suited the hegemonic power. At the Singapore Ministerial Meeting of the WTO, there was agreement that the WTO would explore instruments on investment, competition, government procurement and transparency in trade. It seemed as if there was a steam roller that ensured a smooth passage towards the new vision of a world trading structure based on neo-liberalism. These trends and their impact on the economic development of the developing states have been well studied in the literature on the WTO in the light of the neo-liberal economic principles behind the efforts at liberalisation. The view that developing country international lawyers took of these events stand in marked contrast to those of their developed country counterparts.²⁵ This may have been due to the fact that the articulation of that philosophy at the formulation of the rules of the WTO was more intense

and, as a result, the critical examination of the impact of the WTO rules on economic development was more intense.

The rules of the WTO are kept insulated from the rest of international law. Though efforts are made to show that they are consistent with human rights norms and that the increasing possibility of the constitutionalisation of these norms may permit many problems including human rights to be addressed through the emerging framework of WTO law,²⁶ there has been a clear effort to insulate WTO law from other ethical prescriptions of international law.

But, similar trends that were taking place in the area of foreign investment have been studied with less emphasis from the point of view of the fact that there was the same distinct economic philosophy which drove them. It is on these trends that this chapter will concentrate. Many studies in the area extol the effect of neo-liberalism on foreign investment law.²⁷ They do not present a critical perspective.

The reason may be that the prevailing economic wisdom in foreign investment protection is that the greater protection the law provides, the greater will be the flow of foreign investment; and the greater will be the impetus it provides for economic development. This prevailing orthodoxy has kept inquiry into this proposition at bay. But, there has in recent times been increasing scepticism expressed in non-legal quarters with this orthodox position. There is increasing economic literature questioning the view that the maintenance of protective legal structures is necessary for investment flows or that they have any impact on the economic development of the host state. But, such studies are recent and did not have any impact in the heyday of neo-liberalism.²⁸

There is little doubt that neo-liberal views were given a great impetus during the 1990s. This is evidenced by the great profusion of investment treaties, a spurt from about 900 to nearly 2,500 by the end of the decade. Latin American states, long the preservers of national sovereignty in the form of the Calvo doctrine, began to make investment treaties, indicating a belief that external standards of investment protection trigger greater flows of much needed investment. This assumption was later queried in the economic literature as unfounded.²⁹ Yet, the hold of neo-liberalism was so great that such scrutiny was futile at the time the treaties came to be made. That picture has now changed.

The tenets of neo-liberalism relevant to the area of foreign investment may be identified to include the following: (a) a belief in the liberalisation of the flows of foreign investment on the assumption that such flows will lead to the creation of assets within the host state, bring other associated advantages³⁰ and thereby lead to its economic development; (b) the uniform acceptance of the beneficial effects of foreign investment flows to the exclusion of its negative effects, consequently justifying absolute protection of such investment; (c) the need for safeguards of property rights in the host state, particularly property brought in or acquired by the foreign investor;³¹ (d) the securing of judicial safeguards for such property through external arbitration in the absence of a court system in the host state which would provide secure protection in the face of executive or political displeasure;³² (e) the sanctity of the foreign investment contract on the

basis of which the foreign investment entered the host state should be respected; (f) the standards of good governance are promoted by rules on investment protection;³³ (g) as a result, it is necessary that these desirable rules are administered through secure mechanisms providing neutral arbitration of disputes arising from foreign investment transactions and (h) the redefinition of the rule of law to encapsulate these neo-liberal ideas.³⁴ The neo-liberal belief is that ensuring these conditions was vital to the promotion of economic development.

The investment treaties were intent on ensuring that these goals of neo-liberalism were achieved. Once it was held in *AAPL v. Sri Lanka*,³⁵ that the International Centre for Settlement of Investment Disputes (ICSID) and other nominated arbitral tribunals could exercise jurisdiction at the unilateral instance on the foreign investor under the dispute settlement clauses of these treaties, a large number of arbitral disputes came up for settlement in the course of which the provisions of the investment treaties could be interpreted. ICSID, a hitherto dormant institution, sprung to life.³⁶ The arbitrators, mostly persons trained in international commercial arbitration and lacking expertise in the public law features involved in foreign investment disputes involving states and state entities, decided in accordance with neo-liberal tenets that were favoured by the institutions in the context in which they worked as well as in accordance with their natural inclinations as commercial people.³⁷ Arbitrators, being professionals, may also be inclined to give expression to currently favoured theories so that they may keep themselves active in their profession. There is a self-interest in ensuring that neo-liberal propositions are advanced through the awards.

In the political sphere, the law mandated a march towards democracy. Theories that this was a natural outcome of the liberalising forces that were afoot on the economic front were dominant. The economic progress gained through the adoption of market capitalism had to be conserved. This would require that there would be a natural progression to democracy. But, if there was resistance, such resistance should be overcome through the use of force if necessary. There were efforts to fashion a view that intervention through force to promote democracy in a state which proved resistant to it was to be regarded as lawful, an obvious revision of the Charter principles on the prohibition against the use of force that transcended in scope other doctrines on the use of force such as for humanitarian reason which had hitherto been formulated.

The zenith of its application was in the ultimate justification provided for the intervention in Iraq.³⁸ After weapons of mass destruction could not be found and after the association of Iraq with terrorism also proved unfounded, all that remained to be doled out was that a cruel dictator was deposed and democracy was restored in Iraq.³⁹ The cynical nature of this justification is obvious. The very powers that intervened had been associated with the dictator during his most heinous years. Democracy was not the result of the intervention. Instead, the country is mired in sectional feuds that the intervening army is finding increasingly difficult to deal with. In the process, the hegemony of the United States itself has come to be doubted and the extent of its power in the light of this unsuccessful overreach is beginning to be discussed. On the political front,

the neo-conservative views were taking a beating. The doubts that emerged on the political front had an impact on the neo-liberal theory as a result of its association with neo-conservatism.

Quite apart from the condemnation that resulted from association, independently, neo-liberalism had begun a downward slide. With the financial crisis that became entrenched towards the end of 2008, it became evident that neo-liberalism was a tenet that Western governments were eager to ditch. The measures taken to confront the crisis indicated a return to heavy regulation of the financial and business sectors and the adoption of policies, like control over banks after massive infusion of capital, which were reminiscent of nationalisation measures. Some indicated that such nationalisation measures were not taken even during the heyday of socialist governments of the past.

The retreat to neo-liberalism

The attraction of neo-liberalism was short lived simply because it did not deliver on its promises. States that had converted to market economics were running into financial crises. States of Southeast Asia, which were held out as miracle economies that had achieved growth through the adoption of market capitalism, were going through financial and political crises.⁴⁰ The crisis was mirrored in Latin America where neo-liberal policies on foreign investment had been adopted in the early 1990s.⁴¹ Russia also witnessed a financial crisis.

But, the opposition to neo-liberal policies had begun earlier than these events. Significantly, the initial shots in the battle were fired in connection with an effort to entrenched neo-liberal views through a global investment agreement. In 1995, just a few years after the World Bank had suggested that the world was not ripe for a comprehensive multilateral treaty on investment protection,⁴² the Organisation for Economic Co-operation and Development (OECD), which consisted of developed states, sought to bring about a Multilateral Agreement on Investment. This effort, which began in 1995, had been given up by 1998 as a result of two factors. The first was the pressure created by the non-governmental organisations in the human rights and environmental spheres which regarded the creation of a document protective of the interests of the multinational corporations without addressing the environmental degradation and human rights violations by multinational corporations as inappropriate. The second was that they exerted sufficient pressure on the governments of the developed states to rethink the project not only in terms of their sectional interests but in terms of their national interests. As a result, some states found that the unrestricted foreign investment, which would result from the pre-entry national treatment of investment, would not be in the interests of some sectors of their investment.⁴³ These are protectionist considerations that the developed world did not want the developing world to adopt.

Fervour for the project for the multilateral code diminished as a result of mounting pressure. An effort at neo-liberalism through the law had floundered in the face of emerging opposition from non-governmental groups that engaged in

promoting single issues. The episode had significance in demonstrating the power of NGOs to organise opposition globally. The incident demonstrated that the developed states themselves could not agree upon the international rules for foreign investment. Later, when the project resurfaced within the WTO, the opposition of the developing states ensured that it was defeated. This was an early instance when the big three developing states, China, India and Brazil, acted in unison along with other developing states, giving an indication of the potential of developing states taking united stances. The developed countries gave up on the “Singapore issues” they had promoted at the WTO.⁴⁴ Though neo-liberalism towards structuring global investment rules was so defeated through political opposition, in the legal sphere, it found surprising resistance and recrudescence through arguments that were revived towards the creation of a universal international law on foreign investment, a project stoutly resisted as harmful to development.

The academic project to structure an international law protective of foreign investment continues through back-door means. Thus, it was argued for a while that the existence of so many bilateral investment treaties would lead to universally binding customary international law principles.⁴⁵ The effort is dormant after it was pointed out that given the differences in the treaties, such a result is not possible.

A fresh attempt is the construction of such a universal law through the use of the most favoured nation principle in the treaties.⁴⁶ But, since the states which made the treaties did not contemplate such a use of the clause, it is unlikely that they would buy an argument based on this creative exercise. The tenacity of the neo-liberal vision is obvious but its capacity to produce results is at a vanishing point as they are likely to be confronted by states which would express clear dissent when neo-liberal viewpoints are presented.

Quite apart from the political sphere where every meeting of the institutions of neo-liberalism and its leaders meets with stiff and open opposition particularly in the capitals of the developed world,⁴⁷ it is in the dismantling of some of the advances of neo-liberalism through the instrumentality of international law that the nature of the retreat is most evident. It is interesting that both the creation and dismantling of neo-liberal rules rely on instrumental uses of international law.

This retreat is evident in the sphere of foreign investment, which has been a focus of the battle between neo-liberalism and its opposing ideologies. Though other areas such as trade can be selected to evidence the conflict, foreign investment is an area where the contrasts between the opposing ideas have clearly emerged throughout the conflict. It is for that reason that foreign investment is isolated for special study in indicating the developments it had gone through from the period of the NIEO, through the period in which neo-liberalism was ascendant to the present period where neo-liberalism seems to be in reverse.

Before dealing with foreign investment, a short diversion into the dismantling of neo-liberalism in the area of international trade should be made. One finds the articulation of norms countering the advances that neo-liberalism had made in

the field of international trade and its impact quite vigorous in the short years of the conflict between interest groups in the area. The TRIPS rules may have been made in the interest of the pharmaceutical companies and the protection of their patent rights in drugs, but the assertion of the right to grant compulsory licenses by states faced with pandemics has been fought and won. An exception has been created to provide for parallel imports as well as compulsory licensing of these drugs which undermines the absolute protection that had existed previously so that there was a retreat to accommodate developing country interests. This tussle will go on in other areas of international trade as well. The Doha Development Agenda and its impact are still visible in the area.

It is evident that in the area of international trade, the developing countries have begun to assert their right to ensure that international trade does not solely promote the exclusive interests of the rich countries and multinational corporations but instead conserves and promotes the interests of economic development. The talks on agricultural subsidies and the loggerhead that has been caused in WTO talks indicate that developing countries have begun to reassert a sense of solidarity in pursuing their own interests in the area. Though derided as efforts on the part of India, China and Brazil, the other developing countries have accepted the leadership of these newly industrialising states which continue to have the majority of the poor of the world living in them. It may be too far-fetched to talk in terms of the return of developing country solidarity but, certainly in the area of international trade, there is visible evidence of its return.

Foreign investment and the retreat of neo-liberalism

In foreign investment, the tussle between neo-liberalism and the right to development is more visible. The instruments of the international investment law are premised on neo-liberal viewpoints. The notion of neo-liberalism has been articulated as if it is a new idea but one must remember that it derives sustenance from notions that have existed from much earlier times. The leading instruments in the field of foreign investment, such as the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention) which set up the International Centre for Settlement of Investment Disputes (ICSID), are based on the idea that flows of foreign investment will benefit economic development, a foundational principle of neo-liberalism though not identified as such at the time of its formulation.⁴⁸ It is this principle which also lies at the root of the bilateral investment treaties which began to be made from 1958.⁴⁹ In 1990, there were around 900 treaties. But, by the time the heyday of neo-liberalism ended, there were over 2,500 treaties. With the new millennium, the treaty activity began to subside. Clearly, during the 1990s the neo-liberal thrust resulted in a large number of treaties. But, as neo-liberalism began to lose force, the number of treaties also declined.

In 1991, the award in *AAPL v. Sri Lanka* was based on jurisdiction obtained from the treaty provisions of an investment treaty. Though such treaties had been in existence for over two decades, for the first time it was held that an

appropriately worded dispute settlement provision in an investment treaty could result in jurisdiction being created in the tribunal. The theory was that the provision contained an offer by the state to submit any investment treaty arising from the violation of the treaty provisions to arbitration and that this offer could be converted into an agreement to arbitrate by the simple act of bringing arbitration proceedings as it signifies the acceptance of the offer. As a result of this technique, inappropriately called “arbitration without privity”, the hitherto dormant arbitral institution ICSID, as well as other arbitration centres began to receive many arbitration disputes. Technically then, it could be claimed that there was an emergence of a rudimentary system of international investment law as there was a network of treaties and the treaties contained an effective compliance mechanism through arbitration.

Given this straw, the neo-liberal theorists started assuming that bricks could be built towards the achievement of a global law on foreign investment protection. The first was the argument that the treaties had created customary international law. This argument was put to rest when it was pointed out that there were distinct internal balances brought about through negotiations in every treaty though the external form appeared very similar. The demonstration of this fact led to the subsiding of this argument, though the diehards have not yet given up on it.

The other was the more potent argument that many of the treaties contained most favoured nation clauses and that as a result it was able to determine that the best standard of protection that had emerged in the treaties could somehow be networked into the treaty system to evolve the argument that that standard constituted a global standard. Again, there are problems with such an argument as it is unclear whether states intended such use of the most favoured nation treatment. The awards which have interpreted these provisions have come out with discordant views, sometimes explained on the basis of the drafting differences in the treaties. If that be the explanation, then, it would be an illusion to speak in terms of the evolution of a global law through these means. If the explanation of the technique of using the most favoured nation clauses in this manner is to further the neo-liberal cause, then the opposition that has resulted indicates that the project is a long way from fruition. Coupled with the more direct efforts through the MAI, the failure of these less direct methods of promoting a universal international law on foreign investment have met with reversal. It was felt that these attempts privileged the interests of multinational corporations to the detriment of the interests of the developing countries and other interests such as the protection of human rights and the environment. These latter aims have now assumed a larger significance.

It is in the tussle that is emerging in the area of investment arbitration that the tension between neo-liberalism and the right to development is most evident. As indicated, arbitrators, either because of their background in commercial affairs or for reasons of personal expediency, are often prone to neo-liberal solutions. They may also do so because their experience in dealing with the public law aspects of a problem that may arise in the area is limited. Often, they are not

conversant with the issues of sovereignty and regulatory space that are involved in investment arbitration. For these different reasons, there have emerged a series of inconsistent awards in several areas of investment treaty arbitration. The facile explanation that is given is that the variations in treaty drafting are the basis of this inconsistency. But, any superficial reading of the awards indicates that the differences are not posited on the language of the treaty but proceed from deep-seated ideological preferences for the construction of a neo-liberal system of investment protection exhibited by some arbitrators and in equal measure resisted by arbitrators who believe in the need to adhere to standards of treaty interpretation that do not permit them to be creative of law but reflect the intentions of the parties to the treaty.

It is possible only to make a short survey of the types of schisms that have developed. In the area of invoking jurisdiction of the arbitration tribunal through the use of the treaty provisions on dispute settlement, several interesting disputes have arisen. Thus, the issue of whether a transaction qualifies as an investment for purposes of protection has led to a wide view that the performance of transactions of value would qualify as an investment whereas tribunals have insisted on wider characteristics besides the satisfaction of the definition of the investment in the treaties which would include other criteria such as long duration, nature of the risk in the transaction and above all, whether or not the foreign investment is such as to promote the economic development of the host state.⁵⁰

The widening of the grounds for founding jurisdiction in the arbitration tribunal is an effort that neo-liberal arbitrators seek to attempt as it would ensure that the control mechanism for the rules that they fashion on the basis of the investment treaties could be effectively maintained. But, the fact is that such attempts lack legitimacy as the arbitral system is based on consent and where such consent is lacking or is constructed by the arbitral tribunal on the basis of some extensive interpretation of the treaty provision, the resulting awards will lack the force required for acceptance and enforcement. States will simply rebel. The system will lead to a collapse as a result of such neo-liberal adventurism.

Conscious of this fact, other arbitrators seek a return to the basics, thereby triggering a situation of conflict within the system. The existence of an ever-increasing number of awards showing differences in their conclusions cannot simply be explained away on the basis of differences in language. Rather they display inherent ideological preferences of different groups of arbitrators to solutions of problems. There has been an effort at expansionary interpretation of the language of the treaties by a group of influential arbitrators who have preferred the establishment of a neo-liberal framework of investment protection brought about through the means of a series of arbitration awards. That project is also on the verge of floundering as the number of discordant awards increases. There are many areas of conflict evident in these awards. It is only possible to deal with a few.⁵¹

One such conflict relates to the employment of the notion of corporate nationality. As incorporation is the basis of corporate nationality, it can be manipulated

to provide protection to non-nationals of the state of incorporation. The situation in *Tokio-Tokeles v. Ukraine*⁵² illustrated the point. Here, nationals of Ukraine incorporated a company in and channelled investment through the company into Ukraine. They were held to be entitled to the protection of the treaty. The award raises fundamental issues. The investment treaty is intended to promote foreign investment in order to facilitate economic development. It is difficult to see how funds belonging to the host state which are redirected through an incorporated company and as a result acquire the protection of the treaty on the basis of the reasoning of *Tokio Tokeles* promote economic development of the host state when the funds belonged to the host state from the outset.

Worse still is the new idea that companies may migrate in such a manner as to incorporate in a state which affords them better protection in the event of a dispute. This became a possibility as a result of the award on jurisdiction in *Aguas del Tunari v. Bolivia*.⁵³ The absurdity of the position that has been reached is evident. This would mean that any corporation, which has no link with a state, could migrate into it for purposes of protection. It is an unprecedented event in international law which has required strict standards of links to establish nationality. In this situation, it is claimed that a multinational corporation could simply create a company in the state it believes gives it the best protection so that it could utilise its investment treaty with the host state with which it is having a dispute.

There is considerable cynicism that is involved in such a result. It has nothing to do with economic development. The motive is purely the promotion of the interests of the multinational corporation. Small, developed states like Holland keep themselves open for such migration in the hope that multinational corporations will come into them at least for a short while because of the nature of the protection that is given by their treaties. These considerations have nothing to do with the promotion of economic development of the poorer states, which is the ostensible purpose for which investment treaties are made.

These are but two instances of expansive uses of jurisdictional principles in the service of the neo-liberal cause. There are several other techniques used to ensure that the bases of jurisdiction are enlarged so that the scheme of protection under the treaties could be triggered. But, there is a reaction to what is happening. States are either leaving the system, threatening to leave or are creating new types of treaties with wide defences to liability.⁵⁴ As such trends increase, the neo-liberal adventure will prove a fruitless effort. States may realize that investment treaties merely deflate their sovereignty. As studies showing that foreign investment flows are not furthered by the presence of investment treaties grow, there will be rethinking of the need to make such treaties.

The expansionism that exists in the bases of jurisdiction is matched by the manner in which substantive principles have been used in investment arbitration. Again, it is possible only to provide a short summary of the developments. In the area of expropriation, the trends showed that the awards favoured an expansion of the concept of taking to involve any depreciation in the value of the property as a result of a government measure. It was suggested by some writers that

expropriation law would develop on the basis of the provision in the treaty, which in addition to stating direct as indirect takings also includes acts “tantamount to a taking” as forming part of expropriation, suggesting that the focus of the law will be on this third category of takings. They approved of cases like *Ethyl Corporation v. Canada*⁵⁵ where a ministerial statement threatening to ban the use of a chemical additive to petrol was held to be an expropriation as it resulted in the sole foreign manufacturer’s shares falling.⁵⁶

Such views would have curtailed the power of a state to regulate in the interests of society. It was a view that had to be ended. It was largely ended at the initiative of the United States which found itself at the wrong end of the law that it had helped to create. It engineered an exception to expropriation in the form of a rule that an expropriation which amounts to a regulatory device need not be compensated. The exception first appeared in a side letter to the investment provisions in the Singapore–US Free Trade Agreement but it now features in the US Model Investment Treaty. In a case similar to *Ethyl*, the *Methanex Case*,⁵⁷ the US strenuously argued that a ban on a suspected carcinogenic substance could not be regarded as a compensable expropriation because the ban was needed to protect the health interests of the people of the state.⁵⁸ Clearly, a change is afoot.

The acceptance of a notion of a non-compensable regulatory expropriation creates a gaping hole in the law on expropriation that capital exporting countries had hitherto created. There has been no satisfactory definition yet of the extent of this exception. The exception remains un-chartered. The extent of its potential use by states to regulate foreign investment remains untested. But, the fact that a right to development has emerged anew in international law will mean that a rearrangement of existing foreign investment to advance developmental interests would certainly bear on an expropriation being characterized as a regulatory expropriation. A foundation of neo-liberalism, a strict expropriation law which hindered interference with foreign investment on the basis of property rights having to be respected, has now been attacked.

One other area of expansion may be looked at by way of an example of the effects of neo-liberalism in effecting changes. Investment treaties contained references to a “fair and equitable standard” of treatment from the very inception of such treaty practice. Since the scope of the “international minimum standard” of treatment, a much older standard, remained undefined, there was little interest in the fair and equitable standard of treatment. But, with the law on expropriation being cast on unchartered courses, it was necessary to develop an alternative basis of liability. The law was created in a fashion that would assist the protection of foreign investors. Domestic legal systems do not treat the legitimate expectations doctrine as a substantive doctrine providing damages upon violation. They regard it as having only procedural significance as the life of governance will become impossible if every policy pronouncement has to be kept. It would also lead to bad governance as governments must necessarily react to changes in the circumstances and change policies accordingly.

It may be possible to trace the aberration of the principle in investment arbitration to a few factors. It is a case of an error being passed off as law. An arbitrator made a pronouncement in a paper based on his understanding of English law that that law supports the view that a foreign investor's expectations must be kept.⁵⁹ He suggested that in English law, the violation of legitimate expectations created by the government leads to damages. This is not demonstrable at all. There is no rule of substantive law that damages should follow a breach of legitimate expectations created by a government in any common law system. The law merely provides a procedural safeguard that a hearing should be provided to a person whose legitimate expectations based on prior statements of policy are interfered with by the state. But, the arbitrator had the opportunity of asserting the error in a series of awards as he was fortunate to be appointed chairman or member of tribunals.⁶⁰ The view was also followed by other arbitrators.⁶¹ It has never been demonstrated how such a principle came to be accepted as an interpretation of the fair and equitable standard. It is not a general principle of law. It was not expressed as the intention of the parties that this should be the effect. What has resulted is that a fetter has been placed on the state's ability to change policies in relation to foreign investment on the basis of an innocuous clause to which the parties did not ascribe such an effect. It raises very fundamental issues as to the legitimacy of the techniques that are being used in investment arbitration.⁶²

Clearly, there has been an effort to boost the interests of multinational corporations as investors so as to bring about a law that provides maximum protection to the foreign investor to the detriment of any development oriented policy changes a state may want to adopt at a later stage. The fact is that the international law academy both through its writings and a supply of its members as arbitrators contributed to these developments, which aid avarice and greed over the plight of poverty-stricken people. Given the history of this aspect of international law, there must be some soul-searching done. The so-called highly qualified publicists of the discipline litter the pages of the literature that contributed to the structuring of this iniquitous system. It is a system that has been brought about through arbitral awards and writings of publicists, highly manipulatable low-order sources of international law. Unfortunately for this part of the academy, there is strong opposition that has been mounted to these trends not only from within the academy but also from outside by non-governmental organisations and other institutions. If indeed there is an invisible academy that has a bearing on international law, it appears that it is divided between two camps, both of which seek to make instrumental use of international law, one to further a neo-liberal agenda and the other to dismantle it and establish law as a means to bringing about the economic development of the poor. There will be sufficient opposition growing which will strongly challenge the neo-liberal project and establish a counter order of norms. Though this may be seen as destabilising international law, it will not disconcert those who regard international law as an ever-changing process that sees constant clashes of interests and reconciliation of these interests.

The further task is to determine which of those interests are triumphant at any given stage. It would appear that the second coming of the right to development will tilt the balance in favour of the trend against the neo-liberal agenda that has shaped international law during that last decade and a half.

The return of the right to development

There is clearly a revival of interest in the right to development so that one could contemplate a second coming of the right to development in a much stronger form. Evidence for this revival comes from various sources. First, the Doha Development Round and the stances that have been taken by the developing countries presages a return to solidarity at least on trade issues reminiscent of the NIEO period. The strong leadership given by India, China and Brazil, states now emerging as economic powers in their own right, will counterbalance the power of the developed bloc. One scenario is that these states pursue their own agenda but, as the Indian Trade Minister often observes, the fact is that, despite the economic strides that India and China have made, they are still the home of the vast amount of the poor in the world. It is therefore unlikely that India and China can shake off the mantle of leadership of the developing world. Their rootedness in the solidarity of the developing world will persist for a long time to come. They will, as seen in such issues as the TRIPS and drugs for epidemics, take stances that are favourable to the developing world, though no doubt such stances will also accord with the pursuit of their own interests.

Second, they will be aided in this by the strong presence of non-governmental organisations such as Oxfam, which have entered the fray of international trade in support of shaping rules that will end poverty. They will exert strong pressure to ensure that the lobbying pressure of multinational companies to bring about rules that favour their causes are counterbalanced by the giving of consideration to the interests of eradicating poverty.

Third, the philosophical writings on poverty provide a strong basis for the establishment of the second coming of the right to development. Leading philosophers have addressed the ethical considerations that require the eradication of poverty being placed as the central problem of mankind.

Fourth, the United Nations has declared this the millennium dedicated to the eradication of poverty that afflicts the larger part of humanity. If this is not to remain merely rhetorical, there must be transformations taking place in international law to achieve this objective. Again, international law should become instrumental in reaching a goal that the international community has set itself.

Space does not permit consideration of each one of these factors that make the second coming of the right to development stronger. It is best to concentrate on two other reasons why this second coming will be stronger. The decay of the existing neo-liberal agenda is obvious. A succession of economic crises has demonstrated that the neo-liberal prescriptions do not work. The disillusionment spills out onto the streets of Western capitals.

More telling is the fact that development has been achieved by many states, particularly those in East Asia, by adopting measures that are a denial of neo-liberal prescriptions. Quite apart from the fact that influential economists have debunked the prescriptions of the neo-liberal agenda as having any potential to promote economic growth, the experience of the East Asian states may demonstrate that following prescriptions which stand in marked contrast to those of the neo-liberal agenda may indeed promote growth even more swiftly and more evenly. The work done in the law and development movement indicates that there is no single path to development and that law has been employed in a variety of ways to stimulate development that may not be in accord with the neo-liberal prescriptions.

There is a need to rethink the basis of international law whose moorings have been diverted to serve sectional interests. The increasing fragmentation of international law itself is seen as a strategy to ensure that the developing states are excluded from the province of international law. In that context, the return to the right to development provides a salutary basis on which the foundations of international law can be redrawn so that the law could cater to the interests of the wider international community and the diverse peoples and interest groups within it. The Millennium Goals, by identifying the problems that confront this vast humanity, performs the vital function of indicating the objectives that need to be achieved. It indicates a consensus towards the achievement of those objectives. Its most ardent adherents would admit to the fact that it is at best a set of aspirational aims without any machinery to ensure their achievement.

The revival of the right to development can supply that machinery by redrawing the function of international law through the notion of human security which has become the focus of many studies in the related field of international relations.⁶³ The essential thesis is that the problems that confront mankind relate to the achievement of human security and that this involves not just the reduction of the use of force—the traditional focus of international law—but an array of other factors principally relating to purely internal, domestic issues such as ethnic tensions, religious schisms, poverty, discrimination, environmental depletion and secessionist violence. Many of these factors tie in with the Millennium Goals. They also can be subsumed in the notion of the right to development. In the second coming of the right to development, opportunity is created for the redefinition of a broader right to development that is tied to the problems of human security so that international law can be redefined to include these goals.

One witnesses that struggle ongoing in many areas of international law. The evidence provided by the developments in trade and investment were discussed in this chapter. Resistance to neo-conservative norms is beginning to change the earlier basis of an international law that promoted sectional interests to the exclusion of the vast majority of humankind. Resistance to such law must have a focus. That focus could be provided through the Millennium Goals coupled with the revival of the right to development with a new focus.

Notes

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- 1 Joseph Stiglitz, *The Roaring Nineties* (Penguin, London, 2003).
 - 2 The Millennium Goals are eight development goals announced by the United Nations. The goals were developed out of the eight chapters of the United Nations Millennium Declaration signed in September 2000. They include the eradication of poverty, the achievement of primary education, progress towards gender equality, reduction of infant mortality, promotion of maternal health, eradication of infectious diseases such as AIDS and malaria, achieving environmental sustainability and drawing up a global development agenda. United Nations, *Millennium Goals*, 2007, available at www.un.org/millenniumgoals/pdf/mdg2007.pdf.
 - 3 The leaders of the Group of Eight (G8) committed to assign funds for the Millennium Goals and to take measures towards reducing debt in the Gleneagles Agreement. Few other concrete moves could be pointed to, apart from the assigning of aid.
 - 4 Francis Fukuyama, *The End of History and the Last Man* (Free Press, New York, 1992); Michael Mandelbaum, *The Ideas that Conquered the World* (Public Affairs, New York, 2002).
 - 5 Many found the situation reminiscent of the events leading to the Depression of 1929. In that period too, schemes for making easy money without effort precipitated the crisis. An illusion was created that these means of creating wealth should be permitted by the state and that progress should not be deterred through counter-arguments.
 - 6 Sadly, academic institutions were also guided by profit motives as they were denied state funds. Low-paid academics in the legal field resorted to the practice of law to make up deficits in their salaries. This required them to support the profit motives of legal firms and trends that favoured market forces, which the profession relied on for profits. In foreign investment arbitration, academics joined in as arbitrators and rationalised wide extensions made to the law, which form the basis of the last sections of this chapter. In the United States, support for neo-conservative reinterpretations of international law came from academics, though strong refutations of these trends also were made. See Mary O'Connell, *The Power and Purpose of International Law* (OUP, Oxford, 2008) for a description of these trends.
 - 7 Gandhi had stated that the "world has enough to feed man's needs but never enough to feed man's greed".
 - 8 Arthur Kronman, *The Lost Lawyer: The Failing Ideals of the Legal Profession* (Harvard University Press, Cambridge, MA, 1993).
 - 9 Phillip Allot, *The Health of Nations: Society and Law beyond the State* (CUP, Cambridge, 2004) at p. 399.
 - 10 Broadly associated with the movement described as the Third World in International Law, these authors took different standpoints that were critical of the major literature and trends emerging in the subject. For a representative sample, see Bhupinder Chimni and others (ed.), *The Third World in the International Legal Order* (Martinus Nijhoff, The Hague, 2002).
 - 11 Carolyn Thomas, "Where is the Third World Now?" in Carolyn Thomas (ed.) *Globalization and the South* (St Martin's Press, New York, 1997).
 - 12 Thus, one could argue that the WTO's expansion into fields like intellectual property, services and investment represented the high point of neo-liberalism but the changes and contests in areas such as intellectual property, the unwillingness to progress in areas such as services or investment are reactions to neo-liberalism. So, too, one may detect changes in approach to the law on the environment or the use of force.

- 13 A classic example is defeating the Singapore issues which involved expansion of WTO competence into the areas of government procurement, investment and transparency. Brazil has not signed any investment treaties, standing outside the neo-liberal system on this and succeeding nevertheless.
- 14 Indonesian law provides a classic example. Article 34 of the Indonesian Constitution vests ownership of mineral resources in the people. The Mining Law, Article 10, provides for Contracts of Work to be made with foreign investors but these contracts are to be regulated in the public interest by the Ministry of Mineral Resources. Indonesia pioneered the production sharing contract, which is the widely used form of contracts in the global petroleum industry.
- 15 The spate of Argentine cases before ICSID arising from the economic crisis in that country is instructive. The cases showed that the framework on exploitation of resources remained intact despite the fact that the state had adopted neo-liberal policies on investment. It signed investment treaties but left the internal law intact.
- 16 A resurfacing of these sovereignty-related ideas is evident in the investment area in the practices of developed states. Thus, many of the cases involving the United States and Canada under Chapter 11 of the North American Free Trade Agreement (NAFTA) are argued on the basis of the sovereign right to regulate sectors of the economy or on the right of the sovereign to take measures to protect health or other interests.
- 17 See, in particular, the discussion by Professor Dupuy, the sole arbitrator in *Texaco v. Libya* (1977) 53 ILR 420.
- 18 For a discussion of the differing views, see Maurizio Ruggzi, *The Concept of International Obligations Erga Omnes* (OUP, Oxford, 1997).
- 19 For example, the constitutions of the Philippines, Indonesia, Venezuela, Argentina, Zambia, etc.
- 20 Much of the work in these fields was done by the United Nations Conference on Trade and Development (UNCTAD) in its more vigorous phase as the vehicle for the views of the developing states.
- 21 Jack Goldsmith and Eric Posner, *The Limits of International Law* (OUP, New York, 2005).
- 22 This project is largely associated with the writings of Professor Ulrich Petersmann.
- 23 Contemporary accounts of the drafting of the TRIPS document make this clear. Susan Sell, *Private Power, Public Law: The Globalization of Intellectual Property Rights* (CUP, Cambridge, 2003).
- 24 It unexpectedly benefited the emerging Indian sectors to provide services, with allegations that jobs were being exported to the developing states.
- 25 Lee Yong Shik (ed.), *Economic Development through World Trade: A Developing World Perspective* (Kluwer, London, 2008). Economic writing also indicated that the measures of liberalisation contained in the prescriptions of the WTO may have adverse consequences on development. Ha Joon Chang, *Bad Samaritans: The Guilty Secrets of Rich Nations and the Threat to Global Prosperity* (Random House, London, 2008). There are American economists supporting these views, in particular Joseph Stiglitz and Dani Rodrick. There is much writing on the lack of fairness in the instruments of the WTO. See, e.g. Americo Zampetti, *Fairness in the World Economy* (Edward Elgar, London, 2006). Frank Garcia, "Global Justice and The Bretton Woods Institutions" (2007) 10 *JIEL* 461.
- 26 Such efforts are identified with the writings of Ulrich Petersmann. See Ulrich Petersmann, "Time for a United Nations Global Compact for Integrating Human Rights into the Law of Worldwide Organizations: Lessons from European Integration" (2002) 13 *EJIL* 621. The view has attracted criticism. Philip Alston, "Resisting the Merger and Acquisition of Human Rights by Trade Law: A Reply to Petersmann" (2002) 13 *EJIL* 815; Robert Howse, "Human Rights in the WTO: Whose Rights, What Humanity?" (2002) 13 *EJIL* 651.

- 27 Kenneth Vandeveld, "The Political Economy of the Bilateral Investment Treaty" (1998) 92 *AJIL* 621.
- 28 Much of the discussion has centred around the usefulness of investment treaties.
- 29 There is a burgeoning literature on this issue. See e.g. Jeswald Salacuse and Nicholas Sullivan, "Do BITs Really Work?" (2005) 46 *Harv. JIL* 67.
- 30 These are the transfer of new technology and management skills, creation of infrastructure, greater number of jobs, export of manufactured goods and tax revenues. The trickle-down effect of the wealth created is also emphasised.
- 31 The need for property protection for economic development came to be stressed. See Hernando de Soto, *The Mystery of Capital* (Basic Books, New York, 2000).
- 32 The use of judicial techniques to deal with political and economic matters is a feature of the period. Ran Hirschl, *Towards Juristocracy: The Origins and Consequences of the New Constitutionalism* (Harvard University Press, Cambridge, MA, 2004). In the present case, it is transferred to the international sphere to ensure de-politicisation of foreign investment.
- 33 Sometimes, these neo-liberal values are openly revealed. See for example, the opinion of the dissenting arbitrator in *Thunderbird v. Mexico*. Arbitrators are seldom as honest in revealing their prejudices towards viewpoints.
- 34 This is seen particularly in the literature generated by the World Bank. Alvaros Santos, "The World Bank's Use of the Rule of Law Promise" in David Trubeck and Alvaros Santos, *The New Law and Economic Development: A Critical Appraisal* (Cambridge University Press, Cambridge, 2006).
- 35 (1991) 31 *ILM* 577.
- 36 The case load of ICSID catapulted after *AAPL v. Sri Lanka*.
- 37 This criticism, which has been made by many, is well developed in the work of Gus Van Harten. A large number of arbitrators who have sat on foreign investment disputes have no public law or public international law background. Their experience in reading treaties or taking public interest issues into account is lacking. See Gus Van Harten, *Investment Treaty Arbitration and Public Law* (OUP, Oxford, 2007).
- 38 The invasion of Iraq will forever provide the example. History abounds with examples of interventions made ostensibly for a noble purpose but in reality for the advancement of the interests of the intervening state.
- 39 It is an excuse that has parallels with the expansion of the Vietnam War into Cambodia on the basis of the unproved allegation that the command headquarters of the Vietcong was located across the border in Cambodia.
- 40 Indonesia's success was trumpeted as a model of success for liberalisation of the market but no sooner was Soeharto, a dictator but like many dictators in Asia, a darling of the West, deposed, then the crony capitalism the dictator had practised was blamed for the failure so that the fault could be shifted away from liberalisation.
- 41 Argentina was to undergo a financial crisis in 2001 similar to that in Asia, when funds were pulled out of the country. A political and economic crisis resulted, leading to riots and the fall of six governments within a short span of a few days. It also led to a large number of investment arbitrations. Some of those that have been decided involve huge sums in damages. Argentina has so far avoided paying these sums and challenged them through annulment proceedings. There will also be rethinking of the value of investment treaties as a result of this experience. The experience will also militate against the future possibility of a global investment agreement until at least the present memories fade. There will be a move to return to the Calvo doctrine.
- 42 In 1992, after a study on the possibility of such a treaty, the World Bank Group was content to issue guidelines rather than bring about a multilateral treaty, which the Group felt was not appropriate, given the existing differences in view on the subject. World Bank Group, *Guidelines on Foreign Investment* (World Bank, Washington, DC, 1992).

- 43 Both France and Canada pulled out in the belief that open entry would affect their entertainment and newspaper industries. Holland also pulled out as a result of the pressure of the NGOs. Gradually, fervour for the MAI diminished, due to mounting pressure.
- 44 At the Second Ministerial Meeting of the WTO held at Singapore the Ministers had agreed to study the possibility of WTO competence over investment and other issues such as transparency, government procurement, competition and trade facilitation. After the Cancun Ministerial, the US and the EU abandoned the Singapore issues.
- 45 This had to be given up because, though there was a numerical fact that these treaties were on the increase and were broadly similar in form, the substance of the treaties varied markedly. The claims to customary law were made on the basis of the superficial form the treaties took rather than on the examination of their substance.
- 46 This effort flows from the award in *Maffezini v. The Kingdom of Spain* (2000) 5 ICSID Rpts 387 where the most favoured nation clause in a Spanish investment treaty was used to obtain jurisdictional advantages in another treaty made by Spain.
- 47 Starting with the Third Ministerial Meeting of the WTO in Seattle (1998), which had to be virtually abandoned because of demonstrations, every meeting of financial institutions and of leaders at financial summits have been attended by demonstrations wherever they are held.
- 48 The preamble of the ICSID Convention stresses the need to promote the flows of foreign investment.
- 49 The investment treaty between Pakistan and Germany that year is identified as the first bilateral investment treaty. Rudolph Dolzer and Margarete Stevens, *Bilateral Investment Treaties* (Kluwer Law International, The Hague, 1995).
- 50 *Patrick Mitchell v. The Republic of Congo* (2007) ICSID.
- 51 The author has longer surveys of this problem. See Sornarajah, "Expansionary Trends in International Investment Arbitration", Paper at the Columbia-Sorborne Conference in International Investment Law (New York, 2005) published in a collection of papers edited by Karl Sauvant, *Appeals Mechanism in Investment Disputes* (OUP, New York, 2008).
- 52 (2005) 20 ICSID Rev. 205.
- 53 ICSID, 2007.
- 54 The United States itself has in its 2004 Model Treaty indicated this retreat as the new model permits the possibility of many defences. Venezuela, Bolivia and other states have indicated withdrawals from the process at least as to some sectors.
- 55 (1999) 38 ILM 708/.
- 56 The case was settled through payment of compensation by Canada.
- 57 (2005) 44 ILM 1345.
- 58 The arguments revived the idea that regulatory takings do not amount to expropriation. Some of the pleadings are reminiscent of the language of sovereignty that developing countries use in their defence.
- 59 Francisco Orego-Vicuna, "Foreign Investment Law: How Customary is Custom?" (2005) *ASIL Prcdgs* 97.
- 60 *CMS Gas Transmission v. Argentina* (2003) 7 ICSID Rpts 492.
- 61 *Teemed v. Mexico* (2004) 43 ILM 133; *MTD Equity v. Chile* (2005) 44 ILM 91.
- 62 Further see Peter Muchlinski "The Relevance of the Conduct of the Investor" (2006) 55 *ICLQ* 527.
- 63 Mary Kaldor, *Human Security* (Polity, Cambridge, 2007); K. Fierke, *Critical Approaches to International Security* (Polity, Cambridge, 2007).

3 Japanese law and Asian development

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This chapter examines Japanese legal influence on Korea and Taiwan, dating from the colonial era and imposed by legal transfer. Colonialism made Japan a “reference society” for legal reform in the two countries, a status that has persisted to this day. The chapter argues that Japan transferred a configuration of legal institutions that in turn helped underpin political economy in the high-growth era.

This set of institutions can be called the Northeast Asian Legal Complex.² It involved largely German concepts of state and law, but was embedded in a distinct set of institutions: An insulated administration, a miniscule legal profession, and a relatively high-quality judiciary with a formalist approach. This configuration of interlocking and reinforcing institutions differs from those found in other developing countries, and survived into the 1990s in all three countries. The argument is that these institutions facilitated a distinct political economy, centered around the administrative apparatus and with relatively little involvement of lawyers.

Understanding the Northeast Asian Legal Complex helps to address several issues in the literatures of comparative law and law and development studies. Most obviously, the important role of Japanese legal transfers poses a challenge to the classification scheme of the legal origins literature that has become extraordinarily influential in comparative law and has been revived in the “law and finance” literature.³ It also, however, challenges the “voluntarist” approach of the literature on legal transfers as it has evolved. The Japanese colonial institutions, it turns out, had profound and long-lasting influence despite the fact that they were imposed, sometimes brutally. This should force a re-evaluation of universalist claims about voluntarism as a key condition for legal borrowing.

Finally, the chapter contributes to the evolving set of critiques of conventional law and development studies. Conventional development theory has made several assumptions about the importance of certain features of the institutional environment to the facilitation of economic growth. Many, though not all, of these features were lacking in the Northeast Asian context. Given that these countries were the most rapidly growing in the postwar world economy, this fact deserves further exploration and has profound implications for development theory more broadly.⁴

This chapter proceeds as follows. It begins by framing the issue within the literatures on comparative law and law and development. It then describes the ideal type of the Northeast Asian legal complex and examines the colonial histories of Korea and Taiwan. Finally, it speculates on the implications of the narrative for law and development literature.

Comparative law: are imposed transfers effective?

For most countries around the world, modern law is in large part a foreign phenomenon. Now that the fiction of “socialist law” has been cast away from the discipline of comparative law, we see that most countries in the world have adopted or had imposed on them one of two grand legal traditions, the English common law and the continental Romanist tradition. Bearing in mind that the alleged distinctions between the two are nearly always overstated,⁵ it is still true that these sources provide much of the institutional framework for modern legal practice. Much comparative legal scholarship focuses on the distinction, and recent work in law and development seeks to trace the effect of the adoption of these alternative schemes on economic development.

An extension of this work is the new and influential body of work on “legal origins,” tracing many development outcomes to the particular legal tradition of the colonial power.⁶ The basic argument is that initial endowments of institutions are reproduced over time in ways that affect a society’s patterns of ownership, utilization of resources and growth many years later.

The legal origins literature has been criticized on many grounds. Some argue that the authors misread particular legal histories, shaping the narrative to fit their broader story.⁷ Others point out that their coding of relevant variables is poor and that in many cases they are not capturing *legal* origins so much as broader colonial influences.⁸ The advocates of legal origins have resuscitated the idea of families in comparative law, but have discovered some genetic relationships that might be called into question. For example, we learn that much of Latin America utilizes French law, rather than focusing on the Spanish colonial heritage or the influence of synthetic sources such as Italian law.

For present purposes, it is of interest that Japan, Korea and Taiwan are all characterized as of German legal origin. This is understandable, but of course, one could make a case that they are also of American, French or even Roman legal origin as well. The three cases constitute 60 percent of countries classified as having borrowed law from Germany. My suggestion is that the Meiji Japanese configuration of German legal institutions is novel enough to deserve categorization as a distinct “legal origin.” Certainly, the fact that German influence came through *Japan*, rather than from Germany directly, is essential to understanding the legal institutions in these two most successful former colonies.

Another line of literature in law and development focuses less on *what* legal institutions were transplanted into developing countries, and more on *how* those legal institutions were transferred. Since Alan Watson made his controversial claim that legal transplants are the main source of legal change, mainstream

comparative law has been concerned with understanding why and how transfers occur.⁹ This has taken three main streams. First, some scholars have analyzed whether Watson is indeed correct.¹⁰ Second, others have offered a taxonomic approach to characterizing different kinds of transfers, including such a variety of terms as reception, imposed reception, concerted parallel development, transposition and various others.¹¹ Third, some have taken on the issue of why particular legal transfers are successful.

It is this last question which Berkowitz, Pistor and Richard address in their important set of papers.¹² They suggest that the mode of adoption can be more or less voluntaristic, and this makes a huge difference both for whether the law is effective and for development outcomes.¹³ Their argument is that three features help to ensure effective legal transplants: voluntarism, adaptation and receptivity. Those states that borrow other laws in a voluntary manner would intuitively have a greater interest in making the law work than those which have law imposed. Meiji Japan would seem to be a paradigm case of voluntary adoption, while Occupation Japan would seem to be a paradigm case of imposition. Those states that adapt the borrowed laws by amending them would seem to have more effective legal transfers, as the amendment process involves a certain degree of local tailoring. Finally, those whose populations shared a similar tradition with that of the source nation are seen to be more receptive to the adoption of particular rules.

South Korea and Taiwan are both considered unreceptive transplants in their scheme.¹⁴ The implication is that these countries developed *despite* their poor legal heritage rather than because of it. It is this suggestion that this chapter grapples with. The following section traces the influence of Japan on its colonial subjects, both before and after colonization. It is argued that Japanese law has had significant influence on these societies even after the colonial period ended and that this contributed to their successful development experiences in the postwar era.

The emergence and spread of the Northeast Asian legal complex

First, some basic facts are necessary to frame the question. Following the Meiji Restoration of 1868, Japan embarked on a rapid program of modernization that included adoption of a Constitution (1889), a Civil Code (1896) and institutional structures of modern law such as courts, prosecutors and administrative agencies. Until its defeat in World War II, Japan was the colonial power occupying Taiwan (1895) and Korea (1910). During this period Japan transferred many of its own newly formed institutions to these places.

The dominant influences on Japanese law were French and later German. Japan, Korea and Taiwan thus fit squarely in the civil law tradition in terms of the basic legal structures, although postwar American influence profoundly shaped substantive norms in all three places to a certain extent. What impact did the peculiar fact of Japanese intervention have on these countries, and did it play any role in their subsequent economic growth?

Japan's own adoption of Western law was part of its modernization program, an "inoculation against colonialism rather than infection by it."¹⁵ And yet, as in political economy, Japan's adoption of Western legal institutions did not mean that these institutions operated in the same manner as in the West. With the political economy organized around state intervention and late development to catch up with the West, law as a means of social ordering received much less emphasis. It might thus be considered an embodiment of the Meiji slogan *wakon yosai* ("Japanese spirit, Western technology").

Beginning in the Meiji period and extending into the postwar period, Japan developed a set of interlinked institutions referred to as the Northeast Asian Legal Complex. The term legal complex is meant to highlight the systemic interrelationship and integration of a set of institutions, which served to complement and reinforce each other in a stable and remarkably successful way. The Northeast Asian Legal Complex can be conceived as an ideal type to describe the similar structures in place in Japan, Korea and Taiwan, although it must be recognized that individual countries varied and may have deviated from the ideal type in certain ways at particular times. The Northeast Asian legal complex had three main elements: a professional, somewhat autonomous and competent court system; a small, cartelized private legal profession without much independent political influence; and administrative law regimes that insulated bureaucratic discretion exercised by developmental regimes. Each will be treated in turn.

Semi-autonomous judiciary

The judiciary in Japan had emerged by the 1890s as a discrete branch of government, with a strong reputation for consistency and an insistence on resisting overt political pressure. The judicial system was organized hierarchically, with effective control at the top, and developed an internalized institutional emphasis on providing like solutions to like cases, helping to render predictable decision-making and thereby contributing to a reasonably sound business environment. Courts had a moderate capacity to handle civil and commercial disputes. This in turn helped to keep litigation rates low in Japan relative to other advanced industrial democracies.

Many of the features of the judiciaries in Korea and Taiwan can be traced back to their origins in the colonial administrative apparatus. While there were greater concerns about judicial corruption in post-colonial Taiwan and Korea than have ever been observed in Japan, the basic institutional structure of a hierarchically organized judiciary operated effectively, especially when compared with judiciaries in other developing countries coming out of colonial rule. In the economic sphere, the judiciary retained autonomy. It had a distinct professional ideology and norms of neutrality in most cases.

This is not to assert a complete autonomy from political influence. The Kuomintang (KMT) and the Korean strongmen attempted to develop means of monitoring and disciplining judges, particularly in politically sensitive disputes. The Leninist KMT, with its ability to penetrate into the society, had some

advantages here compared to Park Chung Hee in Korea, whose interference with judicial independence was clumsier.

Small private bar

Northeast Asia is well known for very low rates of lawyers per capita. In both Korea and Taiwan (as in Japan), legal training was generalized undergraduate education, with the bar exam treated as a separate goal for a very small proportion of those who graduated. Relatively few legal graduates would try to pass the bar, and a very small proportion would actually succeed. The bar pass rates fluctuated, but were below 3 percent for most of the postwar period. Most bar passers devoted additional years of study to prepare for the test beyond the undergraduate degree. The few who were able to run the gauntlet to enter the legal profession were rewarded with great status and wealth. The function of the examination was no mere test of basic professional skills and qualifications; rather it was a kind of super-exam, the difficulty of which was itself the point.

One might wonder how economies as advanced as those in Northeast Asia could function without large numbers of private lawyers. The answer lies in part in the fact that law was a popular generalist education, so that many legally trained persons who were unable to pass the bar ended up working in quasi-legal jobs with companies and the government. This meant that background notions of legality and predictability were present throughout the system. In addition, a large amount of 'lawyer's' work is done by adjunct professions such as scribes, paralegals and others with competence in specific arenas of practice, including tax, administrative filings, and patent applications.¹⁶

In each country, the few lawyers who were lucky enough to pass the bar and enter the private legal profession had no incentive to fight for a larger profession because of the monopoly rents they collected. Nor did private business much care to push for more lawyers, focusing instead on cultivating personalistic links with state agents. Predictable courts working in a relatively small zone meant there was little pressure on the system of state-controlled legal training and rationed legal services.

The small, cartelized private bar was relatively quiet for most of the postwar period. The organized bar associations were conservative and inactive. In the 1980s, however, exogenous decisions taken by bureaucratic authorities expanded the number of bar passers. The growth in numbers of bar-passers in Korea can be traced to a 1980 decision by the Chun Doo Hwan administration to expand the number of annual passers of the bar examination from the traditional 100; in Taiwan the numbers did not begin to expand dramatically until 1989, before which only a few dozen persons might pass the exam in any given year.¹⁷ Ministry of Examination statistics show that the Taiwan bar passage rate increased to 14 percent in 1989, a huge jump. The rationale for the changes in Korea and Taiwan policies remains murky. It is tempting to trace both developments in part to the contemporaneous shift toward liberalization in economic and financial spheres, which led to greater demand for business lawyers, but there is no

independent confirmation of this hypothesis, in part because of the general lack of transparency in government administration at the time. Taiwan's Examination Yuan is said to have been prompted to expand the size of the bar in part because of an incident in the early 1980s when an exam-taker committed suicide because of his frustration at repeated failure. In any case, the rather technocratic decision had profound impacts down the road.

Administrative insulation

One of the most important parts of the Northeast Asian legal complex was the administrative law regime, which has received relatively little attention from political economists but was essential to insulate state management of the economy. Courts in all three countries took a hands-off approach to supervising administration, allowing the operation of an informal, flexible style of regulation based on broadly worded statutes.¹⁸ While a large amount of administrative policymaking is inevitable in any modern state, it has been especially apparent in Northeast Asia because of broad delegation to ministries. Less precise legislation requires more making of new rules by ministries. In Japan, this involved a consensual policymaking process governed by *shingikai*, deliberative councils involving the concerned parties as determined by the relevant ministry. Similar mechanisms of business–government coordination were prominent in Taiwan and Korea.¹⁹ The emphasis was on selective, *ex ante* private participation in policymaking arenas that were structured by ministries. This system provided transparency and predictability for the most interested players, and high levels of compliance once policy was adopted.²⁰ For outsiders, however, there was no transparency whatsoever.

In implementing regulatory policy, the Northeast Asian state has operated primarily through case-by-case ad hoc determinations, made on the basis of flexible 'administrative guidance' rather than pre-announced rules. In such a circumstance, without legislative clarity or clear rules, private actors have no choice but to cultivate relationships with the bureaucrats who will in fact be making distributive decisions on a discretionary basis. Network political economy was legally constituted. The academic controversy concerning the extent to which administrative discretion was exercised in the shadow of political power need not concern us here. For now, it is sufficient to say that the entire structure of Northeast Asian postwar political economy was reflected in and sustained by the structure of public law.

Private parties were subject to particularistic regulation, embodied in administrative guidance, that emphasized informal business–government relationships rather than general, transparent rules applicable to all. This mode of regulation was sustained by a lack of transparency. Had regulation been transparent, the companies could have made rational calculations. But because of its flexibility, private information on ministerial policy became crucial for business planning.

It must again be emphasized that this configuration had a particular legal construction. There were no generalized administrative procedures rules.

Government information was not freely available, meaning that bureaucrats could use the regulation of information flows as an important tool in interactions with both private firms and politicians.²¹ While administrative litigation was technically possible, the restricted private legal profession meant that litigation rates were fairly low. Administrative law provided some review of retail level application of law as applied to individual cases, but virtually no challenge to wholesale level rulemaking, and administrative guidance was generally held to a high standard of review.²² Courts would intervene if and only if a private party made absolutely clear its refusal to comply with administrative guidance, a difficult feat given both the high status of bureaucrats and the myriad collateral tools government held to shape an individual firm's business environment.

The equilibrium of the legal complex

Each of these three elements of the Northeast Asian legal complex interacted with the others to produce a set of stable and reinforcing institutions. The predictable courts minimized pressure for private litigation (at least when compared with American 'adversarial legalism').²³ This allowed the state to maintain severe rationing of private legal services. A small private bar, in turn, minimized the possibility of social movement litigation challenging the insulated domains of policymakers.²⁴ Furthermore, the possibility of judicial and prosecutorial retirement to the bar in Korea and Taiwan led to a comfortable conservatism in those countries among the majority of legal practitioners. In Taiwan this was magnified by the ability of military lawyers to gain preferential admission to the bar without passing the exam. Interestingly, there is no general pattern of judicial retirement to the bar in Japan, and the private legal profession tends to be more liberal as a result. Left-leaning bar passers have traditionally been more likely to select the private bar as a career in Japan than in Korea and Taiwan.

The basic configuration of administrative discretion exercised by elite bureaucrats and a restricted supply of legal professionals meant that litigation was relatively unimportant as a means of social ordering, particularly in interactions with the state. Regulated parties, lacking legal recourse, were forced to cultivate particularistic relationships with the state, reinforcing the image of bureaucratic dominance. Long-term relationships among bureaucrats and the large industrial firms provided the basic structure, reducing the need for general rules to govern arm's-length transactions. The Northeast Asian legal complex cabined law to a narrow zone.

An additional factor in Korea and Taiwan was authoritarian rule, justified to maintain security from the external threat of, respectively, North Korea and the People's Republic of China. North Korea and the PRC were not merely neighboring communist countries, but regimes that claimed to be the sole legitimate governments of the nation; they provided a very real alternative vision of national identity and legitimacy. The resulting anti-communist ideology and cold war imperatives meant that both South Korea and the ROC regimes needed some degree of formal legality to distinguish themselves from the totalitarian

alternative. Thus the very existence of a small private bar and formal institutions of judicial independence was necessary to distinguish the regimes from the totalitarians, many of whom lacked any associational life or professional integrity. Formal constitutionalism, too, was needed to maintain U.S. support. The presence of liberal constitutional language meant that liberal law was at least a formal ideal to which reformers and oppositionists could draw on. For most of the period, however, this potential remained dormant.

Japan as reference society

The general influence of the colonial period on subsequent developments in Korea and Taiwan is a complex and extremely controversial question. Some historians believe that the industrial developments imposed by Japan on Korea and Taiwan were important and helped sow the seeds for the postwar period of rapid growth.²⁵ Others have asserted that growth during the colonial period was relatively low compared to colonies of the British and French in Asia.²⁶ In general, paralleling local understandings, scholars studying Taiwan are more likely to give some credit to the Japanese regime, which was less brutal in its colonization of the island than the Korean peninsula.

For Taiwan, Peattie argued that Japanese colonial officials were themselves oriented to the policies of the “superbly successful modernization effort which Japan itself had undertaken in the three decades after the Meiji leadership had overthrown the Tokugawa feudal order.”²⁷ Just as Meiji Japan had transformed a static peasant society by sweeping away old elites, so the Japanese colonists transformed Korea and Taiwan and transferred industrial technology to them.²⁸ On Korea, Cumings has argued that “the colonial period played an undeniable role in placing Korea above most Third World nations by 1945.”²⁹ The political economist Atul Kohli argued that the Japanese laid the basis for the high-growth period after the war, noting substantial institutional continuities between colonial Korea and the South Korean state under Park Chung-Hee.³⁰

Others call these arguments into question. Haggard, Kang and Moon challenged Kohli’s article by noting its “technocratic bias.”³¹ State-centered development theories ignored the role of political coalitions in underpinning growth, and the fact that the massive industrial conglomerates that dominate South Korea’s economy are postwar creations. In addition, many Korean policies in the high-growth period seemed to reverse Japanese colonial policies. Korean scholars are particularly sensitive to the suggestion that the brutal colonial period might have had some long-term beneficial effects.

The best argument for those focused on the positive impact of the colonial tradition is on infrastructure. Colonial powers, including Japan, developed railways and roads, as well as urban amenities, primarily for their own colonial purposes. After colonialism this infrastructure was generally available to the new states for use.³² The argument below is that elements of legal technology follow a similar logic. The following sections discuss each case in more detail.

Korea

Korea emerged from the long period as the Hermit Kingdom through sequential pressure from both the West and Japan. Not much more than two decades after Commodore Perry's "black ships" had opened up Japan, Japan itself opened up Korea in 1876 through forcible entry of its warships. It imposed the Treaty of Ganghwa, an Unequal Treaty of the type that Japan had itself been subjected to by the West. Japanese traders were granted extraterritorial rights and extended privileges.

Attempts to reform Korea from within involved the adoption of the quasi-constitutional *T'ongli-amun* in 1880, but these efforts proved too little too late. A peasant rebellion in 1894 prompted the weak Korean monarchy to turn to the Qing for assistance, but Japan sent its own troops and effectively severed Korea's long tributary relationship with China in the Treaty of Shimonoseki in 1895. At the same time, the government passed a Court Organization Law, along with other statutes as part of a series of last-ditch measures to establish modern legal institutions. These laws abolished hereditary groups and established a principle of equality before the law. Most of these laws, however, were in fact copied from Japan.³³ Japanese instructors served in the fledgling government-run law school established by the Koreans as well.³⁴ Japan's defeat of Russia in the Russo-Japanese War further isolated Korea, as Russia acknowledged Japan's "paramount political, military and economic interest in Korea." With no powers to balance the Japanese, Korea was taken in as a protectorate in 1905 and formally annexed in 1910 by treaty (renounced by both sides in 1965) which involved "complete and permanent cession of all rights and sovereignty over the whole of Korea."³⁵ The brutal period of direct colonial control began.

Within two decades a Japanese-style colonial government structure was in place, including cabinet government, courts, police and legislation.³⁶ From early on, then, law was adopted in Korea not as an instrument to maintain independence in the face of Western colonialism, as it had been in Japan and Thailand, but as a tool to deprive Korea of independence in the interests of Japanese colonialism. The motives of Koreans to absorb legal know-how were thus reduced. *Wakon wasai* was scarcely an attractive formula for Koreans.

Colonial law differs in its logic from the law of the metropole, though there was a large debate on this issue in Japan at the time. Some argued that Japan should integrate the colonies into metropolitan Japan, which would allow direct rule from the government and Diet, but have the potentially troubling effect of extending the rights granted under the Meiji Constitution to Taiwanese and Koreans.³⁷ The contrary view was to treat the colonies as just that, subject to relatively unconstrained rule by the Governor General. These issues were resolved in the first instance with regard to Taiwan, in a compromise formula that held that the constitution did apply to Taiwanese, who were Japanese nationals, but that the political rights were not enforced.³⁸ This formula allowed the Japanese to avoid identification with "colonialism," and was based on perceived ethnic similarities between Japanese and Taiwanese as well as the physical proximity

of the areas.³⁹ Gradually, however, liberals in the Japanese Diet including future Prime Minister Hara Takashi came to the view that the colonial subjects should have political rights as well. If the Constitution was the basis for the delegation of authority to the Governor-General, then it had to be assumed that the Constitution applied and political rights should be extended to the colonies.⁴⁰ Ultimately, Japanese law was extended to the colonies only by the respective Governor Generals.

Whereas Western legal systems had emphasized the separation of powers and judicial independence, already internalized in Japan by the time of the incident at Otsu in 1891, colonial law was almost exclusively oriented toward social control. The Japanese Governor General had exclusive final say over local legislative and administrative developments, under power delegated from the Japanese Diet. Judicial power was exercised by the Governors General, and fused with executive authority. No appeal was allowed to the Supreme Court of Japan. Still, there was institutional resemblance to the judicial system of Japan in structure. Judges were nominally protected against arbitrary dismissal. Discipline was handled by a board of judges rather than being directly under executive control.

Major legislation from the period illustrates the colonial imperative. In addition to ordinary criminal law, there were special laws for political crimes and thought crimes. Torture was routine in criminal investigation. In a number of areas, basic rules of the Japanese Civil Code were modified to fit colonial exigencies, such as a rule that mortgagees could take mortgaged properties immediately upon default.⁴¹ This served the interests of the Japanese landlord class (though Japanese ownership of land probably did not exceed 25 percent of the total).⁴² Rights of petition and redress that had existed under the Confucian system were eliminated.

At the same time, the institutions adopted by the colonial authorities did provide a basis for developments after independence. Legal education, for example, began in the colonial period at Keijo Imperial University (later Kyongsong University), which was established in 1924 by the Japanese as one of Japan's imperial universities. This became the physical and institutional basis for the establishment of Seoul National University in 1946. And the court system provided a modicum of impartial justice.⁴³

Judges were trained in mechanical application of the law, and did not review administrative actions with any vigor. Thus was established a tradition of formalistic jurisprudence that would survive the end of the colonial period. Another factor was the construction of law as a high-status discipline. Koreans were systematically barred from many fields, including engineering, science and management. Talented Koreans were limited to law and medicine among professions, and to practicing law as opposed to serving as judges and prosecutors. The colonial authorities hardly encouraged the study of law, but could not prevent it entirely.⁴⁴ They also allowed Koreans to join the judiciary, unlike Taiwanese.⁴⁵ From the beginning, the number of Korean lawyers outnumbered Japanese lawyers, even though Japanese prosecutors and judges were the majority of those

subprofessions.⁴⁶ A certain number of nationalist lawyers even took on the role of defending criminals, foreshadowing the legal activism of the 1990s.⁴⁷

We thus see several aspects of the Northeast Asian Legal Complex that seem to have emerged in colonial period. The relatively high status, small legal profession was well in place, with the additional twist that certain enterprising Korean lawyers used the system as a means of pursuing social change. The administration was not subject to judicial control. And judges were relatively conservative and formalistic.

Another important legacy of the colonial period was in personnel. Japanese authorities suppressed Korean education, and of course prevented Koreans from reaching senior positions in the administrative bureaucracy. This intensified with the outbreak of World War II, when Korean language education was banned. As a result, there were relatively few Koreans able to staff the bureaucracy and run the country upon independence. Efforts at lustration of “collaborators” had to be set aside for practical reasons.⁴⁸ Patterns of administration that had been set up under the Japanese remained in place: the bureaucracy was maintained virtually intact, and most of the South Korean military officers who dominated politics for three decades after independence had been trained by the Japanese.⁴⁹ It is perhaps unsurprising then that Japanese law remained important after independence.⁵⁰

One might ask why Japan would serve as a legal reference society when it had practiced such a brutal form of colonialism in Korea. Theoretically, one could see post-colonial societies rejecting legal forms associated with former power. The answer is twofold. First, there is path dependence to adopting legal rules and especially those governing institutions. Once an institutional configuration is established, the costs of switching to an alternative are likely to be high and to increase over time. Remaining with the colonial configuration was easier, and provided a comfortable continuity, especially for legal elites schooled in the language of the colonial law. The second reason lies in a general point about legal transplants. Law derives much of its power from its *universalism*, its position as the embodiment of general principles and generic modernity rather than a product of its particular context. In such circumstances, as Takao Tanase has pointed out, the identity of the source of the legal transplant must be downplayed. Indeed, close identification with Japan as the source might be a means of discrediting the law.⁵¹

The position of Japan as the embodiment of imposed modernity thus led to a kind of bipolar relationship with Japanese law. On the one hand, Japanese law provided a standard of what legal reforms might be appropriate in an East Asian political economy; on the other hand, Japan’s adoption of particular reforms provided incentives to surpass and improve on. Just as the goal of catching up with Japan provided a popular motive for development in political economy, so keeping up with Japan became a goal of legal reform in the first few decades after independence. Japan provided a benchmark. The basic “six-law” structure of the Constitution and Codes was retained in Korea and Taiwan, as was the Court structure. Legislation was frequently copied wholesale from Japan. And the basic configuration of administrative discretion exercised by elite bureaucrats

and a restricted supply of legal professionals meant that law was relatively unimportant as a means of social ordering, particularly in interactions with the state. Long-term relationships among bureaucrats and the large industrial firms provided the basic structure, reducing the need for general rules to govern arm's-length transactions.

It must be emphasized again that this configuration had a particular legal construction. There were no generalized administrative procedure rules. Government information was not freely available, meaning that bureaucrats could use the regulation of information flows as an important tool in interactions with both private firms and politicians. This required a failure to continue to borrow from Germany, which developed elaborate systems of administrative adjudication in the postwar period.⁵² The legal profession was highly elite, with bar passage rates that were miniscule. And judges were generally of decent quality, though highly formalist and not willing to challenge government authority.

Taiwan

Japan's first official contacts with the island of Taiwan date from 1592, when Hideyoshi sought to expand influence southward. In the late nineteenth century, Japan's imperial policy led it to again seek expansion. In the Sino-Japanese war of 1895, China was forced to cede Taiwan to Japan in the Treaty of Shimonoseki. Taiwan was chosen, precisely because it was a peripheral area less likely to antagonize the Western powers interested in China proper.⁵³ Taiwan's marginality in the Qing scheme is illustrated that it only became a province in 1885—*after* the Japanese interest was apparent.

Colonial administration in Taiwan differed somewhat from that in Korea. Early on, there was an emphasis on military government and social control to deal with armed resistance among the Taiwanese. But the Japanese aspired to treat Taiwan as an extension of Japan. As a legal matter, they utilized the instrument of the Ordinance of Exception to facilitate the application of ordinary statutes on Taiwan, limiting the power of the Governor General in practice. This differed from the Korean situation of specially applicable colonial legal instruments. Another distinction was the emphasis of the earliest administrators on synthesizing Japan's legal experience with some Chinese imperial institutions and colonial law to tailor a distinct legal system on Taiwan, as a showcase for Japanese colonialism.

Eventually, the Japanese adopted the *Dōka* (同化) assimilation policy, under which Taiwanese were to be educated as Japanese subjects. This policy was initiated in 1919 and followed by a period of more moderate and participatory governance, including advisory committees of local subjects. Even under military governance, the authorities sought to Japanicize Taiwanese society and instill Japanese identity. Taiwan was eventually represented in the Japanese Diet. All this no doubt reflected the view that Taiwanese, unlike Koreans, were an equal or at least less inferior race, and is no doubt one of the reasons the colonial period is viewed with less hostility on Taiwan than in Korea.

As in Korea, modern legal institutions were a product of the colonial era. The Japanese court system, which had been created only a couple of decades previously, was a model, with three levels of courts, later reduced to two instances but ultimately modeled on the domestic Japanese system. There was no appeal to mainland Japan, however. Legal education was a Japanese imposition as well. National Taiwan University was established as Taiwan Imperial University in 1928, and introduced the study of law; previously Taiwanese had been discouraged from studying law.⁵⁴

Still, there were distinctions between Japan and Taiwan on important scores. Wang traces the evolution of judicial institutions in colonial Taiwan and notes that they did not exhibit the same levels of independence that the metropolitan Japanese courts exhibited.⁵⁵ In part this simply reflected the different logic in a colonial situation, but in addition it is tied to the motivation for legal reform in Japan itself. Even after the extension of mainland law in 1919, judges and procurators did not have the same security of tenure as they did on Japan itself (though they had greater security than those in Korea because their salaries could not be lowered).⁵⁶

Wang recounts an interesting case from the 1920s, known as the *Taiwan Parliament Case*,⁵⁷ which arose when a group of intellectuals sought to set up an association to promote the creation of a parliament on Taiwan. They applied to form the organization in Tokyo, where it was not illegal to do so. The Governor General's office opposed any such associations and prosecuted the group using the Public Order Police Law. Lower level (Japanese) judges in the Taipei District Court acquitted the defendants, but appellate courts convicted 13 of the defendants. Wang notes that the lower court did exhibit some legal spine to acquit the group in such an obviously political case, and that this reflected the influence of both Taisho democracy and Japanese judicial conceptions of the proper role of courts. Indeed, the case reminds one of much social activist litigation in contemporary Japan, in which lower courts seem to be more willing to respond to demands from below than do the justices of the Supreme Court.

Statistics from the colonial period indicate that the contemporary pattern of a relatively small legal profession was adopted early on. In 1923, for example, there were 38 judges and 77 lawyers. In 1938, there were 63 judges and 126 lawyers. These were relatively small in terms of population per judges, with roughly twice the population per judge as in Japan.

As in Korea, many Taiwanese went into private practice rather than the judiciary, particularly after the establishment of legal education in Taipei in the 1920s, though their numbers never exceeded the number of Japanese practicing law in Taiwan. This was in part because the Ministry of Justice and the Governor General restricted hiring for the courts and prosecutors offices to those who graduated from the imperial universities. Most Taiwanese were not equipped to gain entrance to these elite schools and so joined private universities such as Meiji University. Wang reports that not a single Taiwanese was ever appointed as a prosecutor.⁵⁸ The lawyers, however, were involved in defending dissidents, as in Korea.⁵⁹

There is one other crucial point with regard to the institutions of the Northeast Asian Legal Complex. As in Japan, the colonial prosecutors and judges were renowned for their honesty, a contrast with the officials of the late Ching dynasty. Only one prosecutor was ever found to be corrupt and no judges were. Wang attributes honesty to high status and high pay,⁶⁰ but norms also play a role. The notion of an autonomous, self-regulating profession with norms that prevented corruption was a crucial part of Japan's colonial heritage.

Wang contrasts the Korean and Taiwanese experiences under Japanese colonialism. Korea had an independent state and functioning if weak government that was forced to turn over the country to Japan. Korea's long history, and indeed its centuries of influence on Japan, led to prolonged hostility to the Japanese annexation, and this was met with brutal suppression. In contrast, Taiwan had no real centralized government when the Japanese took over, and resistance was suppressed fairly quickly. Japan's modernization efforts were perhaps more effective, and certainly softer. Still, in the realm of law, Chen concludes that "justice was probably better served in Korea than in Taiwan, where speedy and efficient intimidation of the indigenous population seemed to be the overriding concern of the Japanese rules."⁶¹

Another difference in the modern perception of these periods is no doubt the result of the fact that Korea became independent, notwithstanding the bloody civil war, by the mid-1950s. Japanese colonialism was replaced with an extended period of rule by Chiang Kai-shek's KMT, who themselves were a sort of colonial power suppressing Taiwanese nationalism for several more decades until the 1990s. In such circumstances, Japanese colonialism tends to be viewed more positively. Ironically, many of the legal reforms introduced by the KMT regime had themselves been independently influenced by Japanese developments, and so they were relatively well suited to the Taiwanese context.⁶²

Alas, the intervening period of Chinese re-occupation of Taiwan led to some decline in the positive aspects of the Japanese colonial institutions. In particular, the notions of judicial independence and honesty went by the wayside at lower levels of courts. Some of the crime suppression institutions were utilized into the 1980s, however. All in all, the institutions of the Northeast Asia Legal Complex were not completely maintained in Taiwan. While administrative insulation remained intact, the quality of the judiciary was not as clear because of the influence of the ROC regime. In addition, the overall configuration of the small, high-status legal profession suffered somewhat. Compared with Korea and Japan, Taiwan had a distinct system of bar passage with separate exams for lawyers and judges. Military lawyers, judges and professors in Taiwan could gain admission to the elite and lucrative profession by means of a 'special examination.'⁶³ These lawyers, especially those with the military credentials, in turn offered not so much good legal advice as connections to the judges, reinforcing personalism in the legal profession. When combined with the severe restrictions on formal 'meritocratic' admissions during the period, this system created a *de facto* political screen for those with wealth and connections.

Japanese colonialism in comparative perspective

Japanese colonialism differed from its European counterparts.⁶⁴ Japan's early colonial enterprise was not driven by a need for foreign markets or for natural resources. Rather it reflected a political imperative of mimicking Western institutional structures and ensuring national independence. It was a reactive and relatively defensive form of colonialism, and its institutional structures were hastily put together rather than a result of deliberate planning.

Recent literature in economic history has sought to tie national institutional structures to long-run institutional patterns established in early colonial contacts.⁶⁵ On the one hand, some colonial powers, such as Spain, were primarily interested in resource extraction, and set up institutions and patterns of authority emphasizing hierarchy, control and repression. Another pattern is settler colonialism in which the metropolitan population is transferred to the colony. This involves a flatter authority structure, in which human capital is emphasized, minimizing the ability to engage in extreme forms of repression.

Japanese colonialism fits uneasily into these conventional categories. It found in Taiwan and Korea societies with a very similar economic, political and social structure to that of Japan itself on the eve of the Meiji modernization. Rice-based agriculture predominated, with an elite and stagnant social structure, sustained by vaguely Confucian notions. There was no oil and little in the way of coal to structure the colonial economic relationship as one of extraction. Nor were the colonies, being themselves densely populated, available for large-scale settlement activity (though substantial numbers of Japanese did move to each colony). These residents often pressured the colonial government to maintain their privileges. But they most certainly did not push for settler institutions, which emphasize equality and horizontal coordination.

Still, the legacy of particular institutional structures persisted. The post-colonial legal system was oriented toward repression, preserving the autonomy of state elites, and developmental imperatives. It was neither extractive nor facilitative of private horizontal exchange. It reflected the logic of insulation at the center of the Northeast Asian legal complex.

Recent influences

With the passage of the Constitution of 1987, Korean legal reform entered a period of intense activity, while Taiwan's gradual democratization in the late 1980s also provoked significant legal changes. Japanese referents have provided one set, but only one set, of sources for the reforms. Perhaps most notable was the adoption of the Administrative Procedures Law, three years after a Japanese statute of the same name. Although it had been proposed decades before by academics, the Japanese statute was adopted in large part because of foreign pressure from the United States in the so-called Structural Impediments Initiative of the late 1980s. Similar pressures were applied in Korea, despite the fact that the United States Trade Representative was also in nearly constant discussions with Korea on trade issues.

The Japanese APL embodied marginal changes in a state-centered scheme. The Korean APL, though organized almost identically to the Japanese law, contains numerous additional provisions that give the law more teeth. These include cost-benefit analysis of regulation, no requirement of exhaustion of administrative remedies before getting into court, and broader standing requirements. In addition, the Korean law was passed in the context of a series of other institutional reforms designed to monitor administrative agencies, such as the creation of an Ombudsman, and several Commissions to examine citizen complaints.⁶⁶ This story then appears to be one of a mixture of Japanese and Western legal technologies designed to reflect a Korean reaction to the strong state period. This pattern exists despite presumably greater pressures on Japan than on Korea from the United States. Thus a focus only on law as an external imposition doesn't seem to capture the dynamics of the legal reform.

Another example is in products liability. As detailed by Nottage, Japan adopted a Product Liability Law in 1994 as a result of a variety of factors, including highly visible cases of injury, the SII talks, and the European Union Directive on Product Liability.⁶⁷ Again, external factors seem to have played a crucial role. The law is modeled on the EU Directive. Korea adopted a Product Liability Act, effective in July, 2002. The Act provides for strict liability for defective products. As in the EU Directive, a state of the art defense is allowed. Again, Japan's adoption of the Act seems to have played a role in timing and content. If Japan believes a reform indicates modernity, then Korea will too.

One last story is the transplant of the duty of loyalty into Japanese corporate law. Originally adopted by occupation authorities, the law lay dormant for many years and only began to be utilized actively in the 1980s.⁶⁸ This reform was adopted by Korea and Taiwan in the 1980s, reflecting a certain amount of continuous influence.⁶⁹

All three jurisdictions have seen some expansion in the rates of bar passage, and struggles over transforming the legal education system. In this period, we have seen institutional transformations of various kinds and types. Some of these reforms have pitted a group of professors trained in Japan and Germany against a cohort of younger U.S.-educated professors who have sought more substantial reforms.⁷⁰ Ultimately Taiwan failed to undertake structural reforms in the major way as has begun in Japan and Korea, but increased competition is changing the face of legal education there.⁷¹ This is despite increased calls from the business community for lawyers who can serve practical needs, rather than focus on the theoretical examination that tends to emphasize rote learning.

Legal origins and transplants revisited

What can we conclude about legal transplants from this story? There are at least three hypotheses as to important factors in legal reform. Sacco and Ajani proposed that prestige was the primary source of voluntary legal transplants. This conjecture is methodologically difficult to verify since the only way to identify prestige is the fact that countries have adopted an institution. In addition, for a

network good like law, we might expect that there would be convergence toward a single “prestigious” model, but this has not occurred, or occurred in only a very few areas.

A second hypothesis was that efficiency should be the leading reason a particular transplant is adopted.⁷² This can be seen as a refinement of the prestige concept: a particular transplant has a reputation for efficiency. While this might make sense in the context of particular areas like the European Union where scholars play an important role in evaluating potential legislative reforms, it seems unlikely to work in more politicized environments for public choice type reasons. Politicians form a veto gate on any legal reform that requires legislation. Therefore legislation that is not in the interests of politicians is unlikely to pass. Politicians are imperfect agents of the citizens as a whole—they are motivated, at least in part, by their own concern for re-election and political security rather than the public good. Typically interest groups that support politicians do not have the public good in mind either. Therefore we should expect much legislation to reflect private rather than public interests. Efficient solutions might be adopted, but we should not expect all legal transfers to be the efficient ones. Indeed if this were the case, then when combined with Sacco and Watson’s assertions that transfers rather than innovation are the main source of change, we should expect most law in the world to be efficient. This seems a claim as empirically dubious as Posner’s earlier assertion that the common law is efficient.⁷³

A third factor that enters the equation is that of chance. Sometimes laws are adopted because of particular fortuitous circumstances unlikely to be repeated but with a profound impact.⁷⁴ The Russian civil code is a famous example. The University of Leiden Law Faculty had long had a Russian legal studies center, and personal connection between Russian lawyers and that faculty helped influence the decision to use the Netherlands civil code as the basis for the Russian one. This choice might have also reflected the fact that the Netherlands had recently overhauled its code and therefore scholars were able to take into account the prestige and efficiency of particular norms.

All of these explanations are oddly apolitical. Norms exist independent of the societies they operate in. A more socio-legal perspective would emphasize the fact that there are important political factors at play. Korea retained Japanese law because Japan remained a reference society during the authoritarian period, because Japanese-speaking legal elites could access outside materials through the Japanese language, because of substantial economic integration, and most importantly because certain aspects of Japanese legal institutions suit Korean political needs: the strong discretionary state in particular. When the needs began to change in a period of democratization, lawmaking also democratized to reflect broader sources.

In the public law area, Japan’s legal influence is declining. Its erstwhile colonies, Korea and Taiwan, have moved more quickly to liberalize the legal profession and control the developmental state. In constitutional law, both countries have seen strong constitutional courts emerge that are regularly citing American,

German, European and other norms. The relatively passive Japanese Supreme Court has not been as much of an influence.

Still, the overall postwar story has been one of a successful instance of an imposed legal transfer. Surely one can hardly imagine a less “voluntarist” means of adopting institutions than colonial imposition. But the institutions of the Northeast Asian Legal Complex served the development of modern law in Korea and Taiwan in ways that insulated the state while ensuring that basic civil dispute resolution could be obtained. And ultimately, this configuration played a role in underpinning the region’s fantastic economic growth in the postwar period.

Conclusion

In emphasizing the beneficial effects of Japanese influence, it is not being asserted that these were intended effects of the colonial power. Japan governed Korea and Taiwan with Japanese interests in mind. The brutality of the colonial period, which involved land confiscation, internal displacement, massive forced conscription (particularly during World War II), forced prostitution (the so-called “comfort women” from both Korea and Taiwan) and, in wartime Korea, a kind of cultural genocide, aimed at suppressing Korean culture and language, should not be whitewashed. The education system featured emperor glorification and Koreans were forced to worship at Shinto shrines.

Yet the impact of legal transfers is determined by more than good or bad intentions. The patterns and internal dynamics of the Northeast Asian Legal Complex were hardly the result of intended planning, but rather emerged from a discrete set of inter-related institutional choices pursued by political elites. The configuration worked together well enough to constitute a significant phenomenon worthy of greater study by those interested in the causes and consequences of the adoption of legal institutions.

Notes

- 1 Professor of Law, University of Chicago Law School.
- 2 See also Tom Ginsburg, “Law and the Liberal Transformation of the Northeast Asian Legal Complex in Korea and Taiwan,” in *Fighting for Political Freedom: Comparative Studies of the Legal Complex and Political Liberalism* 43–63 (Terrence Halliday, Lucien Karpik and Malcolm Feeley, eds., Hart Publishing, 2007).
- 3 See Konrad Zweigert and Hein Kotz, *An Introduction to Comparative Law* (2nd edn, 1998); Rafael LaPorta, Florencio Lopez de Silanes, Andrei Shleifer and Robert Vishny, “Law and Finance,” 106 *Journal of Political Economy* 116 (1998).
- 4 See John Ohnesorge, *Developing Development Theory*, available at SSRN.
- 5 See e.g. Richard Posner, *Law and Legal Theory in England and America* (Oxford UP, 1996), Chapter 3 (arguing that the UK legal system has more in common with the civil law system than the system of the United States).
- 6 The first paper in the series is Rafael LaPorta, Florencio Lopez de Silanes, Andrei Shleifer and Robert Vishny, “Law and Finance,” 106 *Journal of Political Economy* 116 (1998).

- 7 Daniel Klerman and Paul Mahoney, "Legal Origin?" 35 *Journal of Comparative Economics* 278–293 (2007).
- 8 Kevin Davis, "What Can the Rule of Law Variable Tell us About Rule of Law Reforms?" 26 *Michigan Journal of International Law* 141 (2004); Kevin Davis and Michael Trebilcock, "Legal Reforms and Development," 22 (1) *Third World Quarterly* 21 (2001).
- 9 Alan Watson, *Legal Transplants: An Approach to Comparative Law* (1974); Rodolfo Sacco, *Legal Formants: A Dynamic Approach to Comparative Law* 39 *American Journal of Comparative Law* 343 (1991). But see Pierre Legrand, "The Impossibility of Legal Transplants," 4 *Maastricht Journal of European & Comparative Law* 111 (1997).
- 10 William Ewald, "Comparative Jurisprudence (II): The Logic of Legal Transplants," 43 *American Journal of Comparative Law* 1995.
- 11 Esin Örüçü, "Law as Transposition," 51 *International and Comparative Law Quarterly* 205, 214 (2002); see also Terrence Halliday and Bruce Carruthers, "Conformity, Contestation and Culture in the Globalization of Insolvency Regimes: International Institutions and Law-Making in Indonesia and China," paper for Symposium on the Reach of Law in the Pacific Rim, University of British Columbia, May 28–29, 2002.
- 12 Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard, "Economic Development, Legality, and the Transplant Effect," 47 *European Economic Review* 165–195 (February 2003); "The Transplant Effect," 51 *American Journal of Comparative Law* 163–204 (2003).
- 13 *Id.*
- 14 *Id.* at 194.
- 15 Andrew Harding, "Comparative Law and Legal Transplantation in Southeast Asia: Making Sense of the 'Nomic Din,'" in *Adapting Legal Cultures* 199, 202 (J. Feest and D. Nelken, eds. 2001).
- 16 These include *zenrishi*, *benrishi*, *gyosei shoshi* and *shiho shoshi* in Japan; *falu zhuli* in Taiwan, and *beop-mu-sa* in Korea.
- 17 In 1988, 16 lawyers passed the regular exam, while 114 passed the 'special' exam. The next year the numbers swelled to 288 and 87, respectively. This nearly tripled the number of annual admissions and radically shifted the composition away from political connections toward meritocratic selection.
- 18 Liu, 2003: 406–407.
- 19 Andrew MacIntyre, *Business and Government in Industrializing Asia* (Cornell UP, 1994).
- 20 Hideki Kanda, "Finance Bureaucracy and the Regulation of Financial Markets," in Harald Baum, ed., *Japan: Economic Success and Legal System* 305 (Walter de Gruyter & Co, 1997).
- 21 This point is one of divergence from the German model.
- 22 Tom Ginsburg, "The Politics of Transparency in Japanese Administrative Law," in *Japanese Law in Transition* (Daniel Foote, ed., University of Washington Press, 2008).
- 23 Robert Kagan, *Adversarial Legalism: The American Way of Law* (Harvard UP, 2002).
- 24 Frank Upham, *Law and Social Change in Postwar Japan* (Harvard UP, 1987).
- 25 Lloyd G. Reynolds, "The Spread of Economic Growth to the Third World: 1850–1980," 21 *Journal of Economic Literature* 941, 956 (1983).
- 26 Anne Booth, "Did it Really Help to be a Japanese Colony?" ARI Working Paper, No. 43 (June 2005).
- 27 Mark Peattie, "Introduction," in Ramon H. Myers and Mark Peattie, eds., *The Japanese Colonial Empire* 23 (1984).
- 28 Alice Amsden, "The State and Taiwan's Economic Development," in Peter B. Evans, D. Rueschemeyer and T. Skopcol, eds., *Bringing the State Back In* (Cambridge UP, 1985).

- 29 Bruce Cumings, "The Legacy of Japanese Colonialism in Korea," in Ramon H. Myers and Mark Peattie, eds., *The Japanese Colonial Empire* 481 (Princeton UP, 1984).
- 30 Atul Kohli, "Where Do High Growth Political Economies Come From? The Japanese Lineage of Korea's 'Developmental State,'" 22(9) *World Development* 1269 (1994); Atul Kohli, *State-Directed Development: Political Power and Industrialization in the Global Periphery* (Cambridge UP, 2004).
- 31 Stephan Haggard, David Kang and Chung-In Moon, "Japanese Colonialism and Korean Development: A Critique," 25 *World Development* 867 (1997).
- 32 In the case of Korea most of this was destroyed during the Korean War (1950–1953).
- 33 Dai-kwon Choi, "The Development of Law and Legal Institutions in Korea," in Bong Duck Chun, William Shaw, and Dai-kwon Choi, *Traditional Korean Legal Attitudes* (Institute of East Asian Studies, 1980), at 74.
- 34 Pyong-choon Hahm, "Korea's Initial Encounter with Western Law," I *Korea Observer* 80, 85 (1969).
- 35 Articles 1 and 2.
- 36 James Palais, *Politics and Policy in Traditional Korea* (Harvard University Asia Center, 1976).
- 37 Edward I-te Chen, "The Attempt to Integrate the Empire: Legal Perspectives," in Myers and Peattie, *supra* n.27, at 240, 241.
- 38 Chen does not make it clear whether these were simply not enforced or whether a legal formula precluded them. Taiwanese were allowed to voluntarily emigrate to China for the first two years after the adoption of the Treaty of Shimonoseki.
- 39 Chen, *supra* n.37 at 250–251.
- 40 Masahiro Wakabayashi, "A Perspective on Studies of Taiwanese Political History: Reconsidering the Postwar Japanese Historiography of Japanese Colonial Rule in Taiwan," 19–36 in Ping-hui Liao and David Der-wei Wang, eds. *Taiwan under Japanese Colonial Rule 1895–1945* (Columbia UP, 2006) at 22–23.
- 41 Choi, *supra* n. 33.
- 42 Carter Eckert, *Offspring of Empire: The Ko'Chang Kims and the Origins of Korean Capitalism 1876–1945*, 16 (U of Washington P, 1991).
- 43 Cumings, *supra* n.29, at 488 characterizes the Japanese as providing the rule of law for Japanese entrepreneurs in Korea.
- 44 Tay-Sheng Wang, *Legal Reform in Taiwan under Japanese Colonial Rule 1895–1945* (U of Washington P, 2000) at 80.
- 45 Chen, *supra* n.37, at 268.
- 46 Choi, *supra* n.33, at 84–86.
- 47 Tom Ginsburg, "Law and the Liberal Transformation of the Northeast Asian Legal Complex in Korea and Taiwan," in *Fighting for Freedom: Lawyers and Political Liberalism* 43–63 (Terrence Halliday, Lucien Karpik and Malcolm Feeley, eds., Hart Publishing, 2007).
- 48 Choi, *supra* n.23.
- 49 Cumings, *supra* n.29 at 479.
- 50 Yang Kun, "Law and Society Studies in Korea: Beyond the Hahm Thesis," 23 *Law and Society Review* 891, 897 (1989).
- 51 Takao Tanase, "The Empty Space of the Modern in Japanese Legal Discourse," in *Adapting Legal Cultures* 187, 191 (J. Feest and D. Nelken, eds., Hart, 2001).
- 52 Mahendra P. Singh, *German Administrative Law in Common Law Perspective* (Springer, 2001).
- 53 Tay-Sheng Wang, *Legal Reform in Taiwan under Japanese Colonial Rule 1895–1945*, 36 (U of Washington P, 2000).
- 54 Wang, *id.* at 79.
- 55 Wang, *id.* at 68–69.
- 56 Wang, *id.* at 71.
- 57 Wang, *id.* at 72.

58 Wang, *id.* at 81.

59 Wang, *id.* at 88.

60 Wang, *id.* at 86–87.

61 Chen, *supra* n.37.

62 Wang, *id.* at 176. Still, the KMT's Leninist overlay meant that there was less emphasis on judicial or bureaucratic autonomy. See Xiaoqun Xu, *Trial of Modernity: Judicial Reform in Early Twentieth Century China 1901–1937* (Stanford UP, 2008).

63 Jane Winn and Tang-chi Yeh, "Advocating Democracy: The Role of Lawyers in Taiwan's Political Transformation, in Symposium on Lawyering Against Injustice and the Danger of Legitimation," 20 *Law and Society Inquiry* 561 (1995). 1995 at 575; Jane K Winn, "The Role of Lawyers in Taiwan's Emerging Democracy," in *Raising the Bar: The Emerging Legal Profession in East Asia* (William Alford and Setsuo Miyazawa, eds., Harvard UP, 2007).

64 See generally Myers and Peattie, *supra* n.27.

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4 The success of law and development in China

Is China the latest Asian developmental state?

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Introduction

After nearly 30 years of successful economic development, it is clear that law has been a key part of the economic development story of China's market economy. That was also one of Premier Deng Xiaoping's aims when he announced the Four Modernizations and China's Open-door Policy in December 1978. What is less clear is the extent to which law was a driver of economic development and whether China's experience fits into any of the various Western law and development models or paradigms.

This chapter argues that China's development story and Chinese law clearly do not conform with Western notions of the "rule of law" or "democracy". These inhabit rights-based laws, institutions and practices, which have rarely been popular currency in Asia, and never in China. Rather, the chapter argues that modern Chinese law, like law in the 1960s Asian developmental states, is an instrumentalist mix of borrowings and pragmatic adaptations from both east and west which has grown into an autochthonous construct that serves specific local concepts of development. Similar "localist" statutes and institutions have been evident in the newly industrialized nations in Asia, which have been dubbed the Asian developmental states, tigers and miracles. Their laws were designed to serve the developmental purposes of the Asian societies in which they are fostered. As an example, this paper discusses China's path to protecting businesses and private property. It acknowledges the National People's Congress (NPC, China's parliament) revision of the Constitution in 2004 to include the clause: "Citizens' legal private property is inviolable" and examines aspects of business law and the 2007 Property Law which was more than a decade in the making.

The law and development movement, whether in its old or its new guise,¹ appears to hold that to achieve economic development, a developing country must build institutions that allow political participation and implement "the rule of law" (variously defined, but always including, at a minimum, protection for individual property rights and contractual rights). The absence of these, so the theory claims, discourages investment and specialization, and ultimately thwarts economic growth. Even to the untrained eye, China's recent performance appears to refute this proposition. With gross domestic product (GDP) growing

by 9 percent or more nearly every year for the past 30 years, it is clear that China has enjoyed rapid social and economic development—without adopting either the rule of law or democracy. However, right from the start of the implementation of Deng Xiaoping’s modernization policy in 1979, China enacted an abundance of laws and regulations in an attempt to stabilize Chinese society after the lawlessness of the Cultural Revolution (1966–76) and to entice foreign investment that the government hoped would help foster rapid economic development.

Clearly, law is a key part of China’s economic development story. However, in agreement with many scholars, this chapter holds that, even if China were to adopt the Western notion of the rule of law as a serious model for emulation, significant hurdles would need to be overcome before the phrase “rule *of* law” could ever replace the phrase “rule *by* law,” which more aptly describes the current Chinese experience (Lubman 2006; Chen Jianfu 2003; Peerenboom 2007). Instead of re-visiting the rule of law debate, this paper considers whether China’s use of law is more akin to law that was used in the Asian developmental states in the 1960s through to the 1990s and perhaps even today. For, although some have announced the death of the Asian developmental state, close scrutiny reveals that its characteristics are still alive and well and living in Singapore, South Korea, Taiwan, Thailand, Malaysia and so on. For instance, among the wide range of government interventionist measures that these states used to foster economic development from the 1960s and beyond, “governing the market” through the widespread use of law and regulations was one of the most effective. This paper argues that China is doing the same. However, whereas it is popularly agreed that the “Tigers” or “Asian miracles” experienced growth with a high degree of equity, that does not appear to be the case in China.

This chapter is divided into six parts. Following this introduction, the second part contextualizes the Asian developmental state as a basis for discussing China’s experience. The third part paints a picture of the legal culture that pertained in China before the legal and economic reforms were launched in 1979. The main focus is on the period from 1949 when the People’s Republic of China (PRC) was founded and Mao Zedong and the Communist Party experimented with Marxism. Land reform is used as an example both here and in the analysis in the fifth part since property rights are supposedly one of the key factors of production that affect the fostering of economic development. The fourth part addresses the post-1979 legal culture and the prominence given to law and legal institutions during the Deng years and beyond. Part five analyses some of the rules that deal with private businesses and private property in an attempt to discover whether China as an Asian developmental state might be breaking new ground in these areas. Finally, the sixth part concludes that China’s economic development practice exhibits an abundant use of substantive law but weak and inherently flawed enforcement, and enforcement institutions. There is strong evidence that China is using law to intervene and “govern the market” at every conceivable opportunity in order to foster social and economic development.

This conclusion also raises several new questions:

- Does China's model prove definitively that to develop, developing countries need not observe the rule of law since they might be better off growing their own authoritarian regimes that focus wholeheartedly on developing the economy through the instrumental use of law, rather than focusing on the rights-based rule of law and Western democratic institutions which Western aid and other agencies [the Washington Consensus] prescribe?
- Might China's experience be derailed because China is not able to provide 'rapid *growth with equity*' to the same extent or in a similar fashion in which its successful Asian predecessors did during their formative years?
- Specifically, how will China bridge the prosperity gap that is currently widening between its vast rural and its urban population?
- If development is about freedom to choose (Sen 1999), what choices will China make to ensure stability or "harmony" in the countryside and between the countryside and the cities?

Law and the Asian developmental state

"Governing the market" was not only the title but also the economic development model identified by Wade (1990) when he described the bold interventionist policies and actions used to effect rapid economic growth in Taiwan during the 1960s and 1970s. Researching these Asian countries, economists and political scientists such as Chalmers Johnson (1982), Alice Amsden (1989), Thomas Gold (1986), Stephen Haggard (1990), John C. Fei *et al.* (1979), and others also identified and helped to popularize the brand of Asian developmentalism which the World Bank in 1993 admiringly called the Asian economic miracle. My own work on Singapore (Carter, 2002) was one of the few that analyzed the role of law in Singapore's economic development and later sought to explore whether the Singapore model, at Deng Xiaoping's behest, could be replicated in Suzhou, China (Carter, 2003). However, "official" admiration for the Asian model or the Asian tigers' experience was short-lived especially among the World Bank pundits because of fast-changing trends in the so-called law and development model. In her review of the World Bank's report on the Asian miracle, Amsden seems to have found that, despite the Asian developmental states' excellent track records in achieving 'rapid economic growth *with equity*', the world was not experimenting with the East Asian development model because by 1994, the tools for changing the world (according to the Washington Consensus) had changed. Quite simply, a new "moment" in the law and development movement had arrived. This new moment required a wider definition of "law" and of "development" as well as greater adherence to the neo-liberal theory for growth (free trade, free labour market, low interest rates and conservative budgets). The phrase on the lips of most developmental do-gooders from the West was "getting the price right" and since the Asian Tigers only got their prices right through government intervention, the Bank would no longer be able to tolerate what its

1993 report had called “effective but carefully limited government activism.” Under the new moment in the new law and development model, the state or government was to be kept out of the market at all costs since the “free market” would regulate itself—and “get the price right.” This new law and development model seems to have rendered the achievements of the Asian developmental states almost null and void. It effectively prevented attempts to replicate or adapt their model—at least at that moment. Focus was later to turn to the new prescription of “getting the institutions right”—especially in the wake of the economic downturn in Asia in 1997. However, for the Asian states themselves the model of “governing the market” was still intact. The model adjusted to the new realities—for example, pressure from the USA and the European Union to build institutional capacity—but the basic model did not go away. Below, the salient features of “governing the market” using the potent law and development model as practiced by the Asian developmental states are discussed briefly.

The gist of the model is summarized by Amartya Sen (1999, 150):

While different empirical studies have varied in emphasis, there is now a fairly agreed list of ‘helpful policies’ that includes openness to competition, the use of international markets, a high level of literacy and school education, successful land reforms, and public provision of incentives for investment, exporting and industrialisation.

It was as simple as that, but difficult. For at the time, the pioneering Asian nations were “new states” which essentially rejected the then popular economic development mantras in order to try something which in their world seemed more pragmatic. They opted for export markets rather than the recommended import substitution. They prioritized education and skills training to ensure a qualified workforce. They rejected Adam Smith’s theory of the self-regulating (free) market economy and the idea of minimal government interference in economic matters. Instead, they chose Keynes and consistently interfered or intervened in the market to regulate it in the directions they found suitable. They used law as the regulator/intervener; masses of laws—just like China has been doing in the post-Mao era. No section of society or business was left untouched: from labour relations, to housing, health care and education, to pensions and welfare benefits; in short, from the cradle to the grave. They also provided low-interest loans and subsidies to state-owned enterprises and other government-linked companies which operated in strategically-picked industries.

Industrialization, which entails the systematic application of technology to production, thereby mechanizing the manufacturing process, was held to be the source of modern economic growth. This was the story of the developed West—from England, continental Europe, America, Canada, and so on. Therefore, following in their footsteps and in Japan’s, it is clear that industrial manufacturing would be the engine of economic growth for the new Asian nations.

In the case of Singapore, the two key ingredients for rapid economic growth were to ply external free trade while maintaining strong internal economic

control, and building the country's social and physical infrastructure. China's post-Mao strategy seems to match this model. The results are also identical—except for the scale and the accelerated pace.

Singapore's model protected a bundle of rights, including property rights and contracts, but all were subject to "the public interest" just as is the case in the new Chinese Property Law 2007, as discussed below. And "public interest"—not surprisingly—is defined exclusively by the government (Carter, 2002, 203). However, the new law and development moment demands that the (World Bank) approved developmental state model should incorporate not just the "thin" rule of law but the "thick" (Peerenboom 2004, 1) or "comprehensive" developmental model which incorporates human rights, labor rights, good governance, access to justice in addition to the usually required protection of property rights and contract enforcement. There is nothing to indicate that the new demands cannot be met as long as they too are subject to the "public interest" and that what is in the public interest is balanced and decided by the government. But this is where dissonance occurs. For as Sen (1999, 150) puts it:

There is nothing whatsoever to indicate that any of these policies [in the model above] is inconsistent with greater democracy and actually had to be sustained by the elements of authoritarianism that happened to be present in South Korea or Singapore or China.

However, since this cannot easily be proven, a different question can be asked: why did the Asian developmental states display comparatively equal distribution of wealth and social benefits although they were not compelled by law or democratic forces to do so? Or why did the Asian developmental states bother to strive for and achieve "growth with equit" although they were all regimes working without the constraint of the rule of law or democracy? Put another way, why did citizens in Singapore forego their democratic rights and subject themselves to the whims of the Asian developmental [authoritarian] state?

I have argued elsewhere (Carter 2002) that the explanation is that the government *succeeded* in creating a communitarian ideology and delivering a *feeling* or *perception* of social justice and tangible benefits which secured the acquiescence of the people to endure the intrusive activities of the state and its elite bureaucrats. Tangible benefits included all the physical provisions of food, clothing, and shelter to satisfy the base of Maslow's hierarchy, but also education, health care, social security and so on. An obvious question then is: could these tangible benefits and the perception of social justice be construed as "comprehensive development"—the new phrase in one of the new land and development (LAD) movements? Perhaps other rights or freedoms were subsumed or sacrificed for the common good in the "public interest" of achieving and sharing in the overall success of rapid economic growth.

In truth, the issues might be even wider as the new "moment" in the law and development paradigm is extended to incorporate "the social" and "the human" in the ever-emerging paradigm. However as Kerry Rittich (2006: 15) points out,

the new “social” rhetoric might still be based in economic development since even the rationale for introducing basic human rights such as freedom of expression and freedom of association are motivated by the need to “protect the interest of civil society, serve as a counterweight to state power and form part of the political climate necessary to attract investment and ensure growth ... thus serving both an economic and a social purpose” (*id*). So be it, since none of these “freedoms” will be available without economic support and a socio-economic infrastructure. Life does not happen in a vacuum, and it is certainly not gratis to live—with or without these freedoms. Thus “social reforms are seen as both a means as well as an end to development” (*id*) as the crux seems to be a redefinition of what “development” means. However, that’s nothing new in the “growth with equity” model of the Asian developmental states. In fact, arguably, their definition of development was always “comprehensive” embracing both the social and the human—albeit not always the Western notion of “human right.”

Legal culture in China: pre-1979

Characterizing legal culture in China, briefly, is a tough task. The challenge is the amalgam of thousands of years of traditional law and cultural beliefs which underpin legal perceptions in modern Chinese society. But it is also the short, sharp shock of three decades of Marxist-influenced Maoist governance,² remnants of which still hold sway in today’s society. For some three thousand years in traditional China, up to the fall of the Qing dynasty in 1911, formal law essentially comprised commands and instructions to bureaucrats outlining how to govern the country. People’s behavior was governed separately by a code of conduct (*li*) and punishments (*fa*), which were used as a last resort when *li* failed. Their business transactions were regulated mainly by the clan (*tsu*) and craft associations. In other words, society functioned—even if it “lacked” the Western perception of law and legal institutions.

The fall of dynastic rule in 1911 created a power vacuum that was filled by 40 years of various competing political doctrines and an array of imported laws and legal institutions. The Kuomintang (KMT), which overthrew the Qing, was a strong contender for succeeding and for ruling a unified China. However, the successful competitor was Mao Zedong and the Communist Party, which had been established in China in 1923. They allied themselves with the rural population with which they thrived—especially after 1927 when the KMT abandoned the United Front against the Japanese invaders and the Communist Party was forced to flee to the countryside. During the summer of 1949, the KMT began fleeing to Taiwan and on October 1, Mao Zedong and the Communist Party declared the founding of the People’s Republic of China (PRC).

Under Mao Zedong, law (however defined) was treated with immense suspicion and disrespect. Most KMT laws were abolished, and legal institutions—including courts, lawyers and judges—were abandoned. The latter, together with most intellectuals, were banished to the countryside to learn from the peasants. Indeed the “Down to the Countryside Movement,” as it became known during

the Cultural Revolution (1966–76), was the preferred Maoist way of ensuring that everyone shared his revolutionary zeal. In short, the legal system, such as it was, was greatly diminished and politicized. Law became policy-implementing tools (regulations and orders) and the policies emanated from Marxism (as developed by Lenin). Marxism is based on the belief that “the history of all hitherto existing society is the history of class struggles.”³ According to Marx, progress is the result of class struggles, and they cause society to move through a series of inevitable phases, from serfdom to feudalism, capitalism, socialism and finally to communism—a stateless utopia in which land and capital are owned collectively by a society that is free of class divisions (Rohmann, 1999, 250). The belief is that once the Communist utopia is established, the state as well as law would simply “wither away.”

A great deal of what occurred in China during the Maoist years, 1949–76, constituted a period of ideological experimentation, during which the Communist Party tried to implement Marxism-Leninism in China. There was a period of “self-reliance”, at the beginning of which foreign investors were forced to leave China and it is “no understatement to say that between 1949 and 1979 China’s foreign trade was conducted in a legal vacuum” (Lubman 2006, 10). For nearly 30 years, all trade with non-Communist Western countries was conducted through a small clique of trading companies—the most reputable of which were based in London and Hamburg. Disputes with foreign business partners were settled through negotiations relying on the usual anticipation of continued future business relationships and past commercial dealings.

The organization and conduct of domestic business fared no better: the command economy developed its own huge state planning bureaucracy endowed with vast unbridled discretion. The goal, according to Marxism-Leninism, was that land and capital should be owned collectively by society, so the state experiments focused on these. Collective enterprises were set up both in the rural and urban areas of China and work units (*danwei*) and teams were formed so that life for all Chinese soon revolved around these and similar forcibly formed collective organizations.

With its background and primary support clearly solidified among the rural population during the decades in the wilderness, the Communist Party soon delivered on its primary promise to the peasants: land reform. The Party was able to break the dominance of the landlord class in the countryside and redistribute land to the peasants. In so doing, the Communist Party also categorized the rural population into various classes and identified landlords as the “enemies of the people and the Chinese revolution.” In later years landlords were also categorized as “counter-revolutionaries” along with all others (especially jurists and academics) who dared articulate protest against Maoists. Counter-revolutionaries and enemies of the people were to be “treated harshly according to law”—that is, punished in the manner of *fa*.

Teams of students and peasants conducted the confiscation of land in the Party’s name. Confiscation and redistribution were carried out in a confrontational and violent manner in order to demonstrate the power of the Party and the

newly empowered peasant masses. Some sinologists report that many landlords were punished publicly and even executed in “retaliation for centuries of exploitation” while their surviving family members were forced to carry, for the rest of their lives, their new disparaging and dangerous status as “enemies of the people” (Stockman 2000, 179).

Small and mostly economically inefficient plots were created from the redistributed land. This in turn created friction between the new landed neighbours and resulted in food shortages in the cities. To solve these newly created problems, Mao and the Party organized farmers to work together in mutual aid teams (MATs). Their purpose was pure commonsense: work together, lend tools to each other and generally assist each other in conducting chores on the farms. These were feats which farmers in the countryside had always done anyway; that was their chosen way of life. Now there was no choice, they were forced to work in MATs, the precursors of the dreaded Maoist cooperatives and collectives.

To further move towards socialism, the Maoists ordered land-holding peasants to form cooperatives, each consisting of about 35 households whose members would pool the working of their plots, animals and tools. They were allowed to retain titles to their land and small plots for private use. As this experiment was deemed a success, despite complaints from members of the cooperatives, in 1956 the Party ordered the formation of so-called higher-level agricultural producers’ cooperatives (APCs). Each higher-level APC comprised about 160 households. In this model, peasants lost private ownership of all their principal means of production as well as titles to their plots of land, which were now to be held only by the collectives. As ideological zeal rose, so did lawlessness. For example, militant groups of students, who called themselves the Red Guards, roamed cities as well as the countryside “meting out justice” and generally opposing anyone who dared utter protests against the Maoist experiments. During the Cultural Revolution, 1966–76, law itself was denounced as an alien and bourgeois notion.

Legal culture in China: post-1979

As noted above, for the first three decades of the PRC’s existence, the Communist Party and Mao Zedong ruled China without any legal codes of substance and with very little regard for law, culminating in a complete denunciation of law during the Cultural Revolution. Upon succeeding Mao, Deng Xiaoping’s first goal was to seek stability through law in order to foster economic growth in China. This he summarized as a “two hands policy”: on the one hand, the economy must be developed; and on the other the legal system must be strengthened (cited in Chen Jianfu, 1999, 40). Deng’s first major policy declaration, in late December 1978,⁴ launched “the Four Modernizations,” in which he focused on economic and legal reforms. The four modernizations are agriculture, industry, technology and national defence. This policy declaration was accompanied by a raft of statutes and regulations whose stated preeminent goals were social and economic development.

One of Deng's first steps in modernization started in the countryside: it was to lift the artificial restrictions which Mao had placed on the small farmers and peasants. Deng reinstated the small household units and announced that henceforth peasants were only required to sell specified amounts of their crops and products to the government at state-set prices; anything above those set quotas could be consumed by the teams or sold in the free domestic market. It was a small but meaningful gesture as it released "market forces" among the farmers for the first time since the rule of the Communist Party.

Deng's first major experiment in economic development was the establishment of special economic zones (SEZs)—first in Shenzhen (1979), then in Xiamen, Shantou and Zhuhai in 1980. Others followed over the years; what they all had in common was that they were coastal cities or areas in which development experiments could be conducted without affecting the inland/heartland of China. Chinese laws relating to foreign investments and social engineering could therefore be tried out in these areas and were kept insulated from other domestic laws which regulated Chinese domestic enterprises (Carter, 2003). Modeled on export processing zones in other developing countries, China's SEZs soon became pockets of prosperity and management incubators for training young Chinese managers, as foreign investors claimed the tax and other incentives in return for setting up production joint ventures and exporting their manufactured goods. In general, SEZs were regulated by special provincial or local laws; many of which were sometimes contrary to national legislation. It was in these SEZ settings too that the Chinese experiment in "governing the market" accelerated. As a developmental vehicle, the SEZ phenomenon is being studied in its own right and although academic research has been scant, it is expected to accelerate as India and other developing countries attempt to imitate China's model (Carter and Harding, 2009).

From 1979 up to the current period, legal reform and economic development would go hand in hand. The one impacted the other and both are now inextricably entwined so it is difficult to say whether law was the engine or facilitator of economic development or whether rapid economic growth spurred the development of law and legal institutions. Economic development (especially through foreign direct investment—FDI) requires stability within the state, and often economic betterment supports stability. But what is the nature of the law and legal system in the post-Mao era? Clearly it is law in its highly instrumentalist guise, law as the "mature policy" of the state as was the case in the Asian developmental states and as is articulated in Singapore's transformation (Carter, 2002).

Some sinologists identify three waves of legal development in modern China (Cohen, 2006; Chen, 2003). The following sections highlight a few laws in each wave in an attempt to characterize the nature of law that was being developed and implemented.

The first wave of legal development: 1979–92

The “first wave” is represented by the clutch of laws enacted by the National People’s Congress (NPC, China’s Parliament) in 1979, and quickly followed by other laws and regulations enacted by various national and provincial bodies up to the early 1990s. The very first batch of national laws included those that reinstated criminal law, and thus attempted to reestablish law and order, as well as China’s first Joint Venture Law, designed to attract foreign investors. The latter was merely three pages long and investors and others had to await the 1983 Implementing Regulations before the law made much sense. But it was a testimony to the seriousness of Deng Xiaoping’s Open-door Policy and his commitment to foreign investment as an engine of economic growth. It was later called the Equity Joint Venture Law (EJV, 1979) to differentiate it from the 1988 Contractual Joint Venture Law (CJV) which was preferred by many foreign investors of Chinese heritage who returned to invest in the regions of their ancestral homes (especially in Fujian and Guangdong provinces). Indeed, hundreds of CJVs were actually established prior to when the CJV law came into force. This is a continuing feature of law in early post-Mao China: many laws lagged reality and those that were ahead were labeled “provisional” as they were meant to be experimental. Surprisingly, an Environmental code was also enacted in 1979, although, like the Joint Venture Law, it was programmatic and would not get any teeth until later—in this case in 1989.

It was also during this first wave that a new Chinese Constitution 1978 was promulgated but it was based on the very programmatic and unsatisfactory 1954 Constitution and was therefore readily amended in 1982. The 1982 Constitution declared that the “lawful rights and interests” of foreign investors would be protected. It also specified three types of “ownership”: socialist public ownership, collective ownership, and “the individual economy of urban and rural working people, operated within the limits prescribed by law”. The latter was characterized as a “complement” to the “socialist public economy” (Lubman, 2006, 8). Clearly, the experiment of releasing a degree of “free market” operation among the peasants and small farmers in the countryside in parallel with the command economy of public and collective ownership supported a new kind of economic development.

The first of several contract laws emerged in 1981. This, the Economic Contract Law, which applied only to domestic transactions, regulated “agreements reached by *legal persons* to define their mutual relations in regard to their rights and duties so as to realize certain economic goals” (article 2). Separate contract laws were enacted to regulate transactions between Chinese and foreigners—and not until 1999 was the Unified Contract Law enacted. This law is a good example of China’s move to prepare for WTO membership which finally occurred in 2001.

But the single most ambitious piece of legislation of the early wave was undoubtedly the General Principles of Civil Law (GPCL, 1986). Like many of the other new Chinese laws, it was borrowed from the European Civil Law

heritage (as opposed to the Common Law). The GPCL signaled a departure from central economic planning and the command economy. The most important feature was its definition of natural and legal persons capable of having legal rights, and the process by which such rights were to be created, modified or terminated.⁵ These definitions brought Chinese law within the sphere of what the West calls “private law” and thereby indicated a definitive move away from China’s predominantly public ownership policy and code. State-owned enterprises (SOEs), collective enterprises, Sino-foreign joint ventures and wholly foreign-owned enterprises (WFOEs) were all recognized as “enterprise legal persons”.

This wave would seem to coincide with the early developmental phases of the Asian developmental states, for example, Singapore’s early post-colonial experience, and Taiwan’s and South Korea’s early years. However, in the case of these developmental states, laws (mainly inherited Western laws) were already in place. None of these states had the heavy burden that China had to bear in going from a totally lawless society as characterized by the events of the Cultural Revolution and trying to develop a system of laws from ground zero. In addition, none of the Asian Tigers moved from a Communist command economy to a mixed socialist market economy. From these two points of view alone, China’s achievement has been remarkable. That the laws and institutions built in the short period were probably also able to facilitate development is also almost incomprehensible.

The second wave of legal development: 1992–99

The “second wave” of law is counted from around 1992. It is marked by the period after Deng’s now famous southern tour that he made to the special economic zones of Shenzhen and Zhuhai and after the Party made an important policy decision regarding the establishment of the so-called “socialist market economy.” This policy decision was supported by a batch of laws designed to foster fairer, more equal transactions between state and non-state players, to encourage the use of capitalist mechanisms, freedom of contract, and general respect for “rational” law as espoused by Max Weber. The Party’s decision regarding developing a “socialist market economy” specifically mandated that enterprises should become “legal entities bearing civil rights and duties.”

During this wave, the main thrust of legal development focused on business organisations. For example, after many years of debate, the Company Law was enacted in 1994, as was the first Copyright Law (1995), and a Patent Law (1997). The Trademark Law which had been enacted in 1982 was substantially revised in 1993 and its Implementing Regulations made important clarifications in 1995 (Carter, 1996).

The Company Law was modeled on the German corporation law and therefore included a supervisory board as well as a board of directors. However it was not until 2006 that the Standing Committee of the NPC issued “niceties” such as rules regarding piercing the corporate veil—but only when a controlling

shareholder abuses incorporation privileges. The Company Law itself was also amended in 2005 to allow shareholders to bring a civil lawsuit in the interests of the company and in their own names regarding the job-related acts of members of the board, supervisors and so on, which violate laws, regulations, or the articles of association and cause injury to the company. Other examples of piecemeal development of this and other important commercial laws are rife. It points to the fact that the legal infrastructure, especially business law, is still, even now, a work in progress. For as Lubman states (2006, 9): “nationwide standards for Chinese corporate governance remain confused and ineffective, and China’s corporate culture remains muddled and its standards unclear—as shareholders and, sometimes, foreign investors often discover when they encounter corruption in Chinese companies.”

It was during this wave, in 1996, that the 4th plenary session of the 8th National People’s Congress (NPC) announced what some have called a long-term legal development strategy. It promised to “rule the country according to law and build a socialist rule of law country (*Yifa zhiguo, jianshe shehuizhuyi fazhiguo*.)” The declaration was incorporated into both the State (1999) and the Party (2002) Constitutions. This has been exciting news for many Chinese legal scholars, some of whom have interpreted the declaration as a move towards implementing and living up to “the rule of law.” This debate will be left for another paper. Suffice it to say that such declarations are similar to campaigns for the protection of intellectual property rights: they are promises and policy statements which can never and will never replace action. Action, however, is probably what the third wave will try to effect.

The third wave of legal development: 2000 to current

The “third wave” is marked by the fact that China acceded to the Treaty of the World Trade Organization (WTO) in 2001. Accession requires an acceleration of legal and institutional reforms to help ensure that Chinese laws, regulations and the trade-related legal infrastructure comply with WTO rules. That is the stated objective and it will be and has been difficult to fulfill.

The WTO requires that China’s laws and regulations are rendered transparent, easily accessible, stable and universally applicable. This means that Chinese laws can no longer be *neibu* (hidden); all must be published.⁶ Furthermore, judicial and other dispute settlement mechanisms must be impartial, independent and operate transparently so that the results can be predictable. Judicial decisions must also be published—at least to the parties involved.

Some areas of the WTO Treaty specifically require special mechanisms for enforcing and adjudicating rights. For instance, under the appended Agreement on Trade-Related Intellectual Property Rights (TRIPs) member states must provide domestic procedures, institutions and remedies, which allow IP right holders to acquire, maintain and enforce protection of their rights effectively. Furthermore, article 41 compels members to integrate the enforcement procedures listed in Part 111 of the TRIPs Agreement into “their national laws so as to

permit effective action against any act of infringement of intellectual property rights covered by this Agreement.”

Although TRIPs does not require “a judicial system for the enforcement of intellectual property rights distinct from that of enforcement of laws in general” nevertheless the remainder of Part 111 sets out detailed provisions and procedures, including injunctions and court orders for freezing assets, preserving evidence, and so on. All WTO member states must make these remedies available. Like most developing countries, many of China’s laws comply, but only “on paper.”

It is not just in legislation that some Chinese laws fall short. It is especially in enforcement. Indeed, the huge outpouring of laws within an extremely short period of time compounds the issue regarding enforcement. It could be argued that China has not had sufficient time to build the other institutions of the legal system. For instance, the position of lawyers and judges remains problematic. They are neither impartial nor independent. The Party still seems to value total control over Chinese society more than it values promoting legal reforms and an *independent* judiciary. However, this performance also mimics the model of the Asian developmental states.

Furthermore, the powers to restrain the huge bureaucracy’s exercise of its wide discretion are still either too weak or not enforced with much credibility. Several administrative laws have been enacted, and many cases brought to trial but success rate is low (Palmer 2010). In short, neither the government nor the Party is under the law, and both—especially at the local and provincial levels—often hinder the impartiality and independence of judges and lawyers. Judges are selected and their wages paid by the government, and lawyers have yet to regain the respect of the system and society—especially when they represent defendants in criminal cases.

Protecting real property in the PRC

This part analyzes some of the rules that deal with private property in an attempt to discover whether China as a developmental state might be breaking new ground in an area where, according to the 2004 Constitution, legal rights are inviolable. One major issue facing China is how to balance the use of land between its agricultural and its industrial development endeavors; in other words, between its rural and its urban developmental use. Rapid industrialization and export of manufactured goods propelled economic development in the Asian developmental states and so far China has adopted that model well. However, some 70–80 percent of China’s population is still domiciled in the rural areas and as land is expropriated or requisitioned “in the public interest” to facilitate even more industrialization, the peasant farmers are being forced off the land with little compensation and into an insecure future as factory hands. The rural–urban prosperity gap has grown wide and will grow even wider. This is an issue which no Asian tiger had to deal with on a large scale so China will be breaking new ground in its developmental model when it chooses a solution. In this

respect, India could probably also gain useful insights since India seems to be following in China's footsteps in so far as the SEZ strategy for attracting foreign direct investment is concerned.

Land rights are protected and regulated in the Constitution (most recently amended in 2004), the Land Administration Law, the Law on the Contracting of Rural Land and in the PRC's first Property Law, which came into force in October 2007. Aspects of these laws will be discussed below but first some general observations regarding steps towards the modernization of agriculture and land use rights.

A free market for the peasants' crops?

As noted previously, Deng's first act towards modernization was in agriculture. He lifted Mao's artificial restrictions on the sale of produce and allowed peasants to sell their crops on the free market once their pre-arranged state quotas were met. Second, he dismantled the hated MATs: mutual aid teams and reinstated the household units. Third, by setting up SEZs in Shenzhen, Xiamen, Shantou, Hainan and Zhuhai, and later on in dozens of other locations, he encouraged the rural surplus workforce to move to these urbanized developing zones in order to support industrialization and improve the peasant farmers' individual situation.⁷ But the most important move was that in 1979, the Party reinstated the household unit (and jettisoned the team system) as the primary accounting unit. The Household Responsibility System (HRS) allowed individual households to contract with the collectives (the legal holders of the land) for the right to farm certain areas of land. In return they agreed to deliver a certain portion of their crops to the collective in lieu of rent (Stockman, 2000, 137).

A raft of regulations followed during the next few years, all of which aimed to encourage investment in agriculture. For instance, in 1984, the duration of HRS contracts was extended to 15 years and land could be inherited during the contract period. The duration of contracts is now 30 years. TVEs—township and village enterprises—were formed in local governments when the Maoist communes and brigades were dismantled under Deng. Some of these expanded their operations to include management of the collectives' land and since central planning no longer dictated what they must produce, many TVEs thrived. Other TVEs took on the management of industrial operations and thereby introduced industrialization into the countryside. During the 1980s and early 1990s much agricultural land was transferred from agriculture into industrial ventures, which were much more lucrative than agriculture.

Although the circumstances of farmers improved markedly under Deng and subsequent modern-era leaders, they would never achieve the economic standards that are common among people working in industry. One of the main impediments is that the peasant farmer or household does not have a permanent and secure title to the land. The thirtieth anniversary for Deng's initial agricultural reforms, 2008, promised to bring further reforms in an attempt to enhance economic prosperity among people in the rural areas but so far only small and

relatively insignificant steps have been made. Indeed, land grab issues have proliferated as have charges of corruption among officials who allegedly confiscate farmlands and rezone them for factory and residential building.

Constitutional protection of land rights

The principles of land ownership are enshrined in article 10 of the PRC Constitution. This divides all land into two categories: urban land, which is owned by the state; and rural and suburban land, which is owned by collectives or by the state pursuant to law. All other parties who are in neither of these categories have contracts for land use rights of anything from 30 years' duration and up to 70 years in some privileged industrial areas.

Furthermore, "the state may, in the public interest, requisition land for its use in accordance with the law". However, it was not until the 2004 amendment of the Constitution that the NPC added that the state "shall make compensation for the land expropriated or requisitioned." For the first time, those with land use rights contracts were also permitted to transfer their contracts by lawful means.

Article 8 establishes the Household Responsibility System (HRS), creating "rural collective economic organizations" that serve as the source of collective ownership in the countryside. Thus, Household Responsibility System units are the land-title holders as well as the managers who oversee the administration of land use rights.

Article 13 was strengthened in the 2004 amendment to guarantee that "Citizens' lawful private property is inviolable" and the "state protects the rights of citizens to private property." This amendment was necessary to facilitate the new Property Law, which was finally enacted in 2007. It changed the entire foundation upon which the Chinese Communist Party and society had operated in the decades since 1949 when the preeminent objective was to achieve a Communist society, which would usher in a stateless utopia in which all land and capital are owned collectively by a classless society.

The Property Law of the PRC 2007: equal protection to "a rich man's car and a beggar's stick"

Many observers, both in China and in the West, regard the new Property Law as the final nail in China's socialist coffin. It is the definitive step towards a legal system and society patterned on capitalist notions, they say. For it is well known that Marxist theory holds that the state must control all the means of production to prevent individuals from exploiting each other and to preserve equality of labour. Yet the new law accords the same degree of protection to state-owned, group-owned and private-owned property (article 4).

The Property Law is also unique in that it had a long passage in the legislative machine: the NPC's Standing Committee read it seven times, and when a draft was submitted to the public for comments over 11,000 opinions were lodged within 40 days. Of the many who opposed enactment, Gong Xiantian, a Beijing

University law professor was most vocal. Nevertheless, the bill was passed by 98 percent of the NPC's voting delegates—giving equal protection to “a rich man's car and a beggar's stick,” as Professor Xiantian expressed it scornfully.

Surprisingly, while there are solid gains for the protection of urban land use rights, gains for rural holders of land use rights are miniscule. Of course there are several chapters that deal with non-urban lands but most of these mainly reiterate clauses from other laws, e.g. the Land Administration Law and the Law on the Contracting of Rural Land. According to Benjamin James (2007), by reiterating these clauses in the Property Law, the Chinese leadership is likely sending a stern message to local leaders in the rural areas to remind them about how to administer the law honestly.

One possible loophole that may allow fruitful development is article 126, which begins by reaffirming that the contracting period for cultivated lands is 30 years but continues by stating that once the contracting period has been completed “the one holding the right to operate the contracted land may continue the contract according to the relevant national rules” (*id.*). Since there are no known provisions for renewal of these contractual rights no one knows what the phrase “the relevant national rules” means. However, vague and unqualified statements are often used by the PRC leadership to signal some future change or to test some idea for future legislation. In any event, at a minimum, the phrase signals that land use rights holders will not have to return the land to the collective and await redistribution in a manner which is to be determined by the collective alone. It is hoped that renewal and redistribution procedures will be formalized following Deng's first land reform announcement on December 29, 2008. *Prima facie*, the signaled provision offers greater security and a degree of predictability regarding the outcome of redistribution or “renewal” of land use rights. It therefore encourages the rights holder to invest in the land since there is known tenure.

The expectation is that, at a minimum, the Chinese government will make a policy announcement that farmers will be allowed to “subcontract, lease, exchange or swap their land-use rights or to consolidate their farm land with others within shareholding agri-businesses” (Callick, 2008). The main policy change here will respond to speculations that were rife after the vague, programmatic provisions of article 126 of the 2007 Property Law regarding renewal of land use rights contracts. But before the celebrations grow in might, it must be noted that rural land remains in collective ownership and only the transactions of land use rights have been affected. As reported by Xinhua, the state news agency, the government's move is designed to ensure that farmers' incomes will double by 2020. However, there is no indication of how this feat will be achieved. The average income of rural workers was US\$906 in 2007, while the average urban income was US\$3,010 during the same period. As the wealth gap widens between the rural and urban areas in China, all that can be hoped is that the new land use rights arrangements will empower farmers themselves to become the prime actors in land transactions and thus replace the local, often corrupt, party officials whose secret land transactions have often caused protests

and “mass events” throughout China and especially in Fujian and Guangdong provinces where the appetite for land for conversion into industrial parks and special economic zones seems to be insatiable.

What does it all mean?

Development pertains substantially to removing what Amartya Sen (1999, 3) calls “un-freedoms.” These are artificial barriers to natural human agency and economic transactions between individuals and communities. It is argued here that to judge by legislation regarding the protection of property rights, and many other actions in the post-Mao era, China’s recent history of development largely supports Sen’s basic idea. For once Deng Xiaoping and the Communist Party had lifted the artificial restrictions which Mao had imposed under the centrally planned economy, and started to free China’s citizens from the tedious social control of the work-units (*danwai*) and forced agricultural teams, and to gradually allow the rural surplus workforce to move to factories in the urban areas, the economy took off, and China started to (re)gain its rightful place in the world.

To quote Sen (1999, 3):

If freedom is what development advances, then there is a major argument for concentrating on that overarching objective, rather than on some particular means, or some specially chosen list of instruments. Viewing development in terms of expanding substantive freedoms directs attention to the ends that make development important, rather than merely to some of the means that, inter alia, play a prominent part in the process.

Clearly, in Sen’s parlance, China is doing the right thing: focusing on development, widely defined, so the means are perhaps of little importance. However, Sen also defines the sources of “un-freedom” (*id*, 53):

poverty as well as tyranny, poor economic opportunities as well as systematic social deprivation, neglect of public facilities as well as intolerance or over-activity of repressive states.

From this point of view, China’s “development” trajectory seems less secure. “Intolerance or over-activity of repressive states” seems to bring us back full circle to the human rights issues—all those rights that are supposedly protected by the “rule of law”; the rule of law which repressive states as well as many developmental states loved to hate or form in their own image, for their own purpose and convenience.

Conclusion

Since Deng Xiaoping launched the legal and economic reforms in 1978, China’s development path has followed the Asian developmental state model in many

respects. By enacting an abundance of laws in the past three decades, China has put in place many of the statutory controls over trade and capital flows that propelled the Asian developmental states' industrial policies and growth. Despite having to start from a very low base in terms of existing legal infrastructure, Chinese legislation has touched nearly every area of the agreed list of "helpful policies" that populate the Asian developmental state model. These include the use of international markets, a high level of literacy and school education, fairly successful (though recent and timid) land reforms, and public provision of incentives for investment, exporting and industrialization—especially through SEZs.

Law enforcement still lags and corruption is still rife, more so than in any of the original Asian developmental model states. However, the "third wave" of post-Mao legal reforms is only just beginning and as discussed above, this wave will focus on enforcement, transparency, development of an independent and impartial judiciary, and so on, if nothing else then in order to comply fully with WTO treaty commitments.

With its recent moves of inviting successful capitalist entrepreneurs to join the Communist Party and enacting a new Western-friendly Property Law (2007), which many claim is the last nail in China's socialist coffin, China may well be contemplating a move towards a more classical Asian developmental state model.

It is true that China's current performance has deviated from the Asian developmental state model in one major way: that is, there is a less *equal* sharing of the fruits of economic development—especially in allowing the prosperity gap between the urban and the rural populations to widen. This is a paradox since China started from a socialist base, which required equal division of wealth and ownership of the productive resources. However, the current leadership is addressing the issue of property rights and the rural–urban divide. Its professed focus is also on building a more "harmonious" if not a more "equal" society.

Notes

- * Ph.D. (London, UK), Barrister, Professor Law, Royal Roads University, Victoria, BC, Canada.
- 1 For a discussion of law and development in its old guise, see David Trubek and Marc Galanter, "Scholars in Self-estrangement: Some Reflections on the Crisis in Law and Development in the United States" (1974) 4 *Wisconsin Law Review* 1062. For a discussion of the concept in its new guise, see David Trubek and A Santos, eds, (2006) *The New Law and Economic Development: A Critical Appraisal*, Cambridge University Press.
- 2 For a study of law in Communist China in three parts, see Alice Tay (1969) "Law in Communist China – Part 1," 6 *Sydney Law Review*, 153.
- 3 Karl Marx and Friedrich Engels (1848) *The Manifesto of the Communist Party*, available at www.anu.edu.au/polsci/marx/classics/manifesto.html.
- 4 At the 3rd plenary session of the 11th Central Committee of the Communist Party of China.
- 5 For an excellent discussion, see William C. Jones (1987) "Some Questions Regarding the Significance of the GPCL of the PRC," 28 *Harvard International Law Journal* 309.
- 6 Many legal practitioners, including this author, have experienced the surprise of laws

or regulations, especially at the provincial level of government, which were unveiled only when the dispute settlement was being negotiated.

- 7 This latter point is controversial since some academics argue that the displacement of peasant farmers from the countryside to the urban areas creates a new category of migrant workers who suffer huge discrimination in the labour market. For a discussion, see, for example, Bjorn Gustafsson and Li Shi, "The Anatomy of Rising Earnings Inequality in Urban China" (2001) 29 *Journal of Comparative Economics* 118; Cliff Waldman, "The Labor Market in Post-Reform China: History, Evidence and Implications" (2004) 39 *Business Economics* 50; Ronald C Brown, "China's Employment Discrimination Laws during Economic Transition" (2005) 19 *Columbia Journal of Asian Law* 361.

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5 The politics of law and development in Thailand

Seeking Rousseau, finding Hobbes*

*Andrew Harding***

Introduction: The new law and development

Thailand embarked on an ambitious constitutional reform process at the very height of the economic crisis in 1997. It now finds itself, after a decade-long roller-coaster experience of authoritarian government, followed by a military coup and the drafting of a new constitution, with problems of rule of law implementation and political economy. This chapter takes a long look at law and development since the early twentieth century and discusses, in the context of the ongoing constitutional crisis, the problematical nature of the Thai version of the Asian developmental state.

This book raises a number of questions concerning the relationships between development, economics, democracy and the rule of law in the Asian context. The authors of a recent study of the “new law and development” (Trubek and Santos 2006; see also Rose 1998) come to the collective view (whatever nuanced differences there might be between them) that what they refer to as the “third moment” in the history of law and development¹ will be one in which development is redefined as encompassing more than the purely economic, and (to put it in my own words here) the social and the political will be written into the law and development script (Rittich 2006). On this thesis development relates intrinsically to human fulfilment; engages with emergent democracy and good governance; and creates participation as well as accountability, environmental sustainability and social justice as well as growth. Similarly, in the new law and development the law becomes not simply the means of achieving economic growth but an end in itself (Carothers 1998, Bergling 2006).

This redefinition of law and development recognises also that the uniform imposition of what came to be called, during law and development’s second moment, “economic constitutionalism” is practically impossible, and therefore the trajectories of law and development will, in the third moment, differ significantly from one context to another. For the first time,² it seems, national context becomes part of the epistemology of law and development, rather than merely an obstacle to progress.

It therefore becomes problematical to construct any clear and overarching general theory for this third moment, which seems likely to be more pluralistic

and therefore more unpredictable in its efforts and its outcomes than law and development theory has generally allowed for in the past. Part of this emerging pluralism should be a recognition that Asian experiences (Biddulph and Nicholson 2008) of law and development are both instructive and in many ways different from those of the rest of the world. In a chapter in an earlier law and development study (Hatchard and Perry-Kessaris 2003), in which Connie Carter and I studied the experience of Singapore (Harding and Carter 2003),³ law and development was critiqued in the following terms, which might form a starting point for considering law and development in the Asian context:

The “law and development” movement has been unreasonably preoccupied with the problems rather than the solutions to the ... complexity of law and economic development ... Historically, the movement has taken a dismal view of the world, and as problems are actually solved the movement seems to redefine its remit to encompass problems which have not been solved, taking care not to indulge itself in investigation of precisely why things which have gone right have in fact gone right. As its ideas and remit change, the world is re-explained to coincide with these ideas. Learning from brute facts is only allowed, it seems, where the facts fit the hypothesis, but not where they contradict it. ... There is no more obvious example of this tendency than in its attitude to the countries of East and South East Asia. Right from the beginning, these regions have been neglected by the law and development movement, presumably because the specialised nature and conception of law in those regions is opaque to the scrutiny of the discipline, and therefore regarded as a one-off case. The more these countries develop economically the less they are seen as containing lessons or fields of study for law and development. ... Perhaps there is also a hint that if the lessons were learned they would not fit the currently authorised⁴ version of law and development.

This chapter does not take issue with any of the propositions stated above to be main planks of, or at least positions within, the new law and development, but takes the view that what Trubek, in the abstract for the conference which led to this volume, called “new roles for law in a revised version of the development state” captures the essence of the new law and development. Indeed it goes further, to engage with the practical application of public law and constitutionalism (Harding 2002) as an aspect of development not fully explored in conventional law and development literature, which has tended to concentrate on what is variously called “thin rule of law”, “rule of economic law”, “economic constitutionalism” or “the rights hypothesis” (Pistor and Wellons 1998, Peerenboom 2004), indicating in general that what is required to create development is the untrammelled operation of market forces operating under the rule of law, or in other words a legal system which protects property rights and enforces contractual obligations. This latter view implicitly renders public law irrelevant or even politically off limits in a development context, a position that this paper finds

baffling—in the Thai context at least in which development discourse has come to focus almost too concertedly on public law.

To the extent that the third moment becomes one in which the state is allowed a more prominent role (Ohnesorge 2007), it seems inevitable that the pursuit of the rule of law, good governance, accountability, human rights and judicialisation places the implementation of constitutionalism at the centre of our attention (Harding and Leyland 2011). Here constitutionalism is not qualified by the word “economic” but involves, contours, and also circumscribes, the larger concept of “political economy” as it is conceived in the particular national context. Constitutionalism thus takes on a political-economy role, but also takes on other roles consistent with a more comprehensive definition of development encompassing social justice, human rights and participation.

The purpose of this chapter is therefore to discover whether the law and development experience of Thailand supports the Trubek/Santos view of law and development in its third moment. It is also implicit in the approach taken that Asian experiences will themselves differ from each other, and again Thailand, it will be seen, both converges and diverges in various ways from other Asian experiences (Ferguson and Johnston 1998). Hence the title of the chapter,⁵ which implies that in Thailand a legal model that appears to emphasise liberal constitutionalism, at least as an aspiration, turns out on closer analysis to disguise a model in which it is political power that determines both the content and the practice of constitutionalism as it is progressively defined and articulated in the Thai Constitutions of 1997 and 2007, and the nature of the political economy of development as defined in the Thai context.

In examining these issues the chapter takes a long view of law and development in Thailand, but focuses mainly on the last 15 years of deeply problematic “good governance” reforms. In order to understand what is called here the politics of law and development it will be necessary to consider briefly the development of law in Thailand through the inauguration of constitutionalism in 1932 and its chequered career over the last 80 years, which have seen 18 constitutions, 17 military coups and 58 governments. The chapter ends by considering the law and development implications of the period of military rule from September 2006, the drafting of the 2007 Constitution, and the intense conflict between the “red” and “yellow” factions, and drawing some conclusions for the purposes of the present discussion. Given that the law and development literature seems also largely to ignore the lessons of legal history this chapter also attempts to provide a corrective by looking at King Chulalongkorn’s legal reforms of the early twentieth century, and their significance for Thailand and for law and development theory; and it is at this point that the enquiry begins.

Law and Development in the Fifth Reign

When King Chulalongkorn (Rama V) ascended the throne of Siam in 1868 at the age of 15, he inherited a political climate that was favourable to reform, due to the enlightened policy of his father King Mongkut (Rama IV), who, having

signed treaties granting trading rights to foreign powers and conceding the principle of extraterritoriality, was concerned to encourage his people along the path of Buddhist ethics, rationality in social ordering, and Western science, in which Mongkut had made himself expert (Winichakul 1996; Loos 2006; Harding 2008). When Chulalongkorn became of age and took over the reins of government personally, he commenced, and largely completed during the latter part of his reign (1868–1910), a modernising project of vast proportions, known as the Chakri Reformation, which covered almost every aspect of political, economic, social and cultural life in Siam. If the law and development movement and its terminology had existed at the time, Chulalongkorn would without doubt have been its convinced adherent and advocate. His speeches and his actions articulated the view that Siam needed to modernise rapidly, that it needed foreign experts to point the way, and that a reformed legal system formed a vital element of modernisation. “By adopting certain practices of the prosperous and developed countries Thailand itself can become prosperous and developed,” he asserted, displaying what David Engel (Engel 1975) calls an “almost mystical faith that the promulgation of modern codes, statutes and constitutions would somehow produce a modern Thailand.”

This mystical faith describes with some accuracy the “inaugural moment” of the law and development movement, which started about half a century after Chulalongkorn’s untimely death in 1910. If Chulalongkorn was naive in his faith in law and development (he would probably have recognised “civilisation” as expressing more precisely the expected outcome of his reforms), then he was rather precociously naive. It is not very clear, however, whether Chulalongkorn and the Siamese leadership of the time regarded legal modernisation precisely as only a *cause* or as also an *effect* of development; there is no doubt, though, that a modern legal system, along with technology and rationalised public administration, was considered part of the entire package of desiderata that was referred to as civilisation (“*siwilai*”) or, as we would now say, “development”. It is also not surprising if a precise articulation of a theory of what we would call law and economics is missing from Siamese discourse of the early twentieth century. Economics was still an uncertain science, and had not formed any part of the education of Siam’s kings and princes, as King Prajadhipok (Rama VII, 1927–35) was wont to admit freely as he became entangled with the complex economics of the Depression years, 1928–32. It was probably assumed that economic power (“growth” is essentially a post-war, or even post-1970, condition in Thailand, as in most of the developing world) stemmed from a kind of national strengthening which would be achieved through industrialisation and social, including legal, reforms, along the lines of Japan’s late nineteenth century experience of reform.

At first, therefore, development meant railroads, printing presses, telegraphic and postal communication, the draining of swamps for agriculture and cities, and the construction of sewage facilities, canals and hospitals. But Chulalongkorn, even as a teenaged King during the regency, travelling in Asia in 1871–72, also displayed great interest in how the Western powers in India, Burma, Malaya and the East Indies, managed to rule Asian populations with their religious beliefs

and cultures, so different from those of the West, and how they organised their law and their government in these Asian societies (Lim, 2009). Time and time again one finds that developments in Siam were initiated because international experience, especially European experience, indicated a point where best practice, logic and pride met in a conclusive syllogism: the European powers were imperialistic, powerful and prestigious, and in order to avoid becoming yet another British or French colony like all their immediate neighbours (Burma, Vietnam, Cambodia, Laos and Malaya), Siam had to become strong in every way and more like the European powers, at least in technology, government and law. Therefore, as with all the other aspects of development, “modern” law came to be regarded in Siam as the necessary possession and attribute of a strong nation; indeed the extraterritoriality treaties themselves stated in terms that they would be repealed only when Siam had a full set of modern legal codes (Hooker 1986), and this promise was in fact fulfilled in the first third of the twentieth century as the treaties were repealed one by one (Sayre 1928). In the meantime, however, the restrictions on trade tariffs imposed by the treaties acted as a substantial brake on the government’s ability to mount the large projects that the Chakri governments saw as essential components of development. It therefore became imperative that legal reforms be carried out, if only to dispose of the unwanted fetter of extraterritoriality treaties and the unfavorable trading regime that they represented. Law reform was, however, undertaken not reluctantly but with enthusiasm. The French gunboat diplomacy of 1893, when French forces actually sailed up the Chao Phraya River and blockaded Bangkok to force Siamese recognition of French possession of Laos, an act carried out in the view of a terrified Chulalongkorn, showed very clearly the dangers of not pressing on with a self-strengthening agenda.

The legal reforms were laid out by legislative councils consisting of foreign (usually Belgian, French or Japanese) and Siamese jurists. The theory of legal transplantation that these jurists adhered to was highly consonant with the views of twenty-first century law and development consultants and comparative lawyers. Rene Guyon, who was a key adviser in the codification process, wrote as follows (Guyon 1919) of the civil code drafting committee:

[They] avoided indulging in the too-easy plan of copying any foreign code, perfect as it might be, and of transforming their provisions with slight alterations, into Siamese legislation. They have for each draft pursued the same methods: first, they have made a general study of the matter as it stands in the existing Siamese texts ... and in the principal foreign codes ... important decisions have been made and a good knowledge of the local needs has in turn enabled the Commissioners to submit drafts which do not consist only in theoretical terms but are framed according to the actual and real requirements on the country.⁶

The law-reform documentation of the period (Padoux 1909/1988: 580; Hickling 1972) consistently makes mention of realistic expectations, generational

change, social impacts, and the need for ideas and habits to develop over time. It would be wrong to imagine that the Chakri Kings or their legal advisers thought that Western laws were appropriate in every respect to Siam, or could be implemented wholesale without difficulty or unintended consequences. In this sense law and development as practised in Siam 100 years ago was rather more sophisticated than much of what was to follow during the first and second moments of our postwar experience of law and development. For Siam, the example of Japan, which had adopted the German legal system without losing its culture or sense of identity, became determinative, and although there was some flirting with the common law system under the influence of Prince Rabi, the first Minister of Justice, from 1895 it was the civil law that held sway. Japan defeated Russia in war in 1905, and was becoming equal in power to the European states; this showed that to follow the civilian path to legal modernity, drastic as that was, did not mean the abandonment of traditional culture or religion, and had in fact led in Japan's case to the end of extraterritoriality, and to industrialization and military power.⁷ Moreover, the civil law was easier to follow, apply and teach, and seemed more doctrinally certain, complete and rational than the common law with its analogical techniques, remedial bias, and fact-based judgments.

In the event it took about 50 years (1886–1935) to reform the legal system, that is from the first conception of the shape of the reforms to the putting into place of the Civil and Commercial Code in stages between 1925 and 1935. In the meantime the Land Law was passed in 1905, the Penal Code in 1908, judicial and court reforms in the same year, and a Trademark Law in 1914.⁸ By the second decade of the twentieth century one could say that Siam had in operation virtually a full set of modern private laws and institutions to implement them.

Law and development after the end of absolute monarchy

The final version of the Civil and Commercial Code, including the books dealing with family law and succession, was enacted into law in 1935, three years after the military had overthrown the absolute monarchy in a coup d'état, and six years before Thailand (as it came to be called from 1939), under the proto-fascist government of Field-Marshal Plaek Phibulsongkram (Prime Minister 1938–44 and 1948–57), entered the Second World War by allowing Japanese troops to use Thai territory to invade British Malaya. Interestingly enough, the coup of 1932 occurred at the point of Siam's greatest economic collapse, due to the global depression. The "young turks" of 1932 included the right-wing nationalist General Phibul and the left-wing law professor and drafter of the very first Constitution of 1932, Pridi Phanumyong. Pridi was also the pre-eminent economic policy theorist in several subsequent governments before his brief premiership and then exile in the wake of the murder of King Ananda (Rama VIII) in 1946; his economic ideas were generally Marxist, collectivist and redistributive, and his writings expounded the view that the economy had to be organised by the government if real change from a feudal to a modern society were to occur

(Phongpaichit and Baker 2000). Despite the socialist nature of his political economy, Pridi's emphasis on the state created an early notion of the Asian developmental state.

After the war Thailand lurched between civilian, democratically elected, governments, and military rule. The entrenchment of military, or at least authoritarian civilian, rule under Phibul and his successors as Prime Minister,⁹ from the late 1940s to the late 1980s, labels the Thailand of that period as an example of the Asian developmental state (Ohnesorge 2003). Despite popular support for the coup of 1932 and the democracy movements of 1973 and 1976, constitutionalism, although constantly present as a political conception, largely failed to become entrenched in practice in Thai legality. The frequent military coups increasingly enjoyed royal support during the 1960s and 1970s as the monarchy's recovering power burst free of the constraints of constitutional monarchy by securing its economic base and allying itself with selected members of the military. The coups were accepted by the majority and, if successful, even ratified by the Supreme Court. Each turn in the political cycle produced a new constitution. However, as Fred Riggs (Riggs 1966: 152–3) pointed out:

These constitutional documents cannot be taken seriously as binding statements of the rules of the political game, as expressions of fundamental law. It is apparent that, whenever important shifts in the personnel of the ruling clique took place, the previous charter was suspended to permit the promulgation of new rules more compatible with the interests and inclinations of the winning group ... constitutionalism was designed not so much to constrain the rulers as to facilitate their rule.

The frequent changes in political leadership were not however accompanied by any significant or sustained changes in political economy. The state became increasingly an example (albeit a non-conforming example in some respects) of the Asian developmental state, in which economic development was deliberately privileged over democracy and constitutional form (Tan 2004). The Asian developmental state in its Thai manifestation was a curious entity. Unlike other examples such as Japan, South Korea, Taiwan and Singapore, Thailand with its cycle of coups, corrupt civilian governments and new constitutions was politically—and even more importantly, governmentally—unstable, a position that normally betokens a lack of consistent policy. This did not, however, prevent economic growth getting under way from the late 1950s, particularly as a result of Prime Minister Sarit Dhanarajata's encouragement of foreign and government-linked enterprises, and then increasing rapidly during the 1980s and 1990s. In a manner reminiscent of Japan and South Korea, the modern economy was essentially created by the emergence by the late 1970s of around 30 Sino-Thai¹⁰ owned conglomerates; these were family businesses which had grown very large, diversified into most areas of the economy, and secured a symbiotic relationship with generals, the royal family, or leading politicians (Phongpaichit and Baker 1996: 25). They eventually emerged as global corporate players in the late 1980s, so

that globalization became not so much a threat as an opportunity, which, until 1997 at least, Thailand seized with both hands. A prominent example of a Thai “*chaebol*” (to use the Korean expression) was the media and communications empire of Thaksin Shinawatra, who broke the political mould by crossing the divide between business and politics in 1994, becoming a member of the Cabinet, founding the Thai Rak Thai party in 1998, and then becoming Prime Minister in 2001.¹¹ Crucial to the success of these conglomerates, in Thailand as elsewhere, particularly the Shinawatra business empire, was their ability to secure licences and concessions from the government of the day (McCargo, 2005).

The Asian developmental state has typically embodied all or most of: executive-centred government; broad administrative discretion; strong or unquestionable personal or party leadership; government interference in economic and social affairs; restriction of some basic freedoms and judicial independence; persistent attacks on or total submergence of the rule of law; and the backing of a powerful military branch. Most of these features were present in the Thai example, even if the prosopography tended to change rather more frequently than in other Asian developmental states, apart from Japan (Thailand has had no equivalent of Lee Kuan Yew, Mahathir Mohamed, Chiang Ching-kuo or Park Chung-hee). Essentially Thailand diverged from the Asian developmental state only in this latter respect: authoritarian government was still, with some brief democratic interludes, the norm, and the revolving-door governments merely increased the control of the civil service over details of policy. Encouragement of foreign investment, fostering of selected industrial sectors and players, and the creation of development banks clearly also all played an important part.

Crisis and reform: law and development in the 1990s

Despite the emergence of Thailand’s developmental state, and just at the time it reached its apogee in the early 1990s (Antons 2003), the trajectory of events in Thailand during law and development’s second moment and prior to the economic crisis of 1997/8 increasingly emphasised the importance of democracy and constitutionalism. The crisis had the effect of carrying that general trajectory towards root-and-branch public law reform (Harding 2001; McCargo 2002; Connors 2003; Harding and Leyland, 2011).

In 1992¹² the military government of General Suchinda Krapakorn was rejected by the public, following its brutal suppression of street demonstrations. The government was dismissed by the King, and the civilian democratic government that resulted secured the passage of constitutional amendments (McDorman 1998), which required the drafting of a new constitution designed to entrench democracy and human rights, exclude military influence in the political process, adopt a zero-tolerance approach to corruption in public life, and make the formation of stable governments less problematical. This was indeed a highly ambitious agenda.

Dissatisfaction with money politics became more multi-faceted and pressed the need for reform (Laird, 2000). The reform agenda was taken forward by the civilian governments of Chuan Leekpai (1992–95 and 1997–2001), Banharn Silpa-Archa (1995–96), and Chavalit Yongchaiyudh (1996–97). A Constitutional Drafting Assembly (CDA)¹³ consisting of 99 persons was appointed.¹⁴ Its remit embraced everything except the constitutional nature of the monarchy and the system of democracy.¹⁵ The Constitution was drafted and brought into effect during the first ten months of 1997, in the middle of which period the Asian currency crisis, commencing with the floating of the *baht* in June 1997, convulsed the country and then the entire East Asian region (Booth, 2009). Under constitutional amendments of 1991 and 1996 the draft Constitution had then to be considered by Parliament, and either adopted without amendment or else totally rejected.

Amid a virtually unprecedented and very alarming collapse of currency values, the Thai people had therefore to decide whether to adopt the most far-reaching raft of constitutional reforms since the institution of constitutional government in 1932, or forgo this unique and critical opportunity in order to deal with their worst economic crisis since the 1930s. Naturally, the arguments were finely balanced. Many Thais felt that the old expedient of relying on the King¹⁶ to deal with constitutional crises was preferable to the uncertainty of reform, and that there were simply more pressing matters than the Constitution at that time. At the same time, many Thais felt that political reforms were an essential prerequisite to economic reforms. For example, “Bangkok’s businessmen and middle class began to blame the crisis on mismanagement by politicians, and seized on the constitution as the way to bring politics into line with the needs of the globalized economy” (Phongpaichit and Baker 2005: 225). It was of particular interest that the draft Constitution involved drastic reforms of both houses of the National Assembly, and considerably demoted parliamentarians in role and status, exposing them to a wide range of new checks and balances related to corruption and abuse of power. It was, ironically, the military that ultimately determined the issue when they made it clear, amid hints of another coup, that the National Assembly should pass the draft without amendment, which was precisely what occurred in September 1997, the King assenting to it the following month.¹⁷ One might be surprised that the military played this role; it should be remembered, however, that even the military is not immune from social, political and intellectual developments, and conceivably was, in the wake of 1992, convinced that renouncing a political role might even work to its longer-term advantage. Even at the moment when Thailand was closest to the ideas of Rousseau, Hobbes’ Leviathan lurked behind the curtain.

By this process Thailand effectively placed political reform ahead of economic reform (Harding 2007, Antons and Gessmer 2007). Lack of transparency and accountability, corruption, nepotism and crony capitalism were argued to be the main causes of the crisis (Harding 2007); the constitutional reform process in Thailand, even though it commenced some six years before the crisis, and was brought to conclusion during it, was therefore apparently aimed at precisely the

right problems. It would follow that, of all the Asian countries buffeted by the crisis of 1997/98, Thailand was best placed to recover and benefit from subsequent economic and legal reforms, because it had in a sense already left the starting blocks in a flying start whilst others were still deafened or confused by the starter's gun. Purely economic law reforms were of course also highly relevant to Thailand's recovery and reforms in economic law occurred in areas such as intellectual property (Intellectual Property Court Establishment and International Trade and Intellectual Property Procedure Act 1996), bankruptcy law (Bankruptcy Act 1998), competition law (Business Competition Act 1999), and foreign investment law (Foreign Business Law 1999); these accompanied the implementation of the constitutional reforms of 1997.¹⁸ Official findings criticising the Bank of Thailand also resulted in many changes in banking practices, and a Financial Sector Restructuring Authority was put in place as early as 1997.

The Constitution of 1997¹⁹ was designed to bring to an end once and for all to the cycle of coups and weak, corrupt coalition governments. It was accompanied by a thorough overhaul of public administration and fiscal procedures at national, provincial and local government levels. Like many constitution-makers interested in democratic, rule-of-law reforms during the 1990s, the Thai constitution-makers of 1997 decided to create a range of "watchdog" bodies (Leyland 2007), constituting a complex series of checks and balances to ensure that power would be exercised in the public interest; these were the Election Commission, the National Counter-Corruption Commission, the National Audit Commission, the Administrative Courts (Leyland 2007), the National Human Rights Commission (Harding 2006), the Ombudsman (Leyland 2007), the Special Division of the Supreme Court for Criminal Cases Against Persons Holding Political Office, and the Anti-Money-Laundering Office. They also decided to create a Constitutional Court as a capstone which would ensure that the entire constitutional architecture would withstand external forces (Harding 2009; Harding and Leyland 2010, 2011).

The prevailing theory was therefore that good governance had to be implemented in all senses at all levels, and that reviving economic growth was not a secondary objective, but a natural consequence of the reforms themselves. On this view law was a cause of development, and only law creating conditions of good governance could make that development sustainable. It is worth emphasizing that, with reference to the globalization nostrums of law and development's second moment, Thailand had had private law for many decades before its economic take-off as one of Akamatsu's "flying geese" in the early 1980s (Akamatsu 1962), and the apparent final grounding of the goose in 1997 (or was it merely a stopover?) took place nearly a century after Chulalongkorn's reforms. This does not suggest that private law caused development in the Thai context, but rather that the Asian developmental state was responsible for development. There are, however, even more interesting questions about whether the Asian developmental state was responsible for the collapse of development and, if so, what was responsible for the subsequent recovery.

The Thaksin years: the reforms unravelled

The implementation of the 1997 Constitution, initially during 1997–2000 appearing to be relatively smooth, eventually revealed many problems at the heart of Thai constitutionalism. The text itself could hardly have been clearer in its unequivocal adherence to constitutional values, and was without doubt Thailand's best constitution of all those enacted since 1932. It made extensive provision for human rights (Harding 2006), the rule of law, accountability for abuse of power, and for stable, elected, civilian government (Leyland 2007). The result in practice was, however, much more ambiguous, especially during 2001–06, the period in which Thaksin Shinawatra and his Thai Rak Thai Party were in power (McCargo and Pathmanand 2005).

To begin with, when Thaksin was appointed Prime Minister he was under the cloud of a corruption finding by the National Anti-Corruption Commission (NACC). One of the Constitutional Court's major early cases, in which it considered the confirmation of this finding, damaged its standing irrevocably. The case involved an investigation of claims that Thaksin in his declaration of assets, before being elected Prime Minister in early 2001, had concealed vast sums, most of his fortune in fact, as part of a dishonest scheme to conceal conflicts of interest that were unlawful under the 1997 Constitution. It was found that the assets had been registered in the names of his housekeeper, chauffeur, driver, security guard and business colleagues.²⁰ Thaksin had been charged not long before the general election. The NACC had been granted wide-ranging powers not only to investigate, but also, where it found that a person had failed to disclose assets and liabilities, or had attempted to supply false information, to order that person from office with immediate effect and a ban on holding office for five years. However, as a safeguard, this power to issue what has been termed a "red card" had first to be approved by the Constitutional Court.²¹ The NACC duly conducted its investigation and passed judgment by an 8–1 margin against Thaksin. If the decision of the NACC had been allowed to stand unchallenged, the result would have been an automatic suspension from politics for five years, operating with immediate effect, thus depriving Thaksin of the premiership. Instead of accepting the findings as simply part of a process, Thaksin instead set about the subversion of the Constitution. He countered the accusations openly on the political stage by suggesting that the findings were merely part of a political smear campaign (Phongpaichit and Baker 2005). The NACC's decision was then appealed to the Constitutional Court, where it was argued that the failure to declare these assets was no more than an honest mistake. Although the argument was not accepted, the Constitutional Court voted narrowly in Thaksin's favour. The 8–7 outcome was reached after two votes: the first rejected by a margin of 11–4 Thaksin's argument that he was not required to make an asset declaration; the second rejected by a margin of 7–4 Thaksin's assertion that the concealment of assets had been an honest mistake. Overall, according to the conventions of the Court's unusual voting system, the two votes of 4 were added together to make 8, which is set against the 7 who had voted him guilty on the second ballot.

This result raised serious questions about the impartiality of the Court, the role of the political scientists on the Court whose votes were crucial in turning the result in Thaksin's favour, and a voting system that seemed to defy logic.

This decision was indeed a surprising outcome on the facts, given that in 17 other similar cases decided previously the Constitutional Court had always endorsed the decision of the NACC. The failure to act decisively and punish the Prime Minister for this manifest breach of the rules severely undermined the Court's credibility in the face of political interference and a challenge at the highest level. It should be recognised that quite apart from any illegitimate pressures that may have been placed on them, the Judges on the Constitutional Court had an unenviable choice in making their decision. A vote confirming Thaksin's disqualification by the NACC, if it had been carried through, would have in effect invalidated the result of the election with the prospect of political turmoil, and the ensuing crisis would have placed further strain on the constitutional arrangements with what the experience of 2005–06 would indicate to be unpredictable effects.

Abuses of power and of human rights, and widespread corruption and conflicts of interest gradually became evident as Thaksin's hold on power tightened following his narrow escape in the Constitutional Court. Most importantly, in January 2006 Thaksin and his family sold their majority investment in Shin Corp Group to Temasek Holdings, Singapore's state investment arm. The Shinawatra family, with a 49.6 per cent holding, benefited to the extent of almost US\$19 billion tax-free profit on the sale (provisions were rushed through Parliament to nullify the capital gains tax implications), and it was also argued that the deal compromised Thailand's national security by giving another nation effective control of Thailand's communications, including defence communications.²²

The sale was increasingly the subject of enormous controversy in Thailand, resulting in huge street demonstrations and prompting a snap election, called by the Prime Minister but boycotted by the opposition parties. A decision of the Election Commission of Thailand (ECT) to allow the election, which was held on 2 April 2006, was challenged in the courts. During the election itself, there were many allegations of widespread vote-buying.²³ The ECT failed to uphold objections to the results and the Constitutional Court initially confirmed individual results which had been called into question. Although Thaksin won the election, following further street demonstrations he announced that he would only serve as a caretaker Prime Minister until a new government was formed; but after taking short vacation he showed no signs of going. In an unprecedented move the King intervened on 26 April 2006 by addressing the judges of the Constitutional and Administrative Courts directly. He implied in his speech that they should assert their authority under the constitution to resolve the constitutional crisis by invalidating the election, which had been boycotted by opposition parties.²⁴

After the appeal by King Bhumipol to the judiciary the election was declared invalid by a majority of the Constitutional Court in May 2006. There was also considerable criticism following the failure of the ECT to disqualify candidates

for the senatorial elections who had suspected party affiliations²⁵ and the ECT's failure to prevent vote-buying in those elections.²⁶ In July 2006 three Election Commissioners were sentenced to four years' imprisonment for mishandling the April 2006 elections.²⁷

Thaksin promised to step down after new elections, which were to be held in November 2006. However, on 19 September 2006, while Thaksin was attending a summit meeting in New York, the tanks rolled into central Bangkok, ending an episode of acute constitutional crisis and political polarisation. By this time Thaksin and his government had showed blatant disregard for both the letter and the spirit of the Constitution and the law. As well as widely reported human rights abuses, particularly in the Muslim southern provinces of Thailand, the freedom of the press and broadcasting media had been called into question, the independence of many constitutional bodies, and the military itself, had been undermined, conflicts of interest were rampant, and unconstitutional actions had gone uncorrected. Thaksin had also committed what was in the Thai context an even more cardinal error by being seen to have slighted the King on more than one occasion.

The coup was bloodless, but Thailand's new military junta, the Council for Democratic Reform, suspended the 1997 Constitution, removed the Prime Minister, dissolved both houses of Parliament, and abolished the Constitutional Court, the only body with power to rule the coup unlawful. The King assented to the coup, which could not indeed have been attempted without his imprimatur. Nevertheless, following the coup the junta declared its intention to restore democracy, citing the previous government's undermining of the 1997 Constitution as a major reason for the coup, along with national polarisation and widespread corruption. An interim constitution was speedily enacted to provide for a transitional government and for a new constitution-making process, which eventually resulted in the 2007 Constitution. A civilian technocrat government was appointed under Prime Minister Surayud Chulanont, but the military retained reserve powers such as the right to dismiss the Prime Minister.

The constitution-making process prescribed in the Interim Constitution 2006,²⁸ carried out during the course of 2007, was implemented in the manner described in the following section.

2007: the severance of politics?

First, the Council for National Security (CNS, actually the Council for Democratic Reform under another guise) appointed the 2,000 members of a National Assembly, which nominated 200 of its own members as candidates for membership of the Constitution Drafting Assembly (CDA). The National Assembly also functioned as an interim legislature. The CNS then selected 100 of these 200 to form the CDA itself. The CDA also had a Constitution Drafting Committee (CDC) consisting of 35 members (25 members of the CDA plus ten members selected by the CNS from CDA members and non-members).²⁹ It was decreed that no member of the CDA or CDC was to be a current or recent former

member of any political party, or to have held any recent position in a political party. The cut-off point was fixed at two years before the person's appointment as a member of the CDA. In reaching a shortlist for the CDC the rules further required a quota of two representatives each from the academic, social, business and government sectors. The remainder of the nominees were required to either hold a position of professorial, director-general, or equivalent rank, or they must previously (before the two-year cut-off point) have served as an MP or Senator. The upshot was that the drafters of the 2007 Constitution not only had to demonstrate seniority, but they carried with them recognition as members of the Thai establishment. Critics have claimed that the predominance of the old guard was confirmed when veteran spymaster, Prasong Soonsiri, a figure close to the junta and Privy Council³⁰ President (and Prime Minister 1980–88) Prem Tinsulanonda, were elected through a secret vote to chair the CDC.³¹

It was also stipulated that the CDA should hold public hearings at which politicians and others could appear and present their case. Having agreed on the draft Constitution, the CDA were required to disseminate the draft. After the initial draft was completed by the CDC, the CDA were allowed to amend the draft, but only if half of its members submitted a motion together with reasons for the amendment before the CDA meeting day. The resulting draft Constitution was required to be produced within 180 days and to be formally justified by the CDA in terms of how and why it differed from the 1997 Constitution.³² It was then put to the electorate in a referendum after a period of 30 days. The referendum was held in August 2006 and despite a heated campaign against the draft (it was not only Thaksin supporters who felt that, in Thaksin's own words, the draft Constitution was the "fruit of a poisoned tree"), a majority of 58 per cent approved it and it came into effect in August 2006. It is interesting to note that if, following this protracted process, the draft Constitution had been rejected at the referendum, it was provided that the CDA and the CNS could select any previous Thai constitution, suitably amended, to be the next Thai Constitution. Perhaps with the above provisions in mind, Noranit Setabutr, chairman of the CDA, expressed a strong preference for modelling the new Constitution on the suspended 1997 "People's Constitution". He recognized that this approach would save time as well as preventing controversies from "mushrooming out of control". Although there are significant differences it is obvious that the CDA decided to take the 1997 Constitution as the basis for the 2007 draft. However, some important changes relate to anti-corruption measures, wherein particular a code of ethics was introduced for office-holders and public servants; the composition of the legislature; human rights and access to justice; accountability of the executive to Parliament; and the method of insulating the appointment process for "watchdog agencies" from political interference. The 2007 Constitution relies much more heavily than any previous Constitution on the judiciary as a reliable institution, and not only are judges given more powers, but those powers extend beyond what is normally regarded as strictly judicial, for example in their involvement in the appointment of members of watchdog agencies. The 2007 Constitution can be described as representing a significant judicialisation of Thai public law.

It also goes further than its predecessors in spelling out directive Principles of State Policy, including those relating to the economy. Here it is interesting to note that the King's own philosophy of the self-sufficient, sustainable economy, which protects the interests of the small farmers, is actually written into the Constitution and it becomes a duty of the government to implement those principles, amongst many others (ss.82–4). In some ways the military-installed government (under Prime Minister Surayud Chulanond, September 2006 to January 2008) attempted, amid some severe criticism of its economic policy, to implement this principle, but its time in office was short and its successor Thaksin-related or “red” governments during 2008 did not embrace self-sufficiency with enthusiasm.

The return to elected government in January 2008 saw the election of the People Power Party (PPP) under Prime Minister Samak Sundaravej, which was close to Thaksin, and this again prompted large street demonstrations by the opposing “yellow” faction, the People's Alliance for Democracy (PAD), which effectively brought both government and the economy to a standstill during most of 2008. Samak was forced to resign following an adverse Constitutional Court ruling in September 2008, but his successor Somchai Wongsawat fared no better, being forced from office in December 2008 when his party was dissolved, again as a result of a ruling of the Constitutional Court. Defections of Thaksin-inclined MPs then enabled the Democratic Party under Prime Minister Abhisit Vejjajiva to take power without an election (December 2008); but the supporters of the pro-Thaksin parties (the “red” faction), mounted large street demonstrations in downtown Bangkok against the Government, orchestrated to cause maximum disruption, and demanded new elections. These protesters were dispersed with violence by the military in May 2010. The red shirts rested their case on a clear electoral majority in the general elections of January 2008, subverted by a kind of fraud on the constitution; the yellow shirt leaders of the PAD stated a policy objective of parliamentary reform representing a “new politics”, under which only 30 per cent of MPs would be elected and 70 per cent chosen from functional constituencies, effectively removing the right of Thai citizens to select their legislators. It seems clear that such a reform would receive little support across Thailand. Indeed, in a political twist which is ironic in view of the ouster, without an election, of “red” governments in 2006 and then twice in 2008, the general election of July 2011 resulted in Thaksin's younger sister, Yingluck Shinawatra, the leader of Puea Thai, another red party, being elected Prime Minister with a comfortable majority. With this result, the Thai people had spoken clearly: red parties had won every election since 2001.

It has been seen that the process of drafting the 2007 Constitution was clearly designed to exclude political parties from participation. Political parties are thus seen from a yellow perspective as “the problem” in this particular scenario, rather than, as elsewhere, particularly in Asia, as vehicles for mobilization of development itself. This severing of the political from the constitutional requires some explanation and comment.

Under the 1997 Constitution, there was a rule that required a candidate for election to the House of Representatives to have been a member of the political

party for which he or she was standing for at least 90 days prior to the election. All candidates had to be members of a political party, as distinct from a candidate for election to the Senate who was not allowed to be or have recently been a member of any political party. Additionally a party-hopping rule restricted the right of a sitting MP from changing party without forfeiting his or her seat. The 90-day rule was designed to create stronger parties, because party-hopping (both immediately prior to an election and during the parliamentary session) had been a serious problem in Thailand, and had undermined governments on many occasions as factions within parties withdrew their support for the government. In addition, restrictions on the rights of MPs to introduce no-confidence motions had been introduced in 1997. Members of any faction that sought to change party or bring down the government would now lose their parliamentary seats. Under the 2007 Constitution the 90-day rule has been retained, but the restrictions on no-confidence motions remain.³³ Given that one purpose of the 1997 Constitution was to make it more likely that a majority government of one party, or a viable and secure coalition, would stay in office for a full term,³⁴ the 2007 Constitution presented a risk of a return to the unstable coalitions of pre-1997 politics.

The 2007 Constitution is even more clearly directed towards the elimination of corruption than its predecessor. It seeks to patch many of the most obvious loopholes that were apparent in the 1997 Constitution. For example, it contains stricter rules on conflicts of interest by requiring the declaration of assets and liabilities which apply both to the holder of political office and their families and to members of the Senate and House of Representatives.³⁵ In order to avoid conflicts of interest politicians are disqualified from any civil service position and any interference with the award of concessions or contracts is expressly prohibited.³⁶ In addition, there are provisions to facilitate more easily the removal of political office holders following a judgment by the courts. However, the most novel feature of the 2007 Constitution in regard to the fight against corruption is a specific commitment to an ethical code which applies to all persons holding political positions, government officials and state officials at all levels.³⁷ The Ombudsman³⁸ is expected to advise on the drafting of the moral code and then promote awareness of the code that is adopted. Once it is in place, the Ombudsman has an oversight function in investigating and disclosing violations of the code, the most serious of which are to be referred to the NACC. The Ombudsman only has powers to investigate, to refer and to report, but the office is not able to disqualify miscreants. In addition, stringent provisions are included elsewhere in the Constitution to prevent conflicts of interest at all levels, and local administrators and members of local assemblies are required to submit accounts showing particulars of their assets and liabilities and those of their spouses and children.³⁹ On referral to the Constitutional Court (whose powers are greatly increased as compared with 1997: Harding, 2009; Harding and Leyland, 2010) for confirmation any person who fails to comply with these provisions will be subject to an immediate five-year ban from holding any political position or public office.⁴⁰ This emphasis on ethical values can be linked to provisions

designed to achieve greater transparency. Local authorities are required to publish annual reports detailing their budgeting, spending, and performance, thus allowing these aspects to be monitored and scrutinized more systematically.⁴¹

The problem of course goes much deeper than these reforms suggest. Political parties in Thailand, apart from being obliged to conform to certain rules, need to be allowed to create much greater legitimacy. They need a genuine power base and policy manifesto allowing them to be able to challenge each other (perhaps in combinations) as government and opposition on the basis of major differences in policy rather than personal loyalties. Thai Rak Thai party (TRT) emerged very rapidly after its foundation by Thaksin in 1998 and it promised a new form of popular democracy not only by making promises at elections but also by delivering some tangible benefits, especially to Thailand's poorest rural communities: Thaksin promised development funding for every village in Thailand, and a 30 baht health care system, and he delivered on these promises. Despite allegations of corrupt practices, it is obvious that TRT was able to gain wide support from sections of the Thai electorate on the basis of the policies that it offered (McCargo 2002). This may explain the hero-worship of Thaksin in some parts of Thailand, mainly the North around his native Chiang Mai and the undeveloped Eastern provinces.

Thailand's fluid political culture has proved a major challenge, which has called into question the status and credibility of political parties, including the now-dissolved TRT. For political parties to have established status and stability they need roots that extend beyond the interests of particular political leaders, and which do not rely on merely promising voters direct financial benefits. Moreover, in nearly all successful liberal-democratic systems, the effectiveness of parliamentary mechanisms depends on a healthy rather than destructive tension between government and opposition groupings, which has been so clearly and indeed dangerously lacking in Thailand since late 2005. In order to achieve legitimacy, parties need to be established around core principles with a commitment to achieving political ends. Much has been written in Thailand about the need to promote a new politics at grass roots level (Phaharathananunth 2002; Nogsuan 2006). In order to overcome the problem of powerful and rich individuals dominating the agenda of political parties, the issue of state funding for political parties, under strict control, might be considered. New parties launched with state funding in the future might be based on the representation of general interests and socio-economic policies rather than social structures embodying client-patron relationships or an "entourage" system. A well-known Thai academic who has investigated this issue stresses the point in this way:

Thailand must build a new political culture in which people place the country's political future in their own hands, not rotate it among the same elite. Instead of blaming rural people for electing bad governments, the middle class should help strengthen grass-roots politics by supporting political decentralisation, such as provincial governor elections.⁴²

One might add that blaming political parties for all ills is unrealistic, and attempts to confine them tightly within constitutional constraints, even excluding them from participation in the design of those constraints, is not likely to produce better parties.

Following the 2006 coup a number of cases were initiated against TRT and the Democratic Party in regard to alleged wrongdoing at the 2006 elections. The Democratic Party was acquitted but the TRT Party and its officials were found guilty of corrupt practices by the Constitutional Tribunal (set up under the Interim Constitution 2006) in May 2007. As a result TRT was dissolved and 110 of its officials, including Thaksin himself, were disqualified from engagement in politics for five years.⁴³ In the same vein the governing People Power Party was dissolved by the Constitutional Court as described above. Unless there are fresh initiatives along the lines outlined above, which might indeed involve doing away with the power of the Constitutional court to dissolve political parties (which recent events have shown can always be recreated under a different name), it is not at all clear how the chronic political instability of Thailand can be transformed beyond providing a new political show with a similar cast of characters. It became very clear during 2008 that this instability was causing grave economic harm to Thailand, not least due to decimation of the tourist industry, quite apart from the harm caused by the “credit crunch” crisis of 2008, the effects of which continue to have an impact.

The nature of the Thai developmental state

A balance sheet of the remarkable period of polarisation since 2005 might show the following. An attempt to resolve finally the constitutional crisis of 1991/92 and the economic crisis of 1997/98 revolved around the concept of a rule-of-law state, embodied in the 1997 Constitution. This attempt, initially apparently successful, speedily unravelled as Thaksin’s government manipulated or avoided constitutional constraints placed to prevent the very abuses (political interference, abuses of power, conflicts of interest) that characterised the Thaksin years and which the Constitution was intended to forestall. The Thai establishment rejected the Thaksin revolution, but also in effect rejected the rule-of-law state embodied in the 1997 Constitution, effectively mounting a reactionary coup designed to restore the Asian developmental state as it existed in the 1980s, but in a way that attempted to co-opt the strong urban constitutionalist opposition to Thaksin.⁴⁴ This coup in its turn unravelled to the extent that the constitutional process in effect returned Thaksinites to power following the elections of January 2008, albeit for less than a year as it turned out, and then again in 2011. The important point is that it seems that neither of these two political movements, red and yellow, wishes to restore the rule-of-law democratic state, which reached its high-water mark during 1992–2000. The difference between them represents rather a difference in the *type of development state* as between the Prem model of the 1980s, often referred to as “Premocracy” (military/ business corporate state) and the Thaksin model of the 2000s,

referred to as “Thaksinisation” (the “CEO” contracting state). The struggle between these two movements or tendencies will no doubt continue.

However, the 2007 Constitution, for all its difficulties indicated above, if properly implemented, does offer a possible median path that would give legitimacy to the Thaksin model while curtailing its worst abuses of power. It is not the place here to discuss in further detail the problems of the 1997 Constitution and the 2007 attempt to learn from the 1997 experience (Harding and Leyland 2011), but it should be noted that the devil is in the constitutional details, and essentially the outcome will depend on whether constitutionalist ideals can and will be translated into practice. This depends on whether the red faction and the Bangkok elites, especially the military, can cohabit. Early signs following the 2011 election are that such cohabitation has been implicitly agreed, but the issue is whether this can be sustained.

The task of designing effective constitutional accountability mechanisms has been rendered more complex because, in common with many other nations, Thailand has moved, particularly during Thaksin’s premiership, towards a type of “contracting state” (Harding and Leyland 2011). Such an agenda (and trends of this kind are not easily reversed) attempts to reduce the size of public services through contracting out to the private sector, and also by the privatization of state-run industries. The objective is to improve the efficiency of delivery of such services to the citizen by exposure to market forces (Nikomborirak 2007). The result of this initiative is that the business sector is increasingly drawn into the practice of government. The process of contract-making through which private companies assume the task of service delivery, or carrying out construction projects, greatly expands the interface between, on the one hand, members of the government, officials working for the bureaucratic organs of the state and elected politicians (not in government), and on the other hand, private sector organisations responsible for performing these functions. At the same time, these developments increase the potential for conflicts of interest to arise in the award of such contracts.⁴⁵ This is particularly problematical in Thailand as many members of whichever government is in power and elected politicians, including notably Thaksin himself, who essentially dissolved the divide between business and politics, have strong business connections. The constitutional reforms created the NACC and the Anti-Money Laundering Office to patrol this expanding territory (as well as performing other duties), which covers the relationship between the public and private sectors. In addition, associated legislation, such as the Anti-Money Laundering Act 1999, has been passed setting out strict rules and clear guidelines to eradicate conflicts of interest. To date these rules have not been very effective, but the issue is intelligently addressed in the 2007 Constitution. A final point to note here is that, on the one hand the motivation for the involvement of many politicians in politics is to promote and protect their own vested interests; on the other hand, the officials who are responsible for policy implementation generally receive inadequate remuneration.

The significance of Thai experience for law and development in Asia

We can perhaps now in this last section attempt to synthesise and contextualise, law- and development-wise, the story of Thailand's experience of political economy under its developmental state. Modern private law and a modern legal system were introduced in Thailand a century ago. Defined and registered property rights and the law of contract were important parts of that modern law. Legal reforms since then have tended to elaborate property rights in much the same manner as one would expect in the West, for example with regard to securities and intellectual property, and with increasing efficacy. Whatever one thinks about the success or otherwise of this legal transplant in terms of the practical application and efficacy of the law (Engel 1978) and the benefits flowing therefrom, it seems very hard to argue that law has *led to* economic development in any significant way, as opposed to simply being somewhat useful, at any subsequent point in Thai history.

Economic development did indeed occur from the early 1980s, but, as with other examples of the Asian developmental state, causation has to be traced to areas far removed from the favoured instruments of the Washington consensus: modern private law, guaranteed property rights, and rule-of-law institutions. Moreover, Thailand has diverged from other Asian developmental states such as Singapore, Japan, South Korea and Taiwan in that economic development has not entailed growth with equity; indeed the economic, social and political distinctions between city and countryside have probably never been greater, and have contributed greatly to the ongoing constitutional crisis that this chapter has attempted to describe and analyse.

What economic development has led to is a genuine demand in many quarters for democracy, freedom and social justice, although this demand is not being effectively met by political parties, which seems to be a cause of Thailand's political instability. This demand has in turn led to experimental changes in the constitutional structure, and a trend towards "new Asian constitutionalism"; but these changes have proved extremely problematical in their implementation and the long-term outcome still remains doubtful. In the terminology of the title of this chapter they have led not to the embrace of Rousseau-style liberalism, but the discovery of something like an Asian variant of Hobbes' Leviathan, in the form of a combination of bureaucratic, military and royal power at the core of the political system. The Leviathan is challenged, not just by democratic aspiration, but also by an attempt by the business conglomerates, in the form of Thaksin and his supporters, to take control of the political system. That challenge was not terminated by the coup of September 2006, by the election of January 2008, by the appointment of Abhisit as Prime Minister in late 2008, nor in all probability by the election of Yingluck Shinawatra in July 2011. It seems much more likely in the Thai context that in the long run, although not as soon as some would have predicted, development *will lead* to law than that law *has led or will lead* to development. However, law in the sense of the rule-of-law

state based on constitutionalist principles is unlikely to be capable of being legally-instrumentally engineered in the way that the Thai elite seems to imagine. The rule-of-law state will arise in its own good time if at all, and the signs are that some progress is being made in that direction. Peter Leyland's work on the Administrative Courts (Leyland 2007), for example, leads to the conclusion that at some level the performance and survival of many of the watchdog agencies beyond the 2006 coup suggests an underlying advance of a Thai version of the new Asian constitutionalism that may be seen in some other Asian states such as South Korea, Taiwan and Indonesia (Harding and Leyland 2010).

The vicissitudes of recent Thai history, when matched with the significant economic growth of the last three decades, nonetheless pose a conundrum that has some general theoretical significance. In terms of law and development, we might ask some very basic questions: why did Thailand develop, why did the economy collapse, and why has it now recovered?

The answer to this conundrum lies it seems in the nature of the Thai social order, rather than in its law or its politics. It has been argued here that if law causes development, then Thailand would have developed long before the 1980s, and indeed it seems that it was the Thai version of the Asian developmental state to which we can attribute responsibility for the economic growth of 1980–97; law no doubt played its part, but it was not the most significant factor. In general across Asia the success of the developmental state lies in its *stability and predictability* rather than its adherence to the rule of law. It is argued here that in the Thai context what appears at first sight to be instability can be seen on closer inspection to have been in fact a form of stability (at least until 2005); it is simply not stability in the constitutional and governmental sense. Stability has instead been based on the social order, on respect for the monarchy as the one clearly persistent and reliable element in the polity, and on a competent and respected civil service that implements fairly consistent development policy despite whatever political, or constitutional, or even military, weather disturbs the atmosphere above its head. This view explains in significant part the growth of the Thai economy and its collapse in 1997 (see above); the indications are that the recovery of the Thai economy after 1999 owes much to a combination of its underlying strengths, the reforms of the Chuan Leekpai government of the late 1990s, and the economic decision-making of the Thaksin government.

The following passage from a paper by Peter Leyland expresses the idea of social order as a persistent feature of Thai culture that impacts on economic development as well as law:

patron–client relations embody a deeply ingrained set of complementary values. In part, these values establish a strong sense of social order in which every individual is ranked according to wealth, power, birth and status. Each person is expected not only to know their place in the hierarchy, but also to adjust their behaviour accordingly. In Thai consciousness the King is at the very pinnacle of society (also at the peak of the constitution) and he has

sometimes used his unquestioned authority to intervene on the political stage in times of crisis or controversy with immediate impact. In an important sense the stability of society relies on never questioning the authority of those further up the hierarchy. ... Moreover, it has been explained that: “It is a ‘whole’ relationship that unites politics and economics: on the part of the patron [i.e. the holder of power at any level], political influence or power ensures access to wealth ... as for the client, he provides the services that contribute to the patron’s wealth (and power) while he shares, in proportion to his degree, in the proceeds. It is a symbiotic relationship each needs the other to derive the benefits they both receive” (Girling 1981). Linked to this is the concept of *bun khun*. In Thai society this means that a person owes a moral obligation to those who have protected, helped or nurtured them. ... It will be obvious that such an informal, but deeply influential concept which requires that associates repay each other in kind for favours rendered is fundamentally antipathetic to traditional and formal ideas of constitutionalism.

In addition, Buddhist concepts run counter to the whole idea of positive law as a means of resolving what we might call “situations of injustice”.

What is seen by lawyers using Western concepts as an act of injustice caused by an illegal action to be remedied or restored through a process involving attribution of liability, a Thai Buddhist might see as an adverse event which occurs in a context that includes the victim’s actions in a previous life and his or her own fault in this life.

(Harding, 2006; see also Engel and Engel 2010)

Such an approach might also eschew resort to formal rule-making and checking mechanisms altogether on the assumption that outcomes are predetermined and harmonious relations are pre-eminently important.

It is this sense of social order, coupled with the effective economic strategies characteristic of the Asian developmental state, which has brought about development in Thailand. However, a downside of this de-emphasizing of law and constitutionalism was fully exposed when the development trajectory was challenged by the crisis of 1997–98, which revealed extraordinary lapses in regulation, accountability and good governance. Another downside is that these social factors enabled Thaksin to abuse his power and undermine, for a while, with, in effect, the collusion of his opponents, the very stability which has facilitated development. Accordingly the coup of 2006 was designed to restore stability (in fact this was stated to be the main reason for military intervention), but in the process and the result delivered a terrible blow to democracy and the rule of law, which even the carefully drafted 2007 Constitution has not been able to bandage over. The coup was widely regarded as a setback for the democratic process; in particular, the military used the opportunity to consolidate their position in a most undemocratic manner, increasing the military budget, installing

generals to run several state companies, and attempting to confer wide national-security based powers on the military.⁴⁶ The return to elected government in January 2008 did not in the event strengthen democracy at all, and in the midst of all this the economy, already buffeted from without, suffered from simple neglect by governments that have been either incompetent or unable to nurture it. With the July 2011 election result there is presented a chance to reverse this position.

The “rule of law” is an entity capable of more than one definition (Peerenboom 2004): it is also a condition that it takes a great deal of difficulty to establish, given that frequently it is forced to compete with rival normative systems, as we can see clearly in Thai context.⁴⁷ In those societies in which it is fairly well established the rule of law is not necessarily also complete, supreme or pre-eminent. Even in those economically advanced states that we readily identify as rule-of-law states the rule of law is constantly challenged and in need of trenchant advocacy, careful articulation, constant refurbishment, and vigilant protection. It is not to be expected that it will mushroom overnight, fully formed, in states where it has been conspicuous for its routine breach rather than its entrenchment. The rule of law must therefore necessarily be a long-term project, and should be regarded as an outcome of development which can also contribute meaningfully to development.

The experience of Thailand in general terms does support the view that law and development’s third moment represents a rejection of Washington-consensus law and development theory. However it raises the possibility that the “old” Asian developmental state of the 1970s to 1980s came later in Thailand than in other Asian states and never really disappeared. What Thailand appears to show is that the Asian developmental state is itself in a transitional stage in which the rule of law and liberal democracy become increasingly relevant, partly because of the economic collapse of 1997–98 and partly because Asian development itself has led to a demand from the new middle classes of Asia for a form of “new Asian constitutionalism”. However, the political processes involved are complex and messy, as is always the case with transitions. Increasingly the focus will be on the detailed implementation of constitutionalism (the rule of law, accountability, anti-corruption measures, good governance, human rights, participation, electoral representation, and access to justice) in national contexts and along the lines of national trajectories. For the moment at least in Thailand, seeking and expecting to find Rousseau (who presumably will have to bide his time) we appear to have discovered Hobbes.

Notes

* The subtitle is not original but is used by way of a tribute to the late Professor Hugh Hickling (1920–2007) who amongst many other achievements as a lawyer, scholar and literatus, wrote about and advised on law in Thailand, wrote his Ph.D. on Thai legal reform, and sparked my own interest in law in SE Asia. The title of his novel *Finding Hobbes* (1994) is taken in turn from Sir Ralph Dahrendorf 1985.

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- 1 This paper accepts the general analysis of the new law and development in the Trubek/Santos book without necessarily accepting the way in which the “moments” are defined temporally. Indeed, in the Thai context, as will be seen, neither a temporal nor a conceptual distinction along these lines will explain everything. For further thoughts on the history of law and development see Tamanaha 1995.
- 2 In Thailand, however, as is seen below, national context did inform law reform processes a century ago.
- 3 See also Carter 2001.
- 4 We were referring here to the *second* moment of law and development.
- 5 See n.1 above.
- 6 Guyon 1919; see also Padoux 1909/ 1986, 580 and Hickling 1972.
- 7 Japan in its turn imposed extraterritoriality on Siam: Hooker 1986.
- 8 Given that 1908 was in many ways the epicentre of the legal reforms, the reforms can be said to be over 100 years old.
- 9 Principally General Sarit Dhanarajata (1958–63), General Thanom Kittikachorn (1958 and 1963–73), Tanin Kraivixien (1976–77), General Kriangsak Chomonan (1977–80), and General Prem Tinsulanond (1980–88).
- 10 I.e., Thai citizens whose families had migrated from China.
- 11 The career of Thaksin bears striking similarities to that of the current Italian Prime Minister Silvio Berlusconi.
- 12 For the historical background to the recent reforms, see Nanakorn (2002).
- 13 Its remit is expressed in the Preamble to the resulting Constitution of 1997, which states that the CDA’s duty is “to prepare a draft of a new Constitution as the fundamental [*sic*] of political reform ... with the essential substance lying in additionally promoting and protecting rights and liberties of the people, providing for public participation in the governance and inspecting the exercise of State power as well as improving a political structure to achieve more efficiency and stability, having particular regard to public opinions”.
- 14 The CDA membership comprised: 76 members, each representing a province, chosen by the Senate from candidates nominated at the provincial level; and 23 “expert” members (consisting of eight lawyers, eight political scientists, and seven civil servants and politicians). See, further, Nanakorn (2002) and Harding (2001).
- 15 The phrase used in Thailand is “the democratic regime with the King as head of state”.
- 16 This expedient clearly still exists. In December 2005 the King intervened in a fierce dispute between the Prime Minister and his leading political opponent, securing the withdrawal of several legal proceedings by the former.
- 17 The fact that the regime of governance established by the 1997 Constitution is constantly described in the text (for example, the Preamble, ss 2, 7, 313) as “democratic government with the King as Head of State” is an acknowledgment that the monarchy is still very popular and necessary to Thai constitutionalism and (as indicated above) the only constant factor in Thai political life over many years. The monarchy is the *only* aspect of constitutional life that has *not* been subjected to reform.
- 18 Some laws were introduced in satisfaction of IMF conditions when the IMF advanced a huge loan to Thailand in 1998. Recently, following repayment of the loan, some of these laws have been repealed.
- 19 Constitution of Thailand, 1997. *Government Gazette*, 11 October 1997, vol 114, part 55a. Also available at: <http://thailand.ahrchk.net/mainfile.php/docs/133/>.
- 20 Thaksin’s staff were recorded as among the top 10 holders of shares on the Thai stock exchange.
- 21 Organic Act on Counter Corruption 1999. Section 34 was drafted to suggest that where there was such evidence the confirmation would be a formality: “when the Constitutional Court gives a final decision that it is the case of an intentional submission of the account showing particulars of assets and liabilities and supporting docu-

- ments with false statements being included therein or failure to disclose facts which should have been disclosed". Most decisions have been confirmed but see Thaksin's case discussed in more detail below.
- 22 "Singapore's Troubled Shin Corp Deal", *Asian Times*, 13 December 2006.
 - 23 These led to the Constitutional Tribunal's decisions of 30 May 2007 dissolving the Thai Rak Thai Party: see below.
 - 24 See "Thai Court Suspends By-Elections", BBC News Website, 28 April 2006; "April 2 Election: Charter Court to Examine the Legality of Poll" *The Nation*, 1 May 2006.
 - 25 "Democrats Mull Suit Against EC", *The Nation*, 7 April 2006.
 - 26 "EC's conduct panned as 'inefficient, incompetent'", *The Nation*, 20 April 2006; "Major party is 'buying' likely vote winner", *The Nation*, 9 April 2006.
 - 27 "Thai Court Convicts 3 for Election Missteps", *International Herald Tribune*, 26 July 2006.
 - 28 Constitution of the Kingdom of Thailand (interim) B.E. 2549 (2006) Article 19ff.
 - 29 2006 (interim) Constitution, Articles 19–22.
 - 30 The Thai Privy Council comprises personal advisors to the King many of whom are ex senior members of the armed forces.
 - 31 "Hopes for a New, Progressive Constitution Dimming Fast", *The Nation*, 26 January 2007.
 - 32 *Ibid.*, Art.26.
 - 33 2007 Constitution, ss.95(3), 101(7).
 - 34 The supreme irony of the 1997 Constitution is that the first parliamentary elections under it succeeded in producing the desired effect—Thailand's first ever majority, one-party, government; however, that government consisted of Thaksin's TRT which then undermined the entire constitutional reform.
 - 35 2007 Constitution, ss.250 and 252.
 - 36 2007 Constitution, s.256.
 - 37 2007 Constitution, s.270.
 - 38 For which, see Leyland 2007.
 - 39 See generally 2007 Constitution, ss.250–255.
 - 40 Section 254.
 - 41 2007 Constitution, s.278(3).
 - 42 Yos Santasombat, Chiangmai University, quoted in "Four Months After the Coup: Democracy or Political Irresponsibility", *The Nation*, 19 January 2007.
 - 43 The ruling was on 30 May 2007. "Constitutional Tribunal disbands Thai Rak Thai", *The Nation*, May 30, 2007.
 - 44 The PAD protested the illegitimacy of the PPP government on the rather strange ground, unaccompanied by any other significant allegation, that it was "too close to Thaksin". The PPP had been elected to power in January 2008. Samak and Somchai were indeed close to Thaksin, the latter being in fact Thaksin's brother-in-law; however, the protests and occupations made it quite impossible for the PPP to govern and therefore to make any mistakes which could form a case against it. The PAD, while espousing democracy in its title, clearly had no belief in democracy as a principle and in fact advocated restricting voting rights and replacing 70 per cent of MPs with appointed members.
 - 45 See, e.g., "BMA Bidding Scandal: Sudarat Puts Graft Figure at Bt4 Bn", *The Nation*, 24 January 2006.
 - 46 J. Head, "Thailand Coup Turns Sour", BBC News, 19 September 2007.
 - 47 For example, protests against TRT and post-TRT governments involved many illegal actions and deliberate flouting of court orders. At points it even seemed that the government was supporting the rule of law with more enthusiasm than the protesters; but of course the rule of law has ever proved what one might call a double-edged shield.

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6 Law and development, FDI, and the Rule of Law in post-Soviet Central Asia

The case of Mongolia

*Sukhbaatar Sumiya**

Introduction

The argument that Asia has found a different path to modernity and to economic development from that taken by the West holds sway in different parts of the region. Given its unique history and tradition, Central Asia is another sub-region that may potentially reinforce that argument although its economic development experience remains relatively under-researched specifically from a law and development perspective.

This chapter presents a case study of Mongolia to probe and illustrate the possible “otherness” of the countries in Central Asia. Obviously, only one out of six countries is insufficient for any general conclusion. But the purpose here is only to set an example for similar studies in the future.

A convenient tool for a law and development case study is a focused analysis of foreign direct investment (FDI) trends as an indicator of economic development prospects. Of particular interest here is the relationship between law and FDI, which can be indicative of the role of law in economic development. In development circles, it has been asserted that the rule of law is a precondition for attracting and maintaining inward FDI flows. However, the content of the rule of law prescribed by development practitioners has been severely contested and critiqued by law and development scholars. The question is then what are the alternatives.

When it comes to the notion of the rule of law, Central Asia needs to be placed in its historical context of 70 years of Soviet rule before the beginning of market and democratic transition following the collapse of the former Soviet Union in 1991 and the emergence of independent post-Soviet societies.¹ The law in Soviet society possessed many of the characteristics of a modern legal system. However, according to one author, the legal systems inherited by post-Soviet societies are regarded to be undergoing a transition from “party rule” to the rule of law. “Party rule” refers to the monopoly of the communist party that existed in a communist society and was marked, first of all, by the lack of judicial independence from the party state (evidenced by the existence of the so-called “telephone justice”), the strong position of the procuracy (a state organ primarily charged with prosecution) in the legal system, a system subservient to the

privileges of the party *nomenklatura* at the expense of ordinary citizens, the absence of separation of powers, and the denial of fundamental human rights, including property rights.² This is all true, but “party rule” suggests a lawless society while law was an important tool at the hands of the communist party to rule its subjects. Therefore, a more appropriate description could be the “rule by law” existing in place of the ideal of the rule of law.

When post-Soviet societies embarked on a transition to market economy and multi-party democracy, they had had no prior history of such forms of social organization. Even if some had, over 70 years under a one-party rule and central planning meant that these societies had to begin from scratch. While the communist party’s monopoly and the state institutions for governing the economy were quickly and easily dismantled, the market and democratic institutions could not immediately take hold, thereby creating a kind of institutional vacuum, which led to chaos in the beginning until law and order could be restored.

The “shock therapy” imposed on post-Soviet economies assumed that market was a natural state of affairs and needed only liberalization, privatization, and deregulation to come into existence. But it quickly turned out that market can fail without an institutional base. It is not that shock therapists downplayed the role of institutions. Rather they assumed that, once unleashed, market forces would demand the creation of institutions so there was no need to build the institutions first. Some argue that “shock therapy” was the only option because any gradual approach ran the risk of enabling the old system to block the reforms.

The result of shock therapy in the absence of institutions was that the economy ended up in the hands of the so-called “oligarchs” and corrupt bureaucrats. The old bureaucrats preserved their privileged status and turned into a class living on rents extracted from the private sector.

There is no denying that post-Soviet societies have largely achieved an economic recovery and even some growth in recent years despite the initial disappointment. However, the institutional infrastructure of a market economy is far from complete and therefore requires further legal reforms to allow the economy to grow to its full potential. The poor development of capital markets is one problem. Also, diversification of the sources of growth has become another big challenge.

The political systems in post-Soviet societies can be characterized as neither totalitarian any more nor democratic yet. Although elections are held regularly, the same leaders manage to be reelected so as to remain in power as long as they wish. The freedom of press is at best partial because the leaders have learned to manipulate public opinion. Civil society groups are still too weak to effectively check the government between elections. Such systems have come to be labeled by political scientists as “authoritarian” or “semi-authoritarian.”

The slow pace of both economic and political reforms may ultimately be explained by the tremendous difficulty involved in changing the mentality of the rulers as well as the ruled, one that was instilled into them for decades during the communist era. Market and democratic institutions had to develop over centuries in the West. So, it is hard to expect the same to happen in decades. However,

this does not mean that nothing can be done to accelerate the transitional process.

Against this backdrop, it is now possible to move to the case study of Mongolia. It is concerned with some recent changes in the legal approach to FDI adopted by the country's government as witnessed by events affecting the mining industry where most foreign direct investment is concentrated.

Background

The mining industry of Mongolia was regulated by the Minerals Law of 1997 for some time until this law was substantially revised in 2006. The World Bank study concluded in 2005 that the:

[i]mplementation of the [law] ha[d] ... gained a high positive profile with foreign and domestic investors. This law, coupled with a relatively favorable financial and fiscal regime for mining projects, [was] the basis for [the] attractive investment climate [in Mongolia].³ As of 2004, "three thousand and forty-two foreign companies from 73 different countries ha[d] invested over 1bn dollars into 20 different areas of the economy since 1990. Of this, 462m dollars ha[d] been channeled into mining."⁴

Under the 1997 mining law, large foreign investors were entitled to a stability agreement with the government of Mongolia. The government's legal obligation under such an agreement involved guaranteeing a stable tax and royalty regime for the investor in question. Against this background, I will describe in the following two sections some recent notable developments in relation to FDI in the mining industry of Mongolia.

Executive action: initiative for government ownership

Dozens of Canadian mining and exploration companies have joined the Mongolian mining boom in recent years. With millions invested in the Mongolian mining sector, Canada has become the second-biggest foreign investor in Mongolia, ranking behind only China. After exploration by the previous license holder, BHP, was discontinued in 1999, Ivanhoe Mines, a Vancouver-based company, signed an option to earn 100 percent interest in the Oyu Tolgoi Concession in May, 2000 and immediately initiated a drill program. In 2001, Ivanhoe continued drilling, followed by three diamond drill holes. These three holes were sufficiently encouraging for Ivanhoe to mount a major follow-up drill program that continues to the present time.⁵ As already noted, big investors such as Ivanhoe were entitled by the 1997 Minerals Law to a stability agreement with the government. Several such agreements had been made prior to Ivanhoe. Unfortunately, Ivanhoe faced long delays.⁶

The potential large impact of Oyu Tolgoi on Mongolia's economic future apparently prompted the public and government to raise their expectations about

the benefits from FDI in the country's mining industry. The first step was a government initiative to include a provision in the mining law about state participation in large mining projects. Such a provision went far beyond the usual tax and royalty issues and, therefore, the stability agreement under negotiation with Ivanhoe was put on hold until the government could make a legislative proposal and have it passed by the parliament.

This process began after the June 2004 parliamentary election when the two major political parties agreed to control the government in turns. In the first half of the four-year term, the government was to be headed by the Democratic Party leader Mr. Elbegdorj. However, the communists orchestrated the fall of this government in January 2006, several months before the end of the agreed half-term.⁷

In November 2005, when Mongolia introduced its new mining law, Elbegdorj's government was "reportedly considering a 30-per-cent ownership stake in 'strategically important' mining projects. Later, however, Mongolia's president tried to distance himself from the proposal, and Ivanhoe said the 30-per-cent idea had been scrapped, although it said the government was considering a 15-per-cent stake in some mines."⁸

The new cabinet that came to power under Prime Minister Enkhbold was joined by the leader of a small independent party, Mr. Jargalsaikhan, as Minister for Trade and Industry, with responsibility to oversee the mining sector. Small party leaders would normally have very little chance to occupy ministerial posts. Therefore, given Mr. Jargalsaikhan's long prior experience in private business, his appointment may have been strategically important for the Communist Party, which took over the previous government's proposal for state participation in mining projects.

This seems to be confirmed by Mr. Jargalsaikhan's instrumental role in pushing the proposal through the parliament and his relatively short term in office. The minister made comments at several press conferences and media appearances in Mongolia that the government wanted participation in the Oyu Tolgoi project, saying that his views were supported by Mongolia's President Enkhbayar.⁹

The minister was also quite outspoken. He often took a confrontational stance toward foreign investors.¹⁰ After only one year, Mr. Jargalsaikhan was removed from office leaving behind a new law securing state participation in strategic mining projects.¹¹

Thus, the initiative for state participation in mining projects mainly came from within the government but pressure from civil society groups also played a role in enabling the government to push its legislative proposal through the parliament. When Mr. Jargalsaikhan was making his statements during a 2006 mining conference in the capital city of Mongolia, "[a]s if to emphasize his point, [the conference] was picketed ... by banner-waving protesters who warned the foreign investors to avoid any investments that would 'harm the basic interests of the people.'"¹²

One reporter emphasized that "pressure from protesters was a key factor in persuading the Mongolian government to pass the new mineral law [in 2006]. Thousands of people clogged the central square of Ulan Bator, throwing eggs,

pitching tents, holding hunger strikes and even burning an effigy of Ivanhoe's executive chairman, Robert Friedland."¹³ Civic groups seem to have been concerned that the government might be bribed to sign an agreement with Ivanhoe, hurting the interests of the people.¹⁴ By putting pressure on the government, these groups certainly delayed the conclusion of an agreement.

It seems April 2006 saw a real intensification of civil society activity. There were reports about a direct contact between the government and civil groups.¹⁵ One of their demands was:

to distribute dividends to the Mongolian nation from the current and future planned profits of the large minerals deposits—Oyu Tolgoi, Tavan Tolgoi, Tsagaan Suvarga and Tumurtei—and provide a legal environment with Mongolia to have an advantage in the minerals extraction sector.¹⁶

Civil activity continued in 2007. For example, “[t]wo civil movements, Resolute Reform and Green Party, held protests against the visit of [director of Rio Tinto, Ivanhoe’s partner in Oyu Tolgoi project] and his meetings with the country’s leaders and parliament members.”¹⁷

Most recently, “[f]urther uncertainty hung over the plans ... of Canadian miner Ivanhoe Mines Ltd. to develop one of the world’s largest metal deposits, as riots broke out in Mongolia [on July 1, 2008] following the results of a disputed general election.”¹⁸ The massive Oyu Tolgoi copper and gold mining project was “the major campaign issue, with revenue from the mine seen as a potentially huge boon for the underdeveloped central Asian country.”¹⁹

The new provision about state participation in mining projects was a key legislative proposal by the executive branch but when the parliament deliberated the issue, it became clear that there were several other important issues in need of legislative change and consequently the Minerals Law of 1997 was revised as a whole.

Legislative change: taxation and revised Minerals Law

The revision of the Minerals Law of 1997 was adopted in July 2006 but it was preceded by another legislative measure which imposed a very high tax on minerals (copper and gold). Although the main focus of this section is the revised mining law, it is necessary to briefly discuss the taxation law because this law added significantly to the overall negative reaction among foreign investors to the 2006 revision.

Windfall profit tax law

The State Great Khural passed a new tax law on May 12, 2006.²⁰ The law was designed to impose 68 percent tax on gold and copper ore and concentrate when the price exceeded certain thresholds. Here are some of the reactions of the investor community to this law. According to one media report,

Mongolia has joined a growing list of countries trying to keep more of their resource wealth, slamming foreign miners in the East Asian country with a 68-per-cent tax on gold and copper production after prices for the metals pass certain levels. The surprise tax ... could still be vetoed by President Nambaryn Enkhbayar. It caused a storm of protest among companies that have assets in Mongolia and raised the question of whether mining companies that do business in poor parts of the world could come under increasing pressure to take less.²¹

However, “[h]opes among Canadian resource companies that Mongolia would scrap a windfall tax on gold and copper mines were dashed [soon] with reports that the country’s President had not exercised his right to kill the bill.”²² Some companies were not as concerned as they are protected by stability agreements.²³ But others with plans to invest were monitoring developments with concern.²⁴

The actual text of the law is confusing and difficult to understand.

Reports indicated that the new law would impose taxes starting at 68 percent when the price of gold reached \$500 an ounce and copper touched \$2,600 a metric ton. ... Gold has been trading above that since December, while copper last traded at that level in September 2004.²⁵

There were even stronger criticisms. “The windfall profit tax ‘makes no sense’ and is ‘very poorly thought out,’ said Ranjeet Sundher, president of Red Hill Energy, which has two coal projects in Mongolia.”²⁶

Ivanhoe president and chief executive John Macken said “he did not expect the tax to compromise the company’s plans, but he was disappointed it had remained an unamended statute and that it sent a negative message to foreign investors.”²⁷ “We expect that the parliament will address the excessive and now redundant measures within this law in due course,” he added.²⁸

It is difficult to pass a judgment on the tax law. From a purely legal point of view it is the sovereign right of the host country to introduce and change laws provided that certain basic rule-of-law principles such as generality, public knowledge, and prospective application are complied with. But, from a policy vantage point, Mongolia may have hurt its reputation among foreign investors by succumbing to short-term gains from temporary commodity price increases. However, a better, longer-term perspective is being developed under the revision of the mining laws.

Revision of mining law of 1997

The windfall profit tax law was followed after two months by a major revision of the 1997 minerals law on July 8, 2006.²⁹ At a mining conference later, the law was explained to major investors. Under the revised law, “government will be able to intervene and oversee the running of strategic projects to fulfill a gate keeping role. This will promote favorable environment for the miners and

investors alike. The new law also allows investors to participate in any decision-making by presenting their proposal.”³⁰ The government’s regulatory role in the mining industry was expanded significantly and justified as follows: “[t]he involvement of government will stabilize the project by lowering any risks that may face a project, such as the issue of the infrastructure, power and water supplying permission. However, it would not control the projects, only prevent exploitation and provide a stable business environment.”³¹

The most contentious new provision of course is the government’s right to invest up to 50 percent in projects to develop state-found strategic mineral deposits and up to 34 percent in privately found deposits. It is also notable that the revised law adopts the notion of an “investment agreement” instead of a “stability agreement.” Initially, changes to Mongolia’s minerals law adopted the principle that “the government [would] earn the right to gain equity in future mineral deposits *dependent upon the amount of funds the state contributes* to the exploration and definition of the deposit.”³² Ivanhoe Mines “[welcomed] the decision of Mongolia’s government not to participate in the development of future mineral deposits discovered by privately funded exploration and mining companies.”³³

If this initial principle continued to apply, it would award risk-taking and encourage further investment in exploration. However, the Mongolian legislator somehow decided to reserve its right to invest up to 34 percent in privately discovered deposits. After negotiations with the government, Ivanhoe apparently began to realize some benefits from government participation in the Oyu Tolgoi project and withdrew from its earlier position.³⁴ Finally, Ivanhoe agreed to this essential term and signed a draft agreement.³⁵ Unfortunately, the agreement failed to receive approval by the parliament of Mongolia.³⁶

The most significant revisions of the old minerals law of 1997 can be identified. The state will determine by agreement its stake in deposits discovered as a result of state-funded exploration (Article 5.3). This provision applies to past rather than future exploration. There is little prospect for state-funded exploration in the foreseeable future. There were cases when foreign and domestic investors obtained mining licenses free of charge for deposits already discovered by the state during the communist era. There is another similar provision (Article 5.4), which applies to so-called “strategically important deposits.”³⁷ In this case, the legislator stipulates that government stake can be up to 50 percent. But it also provides for a government stake even in privately discovered deposits albeit up to a lower ceiling of 34 percent.

The powers of the legislative body are expanded to include the power to determine which deposits are strategically important (Article 8.1.4) and the percentage of a government stake in any such deposit (Article 8.1.7), and to ban exploration and mining in certain designated areas (Article 8.1.5).

An investment agreement under the new law differs significantly from a stability agreement under the old law. The amount of initial investment required to qualify for an investment agreement has been raised 25 times from US\$2 million to US\$50 million (Article 29.1). Unlike the old provision on stability

agreement, the content of an investment agreement is suggested: 1) a stable tax regime; 2) the investor's right to sell products at international prices; 3) the investor's right to invest locally or expatriate earnings; 4) the duration and size of investment; 5) environmental provisions; 6) restoration; 7) prevention of side effects of operation; 8) contribution to regional development and creation of jobs; and 9) compensation of losses. Most of these repeat the old law. However, "contribution to regional development and creation of jobs" is a new provision.

The duration of an investment agreement has doubled to a maximum of 30 years and varies depending on the size of initial investment as follows: for ten years for investment over US\$50 million, 15 years for over US\$100 million, and 30 years for over US\$300 (Article 29.3).

Understandably, the investor community has concentrated on those provisions that may directly affect their corporate interests. But there are some crucial changes that have great importance for Mongolia as a host country. The old law of 1997 provided that a stability agreement would be signed by the financial minister on behalf of the government. The parliament had no involvement. By contrast, an investment agreement is to be made jointly by three ministers in charge of finance, mining and environment upon authorization by the cabinet (Article 29.2). And the cabinet's mandate is limited to investments up to US\$100 million. Above that amount, any investment agreement is subject to discussion in the parliament (Article 29.4).

By way of an exercise of its power to determine which deposits are to be classified as "strategic," the parliament of Mongolia passed a resolution on February 6, 2007.³⁸ There two annexes to this resolution. Annex 1 contains 15 deposits with proven reserves. The resolution states that three of these would not be affected as they are protected by stability agreements. Four large deposits, including Oyu Tolgoi, are identified as top priority. In Annex 2, there are 39 deposits are listed as potentially "strategic" subject to further determination.

Thus far, the revised minerals law seems to set forth a clear and predictable set of rules of the game. Unfortunately, before and after the parliamentary election in June 2008, further changes to the 2006 revised version of the minerals law threatened the investment climate in Mongolia because of legislative proposals by two groups of legislators (15 members on March 14, 2008 and four other members on April 21, 2008 respectively).³⁹ One key idea of these proposals was to raise the government stake from 34 percent up to 51 percent.

Eventually, the parliament of Mongolia dismissed the two legislative proposals and authorized the government to continue negotiations on Oyu Tolgoi and Tavan Tolgoi, the two largest mining projects.⁴⁰ The most important part is the two identical annexes containing "the basic principles and terms of reference for concluding an investment agreement on joint exploitation of the strategically important" Oyu Tolgoi and Tavan Tolgoi projects.⁴¹

According to the resolution, the government is to comply with the current legislation and the annexes but may propose legislative amendments, if necessary. It is given two alternatives to offer to the investor: 1) the ownership stake of the Mongolian side be initially 34 percent and, upon recouping initial

investment, be raised up to 50 percent; or 2) a production-sharing mechanism. A company is to be established for the purposes of each project. The Mongolian side is to retain the right to directly hold 34 percent of its shares. The capital to be invested by the Mongolian side is to be permissible in the form of tax revenues, royalties, dividends and loans. Advance payment of some portion of the royalty and tax is to be agreed. New infrastructure development (electric power, water, railway, roads) and regional social and cultural development are to be part of the package. The project is to aim at producing finished products and therefore agreement must be reached on the production stages and product variety. There must be plans and programs for training national professionals to be employed in the projects.⁴²

Legal challenge of FDI-intensive economic development: oversight of ministers and investors

From the preceding discussion, it seems possible to make two main references about an emerging national development perspective on FDI and the inescapable regulatory role of the State in implementing such a perspective. While these are policy issues, the legal challenge to FDI-intensive economic development in Mongolia lies in making sure that there are mechanisms to oversee the government's dealings with foreign investors, especially large and influential multinational firms.

A national development perspective on FDI: combining mining and infrastructure development

Mongolia is a country with a small population relative to its vast territory. Economic development is concentrated mostly in the capital city and partly in two other big cities. Regional development has become a major challenge. The main obstacles to development in rural Mongolia have been poor infrastructure such as lack of a railway and highway network, inadequate electric power generation, and scarce water supply. The new mining law of 2006 which combines FDI with a government stake in strategically important mining projects may be regarded as a strategic choice made by Mongolia to meet its economic development challenges. The idea of a government stake should not be viewed merely as a desire to earn a larger share of revenues from the mining industry. It may also be motivated by the necessity to ensure the government's role in project decision-making so that areas of overlapping corporate interests and national development priorities can be identified and exploited. Different views have been expressed both supporting and opposing the possibility of such an approach to FDI.

Nationalism and resources curse

One commentator argues that "failure to specify if and how [the government] would pay compensation or fund a share of the billion-dollar development costs

has spooked foreign investors.” Ordinary Mongolians “are increasingly disillusioned with the failure of their leaders to deliver the promised mineral riches amid regular reports of corruption” while “more than a third of Mongolians living below the poverty line.”⁴³ This view points to the fact that Mongolia lacks the ability to raise enough capital to inject into mining projects. While this might be true, there seem to be ways to solve this problem as suggested by the readiness of certain foreign investors to cooperate. The point about corruption is a serious one. However, this is part of the overall need to have a broader view of the rule of law in Mongolia, meaning a constitutional structure where different branches of government are able to serve as a real check on one another.

The World Bank’s representative in Mongolia, Arshad Sayed, says “Mongolia’s abundant natural resources could propel the country into a brighter future—if it can avoid the ‘resources curse.’ The resources curse, for lack of a better word, is a serious issue that affects many countries that discover natural resources.”⁴⁴ This view is basically alluding to the problem of political corruption in Mongolia.

A small party leader in Mongolia, Mrs. Oyun thinks that

the 1997 minerals law was good but says ‘resource populism’ or ‘resource nationalism’ has now taken hold and both the public and the Government has overreacted to a perceived fear that they were being exploited. We are now at the crossroads. Either we go the better road where both investors are happy and the country benefits as well or vested interests may prevail.⁴⁵

This is again a concern about corruption.

However, Sayed agrees that “there are signs that Mongolia is more or less on the right track. A draft 15-year strategy plan has been completed and the Government has set up an anti-corruption agency supported by the World Bank. Compared with many developing nations, Mongolia has a comparatively stable and open political system.”⁴⁶ Supporting his optimistic view, Canadian geologist Thomas Drown says that:

certain factions in the Government were sincerely trying to do the best for the people.... At some points it might not appear to be the majority. ... There are lots of individuals in political positions and high bureaucrats who are looking for the quick or fast benefit for themselves, but that applies to Canada as well, it’s just a little more overt here.⁴⁷

Michael Howard, a British MP and former leader of the Conservative Party, is of the view that “whatever political make-up [the politicians] have, it’s in their own interest and the people they represent to encourage foreign investment, which is absolutely critical to the development of Mongolia.”⁴⁸

[I]n order to encourage foreign investment, they have to be reasonable in their demands. I’m very keen that the development that takes place should

benefit the people of Mongolia. But the government of Mongolia has to strike the right balance between ensuring the people of Mongolia get their fair share of the benefits, and that foreign investment is not discouraged or deterred.⁴⁹

Similar views are expressed by others, too.⁵⁰ That even those Mongolian politicians actively involved in state participation discourse are acutely aware of the problem of corruption is witnessed by a sharp remark by one of the Democratic Party leaders.⁵¹

To sum up, the idea to jump-start national economic development by regulating the FDI in Mongolia's mining industry is not rejected but is only cautioned against over concerns about political corruption. More specifically, the concern seems to be that the economic and political elite may be trying to enrich themselves by changing the laws, using the rhetoric of national economic strategic interests.

The view of the investor

A national development approach to FDI depends on cooperation by investors. At least, there must be a basic willingness on the part of investors to contribute to the host country's economy. In this regard, Ivanhoe's position can be taken as an example. In one of the latest public statements emanating from the company, we can see a summary of what has been done so far and what lies ahead from the company's own perspective.⁵² Keith Marshall, managing director of the Oyu Tolgoi project, made an important speech at Discover Mongolia Forum in late 2008. Here is an analysis of his speech.

As to the current status of the project, the speaker indicates that, because of delays in concluding an investment agreement, there has been "a significant slowdown in the pre-construction activity" with "a loss of human resources and a curtailment of spending." Nevertheless, there has been "some progress on the exploration front and with our underground development." The benefits of Oyu Tolgoi project are limited to creating jobs,⁵³ transferring skills to local miners,⁵⁴ subcontracting with domestic businesses,⁵⁵ and investing in local communities.⁵⁶ This is what has been done so far. The company is committed to maintaining the momentum into the future.⁵⁷ However, the essential point is that the benefits of Oyu Tolgoi are going to be largely *local* not *national* even though the speaker says:

Oyu Tolgoi is, first and foremost, a Mongolian project. So when we talk about results we are talking about results that immediately will begin to benefit Mongolians. And, more specifically, we are talking about long-term results and a commitment by the investors to ensure that those benefits reach the general population.⁵⁸

The speaker repeats the phrase "an *acceptable* investment agreement" several times (emphasis mine). He also regards the great debate in Mongolia surrounding

the mining sector as “unnecessarily protracted” and “unproductive.” All of this leads to the conclusion that we can hardly expect the investor to be receptive to a national economic development perspective on FDI. Then, the speaker directly attacks the government of Mongolia. “The discovery of world-scale deposits usually is the hard part. However, that has not proved to be the case in Mongolia. Here, the hard part has been the negotiation of an acceptable investment agreement and the ratification of the State Great Khural.”⁵⁹ The investor seems to disfavor the idea of a government stake in the project. Numerous eminent economic advisors have concluded that

state equity participation is not a good idea. They say that the money the Government would be required to invest would give much more beneficial returns if it was directed to education or to much needed infrastructure. Governments should not be deceived by the stellar returns of the last few years; they are the exception, not the norm.⁶⁰

One last important point touches upon the speaker’s view as to how diversification of the economy should occur. Picking up on the resources minister’s speech during a recent World Bank-sponsored economic forum, he says,

Quite sensibly, Zorigt also talked about diversification of the economy. This diversification must be on top of, not instead of, growth in the mining sector. Diversification will follow once we establish a robust mining sector. Just look at the successes of mineral-rich countries like Australia and Canada.⁶¹

The regulatory role of the state

This is the second policy issue that needs justification to support the national development approach to FDI in Mongolia. That the regulatory role of the State is essential in meeting national development challenges through regulation of FDI is implicit in the previous discussions. But it is helpful to explicitly make a few points in this regard.

The failure of the transition from plan to market means a lack of a sound and facilitative institutional framework for corporate governance and equity markets. In practice, this failure leads to a scarcity of domestic investment capital and reluctance of even large domestic companies to take higher risks by entering new industries and operating large infrastructure projects. Thus, lack of industrial diversification and under-development of infrastructure are two “bottle-necks” in Mongolia’s nationwide economic development.⁶²

This situation has in recent years increased the role of FDI by multinational mining corporations. FDI in the mining sector offers both revenues to invest in diversification and infant industry development and opportunity to build infrastructure in rural parts of Mongolia that will be needed anyway for mining operation. Here, the state has to act respectively as the receiver of revenues from mining (also the reinvestment decision-maker) and as the planner for infrastructure projects.

This regulatory role of the State will be best served if the government is able to inject all available domestic capital into the mining operation so as to increase revenues and to act as one of the controlling shareholders and participate in decision-making within the mining projects.

At the start of this discussion, I have raised the issue about the rule of law. Having found some support among various commentators and influential stakeholders for a national development perspective on FDI in Mongolia and the regulatory role of the State that this perspective requires, it seems possible to continue exploring further the need to see the government within a broader rule-of-law framework founded on separation of powers. This question, however, cannot be adequately addressed without a discussion of the outcome of Mongolia's constitutional crisis of 1996–2000,⁶³ which profoundly affected the principle of separation of powers enshrined in the country's new Constitution of 1992.

Oversight of government/investor relationship

Concerns about corruption

One important aspect of the government/investor relationship under the new mining law is the question of corruption. If corruption were not an issue in Mongolia, everybody seemed to agree that the country could successfully pursue a more ambitious approach to FDI in order to meet its economic development challenges of course provided that the approach is not too ambitious to discourage FDI. The discussion above has revealed that there are real concerns about corruption especially as regards the government in Mongolia. The views of several important people seem to suggest that there is a significant difference between the 1997 minerals law and the 2006 revision of that law. This difference, as they seem to suggest further, lies in that the old law avoided corruption while the new law invites it.

Let me first refer to a study into corruption in Mongolia in general. A recent USAID study on corruption in Mongolia finds that the mining sector is one of the emerging areas of corruption.⁶⁴ The study also finds that “by far the most problematic characteristic of corruption in Mongolia is elite-level corruption.”⁶⁵ However, consistent with the optimism held by outsiders as mentioned above, it identifies some signs of hope taking a comparative perspective:

While corruption in Mongolia is certainly serious, it is important to keep the situation in perspective. It does not appear that corruption has reached the cancerous and extortionary levels that typify the world's “worst cases.” For several reasons, corruption in Mongolia is not yet as deeply entrenched as it is in many post-Communist countries, especially the Central Asian countries to which Mongolia is most often compared. Nor are the problems facing anti-corruption efforts nearly as serious in Mongolia as they are in countries facing conflict and grinding poverty.⁶⁶

Nevertheless, it is more realistic to maintain a cautionary, pessimistic outlook on corruption in Mongolia especially in the government/investor relationship which is a possible new site of elite-level corruption. In early 2004, Ivanhoe Mines bought US\$50-million in Mongolian government treasury bills to help the country retire Soviet-era debt held by the Russian Federation. Repayment was promptly made.⁶⁷ However, the deal sparked criticisms. This deal was the first time Ivanhoe's contact with the government caught public attention. It occurred during the term of the Communist Party dominated cabinet from 2000 to 2004 headed by Mr. Enkhbayar, who was later elected President after serving as Prime Minister. This controversial loan deal showed that the relationship between the investor and the cabinet needs to be closely watched.

The Mongolian government was "looking for a financial benefactor. Burdened with a massive Soviet-era debt, it wanted to eliminate the debt to bolster its popularity as an election approached."⁶⁸ That is when Ivanhoe stepped in.

While providing this generous favor to a cash-strapped government, Ivanhoe was simultaneously trying to extract a package of tax concessions from that same government for its Oyu Tolgoi gold and copper project in the Gobi Desert of southern Mongolia.⁶⁹

Opposition politician Elbegdorj, a former prime minister of Mongolia, said "the deal could put the government in a conflict of interest in relation to Ivanhoe. He [said] the loan was negotiated clandestinely. 'It's the old way of doing things—keeping things secret.'"⁷⁰ Prime Minister Enkhbayar said

the \$50-million loan could be seen as a conflict of interest during the current negotiations. But he defended the deal. "We see it as an important signal that Ivanhoe wants to develop the Oyu Tolgoi project, not just to sell the project and quit the country," he said in an interview. "They have shown this goodwill. Both parties are being honest."⁷¹

The US\$50 million loan deal between Ivanhoe and the government of Prime Minister Enkhbayar (2000–2004) occurred while both sides were negotiating a stability agreement. The money was used to settle a debt with Russia. As has been discussed, this deal sparked criticisms and suspicions that Ivanhoe may seek and get substantial concessions from the government on tax and royalty issues.

The head of Mongolia's mineral resources authority said

the government is being careful to prevent any links between the \$50-million loan and the negotiations over the mining project. No favors will be given to Ivanhoe in exchange for the loan. . . . Ivanhoe wanted too many tax holidays and privileges that go beyond the legislation . . . Prime Minister, Mr. Enkhbayar, said the Canadian company had been "too demanding" in the negotiations.⁷²

Although the loan deal was over within a year and can no longer serve as leverage by Ivanhoe, it is a real example of how corruption may affect the government/investor relationship.

The unusually long delays by the government of Mongolia in concluding an agreement with Ivanhoe may be signs of fierce competition among different political factions and financial/industrial groups over who will control the project or lack of agreement as to how they can share the benefits. On such a conspiratorial view, the whole idea about a national development approach to FDI and the regulatory role of the State would turn out to be a sham or an empty rhetoric.

Against this background, I now return to the issue I have raised at the outset of this discussion. Is there really a difference between the 1997 mining law and the 2006 revision in addressing the concerns about corruption? I doubt there is a difference if we take Mongolia's economic development as a yardstick. The 1997 mining law created a favorable regime for FDI in the sense that the government of Mongolia would not interfere with foreign investors and its role would be limited to collecting taxes and royalties. The idea is that the revenues from mining should be properly allocated by the government in the interests of economic development. However, in this scenario, corruption is a huge issue, too. There is an immense competition among domestic companies to have access to nation-wide development projects funded by revenues from mining. They tend to use their political connections and influence to prevail in this competition. Moreover, once the winners are determined, there is a lack of effective institutional mechanisms to ensure performance in the best interests of the country.

The 2006 revision of mining law permits a government stake in mining projects. It is true that this provision invites corruption. However, there are other provisions that see the mining operation and regional development as one package. In this scenario, domestic companies will have to deal with not only the government but also the foreign investors to win a bid and participate in, for instance, infrastructure projects needed for the operation of the mine at issue. This might reduce corruption significantly, owing to the advanced corporate practice that the foreign investors offer. This might be regarded as a kind of institutional "spillover" effect of FDI.

Bargaining

A national development perspective on FDI has to be implemented by means of regulation. While regulation can define only the general conditions such as state participation in financing mining projects, the specific terms of individual projects have to be agreed on a case-by-case basis. This will involve a great deal of bargaining as part of the government/investor relationship. Remember that "government" here means the cabinet of ministers that directly deals with investors.

When it comes to bargaining, the famous "obsolescing bargain theory"⁷³ posits that the bargaining power rests with the multinational corporation at the beginning and then it shifts to the host state (meaning both the cabinet and the

parliament) in resource extraction industry. To induce the firm to accept the risk of investing in the economy, the host government offers a range of concession agreements, such as tax holidays, that promise lucrative profits for the foreign investors. Once the investment has had a few successful years of operation, however, the perceived risk to the firm drops and the host country begins to perceive the high returns garnered by the corporation as inappropriate.

The increased pressure on the host state to raise demands on the investor and the *ex post* immobility of the multinational corporation create a situation where the attractive agreement first carved out by the corporation will inevitably “obsolesce.” Theoretically, obsolescence can take the form of renegotiated contracts, higher taxes, expropriation of assets, or seizure of the income stream of the firm. As Raymond Vernon, who first developed this theory, put it elegantly, “almost from the moment that signatures have dried on the document, powerful forces go to work that render the agreements obsolete in the eyes of the government.”⁷⁴ The bargaining advantage now rests with the host country.

Contrary to the above theory’s assumption about the conflicting nature of the host/investor relationship, the Mongolian case seems to present a more cooperative scenario. The crucial fact is that the long-delayed agreement with Ivanhoe may be much more complicated than a tax and royalty pact. If a simple agreement were hastily ratified (one draft agreement signed by the government failed to obtain parliamentary approval), it would be constantly threatened by renegotiation as the obsolescing bargain theory rightly predicts. The Mongolian State seems to be aware that it is critical to achieve a mutually beneficial agreement now to avoid future complications with the investors, which would damage its reputation as a capital importer.

Mongolia’s constitutional amendment as a response to the challenge of FDI

In the preceding sections, it has been suggested that Mongolia is pursuing an FDI-intensive economic development strategy but the legal challenge is to ensure oversight of ministers and foreign investors. Now it will be argued that Mongolia may be said to have partly responded to this challenge, which is evidenced by what is referred to here as “Mongolia’s constitutional crisis.” Mongolia has a parliamentary form of government according to its new 1992 Constitution. Thus, a majority in the State Great Khural (parliament) forms and changes the cabinet. The head of the state is a popularly elected President with a veto power. Two major political parties have dominated the politics. They are the MPRP (the old Communist Party) and the Democratic Party.

At the heart of the crisis was the choice between two options as regards the personnel in the legislative body and the cabinet of ministers: *strict separation* between individuals serving in parliament and government and *non-separation*, that is, allowing the same individuals to serve as legislators and ministers simultaneously. After a long and difficult process, the choice was eventually made in favor of *non-separation* after a constitutional amendment was agreed to by the two

major political parties, albeit in circumvention of the country's Constitutional Court which had insisted on *strict separation*, pretending that this flowed from the Constitution. Now the choice has been made, it is time to think about its implications for separation of powers, especially between the legislative and executive branches of Mongolian government. In this regard, there are two main opposing views. Tom Ginsburg and Gombosuren Ganzorig defend the choice made by Mongolia because strict separation would have resulted in certain deficiencies:

The insulation of the government from parliament certainly weakened democratic accountability. Neither the chief executive nor any member of his cabinet had won an election. This strange result seems anti-democratic. The usual principal-agent problems that exist between parliament and government in a parliamentary system were exacerbated by the lack of mechanisms for the parliament to discipline the government, and by the social and institutional distance created when cabinet members are not legislators. There was no opportunity for day-to-day policy debate, with the Prime Minister defending his policies before the public. Rather, government members had to be summoned to the parliament, and appear there as outsiders on an infrequent and extraordinary basis.⁷⁵

A diametrically opposite view is held by an influential constitutional lawyer in Mongolia, B. Chimid, who has defended strict separation from the very beginning of Mongolia's constitution-building process, being one of the architects of the 1992 Constitution. In a recent book he writes:

Mixing up legislative and executive powers is a serious mistake that undermines the political system. . . . As a result, party leadership, the State Great Khural, and the government all have almost the same personnel, which takes us back to one version of the pre-1990 regime. . . . A separation of powers means that one branch makes decisions and the other implements them. A strict adherence to this principle prevents concentration of power.⁷⁶

Ginsburg has reacted to this by saying, "Seems very formalistic. All in all, I think he is wrong on his prediction that composing cabinets from parliament will lead to instability. It ignores the crucial role parties play in smoothing out the short term interests of politicians."⁷⁷ The rationale of strict separation adopted in the French Constitution of 1958,⁷⁸ which B. Chimid has advocated for Mongolia, is questioned by one author as follows:

The idea of a parliamentary regime in which the members of the cabinet are forbidden to be members of the legislature, although they remain responsible to that legislature, is a little difficult to grasp. This separation of personnel was necessary, according to M. Janot, to avoid the temptation, to which deputies succumbed in the Third and Fourth Republics, of defeating the government in the hope of office.⁷⁹

Akin to the concern about “temptation ... of defeating the government in the hope of office” as in the above quote that mentions the French system, B. Chimid has expressed the view that the drafters of the constitutional amendment of 2000 were motivated by a selfish desire not only to get elected to parliament but also become ministers.⁸⁰ Even before the amendment, the ambiguity of the rule in question allowed simultaneous occupation by the same person of ministerial and legislative seats. Indeed, since 1992, Mongolia has seen ten cabinets come and go during five parliament terms. Two parliament terms, 1996–2000 and 2004–2008, had four and three cabinets, respectively. But B. Chimid’s theory also predicts that all or most ministerial posts would be filled by parliament members in most of the ten cabinets. This can be tested easily.⁸¹ In each of the ten cabinets, the percentage of ministers who were also MPs at the same time varies greatly but it has never reached 100 except for one case.

B. Chimid also makes a point about the small size of Mongolian parliament, which has 76 seats.⁸² If we suppose that the quorum is set low and close to 20 cabinet members vote in the parliament, the cumulative weight of their votes may be close to a majority. In other words, ministers may be able to make laws to fit their personal interests. However, assuming the possibility of such cabinet domination over parliament, this argument does not take account of the equally forceful motivation on the part of parliament members to resist it.

Thus, I have briefly analyzed the implications of the outcome of Mongolia’s constitutional crisis of 1996–2000—the adoption of non-separation of ministers and legislators as a rule of constitutional law, which seems to be the right solution in the sense that at least its apparently negative effects are not confirmed. It should be remembered that there was a quiet high probability for adopting the other option as witnessed by the fact that the Constitutional Court of Mongolia struck down several legislative proposals to adopt non-separation and ruled consistently in favor of strict separation.

FDI and the Rule of Law in Mongolia: taming ministers/legislators

In the particular context of Mongolia, FDI-intensive economic development is confronted with the legal challenge of overseeing government/investor dealings. One response to that challenge is evidenced by Mongolia’s constitutional crisis. The response is to permit legislators to serve as ministers simultaneously. However, in the absence of strong adherence to the rule of law, there is a potential for undermining the separation of powers.

From the perspective of the rule of law, this mainly required a guarantee that the government will adhere to the existing law and will not renege on its promises. However, recent events leading to the 2006 revision of the mining law as well as the implications of this revision have placed new demands on such a minimal concept of the rule of law understood as government bound by law and its contractual obligations.

In the preceding sections, I have described recent developments surrounding the mining law of Mongolia and foreign investors. Thus, through executive action followed by legislative change, the old foreign investment regime under the 1997 minerals law, for better or worse, has been significantly reformed. The important point is that the rule of law has been respected in the sense that all existing stability agreements remain in force and unaffected by the new rules. The government's failure to conclude an agreement with Ivanhoe may not be regarded as a violation of the rule of law because there was and is no time frame in the old and new mining laws. Although changing the rules of the game has not led to any rule-of-law problems, it places new demands on the rule of law in the mining industry of Mongolia. Under the old law, a stability agreement required only an *ex post* commitment on the part of the government to keep certain existing or negotiated tax and royalty rates unchanged for the duration of the agreement. However, under the new law, the government is going to have a wider range of issues to negotiate with investors *ex ante* and therefore to be given much greater discretion. There need to be legal and institutional mechanisms that can ensure a proper exercise of this discretion. In this situation, the rule of law understood narrowly as government bound by its own past promises is no longer adequate. We need to place the government in a broader rule-of-law system that is based on the principle of separation of powers.

But in order to continue this analysis of the new demands on the rule of law in relation to FDI in mining industry of Mongolia, it is necessary first to address two policy issues—national developments concerns and the regulatory role of the state.

At the beginning of my analysis of recent developments affecting FDI in the mining industry of Mongolia, I have touched upon the rule of law. Having made that analysis and a survey of Mongolia's constitutional crisis, it is now possible to return to it in a more extended discussion. For a national development approach to FDI in Mongolia to succeed and for the essential regulatory role of the State to be effective, we need first to closely examine the different aspects of the relationship between the government (cabinet) and the investor. It will follow from here that the rule of law previously understood narrowly as government limited by law can no longer serve the practical needs of FDI in the mining sector of Mongolia. There is a need for a broader understanding of the rule of law in its constitutional aspects, especially, with separation of powers at its core. The particular issue most relevant to FDI in Mongolia's large mining projects is the relationship between the executive and legislative branches of government. It is particularly useful to examine this relationship in the context of the final outcome of Mongolia's constitutional crisis discussed above.

The reality of FDI in the mining sector of Mongolia is such that a minimal concept of the rule of law understood as government bound by its promises simply falls short of the practical need at present. The government/investor relationship has become the most crucial and unavoidable structural issue that multinational enterprises are facing in today's Mongolia. Corruption and bargaining are two important aspects of this relationship. The practical necessity to place it

in a legal and institutional framework first of all requires extending the minimal concept of the rule of law to constitutional issues, especially separation of powers. The analysis thus shifts from the government/investor relationship to the executive/legislature relationship in the particular context of FDI in Mongolia.

The USAID study mentioned earlier points out that it is crucial to ensure “public and legislative oversight of government affairs.”⁸³ Public oversight is a question of strengthening civil society in Mongolia and falls outside the scope of this paper. Legislative oversight of government is one aspect of separation of powers and hence of an extended concept of the rule of law. The same study further finds the following:

The domination of a single party (and its counterpart, the weakness of opposition parties) in Mongolia, along with a Parliamentary political structure that gives significant executive power to the dominant party in the legislature, constitutes a major roadblock to reform of the conditions that foster corruption. The “winner-takes-all” nature of politics makes the current system an attractive target for criticism by those on the outside, but a dearly-held prize for those on the inside.⁸⁴

This conclusion seems outdated because the politics since 2004 has changed considerably. The two major parties have entered a power-sharing deal twice. After the election in 2004, they reached an agreement to run the government for two years each. In 2008, they agreed on a coalition government although the MPRP won a majority in parliament and had the power to set up its own government.

Remember that the 2006 revision of mining law introduced a new requirement that mining projects above US\$100 million must be discussed in the legislative organ. This provision provides the legal basis for legislative oversight over the government affairs with foreign investors. This is, however, still not sufficient. We need to look at the separation of powers between the executive and legislative branches of government in Mongolia. For legislative oversight to be effective, the constitutional rule about non-separation of ministers and legislators plays an important role. This rule was the final outcome of Mongolia’s constitutional crisis of 1996–2000.

The ability of the parliament of Mongolia to control the government’s deal with foreign investors by legislation so as to minimize discretion is severely limited as it is witnessed by the vague and general principles and terms of reference adopted by the parliament on December 4, 2008.⁸⁵ Parliament and government are in a principal–agent relationship. Government’s self-dealing or lack of willingness and skills to bargain in the best interests of the country may lead to a bad deal with foreign investors from the perspective of the parliament. In that case, the parliament can exercise its power to change the government. Owing to the flexibility of the non-separation rule, the composition of government can be decided to fit the need, depending on the availability and suitability of individuals not only from the parliament but also from outside.

To conclude, recent developments in Mongolia have profound rule-of-law implications for FDI in the country's mining sector. The rule of law needs to be understood in its broader, traditional sense of a government based on separation of powers with checks and balances between the different branches of government. The situation in this regard has so far been relatively promising but it should be born in mind that the security of foreign investors and their multi-million dollar investments are being subjected to even more serious political risks when government is involved and the constitutional framework is still uncertain.

Conclusion

In this final conclusion, I return to some of the issues raised in the Introduction. It was asked what the alternatives were to the concept of the rule of law advocated by international development practitioners. With the launch of market law reforms, post-Soviet Central Asia was imposed a concept of the rule of law that emphasized a liberal regime for FDI with minimum state involvement. The case of Mongolia demonstrates that this concept is no longer adequate and needs to be broadened to take account of constitutional issues because state involvement has become an inescapable reality. Therefore, given the shared post-Soviet background, other Central Asian countries are likely to pose a similar problem with the content of the rule of law that should be promoted there. The relevance of

Table 6.1 The changing percentage of elected ministers in the Mongolian government since 1992.

| <i>Cabinets</i> | <i>Total number of ministers, including Prime Minister</i> | <i>Number of ministers who were also MPs</i> | <i>%</i> |
|--|--|--|----------|
| PM Jasrai, MP (July 21, 1992–July 1996) | 18 | 4 | 22.2 |
| PM Enkhsaikhan, non-MP (July 19, 1996–April 22, 1998) | 10 | 0 | 0 |
| PM Elbegdorj, MP (April 23, 1998–July 24, 1998) | 10 | 10 | 100 |
| PM Narantsatsralt, non-MP (December 9, 1998–July 23, 1999) | 10 | 0 | 0 |
| PM Amarjargal, MP (July 30, 1999–July 26, 2000) | 10 | 0 | 0 |
| PM Enkhbayar, MP (July 26, 2000–August 13, 2004) | 13 | 4 | 30.7 |
| PM Elbegdorj, non-MP (August 20, 2004–January 13, 2006) | 18 | 13 | 72.2 |
| PM Enkhbold, non-MP (January 25, 2006–November 8, 2007) | 18 | 5 | 27.7 |
| PM Bayar, non-MP (November 22, 2007–September 11, 2008) | 16 | 6 | 37.5 |
| PM Bayar, MP (September 11, 2008–present) | 15 | 9 | 60 |

constitutional issues thus may become a vital part of future research into the law and development situation in the rest of Central Asia. The capitalist development in the West is often explained by the rule of law understood as a legal regime that protects private initiative from state intervention. The experience of Central Asia may refute this idea and, consequently, reinforce the argument about the “otherness” of Asia as a whole.

Notes

- * Sukhbaatar Sumiya is vice-governor, Dundgobi province, Mongolia.
- 1 The five Central Asian republics of the former Soviet Union and the dates of their declarations of independence: Kazakhstan (December 16, 1991), Kyrgyzstan (August 31, 1991), Tajikistan (September 9, 1991), Turkmenistan (October 27, 1991), and Uzbekistan (September 1, 1991). Mongolia was also freed from its de facto full dependence from the Soviet empire after the fall of the Berlin Wall.
- 2 Mark K. Dietrich, *Legal and Judicial Reform in Central Europe and the Former Soviet Union: Voices from Five Countries*, Legal Vice Presidency, the World Bank, 4–6 (2000).
- 3 The World Bank, *Mongolia Mining Sector: Managing the Future*, 51 (2005).
- 4 *Mongolian Official Says Foreign Investment Continues to Grow*, BBC Worldwide Monitoring, May 26, 2004 (source: The Mongol Messenger web site, Ulaanbaatar, in English, May 26, 2004).
- 5 Robin Bromby, Mongolia Attracts Ivanhoe, *The Australian*, February 19, 2001, at 39. (reporting the announcement by Ivanhoe that “it might be on the track of a huge copper-gold deposit in Mongolia, possibly as big as 750 million tonnes”); *Ivanhoe Mines Makes Another High-Grade Discovery of Gold and Copper at the Oyu Tolgoi Project in Mongolia: Discovery Remains Open to Expansion in All Directions*, December 8, 2008, www.ivanhoe-mines.com/i/pdf/08Dec08-new-OT-discovery-release.pdf (reporting the most recent update on the exploration progress); *Exploration History of Oyu Tolgoi Gold and Copper Project, Southern Mongolia*, www.ivanhoe-mines.com/s/OyuTolgoi.asp#mrs.
- 6 There are numerous reports on different factors that caused delays. Ivanhoe Granted Mongolian Mining Licenses, *The Globe and Mail* (Canada), December 24, 2003, at B4; Scott Adams, Ivanhoe Faces Desert Storm in Mongolia: Delays Cloud Outlook, *National Post's Financial Post & FP Investing* (Canada), July 30, 2004, at IN1; Andy Hoffman, Ivanhoe Says Negotiations Haven't Begun in Mongolia, *The Globe and Mail* (Canada), November 30, 2006 at B13; Andrew Trounson, Rio Joins Ivanhoe in Gobi Copper Deal, *The Australian* (Australia), October 20, 2006, at 19; Ivanhoe Has Draft Deal for Oyu Tolgoi Project, *The Toronto Star*, June 28, 2007, at B02; Mongolian Cabinet Backs Oyu Tolgoi, *Metals Week*, July 2, 2007, at 8; Andy Hoffman, Ivanhoe Warns Delay May Cause Shelving of Mongolian Project, *The Globe and Mail* (Canada), September 12, 2007, at B8; Louise Egan, Emerson to Push for Ivanhoe Deal in Mongolia; Trade Minister Says He Wants to Discuss Delays in Approval for Copper, Gold Project, *The Globe and Mail* (Canada), January 9, 2008, at B4; Geoffrey York, Miners Could Pull Out, Emerson Warns Mongolia, *The Globe and Mail* (Canada), January 11, 2008, at B5; Peter Koven, Mongolian Opinion on Mining Shifts; More Positive Views May Aid Ivanhoe Project, *National Post's Financial Post & FP Investing* (Canada), October 17, 2008, at FP4; Andy Hoffman, Ivanhoe Cuts Jobs at Project in Mongolia, *The Globe and Mail* (Canada), December 3, 2008 at B7; Ivanhoe Welcomes Date for Deal with Mongolia, *The Globe and Mail* (Canada) December 6, 2008, at B8.
- 7 Wendy Stueck, Ivanhoe Watches as Mongol Government Falls, *The Globe and Mail*

(Canada) January 14, 2006, at B6. "Mongolia's coalition government has collapsed after the country's parliament voted late yesterday to accept the resignations of ten members of a 17-member cabinet. All those who resigned belong to the Mongolian People's Revolutionary Party (MPRP), which holds half the seats in Mongolia's 76-seat parliament."

- 8 Geoffrey York, For Ivanhoe, New Questions in Mongolia; Minister Wants 51% Government Stake; Miner Dismisses Remark as "Trial Balloon," *The Globe and Mail* (Canada) March 13, 2006, at B1.

9 *Id.*

- 10 Geoffrey York, Mongolia Ready to Grab Stake in Ivanhoe Mine; New Law Could See State Owning 34%, *The Globe and Mail* (Canada), September 13, 2006, at B1.

He argued that Ivanhoe should welcome a government stake in Oyu Tolgoi, since it would create more 'security' for the [investor] ... Mongolian government participation will create even more opportunities for Ivanhoe to raise capital on world markets.... If you have the government as your partner, you will enjoy more stability ... Do not be scared of government participation. ... Governments never go bankrupt. We reduce the risks inherent in a project. If foreign investors are unhappy with government ownership, they can simply leave the country. ... You can go to another corner of the world. We're not forcing anyone to stay in Mongolia. I have to work for the interests of the people, and they are demanding that Mongolia's resources be fairly distributed. They want to see government participation, so that the people can gain more of Mongolia's resources. We can't allow 100-per-cent private ownership.

- 11 Andy Hoffman, Mongolia Dumps Minister of Industry and Trade, *The Globe and Mail* (Canada), February 7, 2007, at B12.

Mongolia's parliament voted to remove Industry and Trade Minister B. Jargalsaikhan, according to local reports, ending a year-long term that saw the state tighten its control over the key mining industry. 'You are firing me illegally without any basis,' Mr. Jargalsaikhan yelled after the vote, which was broadcast live, Reuters reported. Known for frequent conflicts with foreign investors, Mr. Jargalsaikhan oversaw a new minerals law that gave the state a right to up to 34 per cent of mining deposits discovered by private funds.

- 12 York, *supra* note 8.

13 *Id.*

- 14 Drew Hasselback, Ivanhoe Faces Challenges at Two Asian Mine Projects: Threat to Production: U.S. Sanctions on Myanmar; Protests in Mongolia, *National Post's Financial Post & FP Investing* (Canada), April 6, 2006, at FP4.

Demonstrators gathered in Ulan Bator [on April 5, 2006] to demand the Mongolian government keep a large share of Oyu Tolgoi's resources.... Mongolia has been rife with rumors Ivanhoe has already signed a stability deal. A protest group called Resolute Reform has said it wants to sue the government over the supposed agreement.... Yet Ivanhoe points out that no agreement has been concluded. Analysts don't expect an agreement before June. Ivanhoe said yesterday it doesn't expect to reach an agreement until Mongolia's government has had a chance to amend mining legislation.... 'The company deeply regrets the fact that civic movements are misleading the Mongolian public by misrepresenting the real facts in order to further their own political interests,' the company said.

- 15 B. Bolortuya, *Mongolian Protesting Groups Give PM Deadline to Respond to Demands*, BBC Worldwide Monitoring, April 19, 2006 (carried in English by Mongolian news agency Montsame).

Ulan Bator, 17 April: Around 3.10 p.m. [local time], four ministers of the Mongolian Government for the National Solidarity held a meeting with the delegates of the civil movements arranging the political sit[-in] for 11 days on the Sukhbaatar Square. At the meeting, J. Batzandan, head of the Healthy Society Civil Movement, said that the prime minister, Mr N. Enkhbold, was informed to hold a meeting in personal with us. Unfortunately, the premier did not come himself and sent four ministers for representation. He handed over the demands from the civil movements to the ministers.

16 *Id.*

17 B. Bulgamaa, Protests as Rio Tinto Director Meets Mongolian Government (Text of report in English by Mongolian newspaper *The UB Post* website on August 23, 2007).

They felt that the real purpose of the visit and the meetings was to put pressure on all to speed up the ratification of the stability agreement. . . . O. Bumba-Yalagch, a leader of the Green Party, shouted in English that the draft does not serve Mongolian interests and as soon as a new draft which is fair to Mongolia is prepared the people will support it. . . . The protesters carried banners saying, ‘Don’t lead the country into a civil war,’ and ‘Don’t try to harm Mongolians by pressing for needless projects.’

18 Grant Surridge, Riots Cloud Future of Ivanhoe Project; Mine Key Issue in Mongolian Election, *National Post’s Financial Post & FP Investing* (Canada), July 2, 2008, at FP1.

19 *Id.*

20 Law of Mongolia “On Tax to Be Imposed on Certain Products with Increase in Price.” The purpose of the law is stated in Article 1(1): to impose tax on the additional income from increase in price of certain products.

21 Wendy Stueck, Miners Reel on Mongolia Tax Grab, *The Globe and Mail* (Canada), May 16, 2006 Tuesday, at B1.

22 Wendy Stueck, Mongolian President Fails to Veto Mining Tax, *The Globe and Mail* (Canada) May 27, 2006, at B3.

23 *Id.* One company said “[it] would not be affected by the law, as its tax rates are set under an agreement with the Mongolian government that is in effect until 2013.”

24 *Id.* “What we are seeing now, unfortunately, is a lot of politics and nationalism resulting from increased metal prices and concerns that Mongolia is not getting its fair share,” another company said.

25 Chia-Peck Wong, In Mongolia, New Tax Could Deter Miners, *Business Asia* by Bloomberg, *The International Herald Tribune*, September 13, 2006, at 21.

26 *Id.*

27 Ivanhoe Hopes to Finalize Mongolian Mine Contract, *The Toronto Star*, July 11, 2006, at D06.

28 *Id.*

29 Law of Mongolia “On Minerals.” The purpose of the law is “to regulate prospecting, exploring and exploiting minerals on the territory of Mongolia” (Article 1.1).

30 *Mongolia Briefs Investors on New Mineral Laws*, BBC Worldwide Monitoring, September 14, 2006 (Excerpt from report dated September 13, published in English by Mongolian newspaper *The UB Post* website on September 14).

31 *Id.*

32 Matthew Boyle, Ivanhoe Welcomes Lack of State Participation in Mongolia, *Platts International Coal Report*, December 19, 2005, at 13. (emphasis mine).

33 *Id.*

34 Wendy Stueck, Ivanhoe, Rio Tinto in Talks with Mongolia; Miners Seek to Reach Tax, Royalty Pact, *The Globe and Mail* (Canada), February 1, 2007, at B4. “It’s not a bad thing to have the government be your joint venture partner, especially when the

government is your regulator,” Mr. Friedland said. “There are a lot of benefits to bringing the government in as a shareholder in a project, and there are creative and interesting ways that can be achieved.”

- 35 Andy Hoffman, Ivanhoe Signs Mongolia Deal, *The Globe and Mail* (Canada), April 11, 2007, at B7; Mongolian Cabinet Approves Draft Agreement with Ivanhoe Mines, *Int'l Herald Tribune*, June 28, 2007 www.iht.com/articles/2007/06/28/business/mining.php; The Government's Stake Will Be Paid for Out of Dividends from the Project: Mongolian Smelter for Rio, *The Australian* (Australia), June 29, 2007, at 27.

The Government has waived threats to impose a windfall copper tax on the project in return for Ivanhoe agreeing to build or facilitate the construction of a copper smelter within five years of first production. Ivanhoe has also agreed to sell all the gold production at Oyu Tolgoi to Mongolia's central bank at international prices. The Government has also dropped threats to increase its shareholding entitlement beyond the already mandated 34 per cent. The Government's stake will be paid for out of dividends from the project. The fiscal regime includes a 5 per cent royalty as well as a corporate tax rate of 25 per cent.

- 36 Mongolia Withdraws Ivanhoe Pact from Review, *The Globe and Mail* (Canada), January 8, 2008, at B10.
- 37 Article 4.1.11 “strategically important deposit” means a deposit that can have an impact on national security or national and local socio-economic development or is producing or can potentially produce more than 5 percent of annual GDP of Mongolia.
- 38 A parliamentary resolution, dated February 6, 2007 lists 15 strategically important deposits, available in Mongolian at www.parl.gov.mn/parl/docs/RP/07-t-27.doc.
- 39 Peter Koven, Mongolia Proposal Chills Investors; “Strategic Deposits,” *National Post's Financial Post & FP Investing* (Canada), March 13, 2008, at FP14; Ch. Sumiyabazar, *Both Major Mongolian Parties Back New Mining Laws*, BBC Monitoring, March 13, 2008 (text of report in English by Mongolian newspaper *The UB Post* website on 13 March); Dow Jones, Mongolian Parliament Set to Give State Greater Control over Resource Sector, *National Post's Financial Post & FP Investing* (Canada), April 10, 2008, at FP6; Mongolia Mulling Mine Ownership, *The Toronto Star*, April 19, 2008, at B02; Lindsay Beck, Mongolia's Ownership in Mines Less Than Ideal, *The International Herald Tribune*, July 8, 2008, at 15; Ch. Sumiyabazar, *Mongolia Seen Backtracking on Nationalization of Mineral Deposits*, BBC Worldwide Monitoring, October 10, 2008 (text of report in English by Mongolian newspaper *The UB Post* website on October 10).
- 40 *Mongolian Parliament Approves Mechanism for Mining Deals*, BBC Worldwide Monitoring December 11, 2008 (text of report in English by Mongolian newspaper *The UB Post* website on December 11).
- 41 Parliament resolution no 40, dated December 4, 2008.
- 42 *Id.*
- 43 Mary-Anne Toy, Mongolia's Chance to Get It Right after Genghis, *The Age* (Melbourne, Australia), March 31, 2007, at 8.
- 44 *Id.*
- 45 *Id.*
- 46 *Id.*
- 47 *Id.*
- 48 Peter Koven, Strike the Right Balance in Mongolia, *National Post's Financial Post & FP Investing* (Canada), June 6, 2007, at FP5.
- 49 *Id.*
- 50 John Garnaut, Mongolia: Best since Genghis, *Sydney Morning Herald* (Australia), August 6, 2007, at 20; Andy Hoffman, Miners Feel Pinch from Producing Countries; From Argentina to Zambia, Governments Are Demanding a Bigger Cut of Industry Revenues, *The Globe and Mail* (Canada), April 30, 2008, at B14.

- 51 A transcript of plenary session of the State Great Khural on December 4, 2008. It was this session that put an end to the long delays and authorized the government to renew negotiations with Ivanhoe and others. Mr. E. Batuul, an influential politician, made this important statement, pointing out that corruption is the stumbling block to government ownership.

There are certain countries which indeed have a certain percentage of government ownership [in mining projects.] However, one essential condition for state ownership appears to be the presence of a [favorable] political culture and the absence of corruption. We all know very well what is happening today with our single [large state-owned mining company]—Erdenet. It is an example of what happens when the state and politicians control the ownership. When copper prices have plummeted down recently, we see that the situation at Erdenet is such that there is no technological upgrading or no progress at all. But [in the case of Ivanhoe], I can say that, when the agreement with the company is brought into the parliament, we will be able to resolve the issue to utmost satisfaction by brainstorming our ideas.

- 52 Keith Marshall, *The Dawn of a New Reality*, a speech delivered at Discover Mongolia 2008, Ulaanbaatar, November 6, 2008 <http://ot.mn/index.php?module=news&sec=details&nid=252>.
- 53 *Id.* “[O]ur commitment [is] to initiating transparent investments in Mongolia and to creating jobs and wealth through the application of responsible corporate citizenship practices.” “Since the initial discovery at Oyu Tolgoi, we’ve employed more than four thousand Mongolians. Currently, 90 per cent of Oyu Tolgoi’s workforce is Mongolian.”
- 54 *Id.* “Our team of contracted Mongolian miners, which has been working underground at Oyu Tolgoi since 2005, has set the highest standards for the development of underground mining in Mongolia. Many of them are preparing to assume senior and supervisory roles as we look to expand our underground exploration and development work.”
- 55 *Id.* “More than nine hundred Mongolian businesses have worked with the Oyu Tolgoi Project since 2001. Every month for the past two years, we have spent an average of 1.2 million dollars with Mongolian companies for the supply of goods and services to the project.”
- 56 *Id.* “Putting Mongolians First also is vital to our enduring partnerships with local communities and in the development of our political and social license to operate. We see this, and our participation in the regional development plans for the South Gobi, to be integral to our operations and good-neighbor policies.” Note that South Gobi is only one of the 21 provinces.
- 57 *Id.* “Once an acceptable Investment Agreement for Oyu Tolgoi is concluded, we are committed to giving preference to Mongolian companies, training as many Mongolian workers as possible and laying the foundation for a long-life mine that will provide well-paid jobs for several generations of Mongolians.” “The Mongolian Parliament holds the key to unlocking these nation-building assets and realizing the benefits for the people living here today—and the generations to come. There are tens of thousands of jobs and a host of tangible economic benefits locked in mineral deposits now being identified across Mongolia.”
- 58 *Id.*
- 59 *Id.*
- 60 *Id.*
- 61 *Id.*
- 62 See generally, The World Bank, *Mongolia-Sources of Growth: Country Economic Memorandum*, Report no. 39009-MN (2007) http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/08/21/000020439_20070821121641/Rendered/PDF/390090MN.pdf.
- 63 Tom Ginsburg and Gombosuren Ganzorig, When Courts and Politics Collide: Mongolia’s Constitutional Crisis 14 *Colum. J. Asian L.* 309 (2001); Stewart Fenwick, The

Rule of Law in Mongolia: Constitutional Court and Conspiratorial Parliament 3 *Australian J. of Asian L.* 213 (2001).

64 USAID, *Assessment of Corruption in Mongolia: Final Report*, 1 (2005).

65 *Id.* at 3.

66 *Id.* at 5. The study gives the following reasons for optimism:

First, the stakes remain relatively low compared to countries with significant natural resources and market size (e.g. Nigeria or Russia). Second, the government system and economy in Mongolia never totally collapsed during the transition as it did in other places (e.g. Albania, Cambodia, or Liberia), thus maintaining standards of living and keeping at least some management systems and controls in place. Nor was the transition marked by such repression that political participation has to be rebuilt from the ground up. A high level of literacy is an additional advantage that was maintained because of a relatively smooth political and economic transition. Third, Mongolia remains free from conflict, and the government maintains control over the entire territory (unlike Colombia, Sri Lanka, or Nepal), so the risks of tackling corruption, should strong leadership emerge, are fewer and the likelihood of having a broad impact is greater. Fourth, Mongolia's small size and culture where 'everybody knows everybody,' while often cited as a constraint on fighting corruption, may also place an inherent cultural check on those who take corruption 'too far.'

67 Drew Hasselback, Ivanhoe Buys US\$50M in Mongolian Debt: One-Year Treasury Bills: Has Already Spent More Than US\$60M on Copper/Gold Play, *National Post's Financial Post & FP Investing* (Canada), January 2, 2004, at FP03; Ivanhoe Gets \$12.5-Million Payment from Mongolia, December 31, 2004, *The Globe and Mail* (Canada), at B7.

68 Geoffrey York, Ivanhoe's Unusual Mongolian Deal Sparks Criticism, Questions, *The Globe and Mail* (Canada), July 26, 2004, at B1.

69 *Id.*

70 *Id.*

71 *Id.*

72 York, *supra* note 8.

73 Raymond Vernon, *Sovereignty at Bay* (New York: Basic Books 1971); Raymond Vernon, The Obsolescing Bargain: A Key Factor in Political Risk, in *The International Essays for Business Decision Makers* (Mark B. Winchester ed., Houston: Center for International Business 1980).

74 Vernon (1980), *supra* note 73, at 47.

75 Ginsburg and Ganzorig, *supra* note 63, at 313.

76 B. Chimid, *Eneegiin Uls Tur Khuulchiin Nudeer* 75–76 (Ulaanbaatar: Admon 2006) (Contemporary Politics in the Eyes of a Lawyer).

77 E-mail correspondence (on file with the author).

78 Article 23 of the French Constitution of 1958 provides that "Membership of the Government shall be incompatible with the holding of any Parliamentary office, any position of professional representation at national level, any public employment or any professional activity." www.assemblee-nationale.fr/english/8ab.asp.

79 M. J. C. Vile, *Constitutionalism and the Separation of Powers* 260 (Oxford University Press 1967).

80 B. Chimid, *Undsen Khuuli ba Undsen Khuulichilsan Khuuli Gekh Asuudal*, public lecture delivered in January 2007 (on the issue of constitution and organic laws).

81 See Annex 1.

82 Chimid, *supra* note 80.

83 USAID, *supra* note 62, at 3.

84 *Id.* at 16.

85 See *supra* note 41.

Part II

Special topics

Institutions and areas of law

7 *Echoes of Through the Looking Glass*

Comparing judicial reforms in Singapore and India

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Introduction

Our focus in this chapter is on debates within the fields of law and development and comparative constitutional law on measuring the success of judicial institutions. The starting point and principal focus of our chapter is a single study: a 2007 World Bank publication titled *Judiciary-led Reforms in Singapore: Framework, Strategies and Lessons* (“the Malik Report”).²

Singapore’s judiciary is routinely criticized in the international media by NGOs such as Amnesty International and other human rights and lawyers’ organizations. In stark contrast, the Malik Report praises the Singapore judiciary for being “one of the most efficient, effective judicial systems in Asia, perhaps in the world”.³ Styled as a report, Malik’s study seeks to chronicle the story of the Singapore judiciary’s efforts to transform itself, from a system which in 1989 was characterized by “delays, limited access, high costs, archaic procedures, and weak administrative capacity” to its current state in the early years of the twenty-first century when it is regarded as a role model for other judiciaries.

The Malik Report’s focus on recent reforms in Singapore’s judiciary enables us to analyse its implications for Singapore, while also assessing its findings comparatively given its conclusion that the Singapore experience carries potentially significant lessons for other jurisdictions, especially those within Asia. To test the comparative claim of the Report, we turn to the Indian legal system, contemporary assessments of which appear to be mirror images of the aforementioned binary assessments offered in respect of the judiciary in Singapore. We focus on ongoing debates about reforming the Indian judiciary, which would seem to be tailor-made for applying the Malik Report’s findings. We then use the debate over measuring the success of the two judiciaries to make some general comments on the indices used to measure the success of judicial institutions more generally.

Our principal aim in this chapter is to demonstrate that the Malik Report’s “management-oriented” perspective focuses only on part of the picture. It does not account for factors that should be considered while measuring the efficacy of judiciaries in general and that of Singapore’s judiciary in particular. Since the Malik Report does not focus on studies that are critical of the Singapore

judiciary's systemic features, it contributes to the unfortunate divide that characterizes assessments of judiciaries in the existing literature.

Assessments of the Indian judiciary, as noted earlier, provide a stark contrast to those of the Singapore judiciary. India's judiciary is often characterized as being in the midst of a severe state of crisis on account of the massive delays and huge backlogs of cases that are such a typical part of its functioning. Yet, India's judiciary is considered by legal and political scholars to be a stellar institution in many other respects, especially in maintaining strong democratic traditions in India. The Indian judiciary seems to have a higher standing when it comes to focusing on issues of justice, but its inefficiency raises concerns about its capacity to deliver basic forms of justice, such as the speedy and effective resolution of disputes.

Our chapter seeks to highlight the vast differences in the criteria used by different actors and institutions to assess judicial institutions. Following from this, we also examine why judicial reform projects, which have now been around for half a century, have had relatively disappointing results. We conclude by focusing on some lessons that the actors who advise and manage judicial reform projects in foreign countries need to bear in mind.

This chapter has six parts, following this introduction. In the second part, we focus on the Malik Report, providing a broad summary of its contents and principal findings and offering a preliminary critique of some aspects of its methodology and analysis. The third part provides an assessment of Singapore's judiciary by other analysts, scholars and organizations, drawing attention to the issues that the Malik Report sidesteps. The fourth part focuses on the Indian judiciary's long history with legal and judicial reform, and assesses the Malik Report's claim that measures applied in Singapore should be replicated in India. The fifth part seeks to link discussions in earlier parts of the chapter with ongoing debates within the field of law and development about legal and judicial reform. This is followed by a short concluding section.

The Malik Report on judicial reforms in Singapore

"I can't believe *that!*" said Alice.

"Can't you?" said the Queen in a pitying tone. "Try again: draw a long breath, and shut your eyes."

Alice laughed. "There's no use trying," she said, "one *can't* believe impossible things."

"I daresay you haven't had much practice," said the Queen. "When I was your age, I always did it for half-an-hour a day. Why sometimes I believed as many as six impossible things before breakfast!"

(Lewis Carroll, *Through the Looking Glass*, 1865)⁴

Setting the context for the Malik Report

Although our focus in this chapter is on the Malik Report, it is important to acknowledge the historical context for the Report. As it happens, the field of law

and development has witnessed considerable debate over similar claims advanced in earlier years by previous legal and judicial reformers.

The Malik Report should be studied as part of the field of law and development, which has been in existence since at least the end of the Second World War. Several contributors to this volume have analysed the historical development of the movement, making it possible for us to provide only a broad sketch here.⁵ The geopolitical situation in the aftermath of the Second World War encouraged the emerging “law and development movement” to argue that developing countries needed a transfer of legal knowledge from more advanced countries to realize their economic and societal goals. Most of the projects were funded by U.S.-based organizations such as the United States Agency for International Aid (USAID) and the Ford Foundation.

By the mid-1970s, however, adherents to the “original” law and development movement declared the movement to be a failure, and called for its end.⁶ The end of the Cold War witnessed a resurgence of the previously discredited idea that reforming the law and legal system was essential for bringing about social and economic progress. Consequently, there was a revival of large-scale law and development projects, funded by agencies such as USAID, the World Bank and other aid institutions from across the world, including those run by the governments of Japan and EU nations. The phase since the 1990s has been described as the “new” law and development movement.⁷ We believe that the Malik Report is better appreciated as being representative of the later phases of law and development, where legal reform is viewed as a technocratic exercise.

Summarizing the Malik Report

It is important, at the outset, to emphasize that though the Malik Report is a single-author study, it bears the official sanction of the World Bank. This is evident from two facts: that the Report is published under the aegis of the World Bank, and that its *Foreword* is authored by three senior World Bank officials who endorse Malik’s principal conclusion, when they assert that “the strategies used and lessons learned from Singapore’s experience [can act] as a potential guide toward successful and sustainable judicial reform” (at page x).

The Malik Report focuses on a particular period in the history of Singapore’s judiciary, and upon a specific set of reforms that were instituted shortly after the appointment of Singapore’s second Chief Justice in 1990. Under Chief Justice Yong Pung How, a series of reforms were undertaken to remedy problems in the existing system, which are the subject of Malik’s Report. Chief Justice Yong Pung How remained in office from 1990–2006. His successor is Chief Justice Chan Sek Keong, who is only the third Chief Justice of Singapore since it gained independence in 1965. Malik’s Report, therefore, covers the entire period of Chief Justice Yong’s term.

The Malik Report is a short document, extending to only 73 pages (excluding appendices), and consisting of six chapters. In the first chapter (pages 1–3), Malik states that he has adopted a “management perspective” to guide his study.

In this analysis, the operators of the judicial system (judges, administrators, bailiffs) are seen as middle managers, whereas the senior judges who govern the courts are perceived as managers, whose goal is “to provide efficient and equitable management of justice and dispute settlement.” In Malik’s words (page 2), the advantage of adopting such an approach is that:

[it] permits us to look at different elements of reform in a simpler manner than using, for example, the conventional legal perspective. Adopting the managerial approach is especially appropriate because it closely mirrors the ways in which the judicial leadership in Singapore introduced novel thinking and innovation into the system. This “business process” approach shaped a unique blend of strategic thinking and business practices as well.

Chapter 3 (pages 9–18) focuses on the Judiciary in Singapore and sets out its basic institutional features, covering details about the structure of the judiciary, the constitutional and legal provisions that empower its institutions, its budget and revenues, its caseload, and a short history of prior judicial reforms. Chapter 4 (pages 19–32) sets out the Report’s “Conceptual Framework”. According to Malik, the new judicial leadership that took over in the early 1990s in Singapore showed an understanding of key management techniques in identifying the following six ‘barriers’ that would have to be overcome in the process of reforms: i) Poor coordination across key functions and units; ii) ineffective “top team”; iii) unclear strategies and conflicting priorities; iv) top-down or laissez-faire management style; v) inadequate leadership skills and development; and vi) poor vertical communication. In Chapter 5 (pages 33–59), Malik seeks to demonstrate the concrete measures that were adopted to address each of the six barriers to reform identified in the previous chapter systematically. According to Malik’s report, this was achieved by adopting an eight-step process (details at pages 34–58 of the report). We provide brief details of each of these steps below as they are crucial for understanding Malik’s approach and overall framework.

- 1 *Strategy One: Using Leadership*—This involved the instituting of strong leaders at the top of the institutional set-up, in the form of a new Chief Justice (Chief Justice Yong Pung How, who was appointed head of the Supreme Court in 1990), a new Registrar of the Supreme Court, and a new head of the subordinate judiciary, all of whom constituted a “top team” that focused on improving the performance of subordinate courts, which had been identified as the principal site of the proposed reforms.
- 2 *Strategy Two: Refining Models of Justice and Expanding Alternatives*—The Supreme Court was restructured in order to free up resources to hear additional cases. The number of judges required for the trial of a capital offence was reduced from two to one in 1992 (as a counter-measure, each defendant was now allowed two instead of one counsel); additional judicial commissioners were appointed, and a single permanent Court of Appeals was established for exercising appellate jurisdiction in both civil and criminal matters.

By 1993, thanks to these and other measures that had already been instituted, the backlog was taken care of. Thereafter, the Chief Justice was legislatively empowered to transfer cases from the Supreme Court to the district courts and vice versa. Jurisdictional boundaries of various courts were expanded to fit more efficient forms of administering justice. Mediation and settlement were encouraged, and become standard practice in family law cases and quasi-criminal cases involving relatives or neighbours. Night courts were introduced, which also allowed people to attend court proceedings after work hours.

- 3 *Strategy Three: Increasing Access*—The judiciary in Singapore has sought to cut costs by making court-fees more rationalized, eliminating them for small-claims. Attempts have also been made to improve the provision of legal aid, while also requiring lawyers by law to provide cost estimates to clients at all stages of the process, when asked for. At the same time, outreach and education campaigns have been launched to involve local and international constituents and consumers of the legal and judicial process.
- 4 *Strategy Four: Improving Court Administration Capacity*—The entire existing system of court administration was revamped, and new incentive structures were put in place. Several new sections were added, dealing with Public Affairs, Customer Service, Research and Statistics, while a new think-tank made up of judges called the Justice Policy Group was also instituted. A decision was made to construct a new Supreme Court building, and efforts were taken to improve the utilization of space and financial resources.
- 5 *Strategy Five: Improving Human Resources Management*—A number of training and development programmes were initiated to “reshape core capabilities” of judges and other professional staff. Though the initial emphasis was on increasing personnel, this did not lead to diminishing returns as judges and judicial officers were encouraged to adopt efficient means of working (including starting on time, retaining control of proceedings, and working beyond normal time to complete the day’s business). Judicial salaries were increased by several degrees, to enable the hiring of the best legal talent from the private bar. Further, scholarships were provided to judges for higher study abroad in the most elite law schools of the common law world.
- 6 *Strategy Six: Emphasising Performance and Results*—Towards this end, annual work plans were instituted, and studies by independent consultants to review particular aspects of reform were commissioned. The Research and Statistics Unit (whose institution was noted earlier) began to assemble information and data for policy decision making, as well as for fine-tuning improvements and to take corrective actions where found necessary. A number of performance-review systems were put in place to monitor the rate and success of the ongoing reforms, for which consultants from some of the best judicial institutes around the world were hired.
- 7 *Strategy Seven: Leveraging Technology*—All judges were encouraged to take a pro-active role in the individual and group management of cases to

ensure that there was no return to the situation of long pendency of cases that characterized the pre-1990 era. This process was greatly facilitated by computerized information technology applications, which allowed judges to set strict time limits on trial adjournments, the setting of hearing dates, and the efficient use of time and space. Information technology was used widely in the judicial system, and experiments were conducted to devise a system that allows e-filings, and eliminates much of the delay caused by manual submission of court documents and their transportation.

- 8 *Strategy Eight: Building Bridges:* To achieve reforms in the judicial process, the expertise and proven track record of other wings of the Singaporean government were utilized. In particular, insights from the civil service reforms of the 1980s and 1990s, the anticorruption programmes, the computerization of the civil service in the 1980s, as well as other programmes were incorporated, often by involving people from other wings of government in discussions and implementation of ongoing reforms. A concerted effort was made to involve every institution that had a stake in the process, including the Attorney General's Chambers, the Ministry of Law, and the Law Society.

In the final chapter (Chapter 6, at pages 61–73) the Report lays out “perceptions, performance and lessons” of the judicial reform process in Singapore. After covering aspects relating to how the reform process was perceived, Malik sets out qualitative assessments of the Singapore judiciary, which demonstrate dramatic changes since reforms were instituted in 1990. According to the figures quoted by Malik, as of 1999, the overall clearance rate for cases in Singapore was 96 per cent. This, according to Malik, demonstrates that apart from being one of the most efficient judiciaries in the world in terms of waiting time for cases to be processed through the judicial system, Singapore's judiciary is also one of the most cost-effective in the world. Malik notes that it is because of these attributes that Singapore's judiciary is consistently ranked as first in the Asia-Pacific region by the international business community.

Analysing some statistics will help appreciate the difference brought about by the reforms under Chief Justice Yong Pung How that are described by Malik. Singapore's judiciary consists of a Supreme Court comprising 15 judges at the current time. The Supreme Court oversees the Subordinate Courts, which are headed by the Senior District Judge and consist of a number of divisions to deal with Family, Juvenile Justice, Civil, Criminal and Small Claims cases. In 1991, there were nearly 2,000 suits that were awaiting hearing before the High Court. It was estimated that at the ongoing rate, these would take as much as six years to be heard (if they were appealed, an additional two years would be added to that time). Even capital punishment cases—which were expedited—would take, on average, four years to be heard. By 2005, thanks to the reforms initiated by Chief Justice Yong, “the average disposal time for writs was just under 7 months, with more than 50% of writs filed concluded under 6 months.”⁸

The success of the reforms is demonstrated by the fact that they have taken hold. In 2008, the Supreme Court of Singapore received a total of 13,957 new

civil and criminal matters. In the same period, a total of 13,538 matters were disposed of. The clearance rate for all civil and criminal matters for 2008 was 97 per cent.⁹ The Subordinate Courts in Singapore (divided into Civil, Criminal, Family, Juvenile and Small Claims Divisions) deal with a larger group of cases, but their disposal rate is also impressively high and quick. In 2008, the Subordinate Courts as a whole handled 342,963 cases, which represented a slight reduction from the figures for the previous year (349,007).¹⁰ Most of these cases were disposed of within 1–3 months, while the longest of these cases lasted almost 18 months.¹¹ This is quite clearly an impressive record by any standards,¹² the significance of which is enhanced when we study the comparable figures for the Indian judiciary in the next section.

The following are the broad lessons that Malik asserts other judiciaries should draw out from the Singaporean experience (at pages 70–72): i) Strategic thinking and business planning are central to institutional success; ii) Strong leadership is essential to create and achieve a vision of change; iii) Institutional reform must be tailored for and targeted at those the institution serves; iv) Increasing knowledge and technological innovation are critical components of change; and v) Judicial reform is facilitated by a stable economy and an efficient political system.

Analysing the Malik Report: preliminary comments

Later in the chapter, we will seek to subject the foundational premises and conceptual basis of the Malik Report to greater scrutiny. For now, we take note of some of the methodological bases of the Malik Report, and also draw attention to issues he excludes from his analysis.

In the introductory chapter, Malik makes an intriguing claim. He asserts that there are several possible ways of assessing the Singaporean judiciary, implicitly recognizing the complexities involved in assessing institutions such as the judiciary, which seek to serve multiple objectives in society. According to him, the alternative options (set out at pages 1–2 of the report) are: a “legislative perspective” (which looks at “changes in law and procedures”); an “economic perspective” (which “assesses the demand for and supply of court services, the costs of litigation, and access”); a “public policy perspective” (that focuses on “the effects of legislative policies and government regulations on court clogs and dispute settlement”); and, finally, a “democracy perspective” (which focuses on “the checks and balances among different branches of government and the role of the judiciary in protecting rights of citizens and serving as an arbiter in inter or intra governmental matters”). Leaving aside all these perspectives, Malik adopts what he calls a “management perspective” in the report which according to him consists of taking “a broad, holistic look at multidisciplinary aspects of the court system and provide insights into various facets of court procedure as well”.¹³

Yet, his “broad” and “holistic” perspective ignores what he himself terms as the “democracy perspective”. In the Executive Summary of the report, Malik provides one more limitation of the study (at page xvi):

Although the overall process of judicial reform in Singapore dealt with the Supreme Court and the subordinate courts, the report focuses mainly on improvements in civil and commercial justice in the lower courts. *The social justice aspects of reform are beyond the scope of the report.*¹⁴

Why Malik's "broad" and "holistic" report excludes "social justice" aspects, even as he praises the Singapore judiciary for its "accessibility", is not made clear. These caveats would seem to indicate that Malik is aware of the criticisms of the Singapore judiciary and the general perception in the West and the broader academic literature, to which we turn in the next section of the chapter. However, Malik never addresses such criticisms directly, and these caveats and exclusions serve to fortify his decision to ignore such analysis, even as they draw attention to what is not being studied.

Assessing Singapore's judiciary: the claims of its critics

The critics of Singapore's judiciary do not dispute the achievements listed out in the Malik Report. Their focus, instead, is on other aspects of the Singaporean judiciary's functioning which are not reflected in such quantitative analyses. And, just as there is diversity among the supporters of the Singaporean judiciary, there are an equally diverse number of categories of critics. One group consists of international NGOs and watchdogs such as Amnesty International,¹⁵ the Bar Association of the City of New York,¹⁶ and the Lawyers' Rights Watch, Canada.¹⁷ At the governmental level, despite maintaining strong diplomatic relations with Singapore, the State Department of the United States has been critical of several aspects of the judiciary in its annual reports.¹⁸ There is also the category represented by opposition politicians in Singapore and former insiders-turned-critics.¹⁹

Much of this criticism is directed towards events and trends that suggest that the judiciary in Singapore is not sufficiently independent of government, reflected in a bias towards government and national leaders in politically sensitive cases. Attention is drawn by such critics towards particular constitutional provisions which authorize questionable practices. Article 98 of the Constitution of Singapore sanctions the hiring of "contract judges" (i.e. retaining judges on contractual bases after they have passed the age of 65, where they work without security of tenure). As a matter of fact, both Singapore's current and two previous Chief Justices completed significant parts of their tenure while under such contracts. The extensions are not automatic, and have given rise to concerns that such contract judges would have a tendency to lean in favour of pro-government outcomes. Critics also focus on Article 94(5) of the Constitution of Singapore, which has, since 1986, enabled lawyers to act as Judicial Commissioners for a "trial period" of 1–2 years, ostensibly facilitating an assessment of their suitability for judicial office. Once again, the concern is that the use of this device allows government to retain control over the outcomes that the Judicial Commissioners will reach, being mindful of the fact that they are virtually on probation.²⁰

Several critics have focused on the absence of tenure for judges in the subordinate judiciary. Indeed, they are a part of the executive government as district judges are routinely shifted between the Attorney General's Chambers and the lower judiciary. Apart from violating classic notions of separation of powers, this results in judges having a strong pro-government mindset in all of their judicial work as well. As evidence of these charges, critics point to the much-discussed transfer of District Judge Michael Khoo, who was transferred to a lower position in the Attorney General's Chambers after delivering what the government of the day construed as an unfavourable verdict in a high profile case involving the opposition politician, J.B. Jeyaretnam.²¹ Even the appointment of Chief Justice Yong—the principal actor in the reforms process that is the focus of the Malik Report—has been called into question. This was because he had been a close personal friend of Prime Minister Lee Kuan Yew, and had, prior to his appointment as a judge at the instance of the Prime Minister, been—by his own admission—completely out of touch with the legal profession for nearly two decades.²²

The aspect of the Singapore judiciary which attracts the most strident criticism is the perception that its courts are used to suppress critical comments and viewpoints through threats of defamation actions and the awarding by the courts of huge damages to individuals who criticize government leaders, leading to their eventual bankruptcy or exile from Singapore. The critics cite a number of defamation suits brought by successive Prime Ministers in Singapore against opposition politicians typically for statements made in the context of elections. These defamation proceedings have been a constant part of the electoral and political landscape in Singapore over the past three decades, and invariably resulted in victories for the government leader in question. No opposition leader has been successful against a government leader in proceedings of this sort before the courts in Singapore.²³

Another feature that draws the focus of critics is the high salary-and- emoluments package paid to judges in Singapore. As noted earlier, the Malik Report was appreciative of the pay raises that were designed to both attract and retain the best available legal talent in the judiciary. But, as the critics note, judicial salaries in Singapore are extremely high, even when compared to those in the highest GDP bracket in the developed world. In 1994, the annual salaries for superior court judges in Singapore were as follows: Chief Justice (SG\$347,000/US\$245,500); Judges of Appeal (SG\$253,200/US\$179,000) and Supreme Court Judges (SG\$234,600/US\$166,000).²⁴ As the Malik Report notes, one of Chief Justice Yong's principal ways of improving legal talent to the judiciary was to considerably raise judicial salaries. These salaries have been revised upwards in the decade and a half that has elapsed, though exact estimates are not easily traceable. Exact information about current judicial salaries is not publicly available, but a press release issued by the Prime Minister's Office in December 2007 indicates that *at a minimum*, a Supreme Court judge in Singapore earns SG\$1,940,000 (or US\$1,366,582).²⁵ Critics note that judges in Singapore are paid net salaries (calculated by taking account of the official salaries as well as

cumulative perks) that are several times more than what their counterparts in the most developed economies of the world earn.²⁶ Their concern is that paying such high salaries and bonuses is a way to influence judicial outcomes, as judicial salaries in Singapore are dependent on executive and legislative measures.²⁷

In order to buttress their claims about the pro-government bias of the judiciary, the critics note that in over 42 years of its functioning since Singapore gained independence, the judiciary is yet to strike down a single statute as unconstitutional. Instances where actions by governmental agencies were struck down or administrative regulations were held to be void do exist,²⁸ but are extremely rare. In general, courts in Singapore have been extremely unsympathetic to rights-based claims, even when based upon rights that are constitutionally entrenched and guaranteed by the Singapore Constitution. In such cases, the critics point out that courts usually go to great lengths to deny, what seem like logical and plain-reading interpretations of rights provisions.²⁹

The sympathetic critics include journalists working for the government-owned *Straits Times* who have raised doubts over the claims made by the Singaporean judiciary (and endorsed by the Malik Report) about the accessibility of the courts. In 2007, the *Straits Times* carried a report which called into question this claim when it asserted that the cost of legal proceedings has gone up considerably in Singapore, making it difficult for middle-class Singaporeans to approach lawyers and the courts.³⁰ This is an important criticism since it goes to the heart of the Malik Report's claim that the reforms initiated in Singapore since 1990 have made the courts more open to the public, and have led to the creation of a support-base among the mass public.

Michael Hwang, the immediate-past President of the Law Society of Singapore (which represents the legal profession and the private bar) has recently pointed to an often neglected but worrying aspect of the legal system, relating to the criminal justice system. Singapore prides itself on its low crime rate, which is seen as key to maintaining its stability, while also attracting foreign investors, and in more recent years, millions of tourists to Singapore, all of which are crucial to maintaining the success of the Singapore economy. But, as noted by Hwang in his January 2008 address, the overzealous attitude of the government towards controlling crime, often by resorting to harsh measures (in the form of the death penalty for a wide range of measures and other harsh methods such as retaining the punishment of caning for a wide variety of offences) is problematic. According to Hwang, this system has resulted in the creation of the

perception that the basic structure of criminal procedure is unnecessarily weighted in favour of the prosecution, and does not give adequate consideration to the rights of defendants. Two areas of particular concern are the statements recorded by the police from witnesses (including potential defendants) and the lack of discovery in criminal proceedings. On the first issue of police statements, there is a longstanding and widespread feeling at the Bar that legislation (or at least a protocol) is needed to prescribe how such statements are recorded and when counsel can have access to their

clients. On the second issue of criminal discovery, while some discovery is from time to time ordered in individual cases, this is dependent on the discretion of individual judges, rather than a principled approach to the question. A statutory framework (or at least a protocol) would therefore be highly desirable.³¹

Many of the aforementioned claims of the critics have been documented extensively, and may even be said to constitute the dominant perception of Singapore's judiciary both within and outside Singapore. What is surprising is how completely such concerns are bypassed by the Malik Report. As we noted earlier, Malik does seem to be aware of the existence of such literature, given the way the report is structured to avoid certain issues, and in the express limitations of the study mentioned in the report. But, by choosing not to address these criticisms head-on, the Malik Report contributes to, and perpetuates, the dichotomy in studies analysing Singapore's judiciary. Later in this chapter, we will focus on the problems caused by the persistence of such a dichotomy. For now, we turn, in the next section of this chapter, to a comparative assessment of the claims of the Malik Report, by focusing on the history of legal and judicial reform in India.

India's judiciary and its problems of backlog and delay

"Well, in our country," said Alice, still panting a little, "you'd generally get to somewhere else—if you run fast for a long time as we've been doing."

"A slow sort of country!" said the Queen. "Now, here, you see, it takes all the running you can do, to keep you in the same place. If you want to get somewhere else, you must run at least twice as fast as that!"

(Lewis Carroll, *Through the Looking Glass*, 1865)³²

In many ways, the state of the contemporary Indian judiciary is the mirror image of its counterpart in Singapore. Like the Singapore judiciary, the Indian court system has attracted bouquets and brickbats from a diverse array of supporters and critics. However, the cast of characters who praise and criticize the Indian judiciary are almost the exact opposite of those who exhibit these reactions towards the judiciary in Singapore.

Over the 60 years since it formally secured independence from colonial rule, India's judiciary has garnered a reputation for being a strong protector of India's newly entrenched democratic and constitutional traditions.³³ The judiciary in India has been lauded for not hesitating to spurn the government of the day when called for, and has struck down a record number of laws, government regulations and other directives for unconstitutionality. The Public Interest Litigation (PIL) movement initiated by the Supreme Court in the mid to late 1970s was generally regarded as responding to the social and economic concerns of the most under-privileged sections of Indian society, gaining the judiciary a reputation for being a champion of the human rights and privileges of the most oppressed sections of

Indian society. In polls conducted within India, the judiciary regularly features in the top bracket of institutions of domestic governance that have the most credibility with ordinary members of the public. Since the 1990s, the perception is that the Indian populace in general reposes far more trust in judges than in elected politicians. All this had caused several academic commentators to describe the Indian Supreme Court as perhaps the “most powerful court in the world” based on an assessment of its wide powers, and the extensive jurisdiction—and influence—it has come to exercise.

An empirical understanding of India’s backlog problem

While appreciating some of the achievements of the Indian judiciary listed above, a number of observers and academics have noted that much of the weight of these accomplishments is undermined by the huge backlogs and delays that characterize its functioning.³⁴

India has a unitary judicial system, with a Supreme Court (currently comprising 31 judges) at the top of a pyramid-like structure, followed by 21 High Courts (which have a total strength of 749 judges) spread across the nation, which in turn supervise a large number of subordinate courts that are collectively referred to as “lower courts”. The sanctioned strength of judicial officers, who are to fill all these lower court posts, as of July 2009, is 16,946, of which only about 12,500 have been filled. Thus, the Indian judicial system consists, at full strength, of nearly 18,000 judicial officers.

Writing in 2007, a noted scholar observed that the overall number of cases pending before the Supreme Court alone was about 20,000 cases, while the High Courts had three million cases pending before them. This apart, across the nation as a whole, there were 24 million cases pending before the lower courts, two-thirds of which were criminal cases.³⁵ The annual reports issued by the Supreme Court of India confirm that the number of pending cases is very high.³⁶ In fact, by the end of 2008, the number of cases before the Supreme Court alone had risen to nearly 50,000.³⁷ A recent study conducted by a reputed research institution indicates that as of July 2009, the number of cases before the Supreme Court is 53,000; cases pending before the High Courts have risen to four million, while those pending before the lower courts amount to 27 million.³⁸ (We have chosen to cite figures over a three-year period in part to indicate that, since more cases are instituted in the Indian Supreme Court than are decided, the backlog is actually increasing every year.)

This has led, not surprisingly, to long delays in the hearing and final decision-making in cases, and it is not uncommon to find reports of cases having taken as long as 20 years to be decided. Even allowing for the large size of the population in India, these are mind-boggling figures. The problem of delay and backlog has attracted the attention of legal reformers for well over a century, dating back to the colonial administration in India. We now conduct a brief survey of some studies on this question, to provide a sense of the many difficult and complex issues that lie at the heart of this problem.

Turning to history: pre- and post-independence efforts at judicial reform in India

One of the earliest studies of the problem was conducted—while the colonial regime was still in place—by the Civil Justice Committee in 1924. Its report identified insufficient judge strength in some of the High Courts as the main cause for delay and backlogs. In 1949, when this problem had become more exacerbated, a High Court Arrears Committee with Justice S.R. Das as its chairman was constituted, which recommended an immediate increase in the judge strength of High Courts. Over this period of nearly a quarter-century, the main cause for delay in the system was perceived to be a problem on the supply side, namely an inadequate number of judges.

In 1955, shortly after it gained full independence, the Law Commission of India was established in part to “recommend revision and updating of the inherited [colonial] laws” for the new nation.³⁹ This body has since become one of the most significant advisory bodies on legal reform within India. It is typically headed by a retired Supreme Court judge, and consists of academics, senior bureaucrats and other qualified experts. Since several of the reports issued by the Law Commission have in fact become law, it merits attention, particularly to appreciate the establishment approach to understanding and solving the problem of delay and judicial backlog in India. Among the early reports released by this body, its 14th Report, issued in 1958, focused on “Reform of Judicial Administration”. A close study of this report throws much light on some other reasons for delay and backlog in India. The 14th Report of the Law Commission begins with an examination of the question whether radical changes were called for to reform the Indian legal system. Specifically, the report sought to address the criticism that the colonial legal framework upon which the post-independence constitutional was based, was unsuited for the Indian context. These critics noted that a large number of Indians were poor, illiterate and based in villages, requiring an indigenous system, rather than opting for the colonial system which had been instituted to serve imperial interests and had caused much delay and miscarriages of justice in the past. The Law Commission emphatically concluded that

the way to reform does not lie in the abandonment of the present system and in replacing it by another. The true remedy lies in removing the defects in the present system and making it subserve in a greater degree our requirements for the present and the future.⁴⁰

In the rest of the Report, the Law Commission detailed a number of changes that were needed to rid the system of its most egregious problems. The colonial legal system had built-in a number of procedures to suit its own interests that directly contributed to the long delays. One such practice was the allowing of a number of appeals (to ensure that all important cases would ultimately come for decision before the few British judges who sat at the higher levels of the judiciary in colonial India). The Law Commission rejected the idea (advanced by other bodies

before it) that these grave problems could be solved merely by increasing the number of judges.⁴¹ The report, instead, advanced a number of recommendations, such as a change in the pecuniary limits of courts (based on their estimate of which courts were the most clogged),⁴² increasing the number of working days for the courts, encouraging conditions for better recruitment of judges, salary raises for judges, and so on.⁴³

Three decades on, the Law Commission focused on the issue of arrears in the High Courts and the Supreme Court in its 124th and 125th Reports, which were issued in 1988. In respect of the High Courts, the 124th Report recommended that specific appeals be eliminated in order to reduce the number of appeals.⁴⁴ It also suggested that a number of specialist courts and tribunals be set up, which would lead to a reduction of cases before the High Courts by a whopping 45 per cent.⁴⁵

This recommendation points to the popularity of the idea, among prominent members of the establishment in the early to mid-1980s, that tribunalization should be introduced within India on a large scale. In pursuance of such a consensus, a number of tribunals were introduced to supplant and supplement the work and jurisdiction of the regular courts. The justificatory provisions for several of these tribunals were two constitutional provisions (Articles 323A and B), which had been introduced by constitutional amendments in the mid-1970s, and facilitated the creation of tribunals. The most prominent example of this trend was the enactment of the Administrative Tribunals Act, 1985, which envisaged the creation of a Central Administrative Tribunal and State Administrative Tribunals in each of the states. A number of these tribunals were actually set up and began functioning, but were thwarted because a number of litigants who were diverted to these tribunals objected to the ouster of jurisdiction of the High Courts and filed cases challenging the constitutionality of these tribunals. In 1997, the Supreme Court accepted some of the grounds of this challenge,⁴⁶ rendering it very difficult for the Administrative Tribunals to function as originally envisaged.

The decade-long experiment with tribunalization in India, which led to the creation of a number of tribunals in the 1980s that were later rendered ineffective, shows the challenge involved in experimenting with new and innovative mechanisms to reduce backlog and delay. This has to be understood against the experience of India's political history where, especially during the illegal Emergency imposed by Prime Minister Indira Gandhi, the executive sought to interfere with judicial appointments and otherwise sought to undermine judicial independence. Given this history, attempts that are perceived as affecting the independence of the higher judiciary, even when motivated by concerns of efficiency, turn out to be unsuccessful because lawyers and citizen-groups have a tendency (as we shall see) to oppose them strenuously. Many of the efficiency-oriented measures implemented in Singapore by Chief Justice Yong would be politically unpalatable in India.

Reform efforts since the 1990s

We now turn to a more recent wide-ranging attempt at bringing about reform. In the mid-1990s, successive Chief Justices of India were able to implement reforms to bring down the backlog at the Supreme Court considerably. One published account authored by the members of a group which sought to bring about judicial reforms in India in the mid-1990s asserts that a set of newly introduced initiatives “dramatically reduced the Supreme Court caseload from approximately 120,000 cases in October 1994 to 28,000 cases in September 1996.”⁴⁷ This reduction of the caseload in the apex court by nearly a fourth was achieved by introducing a comprehensive set of reforms that instituted a uniform classification system according to the subject matter of cases filed, and computerized the filing, listing, and allocation tasks in the Supreme Court’s registry.

Later, the success of the measures implemented in the Supreme Court was sought to be replicated across the nation. To this end, a group of judges, lawyers and scholars from India and the US, comprising 80 Indian members drawn from four states and the country’s capital, was constituted. This group, which referred to itself as the “Indo-US team,” met several times over the course of a calendar year, exchanged several rounds of memoranda and concept papers, before issuing a report that suggested a number of reforms.⁴⁸ The Indo-US team identified the following three main problems as the root causes of delay in the overall judicial system:

First, the internal court management system lacks accountability for the administration of the caseload. Administrative institutions fail to monitor and track the status, substance, and pace of civil litigation, thus forcing the courts to duplicate efforts and allowing controversies to languish without resolution. Second, judicial management of the legal process is undisciplined, and thus unreasonably protracted, discontinuous, duplicative, and fragmented (providing lawyers with opportunities to conduct vexatious, frivolous, and dilatory litigation). Legal professionals fail to observe procedural requirements in the pretrial stages of cases, thereby allowing dilatory practices to protract the case life. Third, available alternative and consensual means of dispute resolution are limited. Insufficient opportunities for reconciliatory, consensual, and informal processes and flexible remedial action, as well as systemic disincentives against early settlement, keep more cases in the system for a longer time. This leaves less time for formal legal adjudication as a means of last resort for irreconcilable legal conflicts. In sum, opportunities to resolve disputes quickly and amicably out of court are limited. Thus, full adversarial trial remains practically the only available alternative.

These causal factors are dynamically interrelated. The lack of discipline in the litigation process and the small percentage of consensual settlements render the internal court management of an already enormous caseload even more difficult. More than any other factor, backlog and delay provide a

profound disincentive for settlement. Defendants, or plaintiffs who have achieved preliminary injunctive relief, benefit from the time value of money by refusing to settle, even in cases that they realize they are likely to lose. The paucity of consensual settlements increases the number of unresolved matters in the courts, leaving less time for other matters. Finally, in addition to being an effect, delay is also a compounding cause and a disincentive for settlement. For example, the eventual unavailability of witnesses in protracted litigation due to relocation or death, requires the use of valuable court time.⁴⁹

To address the systemic problems identified by it, the Indo-US team recommended a range of solutions, which entailed the following three broad sets of measures:

The proposed reforms integrate three sets of recommendations to improve the delivery of civil justice: court administration, case management, and consensual dispute resolution. The first recommends internal monitoring and tracking of the key procedural events in the life of a civil case (“court administration”) in order to increase accountability in the courts. The second recommends greater judicial involvement in preparing and pacing a civil litigation (“case management”) to impose the necessary discipline on the civil process, and thereby significantly reduce the time required to adjudicate a civil claim. The third reform entails the expansion and development of alternative, consensual mechanisms to resolve disputes (“consensual dispute resolution” or “CDR”) in order to increase the availability of speedy and conciliatory dispute settlement processes.⁵⁰

We have set out these recommendations at length to underscore how similar they were to the measures initiated by Chief Justice Yong, which later earned the unqualified approval of the Malik Report. The timing is striking, because the Indo-US team made these suggestions in 1996.⁵¹ At the same time, as the Malik Report narrates, similar changes were being introduced, implemented and fine-tuned under the leadership of Chief Justice Yong and his team in Singapore. We have already demonstrated that Chief Justice Yong’s efforts along these lines brought about dramatic changes in the functioning and results of the judiciary in Singapore. However, similar changes recommended for India by the Indo-US team suffered a very different fate.

In their article published in 1998, the members of the Indo-US team expressed optimism about the chances of their recommendations being accepted, because a number of them had been incorporated into a new bill to amend the Indian Civil Procedure Code.⁵² When the Bill to amend the Indian Civil Procedure Code was introduced in Parliament, it was met with stiff resistance from the organized legal profession. Pratap Bhanu Mehta, a leading Indian scholar, comments acerbically on this sequence of events, and draws some important conclusions which are relevant for our analysis.⁵³ Mehta describes how the lawyers objected to

many provisions in the proposed amendments to the Indian Civil Procedure Code by citing several legal arguments which seem, at least on their surface, to be plausible.⁵⁴ As Mehta notes, the lawyers' groups were ostensibly aggrieved at not having been adequately consulted in the formulation of the proposed reforms.⁵⁵ However, their resistance, according to Mehta's analysis, points to a deeper malaise:

The single biggest weakness of the Indian legal justice system is its legal profession ... [E]very single attempt by the courts to reform their procedures in any way that would expedite matters has met stiff resistance from the respective Bar associations concerned. The issue is simple.... Lawyers get paid for appearances in court; there is no rationalized system of charging for actual amount of work done.... The details of the proposed [Civil Procedure Code] reform legislation are in some ways fairly humdrum, but they signify a general weakness of the Indian state. There is immense resistance to minor changes that could have far reaching effects; the resistance is largely a consequence of the most insecure sections of the profession having control over organized collective power.⁵⁶

The proposed reforms to the Civil Procedure Code stalled as a result of the lawyers' agitation, although some of them were eventually enacted into law after a gap of a few years.⁵⁷ Mehta's analysis may, however, be overly critical of the disorganized and vast legal profession in India. As some other commentators have noted, the Indian legal profession has also proved to be a democratizing force, often arguing strenuously against departures from constitutional norms. It is well documented, for instance, that during the illegal internal Emergency imposed by Indira Gandhi, bar associations and other lawyers groups played a strong role in challenging excesses of state power.⁵⁸

But Mehta's analysis does draw attention to yet another factor that potential reforms to the legal and judicial system in India have to account for. In Singapore, by contrast, Chief Justice Yong had little reason to worry about reactions from the organized legal profession. That body of professionals had, in a bruising set of events that occurred in the 1980s, been tempered and brought under rein. At present, the Law Society of Singapore does not even have the power to comment on legislative proposals or any matter relating to the legal system generally, unless its opinion is expressly sought by the government.⁵⁹ While there were rumblings of protest by individual lawyers to the wide-ranging and far-reaching reforms brought about by Chief Justice Yong in the 1990s, no official protest was ever lodged by the restructured Law Society. In India, by contrast, the representatives of the organized legal profession invariably have responses, and as demonstrated by the attempt to amend the Code of Civil Procedure, also have the political clout to thwart official measures that they do not approve of.

The issue of legal and judicial reform is, happily, one of the priority areas of focus of the current Indian government. Although an analysis of more recent

attempts is beyond the scope of this chapter, it is clear from the issuance of frequent policy papers and vision documents that the need for reform is well appreciated by contemporary policy makers in India.

Judicial reform projects: motivations and achievements

“When I use a word,” Humpty Dumpty said, in a rather scornful tone, “it means just what I choose it to mean, neither more nor less.”

“The question is,” said Alice, “whether you can make words mean so many different things.”

“The question is,” said Humpty Dumpty, “which is to be master—that’s all.”

(Lewis Carroll, *Through the Looking Glass*, 1865)⁶⁰

In this section, we take a step back from the Malik Report and its findings. We turn instead to the general body of literature in the field of law and development studies to examine the Malik Report’s claim that the reforms that were implemented in Singapore in the 1990s should be replicated elsewhere in Asia.

Legal reform through “Rule of Law” projects

As many scholars have noted, several of the legal reform projects that have been championed under the “new” Law and Development movement have invoked the “rule of law” as their primary justification.

In his widely acclaimed, “insider-critique” of reform projects aimed at “democracy promotion”, Thomas Carothers notes that the “rule of law” is an important part of the theoretical justificatory apparatus of these projects, because of the perceived “close connection between advancing the rule of law and promoting democracy.”⁶¹ Yet, as Carothers demonstrates by a close study of several legal reform projects, the phrase “rule of law” is almost as capacious as the term “democracy promotion” and has encompassed a whole range of policy objectives including reforming public institutions, rewriting laws, upgrading the legal profession, and increasing legal access and advocacy. These in turn have included a vast array of subjects including judicial reform, legislative strengthening, retraining prosecutors, police and prison reform, bolstering public defenders, introducing alternative dispute resolution, modernizing criminal laws, updating civil laws, introducing new commercial laws, strengthening bar associations, improving legal education, stimulating public interest law reforms and many others.⁶² It would seem, therefore, that the term “rule of law” is perceived as a flexible concept which allows reformers to bring in both macro and micro elements that they believe would suit their overall purposes.

Carothers’ path-breaking analysis focuses on projects initiated by the USAID as well as other US government agencies involved in “democracy promotion” efforts through the 1980s and 1990s. These projects involve huge amounts of money: USAID alone spent nearly US\$530 million annually in each year of the

1990s, through its several projects covering Sub-Saharan Africa, Asia, Eastern Europe, Former Soviet Union, Latin America and the Middle East. US Federal governmental expenditures multiplied five-fold from the 1980s to the 1990s, amounting to a total of US\$720 million in 1998.⁶³

We now focus upon the role of Malik's parent institution, the World Bank. In his study of the World Bank's involvement in legal and judicial reform projects, Alvaro Santos has noted how the World Bank was, prior to the 1990s, reluctant to intervene in the internal political events of its donor nations. This flowed from a specific prohibition in the founding Articles of Agreement of the Bank. However, starting in the early 1990s, the Bank began to focus on "governance" issues, thanks to a legal strategy devised by its general counsel, Ibrahim Shihata. As Santos notes, Shihata invoked a version of the "rule of law" to argue that the Bank was within its mandate to require donor nations to bring about legal reforms that were expressly linked to economic efficiency, rather than internal political issues.⁶⁴ Here, Shihata was invoking the idea from the "old" Law and Development movement, of legal reform being a crucial ingredient of economic progress.

Echoing Carothers' description of the flexibility accorded to the concept of the "rule of law" by USAID and its allied organizations, Santos demonstrates that the World Bank's understanding of the concept of the "rule of law" allows it to address a host of factors within the donor nations it focuses upon. In his critique of the Bank's legal reform strategies, Santos sketches out four distinct conceptions of the "rule of law" developed in jurisprudence and in the literature of economic development, as a template with which to analyse the Bank's strategies. He then considers the lack of conceptual agreement on the meaning of the rule of law and demonstrates its multiple interpretations, as well as the overlap and tensions among these conceptions. He ultimately argues that these various conceptions of the rule of law, as channelled in the Bank, constitute a hodge-podge that enables different and often conflicting projects to be pursued under the same agenda.⁶⁵ Santos' analysis is backed by a vast and sophisticated literature underlining the essentially indeterminate, amorphous and contested nature of the concept of the "rule of law".⁶⁶

Other scholars have also commented on this trend in more acerbic terms. In their recent book analysing the role of the "rule of law" in law and development projects, Michael Trebilcock and Ronald Daniels assert that within the field of law and development, "even those writers who purport to find near universal support for the 'rule of law,' acknowledge great uncertainty about what it is, precisely, that is universally supported."⁶⁷

Understanding the relative failure of judicial reform projects

As the figures cited by Carothers and Santos illustrate, the funding available for such projects is indeed of monumental proportions. Santos's recent study also provides details about the scope, extent and financial might of the World Bank's projects. According to his analysis, the World Bank has supported 330 "rule of

law” projects in over 100 countries between 1990 and 2006, spending about US\$3.8 billion dollars since 1993.⁶⁸

Given the expenditure and scale of the legal reform projects initiated by USAID and multilateral agencies like the World Bank, it is not surprising that several scholars have turned to the practical achievements of these projects over the nearly two decade long timeframe since they were first initiated. In his analysis of the two decade long experience of judicial reforms projects initiated by USAID and other US governmental agencies, Thomas Carothers argues that the results are “disappointing”. Carothers explains how these projects were started in a big way in the late 1980s and early 1990s in Latin America, but, writing in 1999, his conclusion was that they had “fallen far short of their goals”. Carothers argues that judicial reform projects in Russia, Cambodia, Egypt, Haiti, Guatemala, Romania and Nepal were quite unsuccessful on the whole.⁶⁹

Carothers tries to draw some lessons from such failures, and identifies three broad problems. He argues that the first problem was the huge “gap between the enormity of problems facing many judicial systems and the modest scale of the assistance response”. Carothers notes drily that “[m]erely offering some training for judges and some technical assistance on new administrative methods is unlikely to do much to renovate a system debilitated by these severe financial and political problems”.⁷⁰ The second obstacle is the fact that judiciaries are inherently difficult institutions to reform, as they tend to be “relatively decentralized institutions, with multiple sub-units run by independent-minded people (judges) who by training and usually by temperament are inclined to do things their own way”.⁷¹ Carothers notes that most judicial systems (whether in transitional systems or developed nations) are poorly managed and administered. Moreover, their management is often contested by the executive and judicial branches, and attempts to reform them have to encounter powerful resistance from vested interests within the institutions who benefit from the status quo. Carothers notes the following (often well-founded) fears of those judges and court personnel throughout the system who oppose judicial reforms: that they may lose power “if hierarchical, ingrown management systems are rationalized; they may lose control if outsiders start recommending and designing changes; and they may lose money and perquisites if corruption is reduced and transparency instituted”.⁷²

The third problem that Carothers insightfully identifies is the attitude of lawyers, and his focus on the reasons why they oppose reforms. Carothers asserts that “many of the more successful and powerful lawyers benefit greatly from cozy relationships with senior judges and an insider’s knowledge of how to make a dysfunctional system work to a client’s advantage.”⁷³ Carothers further notes that “lawyers are reluctant to support reforms that will mean major new laws and procedures for them to learn and that will render worthless much of their accumulated knowledge about the peculiarities of the existing system”.⁷⁴ Although Carothers relies upon extensive case studies conducted in Guatemala, Romania and Nepal to draw the above lessons, it is clear that these can be extended to other situations to explain the lack of success of judicial reforms.

For instance, the reasons identified by Carothers that lead lawyers to oppose reforms fit very well with the analysis offered by Mehta to explain why the reforms proposed by the Indo-US team were vehemently rejected by the majority of lawyers' groups in India (detailed in the previous section).

Alvaro Santos' assessment of the judicial reform projects initiated by the World Bank, written nearly a decade after Carothers' assessment of USAID projects of a similar nature, mirror his findings to a high degree. Santos' analysis covers World Bank projects on judicial reforms over a 15-year span. As Santos notes, the first judicial reform project of the World Bank was delivered as a "technical assistance loan" to Venezuela in 1992.⁷⁵ Over time, as Santos details, "the scope of these projects expanded to include aspects related to judicial independence, judicial training, court administration and case management, control of corruption, appointment of judges, criminal justice and government accountability."⁷⁶ The standard judicial reform project ranged from 2.5 million dollars (in Yemen) to 58 million dollars (in Russia). Yet, as Santos notes, the result achieved in these projects "has been disappointing, failing to deliver the expected results".⁷⁷ Santos argues that the failure can at least partly be attributed to the mistaken premises of many of these projects. He relies on published reports to note that the initial World Bank projects on judicial reforms assumed that independent and effective courts were a necessary precondition for economic development. The assumption was that courts would ensure calculability and predictability of economic transactions by effectively enforcing contracts and acting independently to prevent governments' impingement on property rights. Santos argues that these premises were proved to be unfounded when it was demonstrated that for investors, a formal regime of property rights and contract enforcement was not necessarily a priority. They were driven, instead, by returns and often relied on informal mechanisms of enforcement. Second, there was evidence that showed that investors were not all that concerned with the effectiveness of judiciaries in countries where they invest. Here, the examples of Singapore and China as valued destinations of investment, despite not having formal regimes of property rights or strongly independent judiciaries, are relevant. Third, it became clear that investors usually do not solve their disputes in court, but rely upon arbitration or strive to reach a settlement. Lastly, it became clear that good legal systems by themselves do not guarantee investment, but in fact may impede the conditions for certain investments.

Another lesson is that judicial reform projects have to be developed from the ground up, by taking into account the local factors that cause the root problems. While lessons from other jurisdictions are relevant, as Jacques Delisle has argued, they cannot set the basic template for reforms in all societies.⁷⁸ Frank Upham has similarly asserted that meaningful legal reform requires not so much a focus upon the foreign model or institutional goals, but "close attention to, genuine respect for, and detailed knowledge of the conditions of the receiving society and its pre-existing mechanisms of social order."⁷⁹ This would necessarily mean that legal and judicial reform projects cannot be driven solely by foreign experts, and must involve local personnel who possess greater familiarity and

understanding of these issues. This insight is powerfully developed by Kevin Davis and Michael Trebilcock when they note that “[p]olicymakers need to think carefully and modestly about what comparative advantage ‘outsiders,’ especially outsiders from the developed world, possess in inducing or assisting developing countries to embark upon legal reforms, substantive or institutional”.⁸⁰ Davis and Trebilcock note that such outsiders can add value by providing inputs such as money and purely technocratic expertise (e.g. in designing computer systems for court or land registry management). They assert emphatically, however, that “it is difficult to imagine ‘outsiders’ effectively assuming the role of chief designers or principal promoters or champions of such initiatives.”⁸¹

The cumulative lessons from all these experiences would therefore cast at least some doubt on the confidence with which the Malik Report presents the Singapore judicial reform project as a model to be replicated in other societies, each of which will have its own peculiar complexities and problems.

Conclusion

Our purpose in this chapter has been to highlight certain basic contradictions in the way judiciaries are assessed by different sets of actors, including human rights bodies on the one hand, and aid and development agencies such as the World Bank on the other. We use the Malik Report and its focus on recent judicial reforms in Singapore to highlight larger questions about what exactly is it that judicial reforms should be focusing upon. While the reforms that Singapore underwent have resulted in one of the fastest and most efficient judicial systems in the world, critics still question that system’s capacity to deliver justice and its level of independence from the other branches of government. On the other hand, India’s judiciary attracts praise from several quarters for its bold judgments upholding democracy and rights, thereby garnering it a strong reputation for its focus upon delivering justice, while its huge backlog and delay raise concerns about how effectively it can deliver justice given its structural and systemic handicaps.

We are also concerned about the extremely practical and pressing questions relating to the processes of effecting successful judicial reforms to tackle backlog and delay. As our survey of efforts in both Singapore and India show, quite often these factors do have a very strong “local” basis, which even domestic observers, let alone foreign advisers, are not able to come to grips with. Ideas from other jurisdictions, especially practical strategies that have led to demonstrable change in particular societies such as the introduction of information technology and the use of ADR methods, are of course relevant. However, as we sought to show in our analysis of the Indian case, the steps that were simultaneously being implemented very effectively in Singapore were also recommended within India. In India, however, a number of local socio-political factors intervened to thwart the process of effective judicial reforms that were attained in Singapore. In particular, reform processes that sought to bypass the creaky and inefficient system by setting up new tribunals were viewed with suspicion as attempts to

undermine the independence of the existing judiciary. Further, echoing the trend in other jurisdictions, the hostility of the organized legal profession to many specific reforms also acted as a stumbling block. These factors did not, for particular historical and systemic reasons, impede the pace of reforms in Singapore.

Interestingly, our conclusions dovetail well with the expressed recent concerns of the official heads of the judiciary in India and Singapore. The current head of the Singapore judiciary, Chief Justice Chan Sek Keong, devoted a substantial portion of his inaugural speech to the need for achieving both efficiency and justice.

Whilst court disputes should be disposed of in a timely manner, no litigant should be allowed to leave the courtroom with the conviction or feeling that he has not been given a fair or full hearing because it was done hurriedly. Hence, it is important that the Judiciary gets the balance right if litigants are to have confidence in the administration of justice. But efficiency and justice, or the appearance of justice, do sometimes clash. [...] This clash of values goes to the heart of the matter. The fair administration of justice must ultimately trump court efficiency and convenience, where the two are in direct conflict. But in the general run of cases, these values are not antithetical. Justice can be dispensed efficiently. When efficiency is added, justice need not be subtracted.⁸²

It is interesting to contrast these views of Chief Justice Chan, with those expressed by the immediately preceding head of the Indian judiciary, Chief Justice Balakrishnan, in a speech to the Supreme Court Bar Association:

Even as the courts in India, hearing the largest number of cases in the world, zealously guard the rights and liberties of the people, the number of arrears in cases continues to be on the rise. This causes a great delay in deciding cases, and results in Justice being rendered inaccessible. Consequently, the people's faith in the judicial system begins to wane, because justice that is delayed is forgotten, excluded and finally discarded.⁸³

The point that Chief Justice Chan repeatedly emphasizes is that while efficiency is a laudable goal for every judicial system, it cannot be the main focus of a judicial system. Similarly, Chief Justice Balakrishnan notes in the rather different Indian context that an exclusive focus on justice, without a concomitant attention to ensuring that the overall system of administration of justice is efficient, will also result in injustice.

Malik's report has been a good starting point for a comparative discussion on judicial reforms. However, we take great pains to avoid an overly Panglossian view of the Singapore judicial system, which while it has successfully implemented very laudable reforms, still needs improvements as has been conceded by the current Chief Justice of Singapore.

We believe that some general principles can be learnt by each jurisdiction from looking at the experiences of others, but the manifestation of enduring reform will require solutions that are tailored for each jurisdiction by persons with genuine and substantive expertise in local legal systems. This is strikingly clear from looking at the specific jurisdictions we have focused upon. In Singapore, the main drivers of the reform were local judges and administrators, who had both experience and insight into the working—and failings—of the legal system. The outsiders involved were administrators and civil servants from other branches of government and the public sector in Singapore, who had successfully carried out reform initiatives in their respective departments. In India, there has been a tendency to look to foreign technocratic experts to provide enduring solutions to the complex problems confronting its judicial system. The initiatives which have had some degree of success in India, such as the Indo-US legal and judicial reform team that was constituted in the mid-1990s, comprised both Indian judges and administrators, and foreign experts. One lesson that can be drawn in India from the Singapore experience is the need to develop reform expertise among local judges and administrators, in part by drawing upon successes in other governmental and public sector departments. Those reforms, having been achieved against the backdrop of similar socio-political challenges, might well have more to offer to Indian legal and judicial reformers than the experiences of legal reform in quite distant—and vastly different—nations.

In recent work, the law and development scholars Kevin Davis and Michael Trebilcock have asserted that the “next research frontier” for law and development studies would entail “a much more labour-intensive and context-sensitive analysis of particular legal regimes and institutions (both formal and informal) in particular societies and potential reforms thereto evaluated against some set of broad or more generalizable development goals.”⁸⁴ By drawing attention to the history of legal and judicial reforms in Singapore and India, we hope to have contributed in small measure to that laudable ambition.

Notes

- 1 This is a revised version of the paper presented at the original conference in Kyushu in February 2008. We also benefited from presenting a draft at the HKU-NUS-SMU conference held in Singapore in December 2008. We extend special thanks to Varun Gauri for his critical feedback, and to Amogh Chakravarthi for his close review and comments on an earlier draft. The usual caveat applies.
- 2 Waleed Haider Malik, *Judiciary-Led Reforms in Singapore: Framework, Strategies and Lessons* (World Bank, Washington, DC, 2007) (hereinafter referred to as ‘the Malik report’ or more simply, as ‘the Report’).
- 3 *Ibid.* at xv.
- 4 Lewis Carroll, *Alice’s Adventures in Wonderland and Through the Looking Glass* (Signet: New York, 2000) at p. 176.
- 5 See in particular the chapters by David Trubek and John Ohnesorge in this volume.
- 6 David M. Trubek and Marc Galanter, “Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States”, 1974 *Wis. L. Rev.* 1062.

- 7 See generally, David Trubek, "Law and Development: Then and Now", *Proceedings of the 90th Meeting of the American Society of International Law*, 90 ASIL Proc. (1996) at pp. 5–6; Carol M. Rose, "The 'New' Law and Development Movement in the Post-Cold War Era: A Vietnam Case Study", 32 *L & Soc'y Rev.* 93, (1998); Amichai Magen, "The Rule of Law and its Promotion Abroad: Three Problems of Scope", 45 *Stan. J. Int'l. L.* 51(2009); and Amy Cohen, "Thinking with Culture in Law and Development", 57 *Buffalo L. Rev.* 511 (2009).
- 8 Chief Justice Yong Pung How, *Chief Justice's Response*, Opening of the New Legal Year 2006, available at: <http://app.supremecourt.gov.sg/default.aspx?pgid=921&printFriendly=true>.
- 9 *Annual Report of the Supreme Court of Singapore* (2008), available at: <http://app.supremecourt.gov.sg/data/doc/ManagePage/44/AnnualRpt2008/timeliness-of-justice.html> (1 September, 2009).
- 10 See, *Subordinate Courts Annual Report 2008*, pp. 91–2, available at: http://app.subcourts.gov.sg/Data/Files/File/AR_2008/SubCourtsAR08.pdf (1 September 2009).
- 11 *Ibid.*
- 12 The Malik Report is not alone in its awe at the success of the judicial reforms effected in Singapore since 1990. The international business community ranks Singapore's judiciary very highly, as is evident in reports of bodies such as the Hong-Kong based Political and Economic Risks Consultancy (which consistently listed Singapore's judicial system as the best in Asia for several years), the Switzerland-based World Competitiveness Centre and the Geneva-based World Economic Forum which reaches similar conclusions about Singapore's judiciary. Malik's parent institution, the World Bank, has in the past ranked Singapore's judiciary as scoring very highly on the parameters measuring rule of law and control of corruption.
- 13 The Malik Report, at 2.
- 14 The Malik Report, at xvi (emphasis added).
- 15 Amnesty International, Singapore: J.B. Jeyaretnam: Defamation Suits, available at: www.amnesty.org/en/library/asset/ASA36/005/1998/en/96687953-d9da-11dd-af2b-b1f6023af0c5/asa360051998en.html (3 September 2009).
- 16 Beatrice S. Frank *et al.*, *The Decline of the Rule of Law in Malaysia and Singapore Part II—Singapore*, A Report of the Committee on International Human Rights (The Record of the Association of the Bar of the City of New York, January/February 1991), vol. 46, no. 1, pp. 7–85.
- 17 Kelley Bryan, *Rule of Law in Singapore—Independence of the Judiciary and the Legal Profession in Singapore* (Lawyers' Rights Watch Canada: 17 October 2007), available at: www.lrwc.org/documents/LRWC.Rule.of.Law.in.Singapore.17.Oct.07.pdf (3 September 2009).
- 18 *Singapore*, International Religious Freedom Report 2005 (US Department of State: 8 November 2005).
- 19 See, for example, Francis Seow, *Beyond Suspicion? The Singapore Judiciary*, (Yale Southeast Asia Studies, New Haven, Connecticut: 2006).
- 20 Thio Li-ann, "Lex Rex or Rex Lex? Competing Conceptions of the Rule of Law in Singapore", 20 *UCLA Pac. B. L. J.* 1, 17–23 (2002).
- 21 Thio, *ibid.* at p. 22.
- 22 Ross Worthington, "Between Hermes and Themis: An Empirical Study of the Contemporary Judiciary in Singapore", 28 *J. Law & Soc.* 490 (2001).
- 23 See, generally, Chris Lydgate, *Lee's Law: How Singapore Crushes Dissent* (Scribe Publications, Melbourne: 2003).
- 24 The 1994 figures are reported in Thio, *supra* note 19 at p. 17.
- 25 Public Service Division Press Release: Administrative Officers, Political, Judicial and Statutory Appointment Holders to get 4% to 21% pay Increase, 13 December 2007 available at: <http://app.psd.gov.sg/data/Press%20release%20-%2013%20Dec%2007.pdf>. Paragraph 4 states that "[t]he salaries of political, judicial and statutory

appointment holders are pegged to these benchmarks. The entry grade for Ministers is pegged at Staff Grade I, and the higher appointments (for example, the President, Prime Minister, Chairman Public Service Commission, judges, etc) are set based on predetermined ratios to the Staff Grade I salary.” The press release then provides that the base salary of a Minister is SGD 1,940,000 but does not provide the salaries for the “higher appointments”.

- 26 Francis Seow, *The Politics of Judicial Institutions in Singapore*, Lecture delivered in Sydney, Australia (1997), available at: www.singapore-window.org/1028judi.htm (“Indeed, [the Chief Justice of Singapore] receives more than the combined stipends of the Lord Chancellor of England, the Chief Justices of the United States, Canada and Australia”).
- 27 Id. (quoting an unnamed Queen’s Counsel who is said to have queried: “Is this kind of money a salary or an income of permanent bribery?”).
- 28 This is the basis of the defence of the Singapore judicial system offered by C.L. Lim. See, C.L. Lim, “The Singapore Constitution and its Critics”, 2004–05 *Denning L. J.* 63.
- 29 Thio, *supra* note 19 at pp. 70–75.
- 30 Ben Nadarajan and Carolyn Quek, “The Price of Justice in \$”, *The Straits Times* (21 October 2007) (detailing how the overall costs of legal proceedings has risen considerably in the period between 1997 and 2007: the report quotes lawyers who assert that court fees have risen from \$150 to \$1,500 over this period in part to deter frivolous lawsuits, and that this has also caused lawyer fees to double during the same period).
- 31 Michael Hwang, *Address of the President of the Law Society at the Opening of the New Legal Year*, 5 January 2008, available at: <http://app.supremecourt.gov.sg/default.aspx?pgid=2282&printFriendly=true>.
- 32 Carroll, *supra* note 3 at p. 147.
- 33 See generally, Burt Neuborne, “The Supreme Court of India”, 1 *Int’l J. Const. L.* 476–510 (2002).
- 34 Jayanth Krishnan, “Outsourcing and the Globalising Legal Profession”, 48 *William & Mary L. Rev.* 2189, 2219–32 (2007).
- 35 Krishnan, *ibid.* at 2222–23.
- 36 *Annual Report of the Supreme Court of India (2006–07)*. The latest available report on the website of the Supreme Court provides details only of the Supreme Court. See generally, *Annual Report of the Supreme Court of India (2007–08)*, available at: www.supremecourtsofindia.nic.in/sci%20Annual%20Report%202007–08.pdf (August 30, 2009).
- 37 See *Annual Report* for 2007–08, *ibid.*
- 38 See, ‘Vital Stats—pendency of cases in Indian Courts’, PRS Legislative Research, available at: www.prsindia.org/administrator/uploads/general/1251796330~Vital%20Stats%20-%20Pendency%20of%20Cases%20in%20Indian%20Courts%2026Aug2009%20v10.pdf (1 September 2009).
- 39 As outlined at the home page of the official website of the Law Commission of India, available at: www.lawcommissionofindia.nic.in/main.htm#EARLY_BEGINNINGS: (4 September 2009).
- 40 *Fourteenth Report of the Law Commission on “Reform of Judicial Administration”* (1958) Vol. I, p. 38.
- 41 *Ibid.* at Vol. I, p. 93.
- 42 *Ibid.* at Vol. I, p. 94.
- 43 The Report issued several sets of recommendations for various aspects and limbs of the legal system. This is evident from its chapter headings, some of which allow us to obtain a sense of the extent of its remit: The Supreme Court (pp. 32–63), The High Courts (pp. 64–128), Adequacy of Judge Strength (pp. 129–60), Subordinate courts (pp. 161–229).
- 44 *124th Report of the Law Commission of India* (1988) at p. 7.
- 45 *Ibid.*

- 46 The Supreme Court's decision was an attempt at compromise, and while it upheld the constitutionality and legality of the Tribunals generally, it struck down the provision that gave these tribunals the power to substitute the High Courts. See, *L. Chandrakumar v. Union of India*, (1997) 3 SCC 261.
- 47 Hiram E. Chodosh, Stephen A. Mayo, A.M. Ahmadi and Abhishek M. Singhvi, "Indian Civil Justice System Reform: Limitation and Preservation of the Adversarial Process", 30 *N.Y.U. J. Int'l L. & Pol.* 1, 12–13 (1998).
- 48 The article cited in the previous footnote provides an overview of the group's constitution as well as its working methods, while also providing a summary of its main conclusions. See generally, Chodosh *et al.*, *ibid.*
- 49 Chodosh *et al.*, *ibid.* at pp. 30–31 (footnotes omitted).
- 50 *Ibid.*
- 51 See Chodosh *et al.*, *ibid.* at pp. 15–16, providing dates of meetings between members of the team through February–November 1996.
- 52 Chodosh *et al.*, *ibid.* at pp. 74–75 identify how the 12 amendments in the Bill were inspired by the study conducted by the Indo-US team:

The first amendment will limit the time for the completion of pleading. The second amendment will allow for party-controlled service of process. The third amendment provides for the filing of a Case Management Statement and a Joint Case Management Statement. The fourth amendment provides authority to the courts to refer cases to CDR mechanisms, including arbitration, mediation, conciliation, judicial settlement, or Lok Adalat. The fifth amendment allows the court to appoint a commissioner to record evidence. The sixth amendment requires that adjournments be supported by a written justification and a mandatory imposition of costs. A seventh amendment requires the posting of a bond in efforts to obtain temporary injunctive or interlocutory relief. An eighth amendment dispenses with the requirement that appeals be submitted with a certified copy of the decree. A ninth amendment eliminates the practice of sending the trial record to the appellate court unless the appellate court expressly so directs. A tenth amendment eliminates appeals against an appellate decision of a single judge. An eleventh amendment does the same in writ jurisdiction. A final amendment enhances the pecuniary limit in a second appeal from 3,000 to 25,000 rupees.

- 53 Pratap Bhanu Mehta, "India's Judiciary: The Promise of Uncertainty", in *Public Institutions in India: Performance and Design* (Devesh Kapur and Pratap B. Mehta, eds., Oxford University Press: New Delhi, 2005) pp. 158, 190–91.
- 54 Mehta notes the responses advanced by lawyers to many of the amendments suggested by the Indo-US team that are listed out in footnote 50 above. Lawyers argued against the time limits for completion of pleadings (which was the first amendment proposed above) by citing cases where the government was a respondent, which typically required greater time. They opposed the fifth amendment, which proposed allowing court-appointed commissioners to examine witnesses, by arguing that this measure presupposed the neutrality of commissioners and was therefore problematic. The sixth amendment, proposing mandatory costs for adjournments, was bitterly opposed by the lawyers, who seemed to claim a putative right to be granted an adjournment. These and other arguments advanced by the lawyers in opposition to the proposed amendments are listed in Mehta, *ibid.* at pp. 190–91.
- 55 Mehta, *ibid.* at pp. 189–90.
- 56 *Ibid.* at pp. 188–190.
- 57 See the following news report, which enumerates the reforms that were eventually adopted in the text of the Code of Civil Procedure. Some of these were clearly derived from the recommendations of the Indo-US team, even as their most far-reaching recommendations were ignored. 'Civil Procedure Code Amendment to Provide Speedy Justice', *Financial Express*, 22 July 2002, available at: www.financialexpress.com/

- news/civil-procedure-code-amendment-to-provide-speedy-justice/52728/0 (5 September 2009).
- 58 See, for example, Granville Austin, *Working a Democratic Constitution* (Oxford University Press: Delhi, 1999) describing how lawyers and bar associations played pivotal roles in opposing and ultimately undermining the illegal Emergency.
- 59 Section 38 (1) c of the Legal Profession Act in Singapore has been amended and interpreted to mean that the Law Society can comment on questions relating to legislation and public policy only when its intervention is sought. See, Clarissa Oon and Kor Kian Beng, "Should Law Society Speak Up Only When Asked?" *Straits Times* (19 July 2008).
- 60 Carrol, *supra* note 3 at p. 188.
- 61 Thomas Carothers, *Aiding Democracy Abroad: The Learning Curve* (Carnegie Endowment for International Peace: Washington, DC, 1999), p. 164.
- 62 *Ibid.* at p. 168 (setting out a chart which synthesizes and summarizes the various elements of such 'rule of law' projects).
- 63 *Ibid.* at p. 54 (providing a detailed chart setting out individual amounts and sources).
- 64 Alvaro Santos, "The World Bank's Uses of the "Rule of Law" Promise in Economic Development", in *The New Law and Economic Development: A Critical Appraisal* (David Trubek and Alvaro Santos, eds, Cambridge University Press: Cambridge, 2006).
- 65 Santos, p. 256.
- 66 See generally, Paul Craig, "Formal and Substantive Conceptions of the Rule of Law: An Analytical Framework", *Public Law* 467–87 (1997); Randall Peerenboom, "Varieties of Rule of Law", in *Asian Discourses of Rule of Law* (Randall Peerenboom, ed., Routledge: 2004), pp. 1–55; Frank K. Upham, "Mythmaking in the Rule of Law Orthodoxy", in *Promoting the Rule of Law Abroad: In Search of Knowledge* (Thomas Carothers: Carnegie Endowment for Int'l Peace, 2006); and Ugo Mattei and Laura Nader, *Plunder: When the Rule of Law is Illegal* (Blackwell: Oxford, 2008).
- 67 Michael J. Trebilcock and Ron Daniels, *Rule of Law Reform and Development* (Edward Elgar: 2008), pp. 12–13.
- 68 Santos, p. 253.
- 69 Carothers, at pp. 170–76.
- 70 Carothers, p. 173.
- 71 *Ibid.*
- 72 *Ibid.* at p. 175.
- 73 *Ibid.* at p. 175.
- 74 *Ibid.* at pp. 175–76.
- 75 Santos, p. 282.
- 76 *Ibid.*
- 77 *Ibid.*
- 78 Jacques Delisle, "Lex Americana? United States Legal Assistance, American Legal Models, and Legal Change in the Post-Communist World and Beyond", (1999) 20 *University of Pennsylvania Journal of International Economic Law* 179.
- 79 Upham, *supra* note 65 at 101.
- 80 Kevin E. Davis and Michael J. Trebilcock, "The Relationship between Law and Development: Optimists versus Skeptics", 56 *American Journal of Comparative Law* 895 at 946 (2008). See also, Kevin Davis, "Legal Universalism: Persistent Objections", *University of Toronto Law Journal* 537–53 (2010).
- 81 Davis and Trebilcock, *ibid.*
- 82 Response by the Honourable the Chief Justice, Opening of Legal Year 2008, 5 January 2008, paras 12 and 29.
- 83 Address by Honourable the Chief Justice of India to the Supreme Court Bar Association on 15 August 2007 at the Supreme Court Lawns, available at: www.supremecourtindia.nic.in/new_links/August_15_2007.pdf.
- 84 Davis and Trebilcock, *supra* note 79 at 946.

8 Japanese long-term employment

Between social norms and economic rationale

*Caslav Pejovic**

Introduction

The practice of long-term employment in Japan, often referred to as “lifetime employment,” is considered to be one of the most distinctive features of the Japanese employment practice, as well as one of the essential elements of the Japanese economic model.¹ Hence, it is not surprising that it has often been the subject of attention for scholars in human resource management, corporate governance, labor law and economics. During the period of economic expansion, long-term employment was praised as one of the key factors of Japan’s success story. After the bubble burst in the early 1990s and economic recession left many companies with a huge excess of employees, long-term employment came under harsh criticism as one of the obstacles to economic recovery. Since then many scholars have argued for a revision of employment relations in line with the Western model, but so far the fundamental patterns of long-term employment persist.

There are various views on whether long-term employment is really unique to Japan (and some other Asian countries, such as South Korea), or the differences are just a matter of degree. According to the culturalist view, long-term employment is fundamentally different from the Western patterns and its character is determined by the unique culture of Japan. The opposite view disputes this cultural explanation by relying mainly on an economic rationale and focusing on economic factors. This bipolar approach is also present in some other areas of Japanese law and practice, such as the theories concerning the low litigation rate in Japan and the character of Japanese corporate governance.

Several questions may be raised in relation to long-term employment: Why does it exist in Japan? What is its origin? What is really unique about the long-term employment system in Japan? How does it affect Japan’s economic model?

This chapter will firstly address the basic features of long-term employment in Japan. Then, it will analyze the influences of various factors on long-term employment in light of arguments relied on by competing theories on the nature of long-term employment. This approach may be useful in seeing a wider picture of the Japanese long-term employment system which can contribute to a more complete and thorough understanding of it. Understanding the nature of

long-term employment may also be important for assessing possible future trends of long-term employment.

The last part will explore the new tendencies and prospects for changes in long-term employment in Japan as a consequence of economic recession in recent years. In different ways, both economic recession and globalization have affected the long-term employment system. We shall try to analyze the changes from the point of view of changes in attitudes towards long-term employment, the reactions of employers and also possible changes to the legal framework and corporate structures. Particular attention will be given to the assessment of legal reforms and their potential impact on the future of long-term employment. This issue will be analyzed by considering various factors, such as the need for a more flexible labor market, the social constraints that may present an obstacle to comprehensive changes in the existing system, as well as the attitudes of society, firms and the government. The chapter will conclude by evaluating the possible directions of the evolution of long-term employment in the future.

Concept of long-term employment

Long-term employment is one of the typical features of the Japanese economic model. This system is not regulated by any particular law, but it is based on informal norms and practice.² Under this system, an employee is recruited directly from school or university and is expected to remain in the company for the length of his or her career. In return, he or she can expect not to be fired or discharged, except under some extraordinary circumstances.³ The basis of this agreement is the commitment of employers to providing secure employment to their employees in return for loyalty and “lifetime” service. The employer can rely on loyal employees and their dedication to work hard, in exchange for the investment in their training.

As a part of the long-term employment system, the promotion of employees within the hierarchy of the company and wages are based on the principles of seniority and merit (*nenko*).⁴ These principles do not necessarily mean that the promotion and wages depend only on the age or length of employment. Initially, regular employees are promoted on the basis of seniority and in this initial stage employees are promoted at an equal pace. After that initial stage, after ten or 15 years of employment individual abilities become more important, because by that time employers are able to identify more capable employees who are then given priority in promotions. Many companies have established a system of grade classification (*shokuno shikaku seido*), under which the employees are classified based on their ability and performance.

The term “lifetime employment” is misleading if understood in the literal sense that it guarantees employment continuing for a lifetime; it should be understood in a more limited way that it guarantees long-term employment that is not for the employee’s actual life but only for the length of the employee’s career.⁵ The mandatory retirement (*teinen*) system is an essential element of long-term employment which allows the employer to do away with employees

automatically at a fixed retirement date. The standard retirement age used to be 55, but now it must be 60 or higher to be legal.⁶ Presently most companies fix retirement between 60 and 65.⁷

According to some scholars, long-term employment is not an institution at all, since it applies to less than 20 percent of the working population, mostly to male workers in large companies or public institutions.⁸ The long-term employment system usually applies to workers in major Japanese companies. It is far less present in small companies, where employees are more likely to change jobs during their career. Average tenure is longer for men than women, and increases with the size of the company.⁹ Long-term employment is guaranteed only to a certain category of (typically male) employees who are of great importance to the company. This means that the opportunities for long-term employment in Japan are, in fact, quite limited and that many Japanese cannot get such a chance.

Some scholars discussing long-term employment tend to overlook employment in government-related institutions and focus on the private sector. Employees in the public sector should not be excluded from this discussion, since they make up a sizeable proportion of the labor force in Japan. The fact is that long-term employment does not apply only to small and large firms in the private sector, but also to government employees.¹⁰

The long-term employment system does not mean a formal obligation of the company not to dismiss its employees, nor does it mean that the company does not dismiss employees, as this happens in practice. Rather, long-term employment should be understood in the sense that the company will not resort to layoffs unless the company is in deep economic crisis and layoff is the only possible way to keep the company afloat and prevent its bankruptcy. Even in times of crises, such as the oil shock crises, or more recently during the "lost decade," instead of layoffs companies used other mechanisms aimed at avoiding layoffs, such as the reduction of overtime and assigning employees to affiliated companies.

Long-term employment is not really unique to Japan, since similar systems exist in many other countries.¹¹ However, relying merely on the numbers and statistics to prove that the Japanese model is not different from other long-term employment patterns misses the point. The essence of the Japanese model of long-term employment is not in the numbers, but in its character. There are several elements of the long-term employment system that are typical for Japan, such as the way of recruiting graduates,¹² seniority-based wages, internal transfers based on rotation system and on-the-job training, which result in firm-specific skills making extremely difficult for employees to move to other firms. These features make Japanese long-term employment qualitatively different from the corresponding patterns in most other countries.

What may also be more typical for Japan is the feeling of attachment and loyalty to the company, which seems to be stronger in Japan than elsewhere. Whereas in the West the ownership and control of a company are usually associated with shareholding, in Japan it is more often the employees who talk about

“my company.”¹³ Even if some young Japanese are not very enthusiastic about the idea of long-term employment, once they enter a company they realize that changing a company may not be good idea, since the system of long-term employment puts at a disadvantage those who often change companies.

Creation of the long-term employment system

The Japanese employment system developed as a result of the deliberate policy of the interested parties to find a solution to the problems that appeared in the aftermath of World War II. The creation of long-term employment is often placed in the post-war period as a political compromise between labor and management.¹⁴ However, just as each plant has its seeds and roots the same holds true with the long-term employment system in Japan.

It has been argued that long-term employment existed in the Tokugawa period.¹⁵ Such claims should be taken with a dose of caution, at least for the initial stage of the Tokugawa period, since at that time only a tiny portion of the population in Japan was engaged in regular employment. Other scholars argue that the traces of long-term employment can be found in the great merchant houses where the apprentices would be recruited at the age of 10 or even earlier.¹⁶ They would receive training for their job and then move on in their career based on seniority rather than performance. Dore points out the fact that at that time seniority played an important role in determining wages and promotions, which indicates that this was already an organization-oriented rather than a market-oriented wage system.¹⁷ These practices which existed in the second half of the nineteenth century may be taken as the first origins of the modern long-term employment system which developed decades later in the twentieth century.

The modern origins of the long-term employment concept are found in the early part of the twentieth century, when long-term employment gradually developed as a business strategy to avoid high fluctuations in the workforce that created difficulties for companies, particularly in key industries such as iron and steel. To solve that problem, companies started to offer incentives designed to encourage experienced workers to stay, such as increased wages based on seniority and hefty retirement allowances for long-term workers.¹⁸ This was accompanied by an ideological justification for the long-term employment relationship, tying it to Confucian notions of reciprocal obligations as a part of the revival of the traditional values process. This ideological process, jointly with the harsh crackdowns on leftist leaders and the increasing power of the army, enabled large companies to convert their employees into “manageable servants of the company’s interests.”¹⁹ Many large companies employed young boys as trainees who would become permanent employees after the training period, since it was easier to develop loyalty to the company in such young boys’ minds.²⁰ The companies also developed a hierarchical system based on ranks. *Shokuin* (office clerks) formed the upper group from which were recruited managers of the company. This group was granted the privilege of permanent employment from

the start. This privilege was later extended to the core of employees.²¹ This type of employment was just one among several different types of employment that existed in that period in Japan. Another common type of employment involved temporary workers employed on a contract basis where there was work for them to do. However, the recession in 1920s prevented wide adoption of long-term employment in the prewar period.²² The Japanese government emerged in the 1930s as a new factor by regulating the relationship of employers and employees and pushing the employers to adopt the traditional Japanese system of labor management.²³ The Government adopted a number of laws that limited worker mobility and promoted the new policy. Then Japan entered the war and further important developments that played a key role in shaping the modern employment system took place in the postwar period.

Long-term employment was first institutionalized in its present form in the 1950s and became popular in the 1970s. In the beginning, long-term employment was a new strategy based on rational economic choice by employers.²⁴ The modern long-term employment system was allegedly designed as a result of a compromise entered into between management and labor unions aimed at overcoming existing labor problems, being a mutually beneficial bargain, rather than a solution imposed by traditional culture.

Political factors also played a role in the creation of long-term employment. The government supported lifetime employment, because it contributed to reducing the tensions between employers and employees that, in case of escalation, could have endangered the peace and stability of the State. This government policy was expressed through a legal framework that was aimed at supporting the long-term employment system. Moreover, the courts played an important role by supporting the concept of long-term employment as a part of the similar public policy.

Factors determining long-term employment

A number of different factors have played a role in the creation and functioning of long-term employment. This paper will limit discussion to those factors that are considered to be the most relevant: cultural background, economic rationale, structure of corporate control and legal framework.

Cultural background

Theories that emphasize the importance of the cultural factor for the development and functioning of long-term employment rely on the argument that long-term employment has its roots in Japanese history and social norms. According to these theories, the Japanese corporate culture is described as being influenced by the family system, in the sense that the Japanese company is based on the principles of a traditional family.²⁵ This family concept of companies is deeply rooted in Japanese culture, influenced by obedience, hierarchy and loyalty, which all make up important elements of Japanese culture. The kinship-based

economic unit was established in the Tokugawa period and provided the basis for the long-term employment system and seniority-based status, which became the basis of the modern system of employment in Japan. Originally, the Confucian ethic of the group was typically applied to relationships in a family, which are traditionally long-term relationships. The group concept was extended to the traditional *ie* (home) and later on to the firm.

Culturalist theories argue that *kaisha* (company) symbolizes an organization where people are not united by contractual relationships, but rather it includes this element of association resembling that of a family. Of course, the *kaisha* provides the income that enables employees to support themselves and their families, but it also involves an emotional linkage, which may exist in the West too, but usually not as deeply as in Japan. "The company is the people" is a common saying.²⁶ By characterizing the company as a family unit, the company has achieved a greater level of loyalty between management and employees. Each employee has an attachment to the company as "my company" (*uchi no kaisha*), so that all of the employees, in a sense, represent the company. If an employee does something wrong, there will normally be solidarity between the employees, including management, who will try to protect him/her, because such wrongdoings are often done for the company.²⁷

One of the main features of Japanese industrial relations is the identification of employees with the company, which is related to a group mentality and the need of employees for a sense of belonging to a peer group.²⁸ Working in a company is considered to be a part of one's identity, and by moving to another company a person feels deprived of an important part of his/her identity. It is often said in Japan that an employee chooses a company, not a profession. Entry into the company is viewed as "being born again into another family."²⁹ Personal interrelationships give a feeling of belonging to a group (*nakama ishiki*) and security to the individual, but it may also result in a feeling of dependence. Community in Japan may be best understood in terms of mutual interdependency and a shared sense of belonging to a community, or group. The Japanese people even evaluate each other on the basis of the group they are affiliated with, making them very sensitive about the reputation and prestige of their group. As a result of such attitude, frequent changes of jobs and moving from one company to another are not looked upon favorably in Japanese society.

B Economic rationale

Scholars argue that long-term employment developed as a result of economic rationality, rather than being influenced by cultural factors.³⁰ It has also been argued that since long-term employment affects only a portion of employees, and is not universal, it cannot be based on culture, because culture assumes a set of norms and practices that are universal.³¹ Long-term employment in its present form developed due to economic factors, because it contributed to a greater productivity that benefited both the shareholders and management through higher profits on one hand, and labor through greater employment security on the other.

The legal framework that developed during the same period and supported long-term employment was arguably based on a government policy that encouraged the long-term employment practice.

The long-term employment system was beneficial for both employers and employees. It contributed to building the system of investment in human capital, as employees are recognized as an important asset. In the hiring process, large Japanese companies rely on fresh graduates who don't have working experience. The idea behind such hiring policy was that the employees would be trained after they enter company and that they would acquire necessary skills during that process. Companies provided their employees with high-level education while on-the-job training became common practice among Japanese companies. The training process is exercised during the early years of the career and includes rotation of employees through a variety of jobs within the company. Long-term employment is closely related to on-the-job training, which would not make much sense if employees did not stay with the company on a long-term basis.

Absence of an external labor market provided an economic rationale for companies to invest in workers' skill development. From the perspective of companies, long-term employment is beneficial since employees will acquire a higher level of professional skills as they remain in the company. However, job security alone would not be sufficient reason for employees' motivation to learn new skills and improve their competence. Long-term employment by its nature fosters allegiance among employees, which plays an important role in promoting teamwork. Long-term employment gave large Japanese firms "a competitive advantage because the long-term employment system gave employers and employees an incentive to invest in building firm specific skills."³²

Long-term employment is beneficial for employees too. Wage and promotion system are based on principles that correspond with the long-term employment. The employees start with low wages, which are to be raised with the time the employees stay in the company. This represents an incentive for employees to stay in the company as their wages are expected to increase over time. In addition to having stable employment, the wages system based on seniority enabled employees to make long-term plans for their savings and expenditures. Moreover, many companies provide employees with low-cost housing and medical insurance. Employees have also enjoyed other benefits, such as the social status they acquired by becoming employees of prestigious corporations.

Structure of corporate control

One of the key factors that enabled the long-term employment system to function is the structure of control in corporations.³³ Originally, Japan adopted the German model of corporate governance, but in the post-war period it moved towards the American model. American influences became particularly strong after the "bubble" burst in the 1990s. The economic recession was believed to be significantly linked to the deficiencies in Japanese corporate governance, which stimulated the search for a more efficient system.

The adoption of the American model into Japanese business culture was mainly limited to the adoption of form and legal rules, while the actual practice developed in a very different direction. While after World War II Japan adopted corporate governance structures and rules based on American corporate law, in practice, they deviated substantially from the American model.³⁴ Dependence on banks for financing, cross-shareholding, as well as the long-term employment system all developed in the postwar period during which Japan was supposedly following the American legal scheme. One of the paradoxes of the Japanese model is that during the period when the model was presumably under the influence of American-style corporate law, the Japanese corporate practice departed from the American model and developed in a quite different direction. Some commentators defined this divergence from the American model as a puzzle.³⁵

In contrast to the United States, in Japan, the position of shareholders is traditionally weak as the real power is in the hands of management. This is related to the practice of cross-shareholding, which gives greater importance to stability over the profitability of the company. The structure of a large publicly traded company is traditionally characterized by cross shareholding (*keiretsu*), which refers to mutual shareholding through which a number of companies are interconnected in a network of companies in which each of them holds shares in the other companies.³⁶ *Keiretsu* is a structural arrangement of Japanese firms that is characterized by close business relationships intertwined with long-term commitments among their members. Normally, the shares held under these ongoing "stable shareholding" arrangements constitute the controlling portion of the firm's shares.³⁷

Because of the nature of cross shareholding, the shareholders do not show much interest in dividends and short-term profit, but their main interest is to maintain long-term relationships with their trading partners. As a result, the shareholders have not intervened actively in the corporate governance of firms and the real power is in the hands of management, which represents, in fact, employees; many of the top managers consider themselves to be high-ranked employees.

The wide autonomy enjoyed by the management allows directors to pay greater attention to the interests of other stakeholders, particularly the employees, since most directors are promoted to their positions from the ranks of employees. The company in Japan is considered as a kind of community consisting of regular employees, including managers. The position of managers is based on their status as regular employees rather than being agents appointed by shareholders. As a result, managers feel more closely associated with their fellow employees rather than with shareholders. In addition, management and labor share some common interests, including long-term policies based on stable development, which also contributes to stable employment and stable management. In such a system, where shareholders' control is restricted, the managers normally tend to avoid dismissals of the employees and in the process of doing so support long-term employment.

Legal framework

The key legal instrument regulating the legal status of employees is the Labor Standards Act adopted in 1947. While the employer's right to terminate an employee with or without cause derives from Article 627 of the Civil Code, under Article 20 of the Labor Standards Act an employer may terminate an employee by either giving 30 days' notice in advance or by paying 30 days' salary instead of notice.³⁸

Despite statutory provisions that permit dismissal, courts have developed the doctrine of abusive dismissal in a number of cases starting in the 1950s. The courts have taken the stance that abusive exercise of the right of dismissal based on Article 20 of the Labor Standards Law is prohibited by Article 1(3) of the Civil Code which provides: "No abuse of rights shall be permitted." By relying on the civil law abuse of rights doctrine, the courts held that dismissals that are not "objectively reasonable and socially appropriate" constitute abuse of right and are therefore void.³⁹ Courts have strictly construed this standard in favor of employees even in cases where layoffs are motivated by economic necessity.⁴⁰

The Japanese courts have established a complex body of law preventing the employers from "abusing the right to dismiss" that gives employees strong protection against dismissal. Courts have defined criteria that serve as the basis for assessing whether layoffs are appropriate.⁴¹ In deciding what constitutes just cause, the courts have taken a restrictive view, particularly when the termination of employment is based on the economic convenience of the employer. Layoffs must be strictly necessary to keep the employer in operation from a business standpoint. The employer must already have made an effort to avoid layoffs. This may include measures such as reducing executive compensation, cutting work hours, wages, or bonuses, establishing a voluntary early retirement program and so on. The employees to be dismissed must be selected on an appropriate basis, with consideration of their salary, benefits, age and other factors. In addition, the employees must have the situation sufficiently explained to them in advance.⁴²

A typical view of the Japanese courts which clearly emphasizes the need to protect job security is expressed in this judgment of the Nagoya District Court:

In current circumstances, employment constitutes the sole source of a worker's livelihood, so a worker's livelihood may be easily jeopardized by dismissal in that it is difficult to find a new job. Employers, on the other hand, can recruit workers relatively easily. Moreover, Article 27 of the Constitution [which guarantees workers "the right to work"] exists. Taking the foregoing into consideration, dismissal without reasonable cause is usually considered an abuse of the right of dismissal.⁴³

In another case, the Tokyo District Court stated: "An employer may only validly discharge an employee in circumstances where there is sufficient cause to justify the dismissal, based on the common sense of society."⁴⁴ One of the key phrases

in this sentence is “the common sense of society” and its meaning is ultimately determined by the courts.

The goal of maximizing profits is not a sufficient reason for discharging a worker. The employer ordinarily must be able to establish a serious ground for the dismissal decision, and the worker may still counter by showing that the discharge, in fact, was based on an improper motive. Moreover, even for an enterprise facing major economic difficulties, discharges should be treated as a last resort, when other alternatives have failed, and even then the employer must satisfy additional standards designed to protect the affected workers.

The doctrine of abuse of right is firmly established in the case law, despite the fact that it did not have a statutory basis other than Article 1(3) of the Civil Code, which is very general, in contrast to specific rule defined by Article 627, which grants the employers the right to dismiss employees at free will. The reason for this attitude of the courts is closely related to the long-term employment practice which makes it difficult for a discharged employee to find a new job that would provide him/her with the same wages and benefits as the previous one, particularly in light of the wage system based on seniority.⁴⁵ Courts have taken those facts into consideration as a kind of public policy when restricting the right of employers to dismiss employees. These protections apply primarily to regular employees, who are employed on a permanent basis. Dismissal of regular employees requires “just cause,” which is defined at such a high standard as to be almost impossible to satisfy it, “leading to a de facto system of permanent employment”.⁴⁶

The attitude of the courts has led legal scholars to emphasize the importance of restrictions on termination of employment contracts under Japanese labor law as the main factor that contributed to long-term employment.⁴⁷ In fact, it is not very clear to what extent the courts relied on the security of employment policy in taking such a position, but based on some judgments it may be concluded that security of employment had played an important role in creating such an attitude among the judiciary. Development of the abusive dismissal doctrine, which deviated from the statutory provisions that permit dismissal at free will, can be explained by adoption of employment security as a social norm in Japanese society. This social norm allowed the courts to depart from the principle that allowed dismissal at free will under Article 627 of the Civil Code and adopt the doctrine of abusive dismissal.

On the other hand, the courts have also enabled employers to reduce the hardship that such rulings might cause them by recognizing the discretion of employers in decisions relating to job rotation and transfer of employees to other jobs within the company. The courts have also developed other sets of standards concerning employers’ management of the workforce through such measures as transfers, temporary external transfers to other companies (“farming out”), and overtime assignments.⁴⁸ This provided the employers with flexibility in transferring redundant employees to other jobs where their services are more needed, enhancing in this way the efficient use of employees during their long-term employment.

Identifying the nature and rationale of long-term employment

Long-term employment has passed through different stages in its development, during which it has been influenced by a number of different factors. Some practices in the great merchant houses that existed in the second half of the nineteenth century may be taken as the beginnings of long-term employment. However, the modern origins of the long-term employment concept are found in the early part of the twentieth century. At that time, long-term employment was established as a business strategy to avoid high fluctuations in the workforce that created difficulties for companies. Finally, long-term employment was institutionalized in its present form in the 1950s as a result of a compromise entered into between management and labor unions aimed at overcoming existing labor problems.

Long-term employment also developed in parallel in the government sector. These various patterns of long-term employment show some similarities, as well as differences. In some cases economic rationale played the dominant role, while in case of the government employees presumably the economic rationale was not dominant.

One of the explanations for the development of long-term employment is that it is based on economic efficiency. Puchniak in an unpublished doctoral dissertation argued that “(D)espite a myriad of partial explanations for lifetime employment, the most powerful and straightforward explanation for its emergence and longevity has largely been overlooked: lifetime employment simply makes economic sense.”⁴⁹ However, if this is the case, then why don’t we find such a system in any other country in the West? As a matter of principle, economic efficiency theory is normally presumed to be universally applicable. If we borrow Wolf’s argument that culture assumes a set of norms and practices that are universal,⁵⁰ a logical question that arises is: what is more universal, cultural patterns or economic efficiency? The answer to this question is not as straightforward as it may appear at first sight.

Long-term employment certainly provided a number of important advantages to employers. They could rely on the continued use of the company-trained, disciplined and loyal employees, which was particularly important in periods of growth when the market conditions ensured that employees are fully occupied, working overtime when necessary. Wages based on seniority were affordable because the young employees competing for their long-term employment in large firms which would guarantee their future were ready to accept low initial wages being aware that the wages would increase at a later stage of their career as a part of the seniority system. Long-term employment certainly made economic sense in the period of steady growth.

The economic efficiency of long-term employment has been questioned, however, particularly after the bubble burst in the early 1990s. Long-term employment functions well in times of high-speed growth, but it also has its disadvantages, which came to the surface during the economic recession in Japan.

Long-term employment cannot be sustained when companies enter recession and the number of older employees becomes too high. Under such circumstances, long-term employment may be transformed from an advantage into a burden that may contribute to the hardships and even the collapse of a firm. During the period of recession in Japan, many companies were left with a huge excess of employees and were reluctant to resort to layoffs, partly because of fear for their reputation, and also because they were aware of the courts' hostile attitude to dismissals. Long-term employment was cherished as one of the key factors of Japan's success and was deeply entrenched in society, enjoying also the support of the State. Such widespread positive views on the long-term employment system have made changes in the system difficult, causing problem for many companies. It can be concluded that long-term employment has its advantages and disadvantages and its economic rationale will depend on a number of factors, such as the growth rate of the company, the quality of employees and training processes, and the labor market.

The fact that very similar patterns of long-term employment developed in different situations and under different circumstances indicates the existence of some integrating factor that played a role in the structuring of this system in Japan. This is further emphasized by the fact that such patterns have not developed in most other parts of the world, at least not in the form this system existed and exists in Japan. The most common explanation given is that the "unique Japanese culture" played this role.

Cultural values may influence the choice of particular corporate structures and legal rules out of a larger menu.⁵¹ Those values are deeply embedded in people's minds and social institutions. As a result, practices that are compatible with social preferences in other areas are more likely to work smoothly in a particular society. The concept of long-term employment and the way it operates are familiar to employees based on their experiences and education outside the company. They therefore tend to easily adjust to a new environment due to the well-known patterns of conduct that they are accustomed to. The fact that the long-term employment system solution perfectly suits Japanese traditional culture has enhanced its successful implementation.

Long-term employment can be observed from a different perspective, as a kind of cultural engineering. According to this view, firms may have used long-term employment to create a sense of family relationship, but the actual reason for the use of this "family rhetoric," used in a wider context of "family state," was to enhance managerial power.⁵² The use of the concept of *ie* (house) was aimed at creating an image of culture based on relationships and to conceal the reality behind the façade. However, even if the lifetime patterns developed as result of a cultural engineering, culturalistic explanation has some weight. The question that can be asked is why such cultural engineering was not successful, or attempted in Western countries, but was successful in South Korea, which shares similar culture with Japan?⁵³

Although culture may not have played a direct role in the process of the creation of long-term employment, and it may have been used as a justification for

different purposes, culture still had influence in the process of its acceptance and integration into the Japanese economic model, as well as in its functioning. Long-term employment was well accepted by all relevant actors and became an integral part of the Japanese system because its features represented a reflection of Japanese culture and were well suited to the Japanese ways of doing things. The nature of the long-term employment system is perfectly congruent with Japanese cultural values, even if concepts were adopted on account of other considerations.

The role of culture in shaping the Japanese economic model should not be overestimated. While the factor of culture is certainly important in explaining different patterns of behavior, it is also critical not to overstate its importance and to avoid stereotypes. Patterns of conduct and culture are, after all, subject to change. What was typical for Japanese society 50 years ago may not be applicable to modern Japan. The globalization process may lead to the erosion of traditional values and to a greater uniformity and merging of various cultures into a global one. However, at least in Japan, this is likely to be a slow and gradual process.⁵⁴ Reforms in corporate related structures, such as long-term employment, will probably be accompanied by cultural adjustments as well. In order for real change to occur, there should be a consensus in society that those informal ways are considered outdated and an agreement on the need to start a new way of doing things.

As a conclusion, it can be argued that several factors contributed to the development of the long-term employment system. While economic and political interests may have been the driving force behind the adoption of long-term employment in the post-war period, traditional norms and culture played an important role in the process of its smooth integration into the Japanese economic model. In addition, the structure of corporate control was well suited for the lifetime employment concept. Moreover, government policy as expressed in the legal framework, as well as the courts' attitudes in dismissal cases, provided additional and very important support to long-term employment. The long-term employment system in Japan therefore could be said to have resulted from a combination of different factors which all played a role in its establishment and the way it functioned afterwards.

New tendencies

In recent years, particularly since the 1990s, long-term employment has come under pressure as a consequence of economic recession, as well as the globalization which has brought about various changes in the Japanese business and social environment. The Japanese labor market has also been adversely affected by a number of demographic, macro-economic, and structural pressures, which are gradually changing traditional Japanese employment practices. These factors have forced many companies to revise both long-term employment guarantees and seniority-based wages. While the process of globalization has affected some attitudes of the people towards the traditional ways of doing things, economic

recession required Japanese companies to be more flexible in hiring and firing employees than the traditional system has allowed.

Changes of attitudes

Japan has been gradually transformed, especially in the urban part and among the younger generation, which is naturally more open to accepting the changes and foreign influences. Young people have ideas about their careers that are different from those of their parents. Younger Japanese are less committed to long-term employment and are more likely to change companies if other companies offer better conditions. This also indicates the gradual modernization of Japanese society from being family and group-oriented towards an individual-oriented society that gradually adopts Western standards, as a part of the globalization process.⁵⁵ Japanese society and the attitudes of people are likely to change as society becomes increasingly commercialized and exposed to the globalization process. Although the changes in values and attitudes are likely to happen slowly, they carry a potential for change that may undermine the traditional Japanese ways of doing things.

The changing business and social environment in Japan may eventually lead to changes in attitudes towards the long-term employment system. The replies to a Ministry of Health, Labor and Welfare questionnaire are indicative. According to the results of the questionnaire, the reasons employees most often give for choosing temporary work were: 1. They can choose the type of work they have an interest in; and 2. They would like to be hired as a regular employee but have not been able to find such a job.⁵⁶ The answers indicate that, while the desire to find permanent employment is still strong among Japanese, there is also an increasing interest in choosing the type of work they would like to do.

The change of attitudes is also reflected in a substantial increase in labor disputes that has been registered since the 1990s. While the number of labor-related disputes in 1991 was 1,054, in 2005 this number had risen to 3,082.⁵⁷ This statistic puts in doubt a widely accepted view that law is largely irrelevant to the social and economic organization in Japan.⁵⁸ Some scholars even doubt that legal reforms can be effective due to social and cultural constraints.⁵⁹ However, Japanese society is changing, and this also affects the attitudes towards law and its role in society. The increase of labor disputes in Japan is regarded by some scholars as forming part of the increase in the role of law in Japanese society.⁶⁰

The law itself cannot change things immediately, but its existence is still important for creating a legal framework that will legitimize one kind of behavior and prohibit other kinds. There should be no doubt that the law will play an increasingly important role in Japan, as an instrument of driving change in the desired direction.

While the globalization process has an impact on Japanese society and the attitudes of Japanese people, including those towards long-term employment, some distinctly different Japanese attitudes will continue to exist. Despite the fact that the process of globalization leads to a greater convergence of attitudes

and its “spicing and baking process” may have been the same or similar all around the world, “if you start with a different cultural dough you end up with a different social cake.”⁶¹

Several decades after being adopted, long-term employment has become an integral part of Japanese society and its economic model. Its existence is not anymore tied merely to economic factors. That is why the eventual dissolution or possible changes to this system are not dependent only on economic considerations. Actually, one of the key issues in possible reforms of long-term employment is that any of the future solutions will have to consider both economic and social implications. Long-term employment also has its political implications and was used as a political campaign issue in the parliamentary elections in 2009 won by the Democratic Party of Japan (DPJ). One of the DPJ’s goals stated in its manifesto was that worker dispatching (*haken*) should be banned except for some skilled/professional jobs.⁶² It is questionable whether this is practicable or not. Another and even more important question that remains is what the new Government will do about directly-employed temporary workers, whose number is much larger than the number of dispatched workers. In any case, it is expected that the new DPJ government will pursue a policy that will further protect employees and favor the long-term employment system.

Reactions of employers

The long-term employment system came under pressure as the recession caused a substantial surplus of employees in many companies. Under such pressure, since the late 1990s, a number of companies have decided to lay off a large number of employees in the process of restructuring. Typically, the company would offer a “voluntary” termination to the employees by promising generous retirement benefits and implying that the working conditions may worsen for those remaining in the company. On the other hand, in the same period the number of part-time employees has been substantially increased.⁶³

There are several signs indicating the weakening of the long-term employment system in Japan, particularly after the collapse of the bubble economy in the 1990s. Two particularly important tendencies are: a) changes in the structure of employees, and b) changes in the system of wages and evaluation of employees.

(1). *Changes in the structure of employees.* Many companies resorted to a combination of various measures aimed at relieving companies from the pressures of economic hardship, which included substantial changes in the structure of employees. The number of “lifetime” employees has been reduced even in large corporations since the 1990s. In fact, the largest difference in long-term employment in the last decade has been the increase in part-time employees.⁶⁴ By keeping the number of regular employees at a low level and hiring non-regular employees in accordance with actual needs, the companies were able to maintain flexibility and avoided burdens of over-employment. This practice contributed to the competitiveness of

companies, and due to such advantages the practice became widespread in Japanese companies, particularly in some sectors, such as in the manufacturing and retailing industry. Some of the work previously assigned to regular employees was shifted to non-regular employees.

One of the reasons for such attitudes is the avoidance of problems that are associated with straight dismissals. Employers face pressure from the courts, due to the right of discharged workers to seek redress through the courts under the abusive dismissal doctrine. Employers have also become aware of how the laws effectively limit their flexibility. As a result, employers have developed various models that are used to limit the risk of possible wrongful-termination lawsuits through the use of probationary periods and non-regular employment.

Japanese law allows for probationary periods at the beginning of employment. A probationary period is typically for the first three months or so. From the perspective of employers, it is important to establish such a period in the employment contract, or employee handbook, as it greatly increases flexibility on the part of the employer. The employer naturally wants to keep its new employees, in the hope that they will be trained into competent workers in the long run. An employer may extend a probationary period past its original expiry date if the situation calls for it. However, even probationary employment does not give full freedom to employers. When terminating probationary employees, the employers still need to have a justifiable reason, though they are held to lower standards than when terminating a regular employee. Unlike with regular employees, simple poor performance is considered to be an acceptable reason.

Another common solution is hiring employees on fixed-term contracts. The employer can then choose not to renew the contract at its end, with relative freedom. Termination before the contract expires still requires just cause and 30 days' notice. The system of fixed-term employees plays a crucial role in preserving long-term employment. It can even be said that long-term employment of regular employees is made possible by the existence of such a non-regular workforce that acts as a shock-absorber.

These new patterns of employment contribute to the widening gap between various categories of employees—between those who have stable employment and those who don't. In addition, it has mostly been part-time employees that have lost their jobs. That is why the ideas of the new Government to protect non-regular employees may be important in order to maintain stability for all. Since Japan has always had part-time employees in large companies, this is a change in scale not in form. As the system of long-term employment becomes less prevalent, it may be expected that companies will invest less in the training of employees and will increasingly try to recruit employees in the external labor market.

The practices of reducing the number of regular employees without explicit layoffs allowed companies to argue that they preserve the long-term employment system. Despite such claims, most employees in Japan now

feel less secure in their status than before. On the other hand, employers in Japan are reluctant to end the long-term employment tradition, despite the problems that long-term employment may cause to businesses. Firms are not ready to risk their reputation, which might be tarnished if they dismiss employees in large numbers. Japanese employers continue to support life-time employment as a key part of their management policy. In 1995, *Nikkeiren* (Japan Federation of Employers) published a document entitled *Shin Jidai No Nihon Teki Keiei* (Japanese Management in a New Era), which emphasized the importance of long-term employment for core employees. However, this *Nikkeiren* document also advocated for the more limited use of long-term employment than before. Long-term employment should be preserved but limited to the core workforce only.

One of the main reasons for a reluctance to make more radical steps towards dissolution of long-term employment is the fact that the system has proved to be successful in the past. Many managers fear that, if long-term employment declines, so too will the commitment of the workers. Termination of long-term employment bears certain risks: loss of commitment by existing workers, and difficulty in attracting new recruits. This would also affect the highly effective internal training system that constitutes an integral part of a long-term employment system. Employers are aware of the risk that increasing labor mobility may eventually undermine the system. However, they do not wish to take actions that might speed up that process. Permanent relationships and group-oriented systems are the very foundations of the Japanese model. Abolishing long-term employment, which is one of key parts of this system, could undermine the Japanese corporate system as a whole, unless there is certainty that this system can be safely replaced by another system.

(2). *Changes in the wage and evaluation systems.* The seniority-based system has been changing since the 1970s in the direction of a merit-based system. In fact, the criteria were vague and the seniority-based system continued to prevail. Since 1990s a new system called “*seikashugi*” based on performance standards became very popular. This system means that the evaluation of employees is made on the basis of individual business results and performance. This affects both the wages and promotion of employees. The *seikaishugi* system emphasizes short-term business results rather than skills, knowledge and efforts or long-term business results. This new system also affects the security previously enjoyed by employees. However, despite these recent trends, the seniority-based system will probably continue to play a role as long as the company continues to be seen as community.

Changes in labor law

Terminating regular employees in Japan is always a difficult issue, due to the restrictive regulatory environment and the attitude of the courts. Despite new

trends and the reduced certainty of long-term employment, the courts have maintained their restrictive attitude in interpreting “just cause” for the termination of employment. Although employment customs are said to be changing, there is still a widespread belief in Japan that it is only morally acceptable to resort to layoffs when the company faces bankruptcy. This informal understanding has been supported in a number of court cases. In fact, the Tokyo District Court has rendered a number of decisions that allowed dismissals for economic reasons which deviated from the prevailing court practice.⁶⁵

In one such case, the Tokyo District Court held that the evaluation of whether a dismissal is abusive must be based on all circumstances in each case. According to the Court, the requirements that were previously adopted as the basis for such evaluation do not represent requirements in the strict sense but are merely factors that should be considered. The Court held that layoff based on the employer’s business judgment rule should be upheld, regardless of the existence of financial crisis.⁶⁶ The Tokyo District Court made a number of similar decisions.⁶⁷ These decisions failed to reverse the dominant attitude of the Japanese courts. Nevertheless, they may serve as an indication that the stance of the Japanese courts is not as firm as before and may eventually change in the future.

Relating to fixed-term contracts, a number of cases involving such contract workers have come through the courts recently. Courts still take a restrictive attitude, so that employers cannot take for granted that they can lay off employees at their free will. In some cases, if a contract has been renewed repeatedly, the employee may rely on an expectation of employment as an argument against lay off. In such cases, “just cause” may be required in order to not renew their contract.⁶⁸ The legal theory on refusal to renew the fixed-time contracts is ambivalent. It extends the protection of abusive dismissal theory to these workers by analogy in some cases, but it admits their secondary status by saying that the employer may (and probably should) discontinue their contract before resorting to layoff of regular employees.

The government has taken several actions to dispel doubts about its attitude towards long-term employment. The Labor Standards Act was revised in 2003 and the new revised law came into effect in 2004. This revision mainly affects fixed-term contracts, dismissals, and discretionary work schemes.⁶⁹ One of key provisions of this revision is Article 18–2 which reads: “A dismissal shall be considered an abuse of the right to dismiss and therefore null and void if it is not based on objectively reasonable grounds and may not be recognized as socially acceptable.” This provision is clearly based on the “abuse of right” doctrine. In fact, it just recognized the existing precedents based on this doctrine.⁷⁰

The 2003 Revision of the Labor Standards Act was aimed at preventing potential disputes by requiring that the parties clarify in advance the possibility of renewal after the expiration of the contract term. While certain protection was given to all employees, with regular employees being given the highest degree of protection, the outcome will depend on the circumstances of each particular case. After these changes, dismissals still require justification: the company must try a number of other measures first.

The tendency to reinforce the protection of employees has continued in the following years. In 2007, a number of other labor statutes were adopted to further protect employee rights. The Part-time Workers Act, 1993 was revised in 2007 in an effort to improve the working conditions of part-time workers. This revision substantially increased protection of part-time employees, particularly the provisions that for the first time introduced in Japan the prohibition of discrimination against part-time employees. This law aimed at reducing the gap between regular and part-time employees. In addition, a revision of the Employment Measures Act prohibited age discrimination in the hiring process. This law was the first law that addressed age discrimination in Japan by prohibiting employers from setting a maximum age for job applicants.

In 2007 another important statute was enacted, the Labor Contract Act.⁷¹ The main reason for enacting this statute was the rise in importance of individual labor contracts, as well as the increase in labor disputes between employees and employers.⁷² This statute fills the gap by specifically defining the principles governing labor relations which were previously based on judicial precedents only, including the prohibition of the abusive exercise of employers' rights. Article 18-2 of the revised Labor Standards Law, 2007 was incorporated into the new Labor Contract Act, 2007.

The tendency towards less stable employment has not been accompanied by more flexible legal standards on termination itself. While some erosion in long-term employment is likely, that erosion will probably be the result of economic pressures, rather than of a change in the applicable legal standards. As a matter of principle, once firmly established, the legal standards are not easy to revise, despite the changes in the economic sphere. A change in the legal standards is even more difficult when those standards are strongly entrenched in the existing public policy considerations. The fact that long-term employment became deeply embedded in Japanese society increases its persistence and impedes reforms. Even though a more flexible labor market might contribute to better economic performance of firms, the social constraints present a serious hindrance. The government is simply not ready to take a risk of undertaking radical reforms that could undermine the long-term employment system. Although the economy may further suffer as a consequence of the global financial crisis that started in 2008, it is not likely that the long-term employment system will be abandoned, though it may be further modified.

On the other hand, the abusive dismissal theory or just cause standard is rather flexible by nature. As layoffs and unemployment are not so exceptional anymore, courts might be less sympathetic to dismissed employees than before. In addition, as the plight of non-regular employees is publicized, a voice for reducing the privileges of long-term employment seems to be gaining power. One possible direction might be to improve the conditions of non-regular employees. Such development might also affect the attitude of courts and legislators towards long-term employment in the future.

Changes in corporate structure

The assumption expressed above that the structure of corporate control has played an important role in the establishment of long-term employment makes necessary to examine changes in this structure and potential impact of such changes on long-term employment. As consequence of economic recession, particularly since the 1990s, there has been an extensive discussion on the need to revise the corporate governance. In discussions surrounding a new approach to corporate governance, references are often made to the need to adopt “global standards” of governance. This idea of “global standards,” however, was typically understood as American standards.⁷³ Under a sweeping reform of the Japanese corporate governance laws since 2002 some important changes have been introduced in the existing corporate management structure, including the establishment of a totally new governance structure known as the “Committee System,” which was viewed by some scholars as a sign of the Americanization of Japanese corporate governance.⁷⁴

Despite comprehensive law reforms, traditional patterns endure and the fundamental elements of Japanese corporate governance have not changed.⁷⁵ The impression is that Japanese legislators have undertaken reforms as a kind of fashion in order to show that they make efforts to restructure the existing system and to make it more efficient. However, the extent and effect of reforms seems to be designed in a way to adjust the existing model in order to preserve it rather than to subject it to a substantial change. Time will show whether behind the new façade there is also a more efficient mechanism, or if it is just a new façade covering the traditional way of doing things.

Legal reforms of corporate law that moved in the direction of the American model may have raised expectations that employment practices may also be revised in the same direction. Instead, the revision of laws that affect employment relations went in the opposite direction by providing a formal statutory protection of employee rights, including the rights of part-time employees. New laws, such as the Labor Standards Act, can be considered a countermeasure to the new tendency of giving increased importance to the rights of shareholders.

One factor that contributed to preserving long-term employment is that the structure of control of Japanese corporations, including the position of shareholders, has not been changed substantially. There has been much talk on the need to give greater protection to shareholders, but this has not been much more than “lip service.” The firm continues to be controlled by its top management, while shareholders are still prevented from exercising effective control over the corporation. Most shareholders still do not interfere much in the management of the companies and not many things have really changed in corporate governance. For the moment, the corporate governance reforms have not led to radical changes in the board, the presence of outside directors has not been adopted as a standard, and stock-options and hostile takeovers are still a rarity in Japan.⁷⁶ If

such changes occur in the future, e.g., with increased foreign shareholding, the destiny of long-term employment may also be at stake.

The scenario and ingredients for potential changes exist. As a consequence of the crisis in the banking business, a large number of shares held by many banks as assets were sold. This affected the monitoring process in the companies, and the monitoring function of shareholders may become stronger as a replacement for the banks whose function as monitors has been reduced. Companies may become more exposed to the impact of the market and may not be able to afford to maintain surplus funds and keep excess employees. As a result, instead of long-term profit-oriented governance, the short-term governance aimed at improving the value of shares may become more important. Naturally, this may also affect the employment policy, both with respect to the type of employment, as well as the wages and promotion system. Time will show whether such a scenario will become a reality.

Conclusion

Long-term employment in Japan is a complex phenomenon influenced by a number of factors. Economic interests may have been the driving force behind the adoption of long-term employment, while social norms played an important role in the process of its smooth integration in the Japanese economic model. Long-term employment was well accepted by all relevant actors and became one of the key features of the Japanese economic model because it was well suited to the Japanese way of doing things.

While there have been some legal reforms related to labor law, the main feature of those reforms can be described as a tendency to maintain long-term employment for regular employees. Several decisions of the Tokyo District Court may serve as an indication that changes in the direction of long-term employment might occur. But for a real change, in addition to the support by the jurisprudence, a number of other factors will have to be present. At the moment, the social constraints and lack of political will pose serious obstacle to eventual changes in the existing system. It may be expected that Japanese labor law will maintain its main features for the foreseeable period, which means that long-term employment will also continue to play an important role in the Japanese economic model.

With a recession, unemployment and the number of part-time employees are likely to increase. The old model of “lifetime employment” continues to dissolve, causing concerns for their jobs among many Japanese, especially workers lacking the skills and education that are in high demand. It has been repeatedly claimed that long-term employment is disappearing, or even that it does not exist anymore. The fact is, however, that many employees still believe today that they will be employed for the rest of their career at their company, unless something goes very wrong. Even though, due to the economic recession, many companies might not be able to guarantee job security to their employees, the fundamental patterns of long-term employment persist.⁷⁷ The patterns of recruiting core

managers and career employment will most probably continue to exist as the norm. Despite the changes in the economic and social environment, the core features of the Japanese model, including long-term employment, will most likely not disappear in foreseeable future. Instead, some reforms of limited scope and modifications can be expected. So far, an increase of part-time employees and the changes in seniority pay and promotion patterns represent the main modifications in the basic structure of lifetime employment.

There will likely be some other adjustments in the Japanese model, but probably they will be more “cosmetic” rather than drastic changes. It may be assumed that most Japanese companies do not even consider abolishing long-term employment, and are more likely to focus on alternative solutions. As part of this strategy, many companies resorted to the reduction of their core workforce and are relying more heavily on non-regular employees. This was partly done to meet legal challenges posed by dismissed employees who are often supported by the Japanese courts. The Japanese people are getting accustomed to live with the new reality where there is no strong guarantee of long-term employment and there is an increasingly large force of part-time workers working on a contractual basis.

Despite the persistence being demonstrated by the traditional and informal ways of doing things in Japan, it would be misleading to believe that the Japanese corporate culture remains static and inflexible. Over the years, there have been gradual changes aimed at meeting the new trends and challenges brought about by the globalization process and the rapidly changing environment. The family-like company will probably continue to exist, but this kind of concept of the company will most likely become weaker as a result of new trends, including the changing social values and attitudes of the Japanese people. There have been a number of comprehensive legal reforms of the corporate law, but despite their potential no major changes have occurred so far. Many of the legal reforms in Japan had only a symbolical effect, while some reforms brought changes only many years after they were introduced.

The Japanese economy faces serious challenges. Economic recession, rising unemployment and an aging population are only some of the problems that may affect the future of long-term employment. Whatever course is taken in the future, those reform policies will have to consider various factors. What Japan needs is a solution that preserves social stability and the social harmony that long-term employment provided, and yet ensures mobility among the work force that can contribute to a more efficient economic model. These two goals are based, in fact, on the very same considerations that represent the basis of the bipolar approach to the explanation of the nature of long-term employment: cultural and economic. These goals are not necessarily incompatible; the key point will be how to find a proper balance between them.

Notes

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- 1 John Haley, a leading Japanese law scholar, has recently expressed the view that Japan's lifetime employment system is the critical feature that defines Japanese corporate governance and makes it unique from other systems of corporate governance around the world. John O. Haley, *Career Employment, Corporate Governance and Japanese Exceptionalism* (Faculty Working Paper Series, Paper No. 04-04-01, 2004).
 - 2 In the context of this text, the term "informal norms" is understood as the extra-legal norms that evolved through a social custom or tradition without being recognized as legal rules by formal institutions.
 - 3 James C. Abegglen and George Stalk Jr, *Kaisha—The Japanese Corporation* (Charles E. Tuttle Company, Tokyo 1985) 183–188, 191–192, 194–206, Takashi Araki, Changing Employment Practices, Corporate Governance, and the Role of Labor Law in Japan, 28 *Comp. Labor Law & Pol'y J.* 251, 252 (2007), Roland Gilson and Mark Roe, Lifetime Employment: Labor Peace and the Evolution of Japanese Corporate Governance, 99 *Colum. L. Rev.* 508 (1999).
 - 4 *Nen* = seniority and *ko* = merits.
 - 5 Long-term employment is a more adequate term because the employees are employed until their retirement age and not for their lifetime.
 - 6 Article 8 of the Act Concerning Stabilization of Employment of Older Persons [Law No. 103 of 2004]. This Act entered into force on April 1, 2006.
 - 7 Gerald Paul McAlinn, Employment and Labor. In Gerald Paul McAlinn (ed.), *Japanese Business Law* (Kluwer, 2007) 403, at 424.
 - 8 Leon Wolf, The Death of Lifelong Employment in Japan? In Luke Nottage, Leon Wolff, and Kent Anderson (eds.), *Corporate Governance in the Twenty-first Century—Japan's Gradual Transformation* (Edward Elgar 2008) 53.
 - 9 According to the Ministry of Health, Labor and Welfare's *Basic Survey on Wage Structure 2007*, for male employees in companies which have fewer than one hundred employees the average tenure is 10.9 years, while in companies over one thousand employees it is 16.2 years. Average tenure of female employees is in the range between 8.2 years and 9.7 years.
 - 10 Haley, *supra* note 1.
 - 11 *Basic Survey on Wage Structure* prepared by the Japanese Ministry of Health, Labor and Welfare in 2007 indicates that employee tenure in Japan is longer than in other developed nations.
 - 12 The practice of simultaneous recruiting of new graduates (*shinsotsu-ikkatsu-saiyō*) and the way of applying for job by the students (*shūshoku katsudō*) seem to be unique to Japan and South Korea.
 - 13 Masahiko Aoki, Aspects of the Japanese Firm. In Masahiko Aoki (ed.), *The Economic Analysis of the Japanese Firm* (North-Holland, 1983) 5.
 - 14 Wolf, *supra* note 8 at 55.
 - 15 For example, Rodney Clark, *The Japanese Company* (Yale University Press, 1979) 14–17.
 - 16 Ronald Dore, *British Factory—Japanese Factory* (University of California Press, 1973) 377.
 - 17 Dore, *Id.* 384.
 - 18 Koji Taira, *Economic Development and Labor Market in Japan* (Columbia University Press, 1970) 153–160.

- 19 Reiko Okayama, Industrial Relations in Great Britain and Japan from the 1880s to the 1920s. In Keichiro Nakagawa (ed.), *Labor and Management: The International Conference on Business History* (University of Tokyo Press, 1979) 207, at 227.
- 20 Okayama, Id. at 228.
- 21 Okayama, Id. at 229.
- 22 Andrew Gordon, *The Evolution of Labor Relations in Japan: Heavy Industry, 1853–1955* (Council on East Asian Studies, Harvard University, 1985) 132–34.
- 23 Gordon, Id. at 258.
- 24 Taira, *supra* note 18 at 159–60.
- 25 Clark, *supra* note 15 at 14.
- 26 Chie Nakane, *Japanese Society* (University of California Press, 1970), James C. Abegglen, *The Japanese Factory: Aspects of Its Social Organization* (The Free Press, 1958).
- 27 There is a substantial number of cover-ups by Japanese companies aimed at protecting their employees. The Mitsubishi cover-up affair was one of the largest corporate scandals in Japanese history. In 2000 it was revealed that one of the Japanese giants, Mitsubishi Motors Corporation, had suppressed complaints made by consumers to avoid massive and expensive recalls. Mitsubishi was forced to admit a systematic cover-up of defect problems in its vehicles. In another case in 1995 one of Daiwa Bank's bond traders, Toshihide Iguchi, in New York lost \$1.1 billion speculating in the bond market. The company was later indicted for not reporting crimes by Iguchi including unauthorized sales of clients' securities to cover losses.
- 28 Nakane, *supra* note 26 at 11.
- 29 Abegglen, Stalk, *supra* note 3 at 200.
- 30 Aoki, *supra* note 13 at 3–43.
- 31 Wolf, *supra* note 8 at 63.
- 32 Gilson, Roe, *supra* note 3 at 508.
- 33 Ryuichi Yamakawa, The Silence of Stockholders: Japanese Labor Law from the Viewpoint of Corporate Governance, 39 *Japan Labor Bulletin*, 6–10, no. 10 (1999).
- 34 For an explanation of how the corporate law provisions in the Commercial Code were redrafted during the American occupation period to reflect U.S. corporate law, see Thomas L. Blakemore and Makoto Yazawa, Japanese Commercial Code Revisions: Concerning Corporations, 2 *Am. J. Comp. L.* 12 (1953). For an explanation of the significant gap between the U.S.-style corporate law in Japan's Commercial Code and its application in practice, see Zenichi Shishido, Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions, 25 *Del. J. Corp. L.* 189 (2000).
- 35 Mark D. West, The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States, 150 *U. Pa. L. Rev.* 527 (2001).
- 36 *Keiretsu* is the term usually used in the English-language literature to denote cross-shareholding. In Japanese, cross-shareholding is usually called “*mochiai*” or “*kabushiki mochiai*”, while the term “*keiretsu*” refers to the network of companies.
- 37 For an explanation of the efficiency of the *keiretsu* system see, Ronald J. Gilson and Mark J. Roe, Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization, 102 *Yale L.J.* 871 (1993).
- 38 Under Article 627 of the Civil Code, if no period of employment has been fixed, the employment contract may be terminated upon the expiration of two weeks after such notice has been given. Article 20 of the Labor Standards Act extended this period to 30 days.
- 39 Supreme Court, January 31, 1977 (*Shioda v. Kochi Hoso K.K.*) Rodo Hanrei No. 268 (1977) 17. Quoted in: McAlinn, *supra* note 7 at 433.
- 40 Hiroya Nakakubo, The 2003 Revision of the Labor Standards Law: Fixed-term Contracts, Dismissal and Discretionary-work Schemes, (2) *Japan Labor Review* 4, at 14 (2004).

- 41 Kazuo Sugeno, *Japanese Labor and Employment Law* (Carolina Academic Press) 480.
- 42 Nakakubo *supra* note 40 at 14; McAlinn *supra* note 7 at 433.
- 43 Nagoya District Court, Judgment of December 4, 1951 (*Sube v. Kariya Seikatsu Kyodo Kumiai (Kariya Cooperative)*), 2–5 *Rominshu* 578, 579. Quoted in: Tomio Fukui, *Labor Management Relations and the Law 3–4 Law in Japan* (1973).
- 44 Tokyo District Court, Judgment of May 8, 1950 (*Iwata v. Tokyo Seimei Hoken Sogo Gaisha* (Tokyo Life Insurance Co.)), 1–2 *Rominshu* 230, 235–36.
- 45 Labor law cases related to long-term employment are in line with prevailing practice in relation to the long-term contracts in Japan. When a contract is qualified as long-term contract, in a number of cases the Japanese courts have refused to uphold termination clauses in such contracts, when a party attempted to terminate the contract without “just cause.” The courts rely on a very similar reasoning to the one usually applied to the lifetime employment cases. For example, in *The Hokaido Tractor* case (Sapporo High Court, 30 September 1987, *Hanrei Jiho*, 1258, 76), the Court rejected validity of a termination clause which provided for three months’ notice prior to expiration date of contract that the contract will not be continued, otherwise the contract would continue for a further year. The Court did not accept as “just cause” the defendant’s argument that its decision to terminate the contract was motivated by the need to improve efficiency. The Court allowed termination of the contract, but after the expiry of a one-year period. The same as in dismissal cases, where, according to the prevailing view in Japanese labor cases, a dismissal without reasonable cause is considered to be an abuse of the right of dismissal, the Court in *The Hokaido Tractor* case by relying on a similar argument held that termination of a contract without reasonable cause represented, in fact, an abuse of the right of termination.
- 46 McAlinn, *supra* note 7 at 432.
- 47 Yoshiro Miwa and J. Mark Ramseyer, *The Fable of the Keiretsu* (University of Chicago Press, 2006) 159.
- 48 See Daniel H. Foote, *Judicial Creation of Norms in Japanese Labor Law: Activism in the Service of Stability?* 43 *UCLA L. Rev.* 635, 638 (1996), McAlinn, *supra* note 7 at 435.
- 49 Dan W. Puchniak, *Rethinking Comparative Governance: Valuable Lessons from Japan’s Post-Bubble Era*, 306 (Kyushu University, 2008).
- 50 Wolf, *supra* note 8 at 63.
- 51 Amir N. Licht, *The Mother of All Path Dependencies Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 *Del. J. Corp. L.* 147 at 186 (2001).
- 52 Carl Van Wolferen, *The Enigma of Japanese Power: People and Politics in a Stateless Nation* (First Vintage Books Edition, 1990) 16. *See also*, Okayama, *supra* note 19 at 227.
- 53 On long-term employment in S. Korea, see, Brett M. Kitt, *Downsizing Korea? The Difficult Demise of Lifetime Employment and the Prospects for Further Reform*, *Law and Policy in International Business*, Winter 2003.
- 54 On “gradual transformation” of Japanese corporate governance, see Luke Nottage, Leon Wolf, Kent Anderson, *Corporate Governance in the twenty-first Century: Japan’s Gradual Transformation* (Edward Elgar, 2008).
- 55 Masako Ishii-Kuntz, *Collectivism or Individualism? Changing Patterns of Japanese Attitudes*, *Sociology and Social Research*, 73, 174–179 (1989).
- 56 www.mhlw.go.jp/bunya/kodomo/boshi-hoken07/h7_04a.html.
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- 58 Curtis J. Milhaupt and Mark D. West, *Economic Organizations and Corporate Governance in Japan: The Impact of Formal and Informal Rules* (Oxford University Press, 2004) 3.
- 59 Curtis J. Milhaupt and Mark D. West, *Id.* 198 (quoting Philip Lochner, *Corporate Japan: Beginning of a New Era*, Columbia Conference held on March 23 2001).

- 60 Yamakawa, *supra* note 57, at 5.
- 61 Dore, *supra* note 16 at 375.
- 62 <http://search.japantimes.co.jp/cgi-bin/nn20090812f1.html>.
- 63 According to the Ministry of Health, Labor and Welfare (MHLW) figures, there were 34.18 million regular employees in Japan at the end of 2007 (average for October–December), while non-regular employees numbered 17.38 million, or 33.7 percent of the total. See, www.mhlw.go.jp.
- 64 The key characteristic of part-time employment in Japan is the fact that the employee is not a regular employee, regardless of the number of working hours. Part-time employees are often hired by a fixed term contract and they are disposable according to the fluctuation of business. The same is true of other fixed-term employees (often called “*kikan-jugyoin*” or “*keiyaku-shain*”) who may work full time but are definitely non-regular workers.
- 65 See Shinya Ouchi, Change in Japanese Economic Security: Reflecting on the Legal Points, *Japan Labor Bulletin*, 41, 1 (2002).
- 66 Tokyo District Court, January 21, 2000 (*Yasuda v. National Westminster Bank, Ltd.*) *Rodo hanrei* 782 (2000) 23.
- 67 For example, Tokyo District Court, November 29 (*Kadokawa Bunka Shinko Zaidan*) *Rodo hanrei* 780 (1999) 67.
- 68 Supreme Court, December 4, 1986 (*The Hitachi Medico* case), *Rodo Hanrei* 486 (1986) 6. Quoted in Nakakubo, *supra* note 40, at 11.
- 69 See, Nakakubo, *supra* note 40, at 4.
- 70 *Id.* p. 14.
- 71 www.jil.go.jp/english/laborinfo/library/documents/llj_law17.pdf.
- 72 Yamakawa, *supra* note 57, at 4.
- 73 Christina Ahmadjian, Changing Japanese Corporate Governance. In Ulrike Schaeede and William W. Grimes (eds.), *Japan's Managed Globalization: Adapting to the Twenty-First Century* (East Gate Book 2002) 222.
- 74 For more on the 2002 Revision, see Roland Gilson and Curtis Milhaupt, *Choice as a Regulatory Reform: The case of Japanese Corporate Governance* (2004) Columbia Law and Economics, Working Paper No. 251. For an alternative view see, Dan W. Puchniak, The 2002 Reform of the Management of Large Corporations in Japan, 5 *Austl. J. Asian L.* 42 (2003).
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9 Non-economic criteria in the formulation of the world trade regime

From social clause to CSR

*Shin-ichi Ago**

Introduction

Developing countries strive to join the World Trade Organization (WTO) because they consider it beneficial for their economies. A multilateral solution of eventual trade conflicts is also an advantage for them, because power differences can be mitigated. However, there is an inherent danger when these nations become a part of the world trade regime. The regime presupposes universal application of trade rules, which, if applied on an equal footing, would cause harmful effects, even potentially devastating results, for some of the most economically weak developing countries.

It was not only radical environmentalists who rallied on the streets of Seattle to protest the WTO's ministerial meeting in 1999. Many developing countries were wary of the development in the world trade regime, which could put them under a new form of "neo-colonialist" rule.¹ Rules of the game are only fair if they are implemented among equal players. Even if developing countries overcome the risk of one-sided application of the "rules of the rich," they face another type of challenge, which can be described as "unequal treatment in disguise." This chapter contends that the social clause (much debated in the 1990s) and corporate social responsibility (CSR) are both examples of a "wolf in sheep's clothing."

The idea to discuss CSR in the trade law context came to the author, while attending a conference organized by Peking University Law School in 2006.² It was quite surprising to see that CSR was taken up as a subject of legal debate. Chinese labor lawyers seriously discussed whether CSR constituted legal norms or not. If CSR had some elements of law, or at least led to some legal consequences, it would impact the trade law regime, because CSR was mainly applied in export-oriented industries or by multinational enterprises. When applied to export industries in such a way so as to make their conformity with labor laws conditional for trade, it would certainly have the same effect of a social clause. Perhaps not always, but in some cases, a social clause can be applied as a disguised measure of protectionism.³ The basic contention of this chapter is that CSR can become a meaningful instrument in trade law, but if negatively applied, it can become detrimental to developing countries. It starts with

a quick recapitulation of the basic philosophy underlying the world trade regime, followed by a sketch of the social clause discourse, and finally discusses the relevance of CSR in the context of trade.

The underlying idea of the WTO—economic growth by multilateral trade regime based on the classical economic theory

The invisible hand and the law of comparative advantage

“The freer the trade is, the more beneficial are the economic gains.” This is the conclusion of the famous law of comparative advantage, first introduced by David Ricardo in the early nineteenth century and it is still widely believed.⁴ It is also the underlying concept of the multilateral world trade regime, which started with General Agreements on Tariffs and Trade (GATT) in 1947. GATT was the other side of the coin of the Bretton Woods institutions created in 1944⁵ and they equally had this theorem as their underlying principle.⁶

A theory is a theory and it is never impeccable, especially if conditions are changed. Our colleagues in the field of economics have been trying hard to develop the first theorem into a more perfect one by changing and adding various indices and conditions to make a perfect theory applicable to all situations. One of the changes given to the initial theory of free trade was the “infant industry argument,” which justifies the imposition of tariffs to protect a domestic industry while it establishes itself to compete in the foreign market, to take into account an increasing number of developing countries coming onto the scene.⁷

While Part IV of GATT was introduced as early as the 1960s, Generalized System of Preferences (GSP) schemes, which allows for developing and transition countries to receive additional trade preferences, and the Enabling Clause, which on the other hand, contains preferential treatment for developing countries such as reduced tariffs, special treatment for the least developed countries, and non-tariff measures governed by instruments negotiated under the GATT,⁸ were other means to accommodate developing countries’ needs. More recently, compulsory licensing has frequently discussed in the Intellectual Property (IP) scheme to address an unacceptable situation, which would have resulted, if the original IP rules had been strictly implemented. The infant industry argument cannot well explain the compulsory licensing only from the point of view of economic theory, because an element of justice is hidden behind the exceptional treatment of developing countries.⁹

A large number of exemptions from the trade rules are based on these non-economical and justice- (or fairness-) oriented concerns. Trade law cannot be free from non-economic factors and, to that extent, Ricardo’s theory has limits. It has limits, but at the same time, outside its limits it is still the basis for the multilateral trade regime. Members of the WTO discuss every day where the limits are.

Non-trade values in the WTO rules—environment and labor

Notable exceptions from the free trade rules were provided for in its Article XX, which allows contracting states to adopt or enforce measures, including those necessary to protect human, animal, or plant life or health, to secure compliance with laws or regulations which are not inconsistent with GATT agreements, to restrict products of prison labor, to preserve national treasures, and to conserve exhaustible natural resources,¹⁰ from the very inception of GATT. A number of interesting Panel/Appellate Body decisions have issued, for example, with respect to environmental issues. This development is in consonance with the earlier recognition by GATT contracting parties that there is a need for a trade measure that might be inconsistent with Article XI, which forbids the use by a member country, of quantitative restrictions and prohibitions.¹¹ Thus, the slight change in the WTO's recent position towards taking non-economic values into consideration in judging the conformity with permitted exceptions shows that the non-trade value is obtaining a greater civic status in world trade law. When environmental elements are taken into consideration to justify restrictions in trade and these environmental issues represent universal values and general consensus, the restrictions may be justified. The difference of the first Tuna/Dolphin Cases¹² and the last Shrimp/Turtle Case¹³ is that the last decision was based on the assumption that killing sea turtles was against international law and, trade law being a part of international law, it should take also other values of international law into consideration and the otherwise protectionist measure should be exempted from the free trade rules.

Fewer cases are found with respect to labor. Article XX at sub-paragraph (e) provides for prison labor as a justifiable reason for restricting trade, but no cases are found in the decisions of WTO's supervisory bodies. The reason seems to be that the GATT provision is very restrictive (only with respect to prison labor) in allowing exemption. The existing WTO provisions have not been designed to promote core labor standards. Article XX (e) is the only place in the GATT Agreement that includes a provision dealing with labor.¹⁴ It allows states to exclude the products of prison labor and "has been proposed to interpret the provision 'prison labor' extensively as including all forms of forced labor, bonded or exploitive child labor."¹⁵

However, other labor standards, such as freedom of association and discrimination in employment, had not been initially provided for. These might have been applied if countries wished to avail themselves of justification to limit importation of goods from countries that breach fundamental principles of labor law. This led to a long and laborious debate beginning in the 1990s to discuss whether a social clause should be inserted into the forthcoming constitution of WTO.¹⁶

The social clause discourse in the 1990s

The social clause is a clause in trade agreements that authorizes a party to the treaty to take economic countermeasures against, or to revoke trade benefits

from, the other party if a situation is determined that the former has infringed certain prescribed social rules.¹⁷ Some countries tried to insert such a clause into the Marrakesh Agreement so that not only prison labor but also other labor standards could be invoked to justify import restriction of goods coming from countries that allegedly breached these standards.¹⁸ The social clause may be justified as long as the social rules, taken as yardstick, are universally recognized principles, which can even be said to have acquired the status of international customary law.

The idea of combining human rights rules, or social standards in fair trade, is not new. One of the reasons for establishing the International Labour Organization (ILO) in 1919 was to equalize social conditions of nations. The ILO Constitution in its Preamble provides clearly that “Whereas also the failure of any nation to adopt humane conditions of labor is an obstacle in the way of other nations which desire to improve the conditions in their own countries.” This amounts to a statement that equalization of labor standards is required in order to achieve fair trade conditions. At the ILO Conference in 1994, an employer delegate stated that “The ILO is, as such, a social clause.” This statement supports the idea underlining the fundamental aims of the ILO. However, the ILO has adopted a non-compulsory approach from the outset. That is to say, instead of imposing sanctions in a case of breach of ILO standards, it has developed an elaborate system of supervision that is a middle-of-the-road approach between *laissez-faire* and enforcement.

The ILO system has survived the test of time and stands out as one of the most effective mechanism of securing compliance in the international law system. Nevertheless, criticism has been often heard that this excellent supervisory mechanism is not strong enough to bring about full application of standards. There has always been a potential desire to equip the ILO’s supervisory work with teeth that bite. The discussion during the Uruguay Round gave hope to those who wished the ILO’s supervision to become more effective. The ILO did not, however, abandon its historical commitment to a non-compulsory approach. The debate, therefore, continued in the framework of the Uruguay Round.

Two key concepts should be given attention in understanding the implication of the social clause in trade agreements. One is fair labor standards and the other is social dumping. It is only then that we can say it makes sense to utilize labor standards as a yardstick to measure unfair trade practice, and whether the mechanism of the social clause can promote a marriage of labor standards and the international trade system.

Fair labor standards

The yardstick must be universally agreed upon. When a trade sanction is imposed on criteria set forth in a bilateral trade agreement, it has a risk of imposing a value, which is neither shared by the parties, nor by the international community. The Tuna/Dolphin Case again provides a good example, in which the yardstick utilized was a national value (preservation of dolphins). It did not give

justifiable ground for a party to restrict trade and the WTO panel considered the quantitative restriction imposed by the United States as protectionism in disguise. If a country uses its own labor legislation or any other standards it believes to be fair in its bilateral relations with another country, it has a high risk of applying arbitrary criteria. This can too easily be used to disguise protectionism.

The standards, if they can claim to be objective criteria for judging unfair trade, must be something that is also a norm in the jurisdiction of other parties. We have seen that the last case of Shrimp/Turtle hinted to the emergence of a universal norm regarding the protection of sea turtles. That is why the social clause discourse culminated in proposing international labor standards as criteria, because they are so basic that all members of the world community are expected to observe them.¹⁹

Social dumping

Social dumping is not a new concept. It was frequently referred to in the past, with regard to Japan, when developed economies faced tough competition from the Japanese rising economy in the 1930s and also shortly after World War II. It is commonly understood as a situation in which a country or an industry intentionally, or by negligence, suppresses its social standards and as a consequence gains a comparative edge in international trade. Suppose a country makes use of prisoners to produce certain goods free of labor costs, which are subsequently sold in the international market. The relationship between the low price of products and the breach of international standards is direct and trade sanction can be justified. However, this argument is only valid in a particular industrial sector and in a particular product, in which prisoners are employed. It cannot justify an economic sanction affecting the country as a whole. The word “social” in the concept of social dumping should be interpreted as “labor” or “labor-related” and not “societal.” A society as a whole cannot dump.

The criteria with which to judge social dumping is another problem. Criteria (labor standards), such as wages, working hours and other working conditions, have been long advocated for use as a yardstick. Wages, for instance, can differ in many parts of a country, also in developed industrial country, and, therefore, cannot provide an objective criterion to judge social dumping. In other words, there is a merit of trade because there is a difference in labor costs and the “cheap labor” is the comparative advantage of developing countries.

Rebirth of the social clause in bilateral and regional trade agreements

The foregoing argument leads us to a conclusion that the social clause discourse can be supported only when applied to a particular sector of industry using internationally agreed standards as yardsticks. It is, therefore, sensible that during the 1996 WTO Ministerial Meeting held in Singapore, which was the last time the issue of labor rights rose to high level talks within the WTO, delegates affirmed

their commitment to such rights. But they nonetheless declared clearly that it was the mandate of the ILO and not the WTO to address labor issues,²⁰ adding that such issues should not be used for protectionist reasons or to question the “comparative advantage of countries, particularly that of low-wage developing countries.”²¹ However, unsatisfied with this development, some developed countries, especially the United States, started to introduce the social clause by itself into bilateral trade agreements it concluded.²²

The North American Free Trade Agreement (NAFTA), which came into force in 1994, was accompanied by a side agreement on labor and it had distinct paragraphs, which were clearly social clauses. It even provided for fines, in case a breach of the social clause was determined by the committee set up for that purpose.²³ Many other bilateral or regional agreements contained similar provisions. These are the Dominican Republic–Central America–United States Free Trade Agreement, bilateral free trade agreements concluded respectively with Bahrain, Chile, Colombia, Jordan, Korea, Morocco, Oman, Panama, Peru and Singapore.²⁴ The huge group of “labor” chapters in these agreements or in the side agreements constitutes the biggest part of social clauses extant by now.²⁵

Not only the United States but also other countries, such as Canada, have also concluded free trade agreements with social clauses. The Agreement on Labor Cooperation between the Government of Canada and the Government of the Republic of Chile, which is a side agreement to the free trade agreement between Canada and Chile²⁶ and the Agreement on Labor Cooperation between the Government of Canada and the Government of the Republic of Costa Rica,²⁷ are examples.

Inherent problem of inserting a social clause into trade agreements

Many of the labor standards referred to in above-mentioned agreements do not possess elements, which would justify imposition of economic sanctions. Why is it that restriction of trade union rights results in gaining competitiveness in international trade? A naïve explanation might be that suppression of trade union activities would bring about weaker bargaining power of workers, hence cheaper products. The Organization for Economic Cooperation and Development (OECD) report of 1996 indicated that there was no direct relationship in the restriction of trade union rights with the labor costs.²⁸ It is also widely believed that non-discrimination in employment normally increases productivity and greater competitiveness of an industry. It is, therefore, difficult to argue that discriminatory labor practices give grounds for lower labor costs and competitive edge in international trade.

Protagonists of the social clause, many human rights activists and trade unionists, are in favor of making use of the social clause in trade agreements. The international protection of human rights must obviously be strengthened. However, it must be achieved by appropriate means and not by inflicting trade sanctions in a wrong context. Instead, the ILO’s supervisory mechanism should

be reinforced. It should not be done by means that would undermine the inherent virtue of persuasion, the basic operating principle of the ILO. The founders of the ILO knew that coercion would not achieve the desired goal. The basic situation of the international community from which this conviction emanates has not fundamentally changed.

The WTO, and more generally other economic institutions, should strive to bring about liberalization of trade and achieving fruits derived there from, which should then be distributed equally among all the countries of the world and all the social partners in a country. It is important to ensure that fruits derived from the liberalization of trade are shared by the whole population and the whole world, and not by a handful of interested parties.

Even if the WTO system has a strong and effective dispute resolution mechanism while the international system of human rights does not,²⁹ still, the WTO is not an institution to promote labor rights.³⁰ The greatest risk in using the WTO for the purpose of protecting human rights and labor rights lies in that human rights principles may be economically bargained at the cost of human rights, which cannot be abated. For example, there are issues on the competency of the WTO to address human right issues, the organization's biases, and whether such move would subvert rather than support the wealth-producing goal of the global trade system.³¹ As the ILO Constitution says, "Labor is not a commodity." The WTO itself made it clear that it would not deal with labor rights questions. Attention, therefore, should be now cast instead to the increasing number of bilateral trade agreements, which involve labor clauses.

CSR: A social clause in disguise?

Legal nature of corporate social responsibility (CSR)

As mentioned at the start of this chapter, labor law scholars in some countries seriously argue over whether CSR is law or not.³² CSR is a notion frequently discussed today and it is something that is usually covered by the fields of business administration or management. It has not been a legal concept. However, the research in CSR is booming.

It is widely stated that initiatives undertaken by private enterprises, such as the proclamation of company codes or adherence to other CSR codes administered by non-profit organizations (NPOs), are not subject to legal regulation; the OECD Guidelines on Multinational Enterprises and other similar guidelines are international instruments without legally binding effects; and that CSR has objectives different from those of a law. But, then, why is it that this concept has intrigued so many writers?

CSR has a considerable number of legal implications and private enterprises can no longer conduct their operations without taking due consideration of CSR. If CSR is conferred with legal validity one day, enterprise management must conduct their operations in accordance with the legal consequences emanating from CSR. At the same time, the enterprise management, its legal departments

in particular, may stand to gain from the legality of CSR and have an easier task to convince supply-chain enterprises to adhere to the mother enterprise's code.

It can be concluded that CSR is not a valid (international) rule, at least for the time being, although it may well become one if certain conditions are met. On the other hand, it will be contended that CSR does already play a significant role as a process to materialize various international legal rules. Many Chinese companies were approached by some international NPOs to get certified by their codes. This is a result of the practice now being used by their global customers in pressuring their supplier factories to meet standards as specified in their contracts with them.³³ Others have been strongly advised by foreign buyers to adhere to their self-established codes of behavior, normally dealing with corporate governance, environmental and/or social standards.³⁴ Since adherence to such a code becomes conditional for business deals, managers are obliged to observe principles enshrined in those codes. Even if these codes are not law enacted by legislature, they become *de facto* law for those enterprises, which have weaker position vis-à-vis their business partners. That is why the legal nature is seriously discussed.

Existing forms of CSR

*OECD guidelines for multinational enterprises*³⁵

In 1976, long before the world started talking about CSR, the OECD adopted the "OECD Guidelines for Multinational Enterprises" (Guidelines). They are nothing but CSR in our contemporary usage of the term. They provided voluntary principles and standards for responsible business conduct, in a variety of areas including employment and industrial relations, human rights, environment, information disclosure, competition, taxation, and science and technology. The Guidelines are not an international treaty and, therefore, do not legally bind OECD Member States. Nor do they legally bind the enterprises. The unique feature of the Guidelines is that they address not only entities, which are not nation-states, but also the fact that an implementation mechanism is well established. The Guidelines are more than just words; they have an operational impact.

The system of "National Contact Points" has been able to elaborate on the contents of the Guidelines and make them operational. National Contact Points are government offices responsible for encouraging observance of the Guidelines in the national context and for ensuring that the Guidelines are well known and understood by the national business community and by other interested parties. Because of the central role it plays, the effectiveness of the National Contact Point is a crucial factor in determining how influential the Guidelines are in each national context. The recently concluded review has enhanced the accountability of National Contact Points by calling for an annual report of their activities, which will serve as a basis for exchanges of views on the functioning of the National Contact Points among the Guidelines-adhering governments.

Recently, it has become increasingly common for enterprises to refer to the OECD Guidelines in their own code of conducts. High-level political declarations, such as the G8's African Programme of Action 2002 and the Joint Statement by G8's Finance Ministers of May 2003 make special reference to the Guidelines. Analysis of the outcome of several National Contact Points' activities reveals an important development, namely using the Guidelines as a normative framework for the conduct of multinational enterprises. Among several successful cases recorded, credit is usually given to a case on Myanmar, which came to a conclusion in 2003. Operations of an oil and gas multinational enterprise in Myanmar were alleged to have violated a number of provisions under the OECD Guidelines, including prohibition of the use of forced labor and protection of human rights of the people living in the vicinity of the pipeline. The French National Contact Point (NCP) took this case seriously and developed various recommendations, which eventually made the multinational enterprise concerned withdraw its investment from Myanmar.³⁶ In all other cases the Guidelines have been utilized in a quasi-legal way. As such, the legal relevance of the Guidelines can no longer be underestimated.

The International Labour Organization (ILO) tripartite declaration on multinational enterprises

In June 1976 the ILO's tripartite World Employment Conference discussed questions related to multinational enterprises. The Workers' Group, as well as the Group of 77, recommended that a convention on multinational enterprises be adopted. The employers did not share this view but agreed on the usefulness of a tripartite declaration of principles, which would be of a voluntary character. The ILO's Governing Body in November of 1977 adopted the "Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy." There are various reasons for the ILO to adopt the CSR code of conduct as a Governing Body declaration, instead of an ordinary ILO Convention or a Recommendation. First, the target entities are neither states nor ILO constituents, but instead are private enterprises. Multinational enterprises, being by nature multinational and conducting their activities across borders, cannot, in many cases, be regulated by nation states. Even if a country is bound by a treaty and assumes certain duties to control multinational enterprises, the latter frequently by-pass national jurisdictions and, therefore, cannot be effectively regulated. Second, the employer group of the ILO, which largely represents the interests of multinational enterprises, was strongly against adopting a legally binding instrument. In this last point, we find a basis for the argument that CSR has a legal effect. If it did not, why should employers object to having it incorporated into an ILO Convention or a Recommendation?

The Tripartite Declaration is a legally non-binding instrument. However, like the OECD Guidelines, it is more than just a policy statement of an inter-governmental institution. It also has follow-up machinery attached to the substantive provisions. The follow-up is conducted in the form of an "interpretation

by the ILO,” a procedure approved by the Governing Body in 1980 and revised in 1986.³⁷ It provides for the submission of requests for interpretation in cases of a dispute on the meaning and application of its provisions. The importance of this procedure lies in its ability to contribute to the harmonious development of labor relations, either by its use or by its availability, the latter of which may encourage disputants to confront their difficulties and to gain a perspective capable of mutual accommodation.

Unlike in the case of the OECD Guidelines, the ILO’s procedure has not been fully utilized. To date there have only been five cases, in which the Governing Body of the ILO issued “official” interpretations of the relevant provisions of the Declaration. Nonetheless, a “successful” conclusion was reported in one case, where paragraph 26 of the Declaration was “interpreted” as to the duties of a multinational enterprise to give reasonable prior notice of changes, which would have major employment effects.³⁸ The ILO (Governing Body), referring to the Termination of Employment Convention, 1982 (No. 158) as a guide, maintained that paragraph 26 required reasonable prior notice of intended changes in operations to be given to the workers’ representatives and their organizations, where such organizations were identifiable under national law and practice, and if such representatives and organizations existed, it was insufficient to inform the workers affected on an individual basis.³⁹

UN human rights instruments

An instrument entitled “Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights” was adopted in 2003, by the Sub-Commission for the Promotion and Protection of Human Rights of the United Nations.⁴⁰ This document is a product of a Working Group set up under the Sub-Commission in 1998. It has wide coverage: A. General obligations, B. Right to equal opportunity and non-discriminatory treatment, C. Right to security of persons, D. Rights of workers, E. Respect for national sovereignty and human rights, F. Obligations with respect to consumer protection, G. Obligations with respect to environment protection, H. General provisions of implementation, and I. Definitions.

The remarkable fact regarding these norms is that it not only addresses Member-States of the United Nations, but also private enterprises.⁴¹ This fact is by itself an innovative approach from the point of view of traditional international law theory, but it is more important that a UN body is now taking up CSR in a legal document. It is so innovative that it is obvious that a considerable amount of reservations have been expressed with respect to the legal nature of the document as well as its validity. The parent body, the Commission on Human Rights, in its 2004 Resolution explicitly reserved its position and even mentioned that the Working Group had worked without a clear mandate given by the Commission and, therefore, the document must not be followed up.⁴² An uphill task seems to lie ahead in materializing the body of rules established by the Working Group. On the other hand, if the document received sufficient

support, its legal effect would be of a great significance in the future vis-à-vis the legal norms of CSR.

Global Union Federation (GUF) framework agreements

The foregoing sections dealt with a group of documents that are international legal instruments duly adopted by inter-governmental institutions, even though they cannot qualify for formal positive laws. The next two examples are cases in which private entities formulate the norms with an international application in sight. Therefore, under no circumstances can they be called international law in the traditional sense of the term. However, it is worth discussing them in this context because, depending upon how they are applied, they may, nevertheless, have some legal consequences.

The first type of this kind is that of a Framework Agreement concluded between an international sectoral trade union organization (for example, GUF)⁴³ and a multinational enterprise. There are currently over thirty of this kind of agreement concluded, for instance, between Volkswagen, Bosh, Renault, etc. and the IMF, between IKEA, etc. and International Federation of Building and Woodworkers (IFBWW), between Carrefour, etc. and Union-Network International (UNI), between Club Mediterranee, Chiquita, etc. and International Union of Food (IUF).⁴⁴ When we look at the agreement between IKEA and the IFBWW, for instance, we find that many ILO Conventions are referred to therein. As a company selling furniture, there is an important meaning for IKEA to conclude such an agreement with an international trade secretariat organizing workers in the construction, building, wood, forestry and allied trades and industries. The agreement becomes binding for a business, in which trade unions affiliated to IFBWW are involved. One of the final provisions of the agreement states, “that in order to achieve the objectives and undertakings given in the agreement, IKEA and the IFBWW will engage in on going dialogue and will meet regularly and as the need arises to examine the implementation of this agreement and any reported breaches of its terms.”⁴⁵

Another important feature can be found in agreements reached between Volkswagen and the IMF, in which suppliers and sub-contractors are encouraged to apply the contents of the framework agreement as their own codes. The agreement between Daimler-Chrysler and the IMF goes one step further by not only encouraging the suppliers to adopt their own codes in accordance with the framework agreement, but also to consider their adoption as an important element in order to continue Daimler-Chrysler’s business with them. We see from these examples that the scope of the framework agreements has expanded to the supply chain enterprises, some of which may have greater difficulties in applying CSR due to their relative size and economic performance.

When we look at the international legal importance of these framework agreements, the following observations can be made. The Global Union Federations are non-government organizations (NGOs) and they are not subjects of international law. Likewise, multinational enterprises that enter into framework

agreements with GUFs are private legal persons, deprived of a formal international legal personality. What is interesting here and worthy of comment is that the agreement is not a simple contract between Company X and Organization Y, covered by a civil code or a commercial code of a particular country. Both parties to framework agreements of this kind are operating internationally. The GUF, for example, covers over 125 countries and 289 affiliated unions. The effect of the agreements thus immediately spread all over the world and will cover a great many enterprises and workers employed therein. Any multinational enterprises, which seek to maximize profits by shifting their production sites across national borders, are now accompanied by CSR. The importance of a framework agreement can be analogously compared with that of collective bargaining agreements in a national context. While individual labor contracts have legal effects only on the parties, a collective agreement has a wider application and in some countries they are given the status of law. In a similar way, a framework agreement of the kind can perform a quasi-legislative function in the context of a decentralized international legal system.

“Standards” adopted by ISO and other NGOs

The International Organization for Standardization (ISO) published ISO26000 on 1 November 2010. ISO has been greatly successful in introducing and operating a number of technical standards, mainly in industrial sectors. It therefore provoked attention among many commentators, when it announced its intention to draft a standard on CSR. The ILO was one of the entities largely affected by this ISO initiative. It was, therefore, natural that the ILO was very concerned about such a standard, which involved labor standards. Finally, the ILO agreed to support the ISO’s new code by concluding an inter-agency Memorandum of Understanding, which requested the ISO consult the ILO at all times and that no reference to ILO standards should be made without prior consultation with the ILO.⁴⁶ ISO26000 would have a great impact, because the reputation of ISO standards is firmly established and its implementation would presumably be extremely efficient. However, the more the new instrument includes labor rights and human rights, the more difficult it becomes to secure co-ordination with other international bodies working in the field of labor and human rights.

Equally problematic is the relationship between private initiatives of social labeling with the official sources of international law. There are a number of NGOs that provide certification services to private enterprises with their own standards. The most famous NGO in this respect is the SAI (Social Accountability International) based in the USA. With its Code, SA8000, SAI has expanded its influence to many parts of the world and most recently in China, the fastest growing economy in the world. Fair Labor Association (FLA), also based in the USA, is another organization of the same nature and it is also expanding its sphere of influence. The codes these organizations apply frequently refer to official international legal sources, such as the ILO Conventions and UN instruments, but the choice of the standards and the degree of importance attached to

each of these standards are often arbitrary and involve certain risks. As long as their standards offer a higher level of protection in labor conditions and in other general human rights situations, no significant problem arises.⁴⁷ However, if their choice of standards were biased, their interpretation of official international legal sources were wrong and if they competed with other certifying institutions in terms of fees and the level of standards, the outcome would be detrimental in a number of respects. First, such bodies may adopt only those standards that please managers of enterprises. To take a simple example, a significant number of managers do not necessarily endorse the principle of freedom of association. The certifying institutions may decide not to include trade union rights in the set of standards they provide for in their codes. Even when they are included, they may do so by giving trade union rights a secondary place after equality principles or child labor prohibition. Second, such bodies may not be equipped with proper expertise in interpreting international legal instruments. Even if they are, they have no legal authority to interpret international law, such as the ILO Conventions and the International Covenant on Civil and Political Rights. Third, adoption of voluntary codes, such as SA8000, by large multinational enterprises necessarily forces small and medium enterprises to follow suit in order to maintain their competitiveness. However, the certification fees to be paid to certifying agencies are not negligible for some of the small companies and some of the standards, which are suited for large multinational enterprises, may not necessarily be appropriate for small businesses. Here, a drive towards market monopolization can be felt.

The above-mentioned potential detrimental effects may not only negatively affect national societies, but also the international society as well. Suppose the child labor provision of SA8000 is interpreted by SAI in a different way from what the Committee of Experts on the Application of Conventions and Recommendations of the ILO has, for many years, been advocating, and if the number of SA8000 adhering enterprises were big and the market dominating power of those enterprises was sufficiently important, there would be a true risk that the internationally recognized authority of the ILO's supervision would be in jeopardy. The ILO's supervisory machinery has itself been cautious in pronouncing its competence to interpret ILO Conventions, because the ILO Constitution provides that only the International Court of Justice can authoritatively interpret ILO Conventions. Now a new NGO can arguably be said to come along and interpret the Convention as it pleases and to have its interpretation enforced as a result of the enormous power of multinational enterprises. Who has authorized Company "X" or NGO "Y" to set up a code, which may, in practice, substantially revise a positive law? What will happen, when the code conflicts with existing laws?

Many private initiatives, including rapidly expanding codes proposed by private institutions, such as Social Accountability International (SAI) and Fair Labor Association (FLA), refer to international treaties, such as ILO conventions on the prohibition of forced labor and child labor. A company's adherence to such codes is then inspected by consultants hired by the SAI or FLA. How can

we assume that these consultants know the correct interpretation of ILO Conventions Nos. 29 and 138? Who has given authority to the SAI and FLA, and all other private companies, whose codes refer to ILO Conventions or UN treaties, to interpret the international treaties in this way? The soft law aspect of CSR should, therefore, be carefully observed. Legalization without due process must be avoided and necessary measures must be taken so that globalization does not undermine the traditional law-making and law-interpreting procedures of the international community.

CSR in trade agreements

The Canada–Peru Free Trade Agreement, entered into on 29 May 2008, encourages Canadian and Peruvian businesses to follow “internationally recognized corporate social-responsibility standards, practices and principles.”⁴⁸ Article 810 is entitled “Corporate Social Responsibility” and it reads:

Each Party should encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognized standards of corporate social responsibility in their internal policies, such as statements of principle that have been endorsed or are supported by the Parties. These principles address issues such as labor, the environment, human rights, community relations and anti-corruption. The Parties therefore remind those enterprises of the importance of incorporating such corporate social responsibility standards in their internal policies.

Similar provision is also found in the FTA agreement signed with Colombia on June 7, 2008.⁴⁹ These FTA agreements either contain labor clauses or have separate agreements on labor. There is, therefore, a duplication of provisions with respect to labor standards. This fact has the following importance. The CSR provision in the FTA does not call for a dispute-settlement procedure. In other words, non-compliance with the CSR clause in the agreement does not result in economic sanctions. However, the fact that it has been included in an international agreement raised the status of the CSR from a voluntary code to a legally relevant instrument. That is to say, non-compliance with CSR or non-application of CSR, will henceforth be considered as non-compliance with an internationally committed agreement.

Implication of the introduction of CSR into the trade regime

To put this proposition in an extremely simple way, CSR in the international trade regime serves as a vehicle to legally allow quantitative restrictions. Suppose a country does not abide by the OECD Guidelines or does not take necessary measures to make a company in its jurisdiction observe a CSR code established by its parent company in the investor country. The latter can legally impose importation restriction against the other party, usually a developing

country, which has allegedly breached the CSR obligation. In other words, a social clause effect can be achieved by the introduction of the CSR. To make the situation worse, the CSR has a deregulatory nature, i.e., some of them are basically voluntary codes established by an individual (multinational enterprise) and it has no proof that it is in conformity with the public policy and internationally agreed principles.

For example, ILO Convention No. 138 on the minimum age to enter into employment, in Art.2, para.3 states: "The minimum age specified in pursuance of paragraph 1 of this Article shall not be less than the age of completion of compulsory schooling and, in any case, shall not be less than 15 years." The Adidas' Workplace Standards provides: "[b]usiness partners must not employ children who are less than 15 years old, or less than the age for completing compulsory education in the country of manufacture where such age is higher than 15."⁵⁰ It appears, *prima facie*, to conform with the ILO principle. The Adidas' Standards, however, is more strict as it does not allow children under the age of 14 to be employed, while ILO Convention No. 138 in its Art. 2, para.4 provides that "a Member whose economy and educational facilities are insufficiently developed may, after consultation with the organizations of employers and workers concerned, where such exist, initially specify a minimum age of 14 years." When Adidas operates in a country that has availed itself of this provision of the Convention, Adidas may adopt a higher standard than the host country's policy, which is in conformity with international labor standards.

CSR has a positive meaning, in that it concretely supplements a legal obligation, which has been stated in a vague language. It has similar functions as implementation regulations, ministerial regulations and administrative rules of a substantive law. In our context, this would be the case, in which CSR gives concrete meanings to some ILO Conventions. For example, the Forced Labor Convention (No. 29) offers the following definition of the concept of forced labor: "For the purposes of this Convention the term forced or compulsory labor shall mean all work or service which is exacted from any person under the menace of any penalty and for which the said person has not offered himself voluntarily." The corresponding provision in the Adidas' Workplace Standards⁵¹ states: "Business partners must not use forced labor, whether in the form of prison labor, indentured labor, bonded labor or otherwise."⁵² While the ILO's supervisory organs, the Committee of Experts on the Application of Conventions and Recommendations, in particular, have long discussed the problem of bonded labor within the scope of the Conventions, this company code now enforces the ILO's interpretation of the Convention, clearly bringing bonded labor into the scope of the Convention.

The "promotional" effect a CSR code possesses is not without problems. A unilateral declaration by an enterprise proclaiming its determination to achieve *higher* standards is almost outside the implementation process of the law. It may, in fact, enter into the realm of law-making and, as such, it may not always be in the public interest. The expansion of the scope of coverage can, therefore, be admitted only to the extent that it is in conformity with the relevant legal

regulation. Otherwise, it might even cause a negative consequence. That is to say, an enterprise, usually a giant multinational enterprise with considerable power in the international market, may use higher standards to differentiate itself from smaller and weaker enterprises thereby ensuring its dominant status. In other words, CSR would be used as a tool to legally secure a monopoly situation.⁵³ Whilst making this final reservation, it should be acknowledged that CSR plays a significant role in facilitating an effective implementation of *lex lata*.

An example again taken from the forced labor issue: ILO Convention No. 29 admits forced labor as a “consequence of a conviction in a court of law, provided that the said work or service is carried out under the supervision and control of a public authority and that the said person is not hired to or placed at the disposal of private individuals, companies or associations.”⁵⁴ The Adidas’ Workplace Standards as quoted above do not qualify prison labor in this way. It appears as if the company code provides broader protection in the sense that it categorically prohibits the use of convicted prisoners. This may not necessarily be in conformity with the public policy of the country concerned, as well as with the ILO’s practice to allow certain groups of prisoners to work for private companies. The reference cited above on the prohibition of child labor may also give rise to a question in this context.

Labor law and human rights law are, by their nature, regulatory and far from the deregulatory aspiration of the globalization and its market-oriented value.

Conclusion

CSR is a very topical issue discussed at various fora. This chapter has endeavored to situate the highly debated concept in the context of international trade law. It presented a view that it was an important mechanism to bring about governance in the globalized world, but if wrongly utilized, it might end up being a disguised protectionist measure.

Multilateralism, the very heart of WTO, seems to be in jeopardy recently. Countries prefer to sign bilateral or regional FTAs and bypass the WTO. In bilateral agreements, strong countries tend to have bigger leverage. The rebirth of the social clause, once abandoned in the multilateral level, is apparent in many recently concluded FTAs. CSR seems to point in the same direction with the social clause. Not all CSR is problematical, but one should be wary of potentially dangerous misuse. It is especially true in the context of labor standards, which are human rights standards and cannot be bargained. Introduction of human rights standards into an economic system must be handled with great care.

Notes

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1 See, *Postimperialism and World Politics* (David G. Becker, Richard L. Sklar and Simon Hakim, eds., Westport, CN: Praeger Publishers, 1999).

- 2 Shin-ichi Ago, Corporate Social Responsibility and International Law (in Chinese), *Peking Law Journal*, Vol. 18, No. 5, 2006, pp. 523–529.
- 3 A possible solution to this dilemma would be to envision a form of horizontal coordination among international agencies, whereby the ILO would be wholly or largely responsible for determinations of systematic and persistent violations of core labor standards, the UN Committees on Human Rights determinations of systematic and persistent violations of other universal human rights (other than the most egregious abuses), and the WTO would be responsible for overseeing the implementation of sanctions and ensuring that arbitrary and unjustifiable forms of discrimination and disguised protectionism are avoided, as well as proportionality in the scale of the trade sanctions imposed (see, Michael J. Trebilcock, Trade Policy and Labor Standards, *Minnesota Journal of Global Trade*, Vol. 14, p. 261, 2005).
- 4 The British economist David Ricardo, in *The Principles of Political Economy and Taxation* (1817), set out the “first ‘scientific’ demonstration that international trade is mutually beneficial.” Ricardo’s “law of comparative advantage” holds that countries do best by specializing in goods for which their costs of production are comparatively low relative to other goods. Regardless of the fact that “a nation may have an absolute advantage over others in the production of every good, specialization in those goods with the lowest comparative costs, while leaving the production of other commodities to other countries, enables all countries to gain more from exchange” and thereby to enjoy consumption opportunities beyond their production capacities. This notion of comparative advantage “remains the linchpin of liberal trade theory” (Robert Gilpin, *The Political Economy of International Relations*, New Jersey: Princeton UP, 1987).
- 5 J. Jackson and W. Davey, in *Legal Problems of International Economic Relations*, 2nd edn, Eagan, MN: West Publishing, 1986, p. 252, categorize General Agreements on Trade and Tariff (GATT)/WTO into the Bretton Woods system.
- 6 The divisions in international law are replicated in a postwar order consisting of two institutions, the UN and the Bretton Woods systems, both of which are divided along the public/private line. Therefore, the conceptual framework inherited by the two dominant paradigms of international economic development has been similarly fractured by the same public/private split. It is thus not a surprise that the classical liberal model occupies the private component of international law governed by Bretton Woods in general and the GATT in particular. With its emphasis on commercial activities, market actors, and a more or less nonpolitical process, the model attempts to negotiate the international/national market divide in a manner that is as non-confrontational and apolitical as possible (Lan Cao, Toward a New Sensibility for International Economic Development, *Texas International Law Journal*, Vol. 32, p. 239, 1997).
- 7 The infant industries argument maintains that as a country begins its industrial development, the “infant industries” cannot compete with established industries in other countries. Therefore, protection from foreign competition is justified for a period of time (see, generally, Paul Krugman and Maurice Obstfeld, *International Economics: Theory and Policy*, 7th edn, Boston: Addison Wesley, 2006).
- 8 Decision on Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries, L/4903 (November 28, 1979), GATT B.I.S.D. (26th Supp.) at 203 (1980).
- 9 There is the danger that the infant industry argument can be abused to legitimize piracy and misguided economic protectionism to stave off foreign firms and promote what is seen as the local economy (William Easterly, *The Elusive Quest For Gold: Economist’s Adventures and Misadventures in the Tropics* 230, Cambridge, MA: MIT Press, 2002).
- 10 Olufemi Amao, Trade Sanctions, Human Rights and Multinational Corporations: The EU–ACP Context, *Hastings International & Comparative Law Review*, Vol. 32, p. 379 (2009).

- 11 Thus, the General Exceptions of Article XX were created. These exceptions allow member nations to implement trade policies with environmental objectives that are otherwise inconsistent with GATT rules, provided certain conditions are met. First, the measure must fall within one of the listed exceptions specified in Article XX. In the context of measures addressing environmental concerns, the applicable exceptions include: 1) the measure is “necessary” for the protection of the environment (XXb), or 2) “related” to the conservation of exhaustible natural resources (XXg). Second, the measure must meet the conditions of Article XX’s chapeau. It must be applied in a way that does not constitute arbitrary or unjustifiable discrimination between countries, or act as a disguised restriction on trade (Dominic A. Gentile, *International Trade and the Environment: What is the Role of the WTO?* *Fordham Environmental Law Review*, Vol. 20, p. 197 (2009)).
- 12 The Tuna/Dolphin Case involved a U.S. attempt to adopt a restrictive trade policy, the Marine Mammal Protection Act, which was aimed at protecting dolphins by setting regulations on methods of tuna fishing. The GATT Panel did not adopt the ruling, but did hold that the U.S. could not reach beyond its jurisdiction to hold other countries to an American standard (see, generally, Panel Report, United States—Restrictions on Imports of Tuna, WT/DS21/R (September 3, 1991) [hereinafter GATT Tuna Report]). This case is commonly referred to as Tuna I, and the appeal of this case is referred to as Tuna II. Under the ruling of Tuna II, the United States must use measures that are “reasonably available” in its attempt to ban products. Tuna II stood for the standard that restrictions in trade policy must be “primarily aimed at” and “strictly necessary” for whatever protection or intent at which the policy is aimed. The WTO stated that the U.S. could not impose trade barriers to force other countries to comply with their environmental standards and policies.
- 13 In the Shrimp/Turtle Case, the WTO Appellate Body held that the U.S. law setting a standard for shrimp trawling, aimed at protecting sea turtles, was discriminatory. The WTO held that because the U.S. was requiring other WTO members in different conditions to adhere to regulatory standards established by the U.S., this regulation was a violation of WTO trade policy (see Appellate Body Report, United States—Import Prohibitions of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, (October 12, 1998)).
- 14 Markus Burianski, Caroline Negri and Mathias Ulbrich, Free Trade and Core Labour Rights: Status Quo of a Discussion, *Student Law Journal*, 2003 1, 4, available at: www.studentlawjournal.co.uk/articles/2003/pgrad/labourrights.pdf.
- 15 Farkhanda Mansoor, Laughter and Tears of Developing Countries: The WTO and the Protection of International Labor Standards, *Currents International Trade Law Journal*, Vol. 14, p. 60 (2005).
- 16 Shin-ichi Ago, A Crossroad of International Protection of Human Rights and International Trade—Is the Social Clause a Relevant Concept? in *Droit et Justice* (Melanges Nicolas Valticos), Paris, Pedone, 1999.
- 17 A social clause is a provision in international bilateral and multilateral trade treaties that links labor standards to liberalization of international trade. Trading access to markets of developed countries is conditional upon compliance with international labor standards. Failure to comply results in trade sanctions and loss of market access (see R. N. Sanyal, The Social Clause in Trade Treaties: Implication for International Firms, 29 *J. Bus. Ethics* 379, 380, 2001).
- 18 In its preamble, the Marrakesh Agreement, which established the WTO, included not only free trade as its objective, but also human rights and social issues, such as raising the standards of living, ensuring full employment, sustaining development and protecting the environment (Olufemi Amao, Trade Sanctions, Human Rights and Multi-national Corporation: The EU-ACP Context, *Hastings International & Comparative Law Review*, Vol. 32, p. 379, 2009).
- 19 However, to date, the majority of the Contracting Parties to the GATT have rejected

- attempts to incorporate fair labor standards in the GATT (in general, the countries belonging to the “North” favor an inclusion of “fair labor standards” on the WTO agenda, and the countries belonging to the “South” reject such an inclusion). An international commitment to recognized core labor standards, however, is unquestionable (Salman Bal, *International Free Trade Agreements and Human Rights: Reinterpreting Article XX of the GATT*, *Minnesota Journal of Global Trade*, Vol. 10, p. 62 (2001)).
- 20 World Trade Organization, Singapore WTO Ministerial 1996: Ministerial Declaration WT/MIN(96)/DEC, 18 December 1996, para. 4, available at: www.wto.org/English/thewto_e/minist_e/min96_e/wtodec_e.htm.
 - 21 World Trade Organization, Trade and Labour Standards: Subject of Intense Debate, available at: www.wto.org/English/thewto_e/minist_e/min99_e/english/about_e/181ab_e.htm.
 - 22 For example, in 1992 the United States began conditioning new free trade agreements upon adherence to certain child labor principles (see generally Maxwell A. Cameron and Brian W. Tomlin, *The Making of NAFTA: How the Deal was Done*, New York: Cornell UP, 2000).
 - 23 North American Agreement on Labor Cooperation, Article 39, available at: www.naalc.org/naalc/naalc-full-text.htm.
 - 24 Dominican Republic–Central America–United States Free Trade Agreement Implementation Act, H.R. 3045, 109th Cong. (2005). The Act passed the House on July 28, 2005, with 217 votes in favor and 215 votes opposed. 151 Cong. Rec. H6927–28 (2005). It passed the Senate by a vote of 55 to 45 on the same day, 151 Cong. Rec. S9255 (2005), and was signed into law by the President of the United States on August 2, 2005. Pub. L. No. 109–53, 119 Stat.462 (2005).
 - 25 Available at: www.ustr.gov/Trade_Agreements/Section_Index.html.
 - 26 Available at: http://www1.servicecanada.gc.ca/en/lp/spila/ialc/06Canada_Chile_Agreement.shtml.
 - 27 Available at www.hrsdc.gc.ca/en/lp/spila/ialc/08canada_costa_rica_agreement.shtml.
 - 28 *Trade, Employment and Labor Standards—A Case Study of Core Workers’ Rights and International Trade*, OECD, Paris 1996.
 - 29 S. A. Aaronson, Seeping in Slowly: How Human Rights Concerns are Penetrating the WTO, 6 (3) *World Trade Rev.* 413, 2007).
 - 30 Other scholars are of the opinion, however, that that the WTO should promote human rights (see, P. Stirling, The Use of Trade Sanctions as an Enforcement Mechanism for Basic Human Rights: A Proposal for Addition to the World Trade Organization, 11 *Am. U. J. Int’l L. & Pol.* 1, 1996; G. M. Zagel, WTO and Human Rights: Examining Linkages and Suggesting Convergence, 2 (2) *Int’l Dev.-Jurist Paper Series* 1, 2005).
 - 31 Joe W. Pitts III, Current Issues in Public Policy: The Corporate Social Responsibility: Current Status and Future Evolution, *Rutgers Journal of Law and Public Policy*, Vol. 6, p. 334, 2009.
 - 32 In Cambodia, too, CSR is considered to be a part of labor laws. It is a topic taught in classes about labor law.
 - 33 The factories are required to be inspected and certified either by inspectors from the buyer corporation, or by third party inspectors and certifiers (see, Margaret M. Blair, Cynthia A. Williams and Li-Wen Lin, The New Role for Assurance Services in Global Commerce, 33 *Iowa Journal of Corporate Law*, vol. 33, p. 325, 2008).
 - 34 The author learnt, when making an on-the-spot interview of managers of a garment industry in Ho Chi Minh City in 2007, that that company had to undergo an annual inspection executed by an accounting office, which has been entrusted by a big trading company in Europe, to check whether the factory properly observed the code, which had been made conditional for their business deals. The manager confessed that the inspection of these private company codes was more important for them than any codes they had voluntarily accepted. This garment company has been certified with ISO9001, SA8000 and WRAP (Waste & Resources Action Programme). Since the

- year 2000, numerous international companies that have Chinese factories in their supply chains have been attempting to require that the Chinese factories meet a variety of social responsibility standards, including SA8000, WRAP, and ICTII (toy manufacturers), and some codes developed internally by certain large buyers (*Id.*).
- 35 Relevant documentary resources can be found at the OECD's Home Page: www.oecd.org/dataoecd/56/36/1922428.pdf.
- 36 OECD, "Recommendations by the French NCP to Companies on the Issue of Forced Labor in Burma", March 28, 2002, in Annex I of the OECD *Multinational Enterprises Situations of Violent Conflict and Widespread Human Rights Abuses*, Working Papers on International Investment, Number 2002/1, p. 30 (May 2002).
- 37 www.ilo.org/public/english/employment/multi/dispute.htm.
- 38 26. In considering changes in operations (including those resulting from mergers, take-overs or transfers of production) which would have major employment effects, multinational enterprises should provide reasonable notice of such changes to the appropriate government authorities and representatives of the workers in their employment and their organizations so that the implications may be examined jointly in order to mitigate adverse effects to the greatest possible extent. This is particularly important in the case of the closure of an entity involving collective lay-offs or dismissals (International Labour Organization, Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, par. 26, 2006).
- 39 www.ilo.org/public/english/employment/multi/case.htm.
- 40 E/CN.4/Sub.2/2003/12/Rev.2 (August 26, 2003).
- 41 *Ibid.*, Paragraph 1 "Within their respective spheres of activity and influence, transnational corporations and other business enterprises have the obligation to promote, secure the fulfilment of, respect, ensure respect of and protect human rights recognized in international as well as national law, including the rights and interests of indigenous peoples and other vulnerable groups".
- 42 ECOSOC Res.2004/279.
- 43 E.S.C. Dec. 2004/279, UN ESCOR, 49th mtg., Agenda Item 14(g), at 195, U.N. Doc. E/2004/INF/2/Add.2; (EI) Education International, (ICEM) International Federation of Chemical, Energy, Mine and General Workers' Union, (IFBWW) International Federation of Building and Wood Workers, (IFJ) International Federation of Journalists, (IMF) International Metalworkers' Federation, (ITF) International Transport Workers' Federation, (ITGLWF) International Textile Garment and Leather Workers Federation.
- 44 Naoto, Ohmi. "Corporate Social Responsibility Dealt with by Trade Unions", in *Report of the Japan Institute for Labor Policy and Training*, 2005, No. 45, pp. 82–83.
- 45 www.ifbww.org/index.cfm?n=191&l=2&on=
- 46 ILO GB.292/11, March 2005, Geneva, p. 1.
- 47 However, setting higher standards in a voluntary code is not necessary without any problem. See *infra*. 3(4) Implication of the introduction of CSR into the trade regime.
- 48 www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/andean-andin/can-peru-perou.asp.
- 49 http://geo.international.gc.ca/latin-america/colombia/whats_new/default-en.aspx?id=12926.
- 50 Adidas Group, 'Our Workplace Standards', *The Adidas Group Supply Chain Code of Conduct*, www.adidas-group.com/en/sustainability/Overview/our_standards/standards_of_engagement.asp.
- 51 *Ibid.*
- 52 *Ibid.*
- 53 It is admitted that this is the most controversial aspect of CSR as well as the most crucial point in a debate on the very existence and merits of CSR.
- 54 Art. 1, Para. 2(c).

10 China's antimonopoly law and recurrence to standards

*Steven Van Uytsel**

Introduction

The need to take into account the specific circumstances and particulars of developing countries in the design of their respective competition laws has been one of the main lessons that can be drawn from the several studies immersing into the relationship between competition and economic development.¹ China seems to dwell on the idea launched by Frédéric Jenny that “there is no one size fits all competition law.”² Not only has China inscribed provisions dealing with cartel agreements, unilateral exclusionary conduct or concentrations in its newly adopted Anti-Monopoly Law (hereinafter AML),³ but also provisions dealing with the abuse of administrative power.⁴ Further, to allow the enforcement authorities some flexibility in the interpretation of the AML, several standards, such as “public interest,”⁵ “justifiable cause,”⁶ “national security,”⁷ “national economic development”⁸ or “other elements ... (which) have an effect on the market competition”⁹ have been incorporated.

The flexibility that these standards offer in terms of interpreting the AML according to the needs of the Chinese economy also has inherent dangers. The standards increase the amount of discretion of the enforcement authorities, potentially giving an incentive for firms to lobby for an outcome in favor of their interests.¹⁰ Further, these standards allow for the incorporation of different interests, such as those of consumers, small and medium sized companies, and social or even environmental interests. These different interests could complicate the decision-making process, possibly leading inexperienced enforcement authorities to conclusions that are more harmful to their economy.¹¹ On top of that bureaucrats, especially in countries that have relied on centralized planning or heavy government involvement in business affairs, are able to determine or influence the outcome of competition law cases by the use of these standards.¹²

Focusing on the potentiality of lobbying, which often results in decisions wrongly made, firms could take this as an opportunity to shield them from any form of competition. In the end, such an environment will lead to inefficient outcomes in the market. Even with an unchanged cost structure or portfolio of products, these firms will have their market position secured. Any incentive to innovate either the production process or the products themselves will

disappear.¹³ Price levels will thereby rise, evidencing allocative inefficiency¹⁴ or productive inefficiency.¹⁵ New production processes or products will not be put into the market, exemplifying dynamic inefficiency.¹⁶ As a consequence, the inefficient firms will drain the available resources that could have otherwise been spent on other purposes.¹⁷ In the long run, this inefficient spending will mortgage substantial growth and development.¹⁸

The aim of this chapter is to seek an answer to the question to which end of the balance the interpretation of the AML, full of provisions with undetermined standards, will bend. Reformulated, the question could read as whether the AML's standards could provide China a legal instrument that is suitable to support economic development. An answer to this question can only be given if another issue is resolved: what are the criteria to decide what kind of interpretations can contribute to economic development?

The argument will be developed with one important limitation. Rather than focusing on every aspect of the AML, this chapter will focus on concentrations. More than any other area covered by the AML, the area of concentrations is relatively well developed and published. Since the enactment of the AML in 2008, MOFCOM, the enforcement authority for concentrations, has dealt with at least 49 cases.¹⁹ Out of these 49 cases, six have been published.²⁰ Several of the published cases have counterparts in the United States, the European Union, Japan or other countries. The availability of these counterpart decisions facilitates an investigation into the real purpose of the decisions taken by the Chinese enforcement authority for concentrations, MOFCOM.²¹

The chapter will be structured as follows. The second section will provide an introduction to the extensive use of standards in the Chinese AML. The main emphasis is on the provisions dealing with concentrations. Following this introduction, a more general perspective is given on the use of standards in competition law. It will be pointed out that standards are useful to provide flexibility to the enforcement authorities. The third section will point out that this flexibility in the law can be beneficial for economic development. The starting point here is that economic development is a complex process in which various elements play a role, followed by an exploration of which elements may be important within the area of concentrations. In the discussion of these elements they will be referred to as economic development strategies. The fourth section will deal with the downside of the use of standards for facilitating economic development. The push for economic development usually coincides with the liberalization of markets. The evolution to market liberalization is often combined with the phenomenon of firms trying to influence the regulatory agencies. Standards will definitely facilitate this process. As a consequence, the legal instruments that could assist the economic development process can actually be (ab)used to overhaul the success of strategies in favor of economic development. Before concluding in the sixth section, the fifth section will investigate whether the Chinese case law on concentrations reveal either the use of economic development strategies or the pursuit of domestic firms' interests. This will be done via a review of the six decisions on concentrations that MOFCOM has so far published.

China's antimonopoly law and standards

The frequent use of standards

Leaving aside the abuse of administrative dominance, the scope of the AML is determined by monopoly agreements,²² abuse of market dominance²³ and concentrations.²⁴ Unlike many other competition laws, the AML does not start by vaguely stating that monopoly agreements, abuse of market dominance or concentration are to a certain extent forbidden.²⁵ Rather, the AML gives a list of behavior that can be qualified either as a monopoly agreement²⁶ or as an abuse of market dominance.²⁷ It is only at the end of the list that the legislator has indicated the non-exhaustiveness of the list by adding a general standard.²⁸

A similar structure is adopted for concentrations. The general standard formulated for concentrations in Article 28 states that it is the potential or real effect of eliminating or restricting competition that will be prohibited. The preceding Article 27 gives examples of different factors that can be taken into account for determining what the effect of the concentration will be on competition. It lists factors like market share, degree of controlling power, degree of market concentration, the influence on market access and technological progress, the influence on consumers and other firms, or the influence on national economic development.²⁹ Some of these standards are then further linked with other standards, such as relevant market. Besides the listed factors, the Anti-monopoly Authority under the State Council has the power to determine that other factors may have an effect on the market.

Even if the analysis of the above-mentioned standards leads to the conclusion that the concentration has more negative than positive impacts on competition, the firms under investigation may still prove that the concentration is pursuant to the public interest.³⁰ The public interest standard is not specified further. When the concentration involves the takeover of a domestic firm by a foreign firm, national security is the standard that has to be examined. Despite this nothing further is stipulated regarding the national security standard.³¹

Concentrations that have anti-competitive effects and are not cleared based upon a public interest consideration are not necessarily forbidden as such. It may be that the negative impact of such concentration on competition can be overcome by attaching restrictive conditions, leaving aside what the exact meaning of this standard could be.³² The AML makes sure, though, that if a restrictive condition is attached to the concentration, the decision has to be released to the general public in a timely manner.

The extensive reliance of standards in the AML is remarkable but not unusual. Competition law cases, and especially concentrations, require a case specific approach for which it may be impossible to create an all-encompassing rule. Only standards allow for the flexible approach needed in these cases.

Competition law and the use of standards

More than in any field of law, with the possible exception of torts, competition law heavily relies on standards to determine its content. Nearly any competition law deals with cartel agreements,³³ unilateral exclusionary conduct³⁴ or concentrations.³⁵ At best, the legislation may add examples to clarify the standards that are used to describe the behavior that could qualify under each of these three categories.³⁶ Some legislation then adds other standards to exempt conduct out of the vaguely defined prohibition.³⁷ In doing so, the legislator has twice postponed a decision on what the law is. At the first stage, the decision on the determination of the prohibitive character has been postponed. At the second stage, the use of standards delays the decision of the exact scope of the exemptions.

The complex reality of competition law cases probably justifies the use of standards. This complexity may become much more obvious by quoting an example of Giorgio Monti in relation to a concentration:

a merger of firms in a competitive market with low entry barriers does not endanger competition even if the combined market share is higher than 50 percent, while a merger in a highly concentrated market may be problematic even if the combined market share is less than 50 percent. Thus, while a rule might make the law workable, there may be certain instances where the enforcement of the rule makes the market function poorly.³⁸

If the purpose of the law is to prevent a substantial lessening of competition on the market, a clear rule forbidding mergers of firms with a combined market share above 50 percent would be over-inclusive in the first example and under-inclusive in the second example.³⁹ Hence, the application of this kind of rule, however clear and workable it may be, obviously frustrates the purpose of the law. In order to prevent these outcomes, standards offer a better solution to administer the complexity of competition law cases. They allow for a wide-ranging inquiry into the factual situation of a competition law case, increasing the possibility for more accurate decision making.⁴⁰

The use of standards, especially in the light of what has been said above, has a downside. Far from being fixed, these open-ended standards may be an invitation for arbitrariness with side effects of opacity and costly legal processes. If the standards are applied in an environment where the risk is too high that they will be used for purposes they should not serve, it would have been better to avoid them at all. At least this would be the desired outcome if the “costs of applying the more sophisticated standard is greater than the reduction of the likelihood of [over-inclusiveness] or [under-inclusiveness] which would result by applying a simple rule, and a political risk that the standard is interpreted differently in [similar] contexts.”⁴¹ Monti suggests it is less likely to happen when the enforcement authorities have to apply an abridged standard, a standard in which a limited set of factors are taken into account, rather than an all-inclusive public interest standard.⁴²

Pursuing the idea of Monti, the pitfall of the AML becomes apparent. Having a public interest standard, together with several other standards that could be construed as all-inclusive, there is a potential danger of either an over-inclusive or an under-inclusive application of the competition law. The danger increases exponentially when firms can solicit for government favors. Based upon the publicized concentration decisions, the least that can be said is that there is frequent contact between MOFCOM on the one hand and domestic firms and trade associations related to the industry affected by the concentration on the other.⁴³

A further analysis of these frequent contacts can only be realized by developing a reference framework allowing one to judge whether the outcome of MOFCOM's decisions are favoring domestic firms without any justifiable reason. To develop the framework, this chapter draws on the literature regarding competition and economic development. This literature notes that a developing country can take measures in favor of the firms in its domestic industry. These favorable measures should not, however, extend without limit. Depending on the support the industry receives, different limitations are formulated within this literature. Presuming that frequent contacts may lead to favorable measures, whether or not the favorable measures exceed these limitations has to be established. Once they do, it will be presumed that the measures are not serving the public interest of economic development anymore, but the sole interests of the firms active in that particular industry.

Economic development and the requirement of flexibility

The complexity of economic development

The debate on introducing competition law to developing countries is often embedded in a discussion on liberalization.⁴⁴ Without open markets, there is no need to deal with the issue of competition law. Competition law presumes a freedom to trade. Firms need to be relatively free to enter the markets when business opportunities arise and relatively free to leave the market when good business opportunities fade away.⁴⁵ As a large number of developing countries feature many characteristics of a closed economy, the primary step for these countries, but not necessarily the only one, is the opening up of their markets.⁴⁶

By opening up their markets, developing countries will allow foreign firms and their goods to enter their markets. The domestic industry, for a long time shielded from any pressure to compete, will have to cope with the presence of firms offering goods homogeneous to their own. They will face competition, resulting in a disciplinary effect on pricing and innovation. Whereas firms could previously neglect the wishes of the market, the newly created market structure will no longer allow this. The market will make the demand shift to the new entrants. In order to survive this competitive environment, the domestic firms will have to provide either better products or similar products for a cheaper price.

This disciplinary effect, evoked by the entrance of foreign firms into the market, should not be exaggerated. Indeed, the persistence of cartelization and

abuse of dominance in open markets such as the United States, Europe and Japan has proven that trade liberalization is not a substitute for competition law.⁴⁷ The rules adopted for decreasing tariff barriers and opening markets to foreign import competition do not aim at forbidding the practices of private companies impeding market access or distorting the efficient functioning of the market. The sole aim of trade liberalization law is to eliminate government imposed barriers to international trade and nothing more. If the impediments are created by private companies, a different set of rules, competition law, comes into play. Therefore, rather than being substitutes, trade liberalization and competition law tend to complement each other.⁴⁸

Notwithstanding the general agreement in the current literature on competition law and development about the role competition law can play in achieving sustained growth, the literature acknowledges that economic development is a complex process in which not only competition law has a role to play.⁴⁹ Joseph Stiglitz, writing about the East Asian Miracle, confirms this when he indicates that:

[t]he fact that almost all of the economies in the region had industrial policies suggests that such policies were an important part of their growth strategies, whether or not the highly imperfect econometric techniques for quantifying such impacts succeeded in verifying such claims.⁵⁰

Franz Kronthaler lists different possible economic development strategies. Focusing on the economic development strategies that are somehow connected to concentrations, the following section will deal with infant industry protection, establishing national champions, stimulating research and development, preferential treatment of foreign investors and protecting state-owned enterprises.⁵¹

Economic development strategies

Infant industry protection

Ha-Joon Chang has pointed out that an infant industry protection strategy has been common practice in nearly all of the developed countries in order to catch up with their competitors.⁵² Developing countries may want to favor this kind of strategy with the argument that, in order to compete internationally, the underdeveloped domestic industry needs to be put at the same level as the foreign industries. Of course, this requires the preliminary ability of governments to identify which industries are of strategic importance to the country.⁵³

The use of infant industry protection has been defended on the grounds that developing countries do not possess the technological skills and the management experience to enter an internationally competitive environment.⁵⁴ Knowledge in these fields has to be nurtured. This requires an environment in which firms can learn by doing. During this process of acquiring and cultivating the necessary skills, the firms active in this infant industry may need protection.⁵⁵ Otherwise, they will be outperformed by more efficient foreign firms.

National champions

Developing countries may have an established industry in which the scale of each firm is too small to enjoy an efficient cost structure. As long as the domestic market is protected, these firms will face no problems in surviving. In a liberalized market, the survival of these firms can only be guaranteed if they get their cost structure right. One way to this end may be the acquisition of a certain size to enable the domestic industry to rely on economies of scale. Some have put forward the argument that state intervention is a *condition sine qua non* to assure that an appropriate size will be acquired and so a “national champion” will be formed.⁵⁶

Once the national champion is established, the issue shifts to what kind of policy the government should subsequently undertake. Lawrence J. Lau formulates the issue by taking efficiencies into account:

the government has to take into account the existence of increasing returns to scale which render the usual market allocation inefficient. For example, if the size of the market will support it, it is better to have one minimum-efficient-scale plant than to build two sub-minimum-efficient-scale plants. This is whether the government can and should intervene to prevent potentially inefficient and possibly ruinous competition.⁵⁷

Lau seems to indicate that once a national champion is established, government intervention enhancing competition is not necessarily what the market needs. Unrestrained rivalry has negative consequences for innovation and thus for dynamic efficiency. The government only needs to intervene when the monopoly power it has created with its national champion is not overused to the detriment of the consumers.⁵⁸ The insecurity of revenue upon investment will be too profound, taking away the incentive to invest. The government should rather further secure the market concentration.⁵⁹

Stimulating research and development

A liberalized market will lead to more competition as foreign firms enter the newly opened market. Concerns exist that unfettered competition will reduce the research and development activities within that newly opened market.⁶⁰ Indeed, increased competition will drive the prices down to equal marginal costs. Marginal cost pricing deprives the firms of any profit. This profit, however, is a necessary incentive for a firm to introduce new products or processes of production. If a firm cannot count on these revenues, research and development will be stifled. An environment that allows for a certain degree of concentration, with consequent higher prices, will spur innovation.⁶¹

Research and development, resulting in innovative production processes and new products, is seen as the motor behind sustainable economic growth.⁶² Without innovation, the domestic companies will not be able to maintain or gain

a competitive advantage over foreign firms that have newly entered the market. Their reliance on older technologies, knowledge, skills and practices will make them wither away. Their survival is not guaranteed, unless they innovate or imitate innovations. Due to the limited resources of firms, this may only be possible if several firms join forces and cooperate in research and development. Only when economies of scale are achieved may firms in developing countries be able to reach the necessary level of market power giving the incentive to innovate.

Preferential treatment of foreign investors

Developing countries are in need of foreign direct investment and the capital, technology and know-how that go with it. Investors may realize this foreign direct investment via mergers, acquisitions or joint ventures. In the absence of any regulatory framework, the investors can realize their investment without lengthy review processes. At the same time, the investors do not have to fear that their investment will be blocked due to the establishment of excessive market power.⁶³

Developing countries may prefer not to jeopardize the lenient treatment of foreign investors. Since a competition law will establish a regulatory barrier for investors, reducing their incentives to invest, developing countries could opt to not include provisions on concentrations in their competition law. When the competition law includes provisions on concentrations, the competition law provisions could be drafted in such a way that preferential treatment remains possible. Standards, of course, could be the legal instrument to achieve this end.⁶⁴

Maintain state-owned firms

Most developing countries are characterized by the presence of large state-owned firms. Their presence has been justified in terms of assisting the development process.⁶⁵ More specifically, the state-owned firms allow for the pursuit of a variety of different social goals, “including facilitation of industrialization through central planning, acceleration of technology transfer, increased employment, reduced inequality, regional development, and increased national security.”⁶⁶

Economic development strategies and rent-seeking

Liberalizing markets and lobbying

Market liberalization has often been identified as the initial step towards economic development. Armando Rodriguez and Mark Williams in their article “The Effectiveness of Proposed Antitrust Programs for Developing Countries” argued that there is an inherent danger to market liberalization.⁶⁷ This study indicates that reducing tariffs, a characteristic of market liberalization, causes domestic firms to seek other forms of protection. The most common forms of

protection are “product standards, environmental standards, anti-dumping legislation, trade-remedy laws, formal and informal vertical restrictions such as exclusive dealing arrangements.”⁶⁸ The way that the domestic firms obtain this or other kinds of protection is via extensive lobbying activities.

Lobbying for government protection will be facilitated if the domestic firms seeking protection can easily agree to do so and if policy making tends to be less transparent.⁶⁹ The former, referring to transaction costs, is easily met in developing countries. Most of these countries have only a few firms active in several industrial sectors. The prospect of a significant benefit compared to an even bigger loss of rents will further facilitate the cooperation between the few firms to secure their interests.⁷⁰ Also, the latter requirement does not tend to be problematic in developing countries, where policy making often is a central and closed process dominated by high-level administrators and politicians not facing electoral review.⁷¹

Rodriguez and Williams seem to suggest that these lobbying activities will result in making the firms’ interests synonymous with the public interest.⁷² This point of view implies that the public interest cannot be identical to firms’ interests, as the former will be replaced by the latter. In order to draw this conclusion, a framework has to be provided. Without such a framework, a conclusion like the one made by Rodriguez and Williams cannot be made. Having indicated that economic development depends, in addition to market liberalization, on the presence of government support and guidance, the economic development strategies will be central for making a distinction between lobbying activities serving the public interest and those that serve only the interests of the firm.

Rent-seeking and economic development strategies

Economic development strategies contribute to the economic development of a country. Except those aimed at favoring foreign investors, each of the economic development strategies also tends to be beneficial for domestic firms. Whether it is the economic development strategy of infant protection, national champion creation, research and development stimulation or state-ownership protection, firms will be shielded from various forms of competition. Shielding from competition is also something that firms want to achieve due to market liberalization. A line has thus to be drawn between protection that leads to economic development and protection which only benefits firms.

Determining the fine line between government protection that benefits society and that which only benefits firms is most necessary in the framework of concentrations. Indeed, the information advantage the industry has regarding the market makes the enforcement authority often rely on the industry to obtain this kind of information. Interaction with the enforcement authority increases the chances of the domestic industry trying to bend the agency to act in favor of their commercial interests, especially when the concentration involves foreign firms. In this situation of regulatory capture, which facilitates extensive rent-seeking, the interests of the public are no longer served.

Several studies engaging in the research of the efficacy of economic development strategies indicate that an unfocused application of such strategies, and thus of offering unwarranted protection, will not render any beneficial results. To prevent infant industries from remaining “permanent infants”⁷³ or national champions, or state-owned firms becoming just cost consuming entities,⁷⁴ the studies have pointed out that economic development strategies have to be implemented in an environment allowing for competition and innovation. Sheltering a limited number of firms and giving them a certain degree of market power will more likely result in failure.

An environment leading to sustained economic growth is one that focuses on the elements of competition and innovation, which is something quite different from price competition. Price competition implies that firms will provide products and services that consumers want and are willing to pay for and so achieve allocative efficiency.⁷⁵ Even though the empirical evidence is not conclusive, too much competition can have a negative impact on the market.⁷⁶ In order for a firm to use the most effective combination of inputs to maximize its output, and so realize productive efficiency, the firms needs to have access to financial resources for financing the best available technologies. Generally, the firm will generate these resources by appropriating a part of the results of their investment. Such appropriation will reduce the benefits of the consumer and therefore affect allocative efficiency negatively.⁷⁷

Overemphasizing the need for allocative efficiency will have another negative aspect. Competition, in principle, will drive firms to look for better products or production processes. In doing so, dynamic efficiency will be realized. This search, however, requires funding. By increasing and not competition without limit prices will be driven to equal marginal costs. Marginal cost pricing deprives the firms of any profit. Similar to productive efficiency, these profits are a necessity incentive for a firm to introduce new products or processes of production. If a firm cannot count on these revenues, dynamic efficiency will be stifled. In the long run, this will affect consumers by depriving them either of a lower price setting resulting from a more efficient production process for existing products or of new and improved products.⁷⁸

According to Joseph Schumpeter, the ability to engage in innovative activities requires a type of firm which is, unlike in static competition, large or even a monopolist.⁷⁹ Simon Evenett, by summarizing Schumpeter’s understanding of the market, reveals the reason behind the need for the higher degree of concentration. He points out that:

state measures that seek to arbitrarily reduce concentration levels or to reduce the profitability of innovative firms should be avoided, since this will diminish the incentives of both incumbent and potential firms to invest in potentially profitable innovations and related activities in the first place. Rather, according to this perspective, attention should focus on addressing barriers that reduce the profitability or likelihood of entry by new firms into an industry.⁸⁰

The necessity of a concentrated market, according to Schumpeter, lies in the profitability of such markets. The higher profits these firms enjoy in such a market will provide a steady stream of resources that can be reinvested in further research and development to ameliorate the production process or make new or better products. The assumption of reinvesting the appropriated profits only holds when there is at least a little threat of imitation. Competitors do not necessarily have to be present in the market, it suffices that there exist a potentiality of other firms entering the respective market.⁸¹ It has thus to be established how each of the developing strategies can contribute to guaranteeing dynamic efficiency.

Optimal economic development strategies

Schumpeterian competition implies that, with the knowledge that a strong position in the market will provide financial returns, developing countries should aim for a higher degree of concentration in the market. All the economic development strategies mentioned above can somehow be linked to the idea of Schumpeterian competition.

Infant industry protection

The need for developing countries to protect their infant industries is not denied within the literature. The provisions on concentrations, even though the literature devotes less attention to them, may have some importance to infant industry protection. Firms of a domestic infant industry may be a target of a foreign attempt to merge. A competition law enforcement authority may at this point discriminate against foreign firms. Evenett points out, in a slightly different context though, that the discrimination can be *de jure* or *de facto*.⁸² The discrimination will be *de jure* when foreign firms are not allowed to merge with domestic firms or when a different set of rules applies to foreign mergers. *De facto* discrimination will occur when the enforcement authority applies the same competition law differently in cases where foreign firms are involved.

A general caveat has been formulated against shielding firms of an infant industry. Even though the warning has not been formulated in the context of concentrations, it equally applies to this area. The shielding of firms in an industry that is developing creates an 'easy life' environment lacking any incentive to implement new technologies and production processes or develop new or more advanced products.⁸³ In order to prevent these industries from not being able to overcome their infancy stage, sooner or later they will have to face market forces. Therefore, two suggestions are made. First, any protection given to firms in an infant industry needs to be time-constrained. Second, the protective measures should not be construed so as to exclude any form of competition.⁸⁴

National champions

The creation of a strong domestic industry, via the establishment of a national champion, has been identified as another possible economic development strategy. In order to reach this goal, developing countries could select an industry in which they want to establish strong firms and subsequently impose upon the firms active in that industry to merge with or acquire other firms. If this is done from the viewpoint of creating economies of scale, the economic development strategy of establishing a national champion can be successful.⁸⁵

The creation of national champions often results in a concentrated market. Market concentration may also be a vehicle to generate financial resources for investments.⁸⁶ Some scholarship warns that the corporate desire to invest properly, and thus allocate resources so they enhance welfare the most, will only exist if a certain degree of competition remains.⁸⁷ It should be said that other scholarship is of the opinion that imperfect financial markets should not be addressed via collusion, but via measures directly addressing these imperfections.⁸⁸

Stimulating research and development

An economic development strategy that receives quite some support in the economic literature is cooperation to achieve better research and development. Massimo Motta points out that cooperation may be an efficient way to achieve a socially optimal level of research, in the sense that it reduces risks of spillovers, facilitates diffusion of the knowledge, and avoids duplication of research costs.⁸⁹

Indeed, cooperation means that firms will share the costs, preventing one firm from free riding on the efforts of another. In the long run, this will enhance the overall incentive to invest in innovation. Participation allows for the immediate access to the result of the research. Jointly coordinated efforts prevent the waste of human and financial resources.

Even though there is a general agreement on the beneficial effects of cooperation, several scholars point to its risk.⁹⁰ Research and development may be stifled if all important firms join the cooperative effort. Further, if the cooperation extends beyond research and development to the stages of production and marketing, the cooperation may result in collusive behavior with a negative impact on price setting for consumers. It is thus essential that, up until a certain level, competition is guaranteed.

Preferential treatment of foreign investors

Unlike the case of infant industry protection where the domestic firms are shielded from foreign takeovers, the competition law enforcement authority may favor foreign takeovers as they bring in foreign direct investment. It should therefore be presumed that a lax enforcement should be preferred. Even though the empirical evidence is scant, the studies undertaken conclude that there is a

correlation between foreign direct investment and competition law.⁹¹ Some studies seem to indicate that the presence of competition law positively affects foreign direct investment.⁹² There is, however, one exception.

Evenett has pointed out that competition laws requiring notification of a merger or an acquisition negatively affect foreign direct investments.⁹³ This kind of review system made cross-border mergers decrease. The positive result of this study was to be found elsewhere. The cross-border mergers that were effected within this system of review resulted in substantially fewer price increases. Even though there was a decrease in welfare reducing investments, it should not be forgotten that this shift in the allocation of resources to consumers may have had an impact on the dynamic efficiency of firms. Indeed, the reduction in foreign direct investment may have deprived firms of the resources necessary to invest in innovation.

Maintaining state-owned enterprises

The use of state-owned firms to achieve economic development has been questioned from various perspectives.⁹⁴ One of the strongest arguments against state-owned firms is their inefficiency. This inefficiency may follow from the political goals, such as the ones mentioned above, that these state-owned firms have to meet. The degree of inefficiency will be even worse if these goals are imposed to generate political benefits, such as votes.⁹⁵ Managerial slack due to protection from market processes is perceived as another possible cause of inefficiency. The market protection may manifest itself either via outdated production methods or a substantial financial backup.⁹⁶

Empirical studies, though not always unambiguously, tend to confirm the negative effects of state-owned enterprises.⁹⁷ State-owned firms should not be encouraged as a tool to achieve economic development. Heavy reliance on state-owned firms in developing countries will make it impossible for them to shift overnight. State-owned firms will remain part of their economic system. To compensate for the inefficiencies of these firms, a pragmatic solution has been proposed to embed the state-owned firms in a competitive market supported by a competition law. In doing so, there exists a potential for reducing their inefficient outcomes.⁹⁸

China's use of standards: economic development or rent-seeking

Six published decisions on concentrations

Since the AML went into effect, 58 concentrations have been reported to MOFCOM. By the end of June 2009, MOFCOM has made a decision in 46 concentration cases. Out of the 46 decisions, 43 were made without further conditions attached to the concentration. In two cases, MOFCOM attached conditions to the concentration in order to receive approval. Only in one case did

MOFCOM take the decision to disapprove the concentration. Since the latest statistics were published in July 2009, three more conditional approvals have been delivered by MOFCOM.⁹⁹

According to Article 28, a concentration can only be approved if the concentration has a positive impact on competition or it is pursuant to public interests. Alternatively, concentrations will not pass the review process if they have either a negative effect on competition or are against public interests. Whether an economic efficiency analysis has been given priority over the public interest standard cannot be deduced from the cases in which MOFCOM has given an unconditional approval. There rests no obligation on MOFCOM to give publicity to these decisions.¹⁰⁰

Negative and conditional decisions, however, require publicity. According to Article 29, MOFCOM has to publicize in a timely manner its decision in the case that it prohibits a concentration or attaches restrictive conditions on concentrations. Under this provision, the decisions in *InBev N.V./Anheuser-Bush Companies Inc.*,¹⁰¹ *Mitsubishi Rayon Co., Ltd./Lucite International Group Ltd.*,¹⁰² and *Coca Cola Corporation/Huiyuan Juice Group*¹⁰³ were published. The former two decisions involve conditional approvals, whereas the latter one was prohibited by the enforcement authority. More recently, MOFCOM published its decision in *Pfizer Inc./Wyeth*,¹⁰⁴ *General Motors Co./Delphi Corp.*,¹⁰⁵ and *Panasonic Corporation/Sanyo Electric Co., Ltd.*¹⁰⁶

The published decisions are concise, especially the early cases. The extremely limited amount of information that is made publicly available does often not allow for the determination of whether or not the decisions are correct on the facts. The little available information further complicates the conclusion on what part of the AML MOFCOM has based its decision. In other words, the published decisions do not always reveal whether or not the elements inscribed in Article 27 have led MOFCOM to decide that the concentration had a negative impact on competition and therefore either require additional conditions or block the merger.

Taking into consideration the scanty provided information, the six published decisions can be analyzed from different angles. In the next section, the six published cases will be introduced. The emphasis will be mainly on the conditions attached to the approval of the concentration and the reasons thereof. In *Coca Cola Corporation/Huiyuan Juice Group*, the focus will be on the disapproval and the reasons thereof. Following this description, a selection will be made of MOFCOM's decisions based upon their dissimilarity with decisions taken by enforcement authorities of other jurisdictions. When the decisions are similar, there are few reasons to expect that the domestic firms have been influential on MOFCOM's decision making. The decisions that deviate from decisions in other jurisdictions or that have no equivalent in another jurisdiction require closer scrutiny to see whether the decision has been taken to wrongfully advance the domestic firms' interests or not. To complete this exercise, the decisions will be tested against the considerations provided by the economic development strategies.

Conditional approvals and blocked concentrations

MOFCOM has publicized the following decisions: *InBev N.V./Anheuser-Bush Companies Inc.*, *Mitsubishi Rayon Co., Ltd./Lucite International Group Ltd.*, *Coca Cola Corporation/Huiyuan Juice Group*, *Pfizer Inc./Wyeth*, *General Motors Co./Delphi Corp.*, and *Panasonic Corporation/Sanyo Electric Co., Ltd.* For each of these concentrations, the interaction between MOFCOM and the industry and the outcome of the decision will be described, followed by an indication of whether the decision deviates from decisions in other jurisdictions or whether other jurisdictions did not scrutinize the proposed concentration.

InBev N.V./Anheuser Bush Companies Inc.

The first decision on concentrations that has been published by MOFCOM under the AML was the *InBev NV/Anheuser Bush Companies Inc.* merger. The merger, involving two foreign firms, was cleared based on Article 28. Within the same paragraph of stating the applicable article, MOFCOM indicated that to reach this decision extensive consultations were held with concerned government departments, beer trade associations, major domestic beer breweries, the suppliers of raw materials and the distributors.

Having seen the transaction size, MOFCOM did not simply clear the merger, but attached conditions to it. The merged entity, currently known as Anheuser Busch InBev (AB InBev),¹⁰⁷ was to acquire such a significant market share that, according to MOFCOM, it enhanced tremendously the competitive strength of the merged entity. This would negatively affect future competition in the Chinese market.

The conditions that AB InBev had to comply with are as follows.¹⁰⁸ The merged entity was not to increase its existing shareholding in Tsingtao Brewery Co., Ltd. above the current level of 27 percent. The level of shares in Pearl River Brewery Co., Ltd, 28.56 percent at the time of the merger, was not supposed to change. The new merged entity could not purchase or hold shares in the two Chinese breweries in which until that point it had no stake, these being China Resources Snow Brewery Co., Ltd. and Beijing Yanjing Brewery Co., Ltd. Further, any change in AB InBev's controlling shareholding had to be promptly reported to the MOFCOM. It is noteworthy that there was no time limit set on these conditions.

By imposing these kinds of behavioral conditions, MOFCOM's decision deviated from decisions made in other jurisdictions. The UK Office of Fair Trade approved the merger unconditionally,¹⁰⁹ while the US Department of Justice imposed a structural condition.¹¹⁰ AB InBev was to divest the activities of Labatt USA, a daughter company of InBev. The transaction ultimately included "the grant by Labatt Brewing Corporation Limited of an exclusive license to brew Labatt branded beer in the US or Canada solely for sale for consumption in the US, to distribute, market and sell Labatt branded beer for consumption in the United States, and to use the relevant trademarks and intellectual property to do so."¹¹¹

Coca Cola Corporation/Huiyuan Juice Group

The speculations after the *InBev N.V./Anheuser-Bush Companies Inc.* decision were legendary. Some speculated that Coca Cola would abandon the deal,¹¹² others stated that the shadow it cast over the *Coca Cola Corporation/Huiyuan Juice Group* merger has to be situated in the future conditions that MOFCOM might come up with to approve the merger.¹¹³ In the end, this deal, unlike the previous one, dealt with a well-known Chinese brand of fruit juice.¹¹⁴ However, what many did not fear became reality.¹¹⁵ MOFCOM blocked the merger.¹¹⁶

Whereas Coca Cola saw the merger as creating synergies between the products of Huiyuan and Coca Cola's distribution network and raw material purchasing capability,¹¹⁷ MOFCOM had a different view. After having solicited the advice of the concerned government departments, trade associations, upstream suppliers, downstream distributors, partners of Coca Cola and legal, economic and agricultural experts and having failed to reach an agreement with Coca Cola on conditions, MOFCOM decided that the merger had anticompetitive effects and was incompatible with the public interest.¹¹⁸

The anticompetitive effects had to be situated in the fact that Coca Cola had a dominant market position in the market of carbonated soft drinks that could be abused. There was a fear that Coca Cola could use its dominant position in one market to influence a market in which no dominance existed by forcing customers to combine their purchases of carbonated soft drinks with their juice beverages. In doing so, the merged entity would engage in tying or bundling arrangements. It is also plausible that other forms of exclusive dealing could be forced upon its customers. The other anticompetitive effect had to do with market barriers. By having two well-established and famous juice brands, Meizhiyuan (Minute Maid) and Huiyuan, in its portfolio, the market power of the newly merged entity in the market of juice beverages would be significantly enhanced, creating entry barriers for potential competitors.

The *Coca Cola Corporation/Huiyuan Juice Group* merger only triggered the jurisdiction of MOFCOM. Therefore, there is no comparison possible between the way MOFCOM handled this merger and how any other jurisdiction would have handled this case. Nevertheless, some scholars point towards a similar decision made by the Australian Competition and Consumer Commission, which opposed the *Berri Ltd./Coca Cola Amatil Ltd.* acquisition.¹¹⁹

Mitsubishi Rayon Co., Ltd./Lucite International Group Ltd

Mitsubishi Rayon is a leading manufacturer of monomers and polymers, such as poly-methyl methacrylate acrylic (PMMA). Lucite International Group is also active within this market, creating an overlap in special SpMAs, PMMA acrylic molding compounds, and PMMA acrylic sheet. For the production of these polymers, methyl methacrylate (MMA) complexes, which both Mitsubishi Rayon and Lucite International produce, are necessary. After extensive consultation with relevant industry associations, MMA manufacturers, poly-methyl methacrylate

acrylic (PMMA) molding compounds producers and PMMA acrylic sheet manufacturers, as well as the parties to the transaction, MOFCOM found that this merger was quite problematic in the MMA product market.¹²⁰

Lucite International is the world's largest supplier of MMA. After merging, 64 percent of the MMA market would be supplied by the newly formed entity. Besides giving it a dominant market position, the merged entity would be significantly larger than the second and third largest suppliers in China, these being Jilin Petrochemical and Heilongjiang Longxin Company. The large share in the MMA market would also raise issues regarding the PMMA market, of which MMA is the basic raw material. MOFCOM feared that Mitsubishi Rayon could, after having acquired Lucite International Group, restrict competition in the PMMA market by blocking downstream competitors' access to the upstream market. An alternative to the refusal strategy could have been the preferential treatment of its own PMMA business.

MOFCOM and Mitsubishi Rayon worked out a solution to the competition law issues that this acquisition raised. MOFCOM and Mitsubishi Rayon agreed to give an unaffiliated third party the right to purchase 50 percent of Lucite China's MMA products at production cost and this for a period of five years. Further, Lucite China had to remain operationally independent until the completion of the divestiture. Closely connected with this condition is the obligation not to share competition related information regarding the Chinese market between the independent firms. Mitsubishi Rayon must also refrain from acquiring or establishing new plants in China that produce MMA monomer, PMMA polymer or cast sheet, unless it obtains the approval of MOFCOM.

The acquisition, having a worldwide dimension, obliged the parties involved to file for a concentration review in many jurisdictions. By the time that MOFCOM reached its decision, the acquisition was cleared without any condition in six other jurisdictions. Among the six other jurisdictions were the United States, the European Union and Taiwan.¹²¹

General Motors Company/Delphi Automotive Systems Corporation

General Motors and Delphi are active in two different product markets. General Motors is active as a car manufacturer, while Delphi is active in supplying components. Delphi does not supply only to General Motors, but also, and very often exclusively, to many Chinese car manufacturers. Therefore, some of the car manufacturers, like Chery Automobile Co. and the China Automobile Dealer Association, expressed their concern about the acquisition.¹²² MOFCOM upheld several of these concerns. An acquisition by General Motors of Delphi would enable the former to control the supplies of components to Chinese car manufacturers and, possibly, obtain via Delphi sensitive information about Chinese car manufacturers. There was also a fear that General Motors would mainly procure its components from Delphi and that Delphi may turn out to be uncooperative when Chinese car manufacturers stated their intention to switch suppliers of components.¹²³

The effect of eliminating or restricting competition that could flow from this acquisition had to be remedied. Therefore, MOFCOM imposed several conditions on the acquisition. First, the acquisition could not change Delphi's attitude towards the Chinese car manufacturers in terms of guaranteeing a non-discriminatory supply of components. Second, GM had to refrain from illegal actions to obtain confidential information about the Chinese car manufacturers. Similarly, Delphi could not reveal this kind of information. Third, the change of supplier of components could not be hampered after the acquisition was realized. Fourth, General Motors was required to procure its components from various suppliers without imposing unreasonable conditions that could ultimately favor Delphi.

Unlike MOFCOM, the European Commission did not find that this acquisition would significantly impede effective competition. The presence of numerous other suppliers of automotive parts and the substantial buying power of Delphi's customers did not require any further action.¹²⁴ A similar decision was made by the Australian Competition and Consumer Commission.¹²⁵

Pfizer Inc./Wyeth

When the pharmaceutical firm Pfizer decided to acquire Wyeth, Pfizer was about to strengthen its position in a number of product markets as both firms' product range overlapped each other to a certain extent. Within the geographical market that MOFCOM delineated, the overlap was in particular problematic with regard to the market for swine mycoplasma pneumonia vaccine. MOFCOM concluded that in that particular product market the planned acquisition would have a limiting effect on competition, as Pfizer's market share would rise up to 49.4 percent after the acquisition. With nearly 50 percent of the market share, the position of Pfizer would by far exceed that of the second ranking firm Intervet/Shering-Plough Animal Health. This firm only held 18.35 percent of the market. The other competitors were not to be feared. Their respective market share did not rise above 10 percent.¹²⁶

The effect on competition was also deduced from an analysis using the Herfindahl-Hirschman Index (HHI), indicating that the HHI of the merged entity would be 2,182, which was 336 higher than before the merger. MOFCOM further looked at entry barriers. The substantial amount of financial resources and the long time span necessary to develop new products could be perceived as high entry barriers. Adding to this the technical difficulties to produce, market entry would be quite unlikely to happen.

The remedy that MOFCOM imposed on the merged entity was that Pfizer had to divest its Chinese swine mycoplasma pneumonia vaccine business, marketed under the brands *RespiSure* and *RespiSure One*. The third party buying this business in China had to be given the right to ask Pfizer for reasonable technical support, assistance in purchasing materials and the provision of training and consultancy services.

Having a global effect, the acquisition was, among others,¹²⁷ also investigated by the European Union and the United States. The decision of the European

Union and the United States show considerable parallels, in that the main focus was on the animal health vaccines, pharmaceuticals and medicinal feed additives. By acquiring Wyeth, an important competitor of Pfizer would disappear, potentially leading to higher prices or reduced choice of products. To obtain clearance, Pfizer agreed with the European Commission and the Federal Trade Commission to divest several of its business in the area of animal vaccines, including the one that has been within the focus of MOFCOM.^{128, 129}

Panasonic/Sanyo

A more recently published decision is the Panasonic/Sanyo merger decision.¹³⁰ Besides being the most recent, this decision is also the most extensively reasoned. Whereas previous decisions were very often limited to just stating the remedies towards certain competition concerns, this decision also makes reference to the delineation of markets, the degree of concentration within that market, the possible anti-competitive behavior following the merger and the ability of other market participants to counter the market power that would be created by the newly merged entity.

MOFCOM identified three different product markets: the market for rechargeable coin-shape lithium batteries, the market for nickel-metal hydride batteries for daily use and the market for nickel-metal hydride batteries for vehicle use. Within each of these different product markets, MOFCOM saw the high market share of the newly merged entity as problematic. The merged entity would hold respectively 61.1 percent, 46.3 percent and 77 percent market share in the above-mentioned markets. The market power thus created could result in adverse effects on competition, either by limiting downstream supply, unilaterally fixing the prices, creating brand loyalty or eliminating competition at all.

Nothing was present to counter any of these anti-competitive effects. First, in the market for rechargeable coin-shape lithium batteries, customers lacked sufficient buying power to countervail any of the competition concerns. Second, the market for nickel-metal hydride batteries for daily use was slower to develop, making it less attractive for potential market entrants. The brand loyalty that has been created in this market via brand designation further jeopardized the attractiveness of this market.

To address the competition concerns, MOFCOM and the merging firms agreed to several conditions. Sanyo has to divest all of its activities in the first-mentioned product market, being the rechargeable coin-shape lithium batteries market. In the second-mentioned product market, dealing with nickel-metal hydride batteries for daily use, either Sanyo or Panasonic had to sell its activities in this market. Regarding the last mentioned product market, Panasonic had to transfer the nickel hydrogen battery business for the hybrid electronic vehicle. Further, the joint venture Panasonic had with Toyota Motor Corporation in this market, Panasonic EV Energy Co., had to be reorganized. Panasonic had to reduce its stake in the joint venture to 19.5 percent and eliminate the name "Panasonic" from the joint venture's name. Any of the above-mentioned

divestitures relates to the relevant assets required for the operation of the divested business.

Before China decided this merger case, the European Commission had already made a decision regarding the European dimension of the deal.¹³¹ The Chinese decision largely reflects that decision. The European Commission found that the merged entity would have a negative impact on competition in a number of battery markets. Specifically, the European Commission found that the merged entity would negatively affect the market of primary cylindrical lithium batteries, the market of rechargeable coin-shape batteries based on lithium and the market of portable rechargeable nickel-metal hydride batteries. For the former two product markets, the parties agreed on the divestiture of a production plant that currently produces both types of batteries, while for the latter product market the parties agreed to divest the business of one of the merging parties.¹³²

China's economic development undermined by rent-seeking?

Five out of the six published Chinese decisions have decisions that went the other way from other enforcement authorities over the world. Only the last decision published, the *Panasonic/Sanyo* merger, has strong parallels, both formally and content-wise, with the decisions taken elsewhere. The other decisions, even though there may be formal similarities, deviate content-wise from the decisions taken elsewhere. This has led some authors to state that MOFCOM has been “taking relevant country-specific competition conditions into consideration.”¹³³ Many of the country-specific conditions are formulated in favor of domestic firms or the domestic market. An analysis is therefore needed to see whether the decisions have the underpinnings of the economic development strategies or whether the domestic firms have been able to engage in rent-seeking.

The analysis of the decisions can be confined to those cases that deviate from the decisions taken elsewhere. In doing so, the analysis presumes that the domestic firms have not been able to capture MOFCOM on the decisions or specific conditions that show a strong content-wise similarity with decisions taken elsewhere. For the decisions that deviate, an analysis has to be made whether the decision can be justified by one of the economic development strategies. If this is not the case, the decision is presumed to be only serving the interest of the domestic firms.

InBev NV/Anheuser-Bush Companies Inc.

The conditions MOFCOM imposed on AB InBev are characterized by the fact that they have nothing to do with the current merger, but rather deal with “the future strategic acquisitions of the merged entity.”¹³⁴ Even though the *Financial Times* purports that these kind of conditions are an unusual approach in international competition law enforcement,¹³⁵ it was common practice in the United States to prescribe during the 1990s. The only difference between the Chinese

and the U.S. practice is that the U.S. enforcers usually imposed their behavioral conditions for a limited period of ten years. This practice has been stopped because it turned out that any future merger or acquisition had to be reported to the enforcement authority anyway.¹³⁶ Notwithstanding the desuetude of the behavioral conditions regulating future stockholding, MOFCOM imposed such a condition on AB InBev.

It is questionable whether this decision was driven by a desire to protect an infant industry. In the end, the four largest domestic beer breweries, China Resources Snow Breweries, Tsingtao Breweries, Beijing Yanjing Brewery and Zhujiang Brewery have been able to obtain more than 40 percent of the industries' revenue, and this in the presence of foreign firms.¹³⁷

The other possible strategy of considering the four large beer breweries to be national champions, of which the survival needed to be guaranteed, is also not likely. Indeed, the decision of MOFCOM to impose behavioral conditions cannot lead to the conclusion that the merged entity as such could be considered a threat to national champions. If such consideration would have driven MOFCOM, structural conditions would have been more effective. Indeed, MOFCOM could have taken merger as the opportunity to impose a divestiture of the stakes the merged entity holds in Tsingtao Breweries or Zhujiang Brewery.

The behavioral conditions do not change the structure of the market. The domestic firms do not necessarily gain anything by this. Therefore, it can well be argued that the conditions will not negatively impact economic development. To the contrary, competition between independent firms is guaranteed.

It has been suggested that the real reason for these conditions is rather connected with the structural problems of MOFCOM.¹³⁸ The limited enforcement capability of MOFCOM may prevent an effective dealing with anti-competitive practices *ex post*. By imposing behavioral remedies, MOFCOM basically can switch the burden of proof to AB InBev and require from them any evidence that an increased equity in any of the competing Chinese breweries will not result in an anti-competitive practice. The question is, however, whether such a shift needs to be unlimited in time and whether the other beer breweries can formulate their objections. If the latter is the case, what looks at first sight pro-development may actually turn out to have opposite effects.

Coca Cola Corporation/Huiyuan Juice Group

The decision to block the *Coca Cola Corporation/Huiyuan Juice Group* merger has been severely criticized on the basis that "the merger would not harm competition and therefore should have been permitted."¹³⁹ The lack of any competition law concern relates to the fact that the product market had been delineated into a fruit juice market and a carbonated soft drink market. Due to this separation of markets, the merger only affected a relatively small part of the fruit juice market. Coca Cola Company only held about 15 percent market share in that market and Huiyuan Juice Group nearly 14 percent. However, MOFCOM was convinced that the nearly 61 percent market share of Coca Cola Company in the

carbonated soft drink market would be leveraged into the fruit juice market.¹⁴⁰ Therefore, MOFCOM feared that Coca Cola Company could engage in tying and bundling agreements or in discriminatory pricing strategies. Both the agreements and strategies would then create entry barriers for new firms and work as exclusionary devices for incumbent firms.

Based upon the information available in the decision, two possible conclusions can be drawn regarding the approach towards the merger. It is possible that MOFCOM, due to its weak enforcement capacity, only speculated about the negative impact on competition and created a situation in which the burden of proof shifted to Coca Cola Company. Coca Cola Company would have to prove that either it did not have the ability to engage in market foreclosing activities or, if it had the ability, that it would not actually use the ability.¹⁴¹ However, the decision is quiet as to whether such a process of rebutting the presumption of any negative effect on competition took place.

Another approach starts by looking at the concerns that MOFCOM formulated regarding the merger. Out of these concerns, it may well be concluded that it was not so much the impact on the competitive process that drove the decision. By referring to the protection of small and medium sized domestic firms and the survival of a domestic fruit juice beverage market in which domestic firms can compete and independently innovate, other public interests seem to have prevailed. In short, whatever contributes to the sustainable and healthy development of the domestic juice industry could be perceived to conform to the public interest. These public interest concerns, called industrial policy by Furse¹⁴² and protectionism by *The Economist*,¹⁴³ could well be categorized under some of the economic development strategies.

The fruit juice market in China has three major players, Uni-President China, Coca Cola Company and Huiyuan Juice Group.¹⁴⁴ With the exception of Coca Cola Company, these firms were all established in the early 1990s.¹⁴⁵ Since then they have grown into major players within the Chinese fruit juice market. However, their respective market share is still relatively low.¹⁴⁶ These elements combined could warrant the conclusion that the fruit juice market is a rather infant industry that may need government protection to further grow. In this sense, shielding off Huiyuan Juice Group from a takeover by a foreign firm via a *de facto* discriminatory application of the AML could be justified.

For an economic development strategy aimed at the protection of an infant industry it is crucial that the industry gets immersed in a competitive process. This issue should not be a concern. In the end, the decision does not drive Coca Cola Company out of the fruit juice market. Further, the structure of the fruit juice market is highly deconcentrated. Survival within this competitive market will thus depend on the innovative capacity of the firms.

Mitsubishi Rayon Co., Ltd./Lucite International Group Ltd.

The *Mitsubishi Rayon Co., Ltd./Lucite International Group Ltd* merger, being global, triggered the merger procedures in several jurisdictions. The merger was

cleared without any conditions in major jurisdictions like the United States and Europe. MOFCOM approached the merger differently. Rather than clearing the merger without any conditions, MOFCOM decided that the merged entity had to divest a part of Lucite China's production capacity for a period of five years, had to maintain Lucite China as an independent entity until the moment it started to divest a part of its production capacity, and had to comply with expansion restrictions for a period of five years.

Local competition concerns could have driven MOFCOM in its decision, as some literature seems to imply.¹⁴⁷ This would be a plausible and acceptable reasoning if MOFCOM would have correctly delineated the market. It is not necessarily the product market as such, here defined as the methyl methacrylate market that is problematic. Rather, the geographical dimension given to the relevant product market poses problems. By restricting the relevant product market to the national geographical market, the merging entity would acquire a much higher market share than if the market would have been defined on a world-wide basis. The market share of the merged entity would drop from above 60 percent to below 40 percent.¹⁴⁸ Some studies even indicate that, if newly established production capacity would have also been taken into account, the competition concerns raised by the merged entity would definitely cease to exist.¹⁴⁹

Nevertheless, MOFCOM chose a different path. Looking at some of the firms active in the narrowly defined geographical product market, a different reasoning can be built. The second and third largest suppliers of methyl methacrylate are Jilin Petrochemical Corp. and Heilongjiang Longxin Chemical Co. respectively.¹⁵⁰ The prohibition of setting up a firm that offers more competitive advantages than disadvantages may require from the incumbent market participants an effort to rationalize their business. This may have been cumbersome for one of these firms. Indeed, data show that Jilin Petrochemical Corp., a huge state-owned firm, has been trying to set its business back on track and has recently succeeded in doing so.¹⁵¹

Severe competition may not be beneficial for what has recently been an ailing firm. By making the merger conditional, MOFCOM offered a term of respite. The respite will only negatively affect economic development if the protection alienates the firm from competition. The conditions obviously have neither the intention nor the ability to terminate competition in the methyl methacrylate market. There is no better proof of this than the establishment of a new company, Evonik Degussa Shanghai, which started to produce in late 2009.¹⁵²

The conditions' main aim seems to be to keep competition at the same level for each of the market players by preventing one big firm, at least on the national geographic market, from arising. Further, the temporary character of the conditions, not extending beyond a period of five years, forces the domestic firms to prepare for more severe competition in due time.

General Motors/Delphi

The General Motors/Delphi acquisition concerned a firm active in the downstream market of passenger vehicles and commercial vehicles and a firm active in the upstream market of automotive parts. China got particularly interested in this acquisition, because Delphi had strong connections with several of the Chinese car manufacturers as the exclusive supplier of automotive parts. Tying Delphi strongly into one of the competitors of the Chinese car manufacturers, MOFCOM formulated concerns regarding the reliability, price, and quality of the supply of Delphi's auto parts. Further, via the acquisition, General Motors may have come to be in a position to gain access to competitively sensitive information or to influence Delphi's business strategies regarding supply either to hamper Chinese car manufacturers switching smoothly to other suppliers or to increase the supply to General Motors to the detriment of other car manufacturers.

MOFCOM's concerns mainly relate to the possibility of foreclosing Chinese car manufacturers from access to necessary parts for the production of their cars. Market foreclosure only occurs, however, when the market player has a dominant position within the market and is able to use it.¹⁵³ The lack of any analysis on this issue within MOFCOM's decision, except for the reference to Delphi's leading position on the global and Chinese automotive and auto parts market, made several commentators formulate criticisms.¹⁵⁴ The actual dominance of Delphi in the upstream market or of General Motors in the downstream market had to be proven. MOFCOM had to further investigate whether the firms could effectively use their dominant position to foreclose by indicating that other firms would step in and diminish the effect of Delphi's or General Motors' intent. By advocating for a more detailed analysis justifying the measures taken by MOFCOM, the literature does not necessarily deny the possibility of anti-competitive effects.¹⁵⁵

Another way of viewing MOFCOM's decision to attach conditions to the acquisition could be by putting the conditions against the backdrop of the economic development strategies. The Chinese Government's interest in the car manufacturing sector became apparent in the 1990s with the establishment of several state-owned car manufacturers. With the Chinese car market expected to grow tenfold by 2030,¹⁵⁶ it has become one of the policy goals to strengthen this industry. The car manufacturers have to close the gap with foreign competitors and, eventually, surpass them.¹⁵⁷ In order to prevent a foreign acquisition from interfering with these plans, as is suggested by Chinese car manufacturers, particularly Chery Automobile Co., and the China Automobile Dealers Association, MOFCOM took the decision to make the clearance of the acquisition conditional.¹⁵⁸

The conditions imposed on General Motors and Delphi are not of the nature to prevent competition. To the contrary, they may even be designed to prevent anti-competitive effects, these being the foreclosure of Chinese car manufacturers from automotive parts. However, the conditions are not formulated as

structural remedies. They are conceptualized as behavioral remedies, implying that the regulator will monitor the merged entity's compliance with the conditions. The scrutiny process will not necessarily depend on MOFCOM.¹⁵⁹ It is well possible that the Chinese car manufacturers will file complaints to MOFCOM whenever they perceive a business transaction is contrary to the conditions. It is exactly at this point that these behavioral remedies are potentially harmful for economic development.

The possibility to file complaints with MOFCOM turns the behavioral remedies into a potential tool for the Chinese car manufacturers to threaten Delphi. The bargaining power of the Chinese car manufacturers becomes much stronger. As a result, Delphi may be forced to consent to business conditions favorable to the Chinese car manufacturers. In a properly functioning market, these conditions may not have been given. These favorable conditions may have a foreclosing effect on the Chinese auto parts manufacturers, due to which they will not be able to gain a much stronger position. Taking into account that the behavioral remedies are imposed without any time restriction, a negative economic effect on the Chinese upstream market may be created.

In the same vein, Chinese auto parts manufacturers may use the behavioral remedies to prevent certain business deals from being implemented. The behavioral remedies may thus be used to protect their own interests. In doing so, they shield themselves from entering into a proper competitive process, something that may be necessary for the development of the industry. However, the economic development strategies are quite unanimous regarding the lack of competition. In the long run, such a model will not lead to economic development. Therefore, it is important that, if competition is restricted, a time limit is stipulated. Nothing reveals that it is the case in this decision.

Conclusion

MOFCOM's approach towards concentrations has been followed with quite some suspicion. The few commentators on the AML expected that MOFCOM would use the AML in favor of its own industry. This chapter has not been able to deny such suspicions. Nearly all the published decisions on concentration show that the foreign firms have either had to adapt the structure of the merged entity or abandon the plans to merge. Undeniably, such kinds of decisions are in favor of the domestic firms' active in that particular industry. They either face a competitor that is less strong or can continue their business without being taken over.

Nevertheless, this chapter has shown that the decisions in favor of the domestic firms are not necessarily counterproductive for achieving economic development. Based upon the framework combining free market principles with government intervention to achieve economic development, the analysis of the concentration decisions of MOFCOM has shown that a right balance between free market and government intervention has been respected. Only in the *General Motors/Delphi*, and to a lesser extent in *InBev NV/Anheuser Bush*, is it

possible to argue that MOFCOM has given the domestic industry too much protection. The protection exists in the form of increased bargaining power towards the foreign firms due to the absence of a time limitation on the behavioral remedies.

Notes

- * Associate Professor at Kyushu University. The author would like to thank Dr. Bi Ying, who has provided translations of several Chinese documents. Any mistake remains the responsibility of the author.
- 1 See Franz Kronthaler, *Implementation of Competition Law in Developing and Transition Countries: Theoretical and Empirical Considerations* 54 (Baden-Baden: Nomos, 2007); Simon J. Evenett, The Return of Industrial Policy: A Threat to Competition Law?, in *Competition Law Today: Concepts, Issues, and the Law in Practice* (Vinod Dhall, ed.) (New Dehli: Oxford University Press, 2007); William E. Kovacic, Creating New Competition Policy Institutions in Transition Economies, 23 *Brooklyn J. Int'l L.* 403 (1997); UNCTAD, Trade and Development Board, *Empirical Evidence of the Benefits from the Applying Competition Law and Policy Principles to Economic Development in Order to Attain Greater Efficiency in International Trade and Development*, TD/B/COM.2/EM/10/Rev.1, at 3 (May 25, 1998).
 - 2 Frédéric Jenny, Foreword, in *Pulling up our Socks: A Study of Competition Regimes of Seven Developing Countries of Africa and Asia under the 7-Up Project*, i, at iii (CUTS, ed.) (Jaipur: Jaipur Printers P. Ltd, 2003).
 - 3 See Anti-Monopoly Law of the People's Republic of China, adopted at the 29th meeting of the Standing Committee of the 10th National People's Congress of the People's Republic of China on August 30, 2007, available at <http://tradeinservices.mofcom.gov.cn/en/b2007-08-30/9043.shtml> (last visited November 30, 2009) [hereinafter "AML"].
 - 4 See Articles 32–37 AML.
 - 5 See Articles 1, 15 (4), 28 AML. Article 15 (6) AML phrases the interest in the framework of foreign trade and cooperation. This Article speaks of 'justifiable interest in the foreign trade and foreign economic cooperation.' Article 27 (5) specifies the public interest as the 'national economic development,' which may link with one of the other goals mentioned in Article 1 AML, being 'promoting the healthy development of the socialist market economy.'
 - 6 See Article 17 (2), (3), (4), (5) AML.
 - 7 See Article 31 AML.
 - 8 See Article 27 AML.
 - 9 Id.
 - 10 See A. E. Rodriguez and Mark D. Williams, The Effectiveness of Proposed Antitrust Programs for Developing Countries, 19 *N.C.J. Int'l & Com. Reg.* 209, 214–8 (1994) (without mentioning that it is necessarily due to the use of standards, the authors imply that the lost protection due to liberalization will be undercut by new forms of rent-seeking. It is quite obvious that standards in a competition law allow enforcement authorities to go along this path).
 - 11 See Robert H. Lande, Creating Competition Policy for Transition Economies, 23 *Brook. J. Int'l L.* 339, 345–6 (1997); See also Paul E. Godek, A Chicago-School Approach to Antitrust for Developing Countries, 43 *Antitrust Bulletin* 261, 271–3 (where the author elaborates on the harm misguided antitrust policy can cause).
 - 12 See Lande, *supra* note 11, at 346.
 - 13 See Christopher Townley, *Article 81 EC and Public Policy* 16–18 (Oxford: Hart Publishing, 2009).
 - 14 See Rodriguez and Williams, *supra* note 10, at 216 n.30 and 226; On the concept of

- allocative efficiency, see, e.g., Townley, *supra* note 13, at 16–18 (defining allocative efficiency as “the existing stocks of goods and productive output are allocated through the price system to buyers who value them most”); Massimo Motta, *Competition Policy: Theory and Practice* 40–5 (Cambridge: Cambridge University Press, 2004).
- 15 See Roger J. Van den Bergh and Peter D. Camesasca, *European Competition Law and Economics: A Comparative Perspective* 30 (London: Sweet & Maxwell, 2006); On the concept of productive efficiency, see, e.g., Townley, *supra* note 13, at 16–18 (defining productive efficiency as “a given set of products are produced at the lowest possible cost, given current technology, input price, etc.”); Motta, *supra* note 14, at 45–55.
 - 16 See Van den Bergh and Camesasca, *supra* note 15, at 30–1; on the concept dynamic efficiency, see, e.g., Townley, *supra* note 14, at 16–18 defining dynamic efficiency as “the extent to which a firm introduces new products or processes of production”); Motta, *supra* note 14, at 55–64.
 - 17 See Rodriguez and Williams, *supra* note 10, at 216.
 - 18 See UNCTAD, *supra* note 1, at 12.
 - 19 See Ministry of Commerce of the People’s Republic of China, Anti-monopoly Bureau, *Jingyingzhe jizhong fanlongduan shencha anjian zuixin tongji qingkuang* [The Latest Statistics on Cases Concerning Anti-monopoly Review of Undertaken Concentrations] (21 July 2009), available at: <http://fldj.mofcom.gov.cn/aarticle/zcfb/200907/20090706409831.html> (last visited December 8, 2009); See Ministry of Commerce of the People’s Republic of China, Anti-monopoly Bureau, *Tongzhi Gonggao* [Announcement], available at: <http://fldj.mofcom.gov.cn/ztxx/ztxx.html> (last visited December 8, 2009) (for the three extra decisions that have not been incorporated in the recent statistics).
 - 20 See Ministry of Commerce of the People’s Republic of China, Anti-monopoly Bureau, *Zhonghua renmin gongheguo shangwubu [2009nian] di82hao gonggao (guanyu futiaojian pizhun songxia gongsi shougou sanyang gongsi fanlongduan shencha jue ding de gonggao)* [The People’s Republic of China Ministry of Commerce Announcement [2009] No. 82 on the Decision of Antimonopoly Review Concerning Conditional Approval of [Panasonic’s] Acquisition of Sanyo] (October 30, 2009), available at: <http://fldj.mofcom.gov.cn/aarticle/ztxx/200910/20091006593175.html> (last visited December 8, 2009) (hereinafter Announcement No. 82); Ministry of Commerce of the People’s Republic of China, Anti-monopoly Bureau, *Zhonghua renmin gongheguo shangwubu gonggao [2009nian] di77hao (guanyu futiaojian pizhun huirui gongsi shougou huishi gongsi fanlongduan shencha jue ding de gonggao)* [The People’s Republic of China Ministry of Commerce Announcement [2009] No. 77 on the Decision of Antimonopoly Review Concerning Conditional Approval of Pfizer’s Acquisition of Wyeth] (September 29, 2009), available at: <http://fldj.mofcom.gov.cn/aarticle/ztxx/200909/20090906541443.html> (last visited December 8, 2009) (hereinafter Announcement No. 77); Ministry of Commerce of the People’s Republic of China, Anti-monopoly Bureau, *Zhonghua renmin gongheguo shangwubu gonggao 2009nian di76hao* [The People’s Republic of China Ministry of Commerce Announcement [2009] No. 76] (September 28, 2009), available at: <http://fldj.mofcom.gov.cn/aarticle/ztxx/200909/20090906540211.html> (last visited December 8, 2009) (hereinafter Announcement No. 76); Ministry of Commerce of the People’s Republic of China, Anti-monopoly Bureau, *Zhonghua renmin gongheguo shangwubu gonggao 2009nian di28hao* [The People’s Republic of China Ministry of Commerce Announcement [2009] No. 28] (April 24, 2009), available at: <http://fldj.mofcom.gov.cn/aarticle/ztxx/200904/20090406198805.html> (last visited December 8, 2009) (hereinafter Announcement No. 28); Ministry of Commerce of the People’s Republic of China, Anti-monopoly Bureau, *Zhonghua renmin gongheguo shangwubu gonggao [2009nian] di22hao (shangwubu guanyu jinzhi kekoukele*

gongsi shougou zhongguo huiyuan gongsi shencha jue ding de gonggao) [The People's Republic of China Ministry of Commerce Announcement [2009] No. 22 on the Decision of Antimonopoly Review Concerning Denial of Coca-Cola's Acquisition of Huiyuan] (March 18, 2009), available at: <http://fldj.mofcom.gov.cn/aarticle/ztxx/200903/20090306108494.html> (last visited December 8, 2009) (hereinafter Announcement No. 22); Ministry of Commerce of the People's Republic of China, Anti-monopoly Bureau, *Zhonghua renmin gongheguo shangwubu gonggao [2008nian] di95hao* [The People's Republic of China Ministry of Commerce Announcement [2008] No. 95] (November 18, 2008), available at: <http://fldj.mofcom.gov.cn/aarticle/ztxx/200811/20081105899216.html> (last visited December 8, 2009) (hereinafter Announcement No. 95).

- 21 Mark Furse, *Antitrust Law in China, Korea and Vietnam* 71 (Oxford: Oxford University Press, 2009).
- 22 See Articles 13–15 AML.
- 23 See Articles 17–19 AML.
- 24 See Articles 20–31 AML.
- 25 See, e.g., Article 101 and 102 TFEU (respectively starting out with the words:

The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which [...]

and “Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market insofar as it may affect trade between Member States”); Section 1 and 2 Sherman Act (respectively drafted as “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal” and “Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony”).

- 26 See Articles 15 AML.
- 27 See Articles 17 AML.
- 28 See Articles 13 (6) AML (stating that “other monopoly agreements as determined by the Anti-monopoly Authority under the State Council. For the purposes of this Law, ‘monopoly agreements’ refer to agreements, decisions or other concerted actions which eliminate or restrict competition”) and 17 (7) AML (reading “other conducts determined as abuse of a dominant position by the Anti-monopoly Authority under the State Council. For the purposes of this Law, ‘dominant market position’ refers to a market position held by a business operator having the capacity to control the price, quantity or other trading conditions of commodities in relevant market, or to hinder or affect any other business operator to enter the relevant market”).
- 29 The interpretation guidelines emphasize the importance of economic development for judging concentrations. The main message is that the influence of a concentration on national economic development is at least as important as the influence on competition in the market. See Chinalawinfo Co., *Bentiao shi dui shencha jingying-zhejizhong yingdang kaolv de yinsu de guiding* [Under this Article Are Provisions Concerning the Factors that Should be Taken into Consideration During the Examination of the Concentration of Undertakings], available at: http://vip.chinalawinfo.com/newlaw2002/SLC/SLC_SiyItem.asp?Db=SyItem&Gid=838867649 (last visited January 25, 2010).
- 30 See Article 28 AML. The interpretation guidelines indicate that the public interest should be broadly understood, including promoting employment, giving a remarka-

- ble impetus to technical improvement or boosting international competitiveness. See Chinalawinfo Co., *Bentiao shi dui jingyingzhejizhong zuochu jinzhi he huomian jue ding de guiding* [Under this Article Are Provisions Concerning the Determination of Ban or Exemption on the Concentration of Undertakings], available at: http://vip.chinalawinfo.com/newlaw2002/SLC/SLC_SiyItem.asp?Db=Syltem&Gid=838867650 (last visited January 25, 2010).
- 31 See Article 31 AML. The interpretation guidelines for the AML provide some insights as to how to understand the concept of national security. First, the guidelines refer to Article 7 of the Provisions on Guiding the Orientation of Foreign Investment. This Article stipulates that any foreign investment is prohibited if one of the following situations occurs: 1) harming the State safety or impairing the public interest; 2) polluting the environment, damaging natural resources or harming human health; 3) occupying too much farmland and being adverse to the protection and development of land resources; 4) harming the safety and usage of military facilities; 5) using particular techniques or technologies of China to produce products; 6) other situations as provided by the laws and administrative regulations. Second, the guidelines also revert to Article 12 of the Interim Provisions on the Takeover of Domestic Enterprises by Foreign Investors. This Article reveals that national security can be harmed by taking controlling power in an important industry, by having an impact on the national economic security, or by taking control over a firm that holds a famous trademark or China Time-Honored Brand. See Chinalawinfo Co., *Bentiao shi guanyu jingyingzhejizhong de fanlongduan shencha tong guojiaquan shencha de xianjiexing guiding* [Under this Article are Provisions Concerning the Connection Between Antitrust Examination of the Concentration of Undertakings and National Security Scrutiny], available at: http://vip.chinalawinfo.com/newlaw2002/SLC/SLC_SiyItem.asp?Db=Syltem&Gid=838867653 (last visited January 25, 2010).
- 32 See Article 29 AML.
- 33 See, e.g., Chris Noonan, *The Emerging Principles of International Competition Law* 60 (Oxford: Oxford University Press, 2008); Martyn Taylor, *International Competition Law: A New Dimension for the WTO?* 93–5 (Cambridge: Cambridge University Press, 2006).
- 34 See, e.g., Noonan, *supra* note 33, at 61; Taylor, *supra* note 33, at 89–93.
- 35 See, e.g., Noonan, *supra* note 33, at 61.
- 36 See, e.g., Article 101 (1) TFEU (listing the following examples: “(a) directly or indirectly fix purchase or selling prices or any other trading conditions; (b) limit or control production, markets, technical development, or investment; (c) share markets or sources of supply; (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts”) or Article 102 (2) TFEU (giving as examples the following list: “(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; (b) limiting production, markets or technical development to the prejudice of consumers; (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts”).
- 37 See, e.g., Article 101 (3) TFEU (stating that agreements may be exempted if they contribute to “improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not: (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; (b) afford

- such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question”).
- 38 Giorgio Monti, *EC Competition Law* 16–17 (Cambridge: Cambridge University Press, 2007).
 - 39 See *id.*, at 17.
 - 40 See *id.*; See also Louis Kaplow, *Rules versus Standards: An Economic Analysis*, 42 *Duke L.J.* 557 (1992).
 - 41 Monti, *supra* note 38, at 17.
 - 42 See *id.*
 - 43 See *infra* Section V. B.
 - 44 See, e.g., Eleanor M. Fox, *Economic Development, Poverty and Antitrust: The Other Path*, 13 *Sw. J. L. & Trade Am.* 211, 216–19 (2007); Rodriguez and Williams, *supra* note 10, at 213–4.
 - 45 See Francisco Marcos, *Do Developing Countries need Competition Laws and Policy*, Section 1.1. (Conference Paper Presented at the EALE Conference, Madrid, September 16, 2006), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=930562 (last visited January 22, 2010).
 - 46 See Mark Williams, *Competition Policy and Law in China, Hong Kong and Taiwan* 46–8 (Cambridge: Cambridge University Press, 2005) (discussing the various debates on whether liberalization is sufficient to create an environment guaranteeing development).
 - 47 See Kronthaler, *supra* note 1, at 34.
 - 48 See Craig W. Conrath and Barry T. Freeman, *A Response to the Effectiveness of Proposed Antitrust Programs for Developing Countries*, 19 *N.C. Int'l & Com. Reg.* 233, 235 and 243–4 (1994).
 - 49 See Kronthaler, *supra* note 1, at 54.
 - 50 Joseph E. Stiglitz, *From Miracle to Crisis to Recovery: Lessons from Four Decades of East Asian Experience*, in *Rethinking the East Asian Miracle* 509, at 519 (Joseph E. Stiglitz and Shahid Yusuf, eds.) (New York: Oxford University Press, 2001).
 - 51 See, Kronthaler, *supra* note 1, at 32–46 (Kronthaler is not limiting its economic development strategies to ones that are mentioned here. He further mentions export promoting policies, investment activity, foreign direct investment and dealing with corruption).
 - 52 See Ha-Joon Chang, *Kicking Away the Ladder: Infant Industry Promotion in Historical Perspective*, 31 *Oxford Development Studies* 21, 24–7 (2003).
 - 53 See Jean-Jacques Laffont, *Competition, Information, and Development*, in *Annual World Bank Conference on Development Economics 1998*, 237, at 245 (Boris Pleskovic and Joseph E. Stiglitz, eds.) (Washington, DC: World Bank, 1999), available at: http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/1999/09/14/000094946_99051205334462/Rendered/PDF/multi_page.pdf (last visited December 4, 2009).
 - 54 See *id.*, at 245.
 - 55 See *id.*, at 245.
 - 56 See Simon J. Evenett, *Study on Issues Relating to a Possible Multilateral Framework on Competition Policy*, WT/WGTCP/W/228, at 21 (Study upon Request of the World Trade Organization, Working Group on the Interaction between Trade and Competition Policy, May 19, 2003) (holding that the methods used could be forced mergers and acquisitions or state-encouraged mergers and acquisition of private firms).
 - 57 Lawrence J. Lau, *The Role of Government in Economic Development: Some Observations from the Experience of China, Hong Kong, and Taiwan*, in *The Role of Government in East Asian Economic Development* 41, at 59 (Masahiko Aoki, Hyung-Ki Kim and Masahiro Okuno-Fujiwara, eds.) (Oxford: Clarendon Press, 1996).
 - 58 See *id.*, at 59 (indicating that the government should not focus on creating more

- competition but on preventing the monopoly firm from using its monopoly power to the detriment of the consumers).
- 59 See Jerry Ellig and Daniel Lin, A Taxonomy of Dynamic Competition Theories, in *Dynamic Competition and Public Policy: Technology, Innovation, and Antitrust Issues*, 16, at 20 n.4 (Jerry Ellig ed.) (Cambridge: Cambridge University Press, 2001).
- 60 See Kronthaler, *supra* note 1, at 41.
- 61 See Ellig and Lin, *supra* note 59, at 18–19.
- 62 See John Stanley Metcalfe and Ronnie Ramlogan, Competition and the Regulation of Economic Development, in *Competitive Advantage and Competition Policy in Developing Countries* 9 (Paul Cook, Raul Fabella and Cassey Lee, eds.) (Cheltenham: Edward Elgar, 2007).
- 63 See Kronthaler, *supra* note 1, at 42.
- 64 See *id.*
- 65 See *id.*, at 43.
- 66 Mary M. Shirley and Patrick Walsh, *Public vs. Private Ownership: The Current State of the Debate* 16 (The World Bank—Regulation and Competition Policy, Development Research Group: Policy Research Working Paper nr. WPS 2420, January 2001), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=261854 (last visited December 7, 2009).
- 67 See Rodriguez and Williams, *supra* note 10.
- 68 *Id.*, at 216 (footnotes omitted).
- 69 See *id.*, at 215; see also Roger J. Van den Bergh and Peter D. Camesasca, *European Competition Law and Economics: A Comparative Perspective* 135 (Antwerp: Intersentia, 2001) (discussing the elements that facilitate lobbying).
- 70 See Rodriguez and Williams, *supra* note 10, at 215–16 and 220–1 (The above-described framework makes it harder for consumers to push their interest through. The consumers are too large in number and diffused to get them organized. The cost of an organized action in the fight for political influence will be disproportionate to the benefits that each individual consumer will derive from such an action. Therefore, the producing firms tend to be more influential).
- 71 See *id.*, at 221.
- 72 See *id.*, at 217; for authors referring to or discussing Rodriguez and Williams viewpoint, see Williams, *supra* note 46, at 44–5; Conrath and Freeman, *supra* note 48.
- 73 UNCTAD, *supra* note 1, at 14.
- 74 See Kronthaler, *supra* note 1, at 34 and 44.
- 75 See *supra* note 14.
- 76 See Van den Bergh and Camesasca, *supra* note 15, at 31.
- 77 See Townley, *supra* note 13, at 16–17.
- 78 See *id.*, at 23–4.
- 79 See Joseph Schumpeter, *Capitalism, Socialism and Democracy* 106 (New York: Harper and Row, 1942).
- 80 Evenett, *supra* note 56, at 25.
- 81 See *id.*
- 82 See *id.*, at 23.
- 83 See Kronthaler, *supra* note 1, at 36.
- 84 See *id.*, at 36.
- 85 See *id.*, at 36–7; On economies of scale, see Van den Bergh and Camesasca, *supra* note 15, at 169–71 (The economies of scale can take different forms: reorganize production to improve the division of labor, reduce costs by joining productions, create synergies in the research and development section, the distribution section or the marketing section, or save costs in the administration).
- 86 See Ajit Singh, *Competition and Competition Policy in Emerging Markets: International and Developmental Dimensions*, at 15–16 (United Nations Conference on

- Trade and Development, G-24 Discussion Paper Series No. 18, September 2002), available at: www.g24.org/Singh.pdf (last visited January 25, 2010).
- 87 See Kronthaler, *supra* note 1, at 40.
- 88 See Motta, *supra* note 14, at 27 (indicating that it is not the role of competition law to correct imperfections of financial markets).
- 89 See *id.*, at 65–6.
- 90 See, e.g., Richard Whish, *Competition Law* 583 (Oxford: Oxford University Press, 6th edn, 2009); Van den Bergh and Camesasca, *supra* note 15, at 177 and 186–8; Motta, *supra* note 14, at 204.
- 91 See Kronthaler, *supra* note 1, at 42–3 (referring to several studies in this field).
- 92 See Simon J. Evenett, *Links Between Development and Competition Law in Developing Countries*, 8–9 (United Kingdom’s Department for International Development: Case Studies for the World Development Report 2005: Investment Climate, Growth and Poverty, October 2003), available at: www.alexandria.unisg.ch/EXPORT/DL/22249.pdf (last visited January 25, 2010) (especially Evenett’s reference to the work of S. Cooke and D. Elliott, *Competition Policy Issues for Developing Asian Economies*).
- 93 See *id.*, at 9.
- 94 See Kronthaler, *supra* note 1, at 44.
- 95 See, e.g., Shirley and Walsh, *supra* note 66, at 14 and 20–7; Roman Frydman, Cheryl Gray, Marek Hessel, and Andrezej Rapaczynski, When Does Privatization Work? The Impact of Private Ownership on Corporate Performance in the Transition Economies, 114 *The Quarterly Journal of Economics* 1153, at 1181 (1998), available at: www.mitpressjournals.org/doi/pdf/10.1162/003355399556241 (last visited December 7, 2009); Andrei Shleifer and Robert W. Vishny, Politicians and Firms, 109 *The Quarterly Journal of Economics* 995, 995–7 (1994).
- 96 See, e.g., Kronthaler, *supra* note 1, at 44; Shirley and Walsh, *supra* note 65, at 34–6; on managerial slack, see Motta, *supra* note 14, at 47.
- 97 See Shirley and Walsh, *supra* note 65, at 48–52.
- 98 See, Kronthaler, *supra* note 1, at 45.
- 99 See *supra* note 19.
- 100 See Article 29 AML.
- 101 See *supra* note 20, Announcement No. 95.
- 102 See *supra* note 20, Announcement No. 28.
- 103 See *supra* note 20, Announcement No. 22.
- 104 See *supra* note 20, Announcement No. 77.
- 105 See *supra* note 20, Announcement No. 76.
- 106 See *supra* note 20, Announcement No. 82.
- 107 See AB InBev, *About AB InBev*, available at: www.ab-inbev.com/go/about_abinbev.cfm (last visited January 25, 2010).
- 108 See *supra* note 20, Announcement No. 95; for English translations and summaries, see Martyn Huckerby, *Chinese Merger Review Receives its First Toast* (21 November 2008), available at: www.mallesons.com/publications/2008/Nov/9700478w.htm (last visited January 25, 2010); Matthew Bachrack, Cunzhen Huang and Jay Modral, *Merger Control under China’s Antimonopoly Law: The First Year, The China Business Review* (2009), available at: www.chinabusinessreview.com/public/0907/aml.html (last visited January 25, 2010).
- 109 See Office of Fair Trading, *Anticipated Acquisition by InBev NV/SA of Anheuser-Busch Companies, Inc*, ME/3826/08 (18 November 2008), available at: www.offt.gov.uk/shared_offt/mergers_ea02/2008/InBev.pdf (last visited January 25, 2010).
- 110 See Press Release, *InBev Receives Antitrust Clearance from DOJ* (November 14, 2008), available at: www.ab-inbev.com/press_releases/20081114_1_e.pdf (last visited January 25, 2010).
- 111 Press Release, *Anheuser-Busch InBev Reaches Agreement to Sell InBev USA*

- (February 23, 2009), available at: www.ab-inbev.com/press_releases/20090223_1_e.pdf (last visited January 25, 2010).
- 112 See Furse, *supra* note 21, at 109.
- 113 See Sundeep Tucker, InBev Ruling Sparks Fears for M&A in China, *Financial Times*, November 30, 2008, available at: www.ft.com/cms/s/0/d7addf8e-beff-11dd-ae63-0000779fd18c.html (last visited January 25, 2010).
- 114 See Furse, *supra* note 21, at 109; Wang Xiaoye, *Comments on MOFCOM's Decision Involved [sic] Coca Cole [sic] & Huiyuan*, PowerPoint Slide 15 (presentation at the Conference 'Effects of Anti-competitive Activities in Small and Developing Economies', Hanoi, May 26, 2009), available at: www.asiancompetitionforum.org/090526_Hanoi/Presentations/09_Xiaoye_Wang.pdf (last visited January 25, 2010) (both authors point out that, from a legal technical point of view, Huiyuan Juice Group should be considered a foreign firm; it was incorporated in the Cayman Islands, and registered on the Hong Kong Stock Exchange).
- 115 See Tucker, *supra* note 113.
- 116 See *supra* note 20, Announcement No. 22.
- 117 See Martyn Huckerby, *Coca Cola's China Juice Deal Goes Sour* (March 19, 2009), available at: www.mallesons.com/publications/2009/Mar/9842472W.htm (last visited January 25, 2010).
- 118 See *supra* note 20, Announcement No. 22; for English translations and summaries, see Huckerby, *supra* note 117; Bachrack, Huang and Modral, *supra* note 108.
- 119 See Australian Competition and Consumer Commission, *ACCC Assessment of Coca-Cola Amatil Limited's Proposed Acquisition of Berri Limited* (November 19, 2009), available at: www.accc.gov.au/content/item.phtml?itemId=503214&nodeId=933cf0f7f72fc1bbe102c39b6243b815&fn=Coca-Cola+Amatil+Ltd%27s+proposed+acquisition+of+Berri+Ltd+-+8+October+2003+-+re+carbonated+soft+drink+and+fruit+juice.pdf (last visited January 25, 2010).
- 120 See *supra* note 20, Announcement No. 28; for English translations and summaries, see Martyn Huckerby, *Chinese Regulators Nearly Battle Ready* (April 30, 2009), available at: www.mallesons.com/publications/2009/Apr/9892521w.htm (last visited January 25, 2010); Bachrack, Huang and Modral, *supra* note 108.
- 121 See Xinzhu Zhang and Vanessa Yanhua Zhang, *Chinese Merger Control: Patterns and Implications* 13 (2009), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1439765 (last visited January 25, 2010).
- 122 See Freshfields Bruckhaus Deringer, *MOFCOM Conditionally Clears Two Offshore Acquisitions* 3 (2009), available at: www.freshfields.com/publications/pdfs/2009/oct09/26807.pdf (last visited January 25, 2010).
- 123 See *supra* note 20, Announcement No. 76; for English translations and summaries, see Martyn Huckerby, *China's Competition Regulator Imposes Conditions on Two Proposed Mergers under the AML* (October 6, 2009), available at: www.mallesons.com/publications/2009/Oct/10091544w.htm (last visited January 25, 2010); Freshfields Bruckhaus Deringer, *supra* note 122.
- 124 See European Commission, *Case No COMP/M.5617—General Motors/Delphi* (October 2, 2009), available at: http://ec.europa.eu/competition/mergers/cases/decisions/m5617_20091002_20310_en.pdf (last visited January 25, 2010); Press Release, *Mergers: Commission Clears Proposed Acquisition of Delphi Corporation by General Motors* (October 2, 2009), available at: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1409> (last visited January 25, 2010).
- 125 See Australian Competition and Consumer Commission, *General Motors Company—Proposed Acquisition of the Non-Steering Business of Delphi Corporation* (April 28, 2009), available at: www.accc.gov.au/content/index.phtml/itemId/894087/fromItemId/751043 (last visited January 25, 2010).
- 126 See *supra* note 20, Announcement No. 77; for English translations and summaries, see Martyn Huckerby, *China's Competition Regulator Imposes Conditions on Two*

- Proposed Mergers under the AML* (October 6, 2009), available at: www.mallesons.com/publications/2009/Oct/10091544w.htm (last visited January 25, 2010); Freshfields Bruckhaus Deringer, *supra* note 122.
- 127 See Federal Trade Commission, *FTC Order Prevents Anticompetitive Effects from Pfizer's Acquisition of Wyeth: Preserves Competition for Animal Vaccines and Other Animal Health Products* (October 14, 2009), available at: www.ftc.gov/opa/2009/10/pfizer.shtm (last visited January 25, 2010) (throughout the course of the FTC's investigation, staff communicated and cooperated with their counterparts in the European Commission's Competition Directorate (EC), and the competition authorities in Canada, Australia, Mexico, New Zealand, and South Africa that are also reviewing, or already have reviewed, this proposed merger).
- 128 See European Commission, *Case No COMP/M.5476—PFIZER/WYETH* (July 17, 2009), available at: http://ec.europa.eu/competition/mergers/cases/index/m109.html#m_5476 (last visited January 25, 2010).
- 129 See *Federal Trade Commission, Statement of the Federal Trade Commission Concerning Pfizer/Wyeth: FTC File No. 091-0053* (October 14, 2009), available at: www.ftc.gov/os/caselist/0910053/091014pwyethstmt.pdf (last visited January 25, 2010).
- 130 See *supra* note 20, Announcement No. 82; for English translations and summaries, see Martyn Huckerby, *China's Intervention in Global M&A Heats up While AML Private Action Cool Down* (October 30, 2009), available at: www.mallesons.com/publications/2009/Nov/10131333w.htm (last visited January 25, 2010); Jun Wei, Sherry Gong and Lynda K. Marshall, *China's Merger Review Regulator Conditionally Approves Panasonic's Proposed Acquisition of Sanyo* (November 10, 2009), available at: www.hhlaw.com/zh-CHS/pressroom/newspubs/pubdetail.aspx?publication=4901 (last visited January 25, 2010).
- 131 See European Commission, *Case No COMP/M.5421—PANASONIC/SANYO* (September 29, 2009), available at: http://ec.europa.eu/competition/mergers/cases/decisions/m5421_20090929_20212_en.pdf (last visited January 25, 2010).
- 132 The United States decision followed all the other decisions. The Federal Trade Commission focused on several battery markets, resulting in a condition to divest one of Sanyo's portable nickel-methal hybrid batteries. The other market that was within the focus of the Federal Trade Commission was the Li-ion HEV batteries for cars, but it found that other competitors would restrain the market power of the merged entity. See Federal Trade Commission, *FTC Order Sets Conditions for Panasonic's Acquisition of Sanyo* (November 24, 2009), available at: www.ftc.gov/opa/2009/11/sanyo.shtm (last visited January 25, 2010).
- 133 Zhang and Zhang, *supra* note 121, at 14.
- 134 Furse, *supra* note 21, at 109.
- 135 See Tucker, *supra* note 113; see also Furse, *supra* note 21, at 109.
- 136 See W. Stephen Smith, Xiaohu Ma and Tej Srimushnam, *InBev-Anheuser-Busch: China's First Public Merger Decision Under the AML* (2008), available at: www.mofo.com/news/updates/files/14970.html (last visited January 25, 2010).
- 137 See Xinzhu Zhang, Vanessa Yanhua Zhang and Howard Chang, *The InBev and Anheuser-Busch Merger in China: A View from Economists, 2008, The Global Competition Policy Magazine* 4, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1322526 (last visited January 25, 2010).
- 138 See Zhang and Zhang, *supra* note 121, at 7.
- 139 See Christopher Hamp-Lyons, Note: *The Dragon in the Room: China's Antimonopoly Law and International Merger Review*, 62 *Vanderbilt L. Rev.* 1577, 1601 (2009).
- 140 See Zhang and Zhang, *supra* note 121, at 10.
- 141 See *id.*, at 11.
- 142 See Furse, *supra* note 21, at 110.

- 143 See Hard to Swallow, China Indicates the Real Targets of its Anti-monopoly Law: Outsiders, *The Economist* (March 19, 2009).
- 144 See Zhang and Zhang, *supra* note 121, at 10.
- 145 See Uni-President China Holding Ltd., *Company Introduction*, available at: www.upch.com.cn/index_e.htm (last visited January 25, 2010); Huiyuan Group, *Introduction of Huiyuan Group* (2007), available at: www.huiyuan.com.cn/en/about/ (last visited January 25, 2010) and Huiyuan Group, *Our History* (2007), available at: www.huiyuan.com.cn/en/about/develop.html (last visited January 25, 2010).
- 146 See Hamp-Lyons, *supra* note 139, at 1600–1 (indicating that Coca Cola was the number one in the fruit juice market in China in 2008, followed by the Huiyuan Juice Group. Both firms together would only have a combined market share of 18 to 20 percent); compare Zhang and Zhang, *supra* note 120, at 10 (stating that Uni-President was the largest fruit juice producer with 18.69 percent, while Coca Cola and Huiyuan had respectively 15.04 percent and 13.95 percent in 2007. The merger would have made the merged entity the largest fruit juice producer).
- 147 See Zhang and Zhang, *supra* note 121, at 13.
- 148 See *id.*, at 12.
- 149 See *id.*
- 150 See Baker and McKenzie, *China Merger Control: Global Transactions Subject to Scrutiny, Divestment Conditions* (2009), available at: www.bakernet.com/NR/rdonlyres/250DF25C-8C1F-4E15-9C99-088741EF7D07/0/hk_china_merger_control_ca_apr09.pdf (last visited January 25, 2010).
- 151 See Ming Thai, *Jilin Petrochemical Overcomes Difficulties*, *China Daily* (2002), available at: www.chinadaily.com.cn/en/doc/2003-10/24/content_275129.htm (last visited January 25, 2010).
- 152 See Zhang and Zhang, *supra* note 121, at 12.
- 153 See Freshfields Bruckhaus Deringer, *supra* note 122, at 2.
- 154 See *id.*
- 155 See *id.*
- 156 See Jonathan Watts, China's E6 Electric Car: We're Not Trying to Save the World—We're Trying to Make Money, *Guardian* (April 2, 2009), available at: www.guardian.co.uk/environment/2009/apr/02/china-e6-electric-car (last visited January 25, 2010); see also China to be the Largest Auto Market in the World, *China Daily* (October 20, 2010), available at: www.chinadaily.com.cn/china/2009-10/20/content_8820728.htm (last visited January 25, 2010); China's Car Market is Now Bigger than America's, *The Economist* (October 23, 2009).
- 157 See Watts, *supra* note 158; See also Deacons, *China: New Car Industry Policy* (October 1, 2004), available at: www.hg.org/articles/article_457.html (last visited January 25, 2010).
- 158 See, e.g., Freshfields Bruckhaus Deringer, *supra* note 121, at 2; John V. Grobowski and Yiqiang Li, *Ministry of Commerce Approval of Acquisitions by General Motors, Pfizer With Conditions Affecting Companies' Activities in China* 3 (2009), available at: www.faege.com/webfiles/Nov_Ministry%20of%20Commerce.pdf (last visited January 25, 2010).
- 159 See Freshfields Bruckhaus Deringer, *supra* note 122, at 3.

11 The privatization of investor–state dispute resolution

*Gerald Paul McAlinn**

Introduction

There is little doubt that the growth of foreign direct investment (FDI) and the rapid advance of globalization (accelerated by the information revolution) have played major roles in development and have contributed to the overall prosperity of the global economy.¹ This, in turn, has produced many benefits to people throughout the world, such as a marked advancement in the standard of living, and a heightened awareness of, and a general improvement in, the areas of human rights, environmental protection, and corporate social responsibility. In the first half of the twentieth century, when technological development did not allow for rapid globalization, people lacked awareness of the interconnectivity of issues occurring in seemingly remote corners of the world. This is no longer the case. Major multinational enterprises (MNEs) cannot operate with impunity outside of their home countries safe in the belief that they will not be called to task for their overseas operations, policies and practices.

While the positive elements of globalization are manifest, the process is not without its darker side. Time honored traditions and cultural diversity are obvious victims of the drive towards a universal standard of living projected by television—and, increasingly, Internet advertisers—promoting the goods and services necessary for a “lifestyle” that can only be provided by multinational icons such as McDonald’s, Nike, Starbucks, and Coca-Cola. The goods and services offered by MNEs are considered by some, not without reason, as being Trojan horses for Western economic and cultural values. To these critics, globalization is little more than a virulent form of economic imperialism. A similar claim has been lodged against Western industrialized nations for their strong promotion of “Rule of Law” initiatives in various forms.

The notion that actions should be governed and judged by law, as if law is a neutral, objective, and sacred talisman of justice and fairness, is central to the search for a dispute resolution regime that seeks to protect foreign investment from arbitrary (and, sometimes, corrupt) and politically motivated behavior by national governments. The main criticism of the Rule of Law movement is, in short, that it places too much emphasis on the procedures of law without regard to the consequences and content of the rules it espouses. Readers may recognize

in these arguments a similar theme asserted by adherents of the critical legal studies movement, i.e., that law cannot be disassociated from the interests of those who make and promote it. Since the international rules have largely been made by the developed countries and, as the argument goes, they necessarily contain biases favoring established interests, the developing world is essentially being forced to follow rules it did agree to voluntarily or help to make. Finally, it is argued that law can be used to give legitimacy to actions many people would find objectionable. Put in other words, injustice cannot be made just by virtue of having been authorized by law. History is replete with examples of law having been used as an implement of oppression and nowhere is this more evident than in the darker aspects of the colonial legacy.

Whether by chance or choice, one notable victim of the process of globalization is the absolute sovereignty of nations. Countries clearly no longer operate in a vacuum. Just as they cannot withstand the onslaught of global marketers, they equally cannot keep the forces of internationalization and change at bay forever. Even legitimate efforts by the governments of industrialized and developing states alike to protect fledgling industries, to promote intellectual advancement, to husband vital natural resources for the use and prosperity of future generations, and to ensure that all people have access to increasingly essential goods and services at affordable prices, are increasingly met with claims by the governments of industrialized nations, backed by powerful MNEs, of unfair trade practices and protectionism.² These claims carry with them, of course, a none too subtle subtext warning nations that dare to stand in the way of globalization that they risk being ostracized and otherwise cut off from the global economic community.

These issues are frequently played out on the diplomatic stage, with nations acting as little more than proxies for vested private commercial interests operating in host countries. When Japan and the United States, by way of example, negotiated a new "Open Skies" treaty at the end of 2009, purportedly for the mutual benefit of each country, it was the individual airlines that were the real recipients of the private benefits associated with deregulation and enhanced freedom of operation.³ Private investors have not been shy in letting their national governments know where the short- and long-term economic interests of the company reside, as well as reminding their elected officials, if necessary, of the close link between commercial interests and national security. The point here is that private investors have traditionally carried a national flag and, in return, governments have readily used diplomacy as a tool to help their nationals advance their economic and strategic interests abroad.⁴

One area where this has been true is in the field of dispute resolution. Investors doing business abroad have long been reluctant, for obvious reasons, to submit their disputes to the national courts of host nations. Treaties negotiated with Japan, for example, by the Western powers at the opening of the Meiji Restoration (1868) regularly included provisions exempting their nationals from the jurisdiction of the Japanese legal system in both civil and criminal matters.⁵ The unwillingness of foreign nationals and commercial enterprises (and their ability

to influence their national governments to advance their positions through the diplomatic process) to submit disputes to the legal process of Japan, such as it was at the end of the Edo era, is just one instance of the problem. While less acute today, the concern remains when MNEs do business in countries without a well-developed infrastructure regardless of whether the dispute is between private parties or of the investor–state variety.⁶

In the investor–state context, a foreign investor will naturally feel insecure about its rights being protected when the only recourse is to appeal for justice to national courts. Judges in national systems ultimately come under the control of the very governmental entity that is being accused of breaching an obligation of international law or contract, or against which an obligation is sought to be enforced. This is all the more problematic for foreign investors when the host state is a developing country lacking an independent judiciary, a mature bar, and an honest government.

The issues are exacerbated by the reality that developing countries are the ones most in need of FDI and, at the same time, the ones most likely to come into conflict with the economic interests of foreign investors. Asian countries such as China, Indonesia, Thailand, and Vietnam have a vast appetite for infrastructure projects requiring huge financial outlays. Energy production, petrochemical plants, and oil and gas infrastructure, and large-scale industrial manufacturing facilities are among the projects requiring the greatest amount of foreign capital and expertise. Winning a major contract for a large infrastructure project in a developing country is a prize sought by MNEs because these projects promise a strong return over an extended period of time. They can offer access to rich natural resources, high visibility, and an opportunity to influence local and national government at the most senior levels. MNEs lower on the proverbial food chain, i.e., those seeking only cheap labor in order to staff low-skilled manufacturing and assembly operations, are prepared to bring investment to developing countries in return for cheap labor and lax regulation.

Developing states, however, are frequently vulnerable and in need of protection against the sheer economic power of global goliaths. MNEs have the capacity (and all too frequently, the willingness) to corrupt government and to exploit underdeveloped standards of living and immature regulatory infrastructure. Lesser-developed countries can rightly claim that they need breathing room before being able to meet emerging global standards shaped largely through the influence of MNEs.

These complex issues reside at the center of the debate over globalization and development. Other chapters in this book take up different aspects of the issue. This chapter will focus more narrowly on the successful drive by MNEs to decouple dispute resolution from diplomatic protection (i.e., the right of one state to espouse the interests of an individual or MNE allegedly harmed in contravention of international law by the actions of another state) and to remove it from the sovereign authority of national governments via their national courts. This is what is meant by the privatization of dispute resolution. Privatization has been accomplished by advocating for a new commercially oriented forum for

resolving investor/state dispute resolution modeled on alternative dispute resolution as practiced in the private commercial transaction context. To a large degree, this development is just an extension of the privatization movement that seems to have swept the world in the past 25 years. It is also the result, unfortunately, of a failure of the public international law regime to offer creative solutions to real problems and to tackle inefficiencies within the traditional rubric of dispute resolution.

As asserted earlier, trade and investment can bring mutual benefits to state and investor alike. They can also lead to conflict. This is especially true when the interests of foreign investors are seen as impeding development and other important public policy initiatives of the host nation. Any conclusion needs to balance these sometimes competing interests.⁷ This chapter will argue that the traditional recourse to diplomatic protection may still be useful, but is not sufficient, in the era of global business.

This chapter tracks the evolution of investor–state dispute resolution from the sphere of public international law to what amounts to an essentially private system of dispute resolution embodying the same rules as govern international commercial arbitration. Concern has been expressed in this regard as to the overwhelming resources available to multinational enterprises, especially when developing countries are involved, and the legitimate right of sovereign nations to shape their own destinies. This is embodied in the assertion of a right of development, without undue distortion resulting from global forces advocating for the free and largely deregulated flow of capital, goods, technology, and services.

Private rights in public international law

Conflicts between foreign investors and host nations are not new. Countries have grappled with the issue of how to protect their nationals when they go abroad since the inception of international trade and intercourse. Bilateral treaties of friendship, commerce and navigation (FCN treaties), which hinge on the twin principles of (i) free access for the nationals or enterprises of one party to the territory of the other and (ii) national treatment once present in the other party's territory, were (and still remain to a degree) an important means of ensuring reciprocal protection. For example, under the Treaty and Protocol between the United States of America and Japan regarding Friendship, Commerce and Navigation of 1953,⁸ nationals and companies of either nation shall, among other things, be accorded national treatment and most-favored-nation treatment with respect to access to the courts of justice and to administrative tribunals and agencies (Article IV, paragraph 1); shall have their agreement to arbitrate disputes respected and their final and enforceable awards recognized and enforced (Article IV, paragraph 2); shall be free from unreasonable and discriminatory measures that would impair legally acquired rights or interests (Article 5, paragraph 1); shall have their property fully protected (Article VI, paragraph 1); and shall receive national treatment with respect to engaging in all types of commercial, industrial, financial and other business activities (Article VII, paragraph 1).

The United States has issued the following statement regarding the government's willingness to espouse claims on behalf of U.S. nationals:

Under international law and practice the United States does not formally espouse claims on behalf of U.S. nationals unless the claimant can provide persuasive evidence demonstrating that certain prerequisites have been met. The most important of these requirements are that the claimant was at the time the claim arose and remains a U.S. citizen, that all local remedies have been exhausted or the claimant has demonstrated that attempting to do so would be futile, and that the claim involves an act by the foreign government that is considered wrongful under international law.⁹

The U.S. position places a relatively high threshold burden on the individual or MNE seeking diplomatic protection. It is not necessarily a bad thing that the government imposes such a burden before it undertakes to use the full weight of its diplomatic apparatus and expend political capital to influence a foreign sovereign. What is not stated in this position, however, is the caveat that even having met the burden it is still possible that the government will decline to advocate if to do so might conflict with other more paramount foreign policy interests.

Notwithstanding the widespread existence of FCN treaties, nations have increasingly resorted to trade and investment specific treaties focusing exclusively on business concerns in the form of bilateral investment treaties (BITs), multilateral investment treaties (MITs), free trade agreements (FTAs), and, a form favored by Japan, economic partnership agreements (EPAs).¹⁰ A United Nations Conference on Trade and Development (UNCTAD) report comments on the trend as follows:

Since the late 1950s, bilateral treaties for the promotion and (reciprocal) protection of investment have become the most widely used type of treaty in the field of foreign investment. Such treaties have replaced an earlier type of bilateral treaty, the treaty of Friendship, Commerce and Navigation which included provisions on rights of foreign nationals and companies among rules on a broad range of aspects of bilateral economic and political cooperation. By contrast, the distinguishing feature of the modern BIT is that it deals exclusively with issues concerning the admission, treatment and protection of foreign investment.

BITs exhibit a certain pattern of uniformity in their structure and content. Elements common to virtually all such treaties are the use of a broad definition of the term "investment", the inclusion of certain general standards of treatment of foreign investment, such as fair and equitable treatment and constant protection and security, and more specific standards of protection regarding expropriation and compensation, transfer of funds, and the protection of foreign investment in case of civil strife. Most such treaties also provide for national and MFN treatment, although this is frequently limited

to the treatment of foreign investment after admission. Many such treaties provide for the ability of States as well as foreign investors to resort to international arbitration.¹¹

In any event, the last decade of the twentieth century saw an explosion in the number of BITs entered into by nations. The UNCTAD report quoted above states that there were 386 BITs in force at the end of the 1980s. The number rose to 2,181 by the end of 2002. The report goes on to say that

The majority of these treaties are between a developed country, on the one hand, and a developing country or economy in transition, on the other, but the proportion of BITs concluded between developing countries and between developing countries and countries in transition is increasing. BITs have rarely been concluded between developed countries.¹²

More recent estimates indicate that there are now over 2,500 BITs in force throughout the world, involving more than 175 countries.

In the Asia Pacific region, the move towards BITs, MITs and the like is accelerating as countries seek economic alliances to rival the situation under the North American Free Trade Agreement (NAFTA) and the EU. China and Taiwan concluded a landmark Cross-Strait Economic Cooperation Framework Agreement (ECFA) in June of 2010. The Mainland Affairs Council of Taiwan lists three main objectives to be derived from the ECFA:

- promotion of normal cross-strait economic and trade relations;
- avoidance of Taiwan being marginalized by regional economic integration; and
- enhancement of Taiwan as a platform for regional investment.¹³

The detailed contents of the ECFA are yet to be negotiated but they are likely to track the ASEAN–China Framework Agreement on Comprehensive Economic Cooperation.¹⁴ This move by Taiwan is seen as paving the way for entering into an FTA in the near future with Singapore and creating “leverage to realize FTAs with Japan, the U.S. and European and Asian countries.”¹⁵ Just as when the NAFTA was coming into force, companies seeking to import goods into the emerging patchwork of FTAs in Asia will be at a competitive disadvantage: versus those with manufacturing facilities located inside the wall. This will undoubtedly lead other countries to forge their own FTAs with major trading partners throughout the world.

Diplomatic protection and the foreign investor

This section will provide a brief summary of how diplomatic protection proved ineffective in protecting the real interests of foreign investors. The first case for consideration is the 1939 decision of the Permanent Court of International

Justice in *The Panevezys–Saldutiskis Railway Case*. This case arose out of a decision by the Lithuanian government to seize and operate the Panevezys–Saldutiskis railway, allegedly depriving an Estonian company of certain concessionary rights it possessed in the railway. The Permanent Court of International Justice wrote regarding the rights of a foreign investor in public international law as follows:

In the opinion of the Court, the rule of international law on which the first Lithuanian objection is based is that in taking up the case of one of its nationals, by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own right, the right to ensure in the person of its nationals respect for the rules of international law. This right is necessarily limited to intervention on behalf of its own nationals because, in the absence of a special agreement, *it is the bond of nationality between the State and the individual which alone confers upon the State the right of diplomatic protection*, and it is as a part of the function of diplomatic protection that the right to take up a claim and to ensure respect for the rules of international law must be envisaged. Where the injury was done to the national of some other State, no claim to which such injury may give rise falls within the scope of the diplomatic protection which a State is entitled to afford nor can it give rise to a claim which that State is entitled to espouse. (emphasis added)¹⁶

As the above quote makes clear, the only international recourse available to a foreign investor injured by the actions of a host state under traditional principles of international law is to seek diplomatic protection from the state of which it is a national. It follows from this proposition that the only party with the right to assert a claim on behalf of the foreign investor is the nation where the foreign investor is a national.¹⁷ Since a foreign investor has no direct recourse in international law other than applying to its own country for assistance, the foreign investor must expend political capital with its own government or endeavor to prosecute its interests through the domestic courts of the host nation. The latter route is one likely to be available more in theory than in reality, especially if the host nation asserts the doctrine of sovereign immunity.

The obvious problem for the investor relying on diplomatic protection is that the interests of the investor's home nation may not be always fully congruent with those of the investor. Diplomatic protection is inherently political in nature. It is, therefore, not unusual for an investor to find that its interests have been sacrificed for the good of some larger perceived geo-political objective of its country of citizenship.¹⁸ Diplomatic protection is, in short, a power that relies substantially on international relations. It does not gain its legitimacy from law, although diplomatic protection is firmly recognized in international law, so much as from ancient principles of comity and reciprocity.¹⁹

There is a further problem with diplomatic protection. The reality of modern MNEs is that business is done through a complex web of subsidiaries and

affiliates. The real party in interest to an alleged harm may be a sole shareholder that is the ultimate parent of the injured entity. While these subsidiaries and affiliates are treated in law as separate and independent juridical persons, the economic reality is frequently different, making the country of incorporation (and, thus, nationality) more a matter of convenience than a true representation of the national identity of the legal entity.²⁰

The International Court of Justice made this point abundantly clear in the *Barcelona Traction Case*, discussed later, by holding that investors have no rights independent of their national state and, as a consequence, must abide by the state of incorporation's decision whether to extend diplomatic protection. In this connection, the ICJ wrote as follows:

78. The Court would here observe that, within the limits prescribed by international law, a State may exercise diplomatic protection by whatever means and to whatever extent it thinks fit, for it is its own right that the State is asserting. *Should the natural or legal persons on whose behalf it is acting consider that their rights are not adequately protected, they have no remedy in international law.* All they can do is to resort to municipal law, if means are available, with a view to furthering their cause or obtaining redress. The municipal legislator may lay upon the State an obligation to protect its citizens abroad, and may also confer upon the national a right to demand the performance of that obligation, and clothe the right with corresponding sanctions. However, all these questions remain within the province of municipal law and do not affect the position internationally.

79. The State must be viewed as the sole judge to decide whether its protection will be granted, to what extent it is granted, and when it will cease. It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the particular case. Since the claim of the State is not identical with that of the individual or corporate person whose cause is espoused, the State enjoys complete freedom of action. Whatever the reasons for any change of attitude, the fact cannot in itself constitute a justification for the exercise of diplomatic protection by another government, unless there is some independent and otherwise valid ground for that. (emphasis added)²¹

The right of diplomatic protection belongs to the state and not the injured private party. This was expressly confirmed in paragraphs 78 and 79 of the ICJ's opinion, if there were ever any doubt on the point. The state decides if, and to what degree or form, it will seek to protect the rights of its nationals. Injured parties have no right to contest the action, or inaction, of their own governments since "they have no remedy in international law." Since the doctrine of sovereign immunity and principles of separation of powers that exist in most nations would effectively preclude any attempt to compel the exercise of diplomatic protection, the result is a dead-end for the injured party seeking redress.

Professor J.L. Brierly, a leading Oxford scholar of international law, noted the problems with the traditional view of diplomatic protection as a method for protecting investors' interests in his classic treatise entitled *The Law of Nations*. He acknowledged a nation has a certain interest in protecting its citizens internationally, but concluded "it is an exaggeration to say that whenever a national is injured in a foreign state, his state as a whole is necessarily injured too."²² The home state may decline to extend diplomatic protection for reasons wholly unrelated to the validity of the claim of its injured national, or substantial delay may result in injustice being done to the national while the gears of diplomacy grind forward.²³ Presaging developments to come, Brierly speculated as follows:

It has been suggested that a solution might be found by *allowing individuals access in their own right to some form of international tribunal for the purpose*, and if proper safeguards against merely frivolous or vexatious claims could be devised, that is a possible reform which deserves to be considered. For the time being, however, *the prospect of states accepting such a change is not very great.*

...in the absence of a regular procedure for dealing with [investment disputes] the rules by which they ought to be determined have been obscured, both by the tendency of the stronger powers to press the claims of their nationals without much regard to legal justification, and by that of the weaker powers to try to avoid responsibilities for corrupt or incompetent administration by exaggerating emphasis on the rights supposed to be inherent in their independent status. (emphasis added)²⁴

The development of investor–state dispute resolution is the story of a search by foreign investors for "access in their own right to some form of international tribunal" as Brierly would have it. Before turning to the form of international tribunal that has evolved in the vacuum created by the defects in the institution of diplomatic protection, it is necessary to demonstrate to one further degree the failure of public international law to provide a suitable forum.

Private parties and the International Court of Justice

A trio of cases decided by the International Court of Justice over a period of 27 years stretching from 1952 until 1989 demonstrated conclusively the difficulty traditional principles of public international law presented to providing a satisfactory regime for resolving disputes that involved both state actors and private parties. As a prelude to the discussion of each of these cases, it is worth observing again that only states may be parties before the Court.²⁵

Assuming a private investor can prevail on its country to champion its cause before the ICJ, there are at least two other formidable hurdles to be surmounted. First, jurisdiction in the ICJ, consistent with the concept of sovereignty, is voluntary.²⁶ The Court lacks the authority to compel a nation to appear. While many

nations agree to jurisdiction in declarations lodged with the Court, these declarations often include qualifications. Second, ICJ jurisdiction is limited, in effect, to claims sounding in violations of treaty and/or customary international law. Actions of a state may be quite capable of depriving a foreign investor of the benefit of its bargain at the same time as falling short of being a recognized violation of public international law.

All three cases discussed below presented either jurisdictional or other procedural problems that, in the end, frustrated the Court's ability to serve as a forum for resolving investor–state disputes. This arguably led the foreign investment community to give up hope that the ICJ would become a viable forum necessitating the forging of a different route to the desired goal.

The Anglo-Iranian Oil Case (UK v. Iran, 1952)

The Anglo-Iranian Oil Company entered into an oil concession agreement with the Government of Iran in 1933. The United Kingdom was not a party to the agreement. Subsequently, Iran nationalized the oil industry in 1951. The United Kingdom exercised its right of diplomatic protection and took up the cause of the company by bringing a case challenging the expropriation before the International Court of Justice. Iran objected to the jurisdiction of the ICJ on the grounds that jurisdiction could only be premised on a treaty or convention agreed to by Iran. While both Iran and the UK had lodged declarations with the ICJ accepting the Court's jurisdiction, Iran contended that its acceptance of compulsory jurisdiction was limited to treaties entered into after its declaration and, thus, no consent to jurisdiction existed for treaties predating the declaration.

The ICJ examined the language of the Iranian declaration and concluded that the most natural and reasonable reading favored the position of Iran. By a vote of nine to five, the ICJ decided that it did not have jurisdiction and the case was dismissed.

The Barcelona Traction Case (Belgium v. Spain, 1970)

This landmark case at the intersection of public international law and private investment rights, mentioned above, arose out a 1948 judicial decision by a Spanish court declaring the Barcelona Traction, Light and Power Company bankrupt and ordering seizure of its assets as well as the assets of two of Barcelona Traction's subsidiaries. Barcelona Traction was a Canadian company incorporated in 1911. Its head office was located in Toronto, Canada. The main business of the company was to develop an electric power production and distribution system in Catalonia, Spain. It formed a number of subsidiaries to carry out its purposes, some of which were incorporated in Canada and others in Spain.

Barcelona Traction issued a series of sterling denominated bonds to help fund its operations in Spain. Some of these bonds were purchased by Spanish nationals. The company was successful and supplied, through its subsidiaries, a

predominant share of electricity in the region by 1936. The outbreak of the Spanish Civil War in 1936 dealt a blow to the company's fortunes and it was forced to stop servicing the debt on its bonds.

After the cessation of the Civil War, the Government of Spain imposed conditions on the transfer of foreign currency that made it effectively impossible for the company to service its sterling bonds. The Spanish bondholders filed a lawsuit in 1948 in the Spanish court seeking a declaration that Barcelona Traction was bankrupt because it was not able to service its corporate bonds. The Spanish court agreed with the bondholders and ordered seizure of the company's assets.

Over the intervening years following its incorporation and the outbreak of the Spanish Civil War, a majority of the shares of Barcelona Traction came to be held by Belgian nationals, although the exact amount of Belgian share ownership was contested. The company, nevertheless, remained headquartered in Toronto. In 1948 and 1949, the governments of the UK, Canada, the U.S. and Belgium all sought to resolve the matter through direct negotiations with the Government of Spain. Apparently, Canada ceased advocating on behalf of Barcelona Traction by 1955, preferring to push for a settlement among the relevant parties rather than to advance the matter through the assertion of diplomatic protection.²⁷

The Government of Belgium sought to exercise the right of diplomatic protection on behalf of the Belgian shareholders of the company by instituting a suit against Spain in the ICJ in 1962. Spain objected to the right of Belgium to bring an action against it and, after some jurisdictional wrangling in what is known as the First Phase decision of 1964, the case was allowed to proceed.²⁸

The case returned to the ICJ for the Second Phase where the Court was required to resolve the triangular relationship of Spain, Canada and Belgium under international law. The Court considered this issue from the perspective of whether Belgium had standing (i.e., whether a right of Belgium had been violated by the actions of Spain taken against a Canadian corporation) to represent the interests of the Barcelona Traction shareholders. This, in turn, required the Court to answer the question of how to determine the proper nationality of a corporation.

The Court noted that "international law has had to recognize the corporate entity as an institution created by States in a domain essentially within their domestic jurisdiction."²⁹ This led the Court to conclude as follows:

The traditional rule attributes the right of diplomatic protection of a corporate entity to the State under the laws of which it is incorporated and in whose territory it has its registered office. These two criteria have been confirmed by long practice and by numerous international instruments.

This notwithstanding, further or different links are at times said to be required in order that a right of diplomatic protection should exist. Indeed, it has been the practice of some States to give a company incorporated under their law diplomatic protection solely when it has its seat (*siège social*) or

management or centre of control in their territory, or when a majority or a substantial proportion of the shares has been owned by nationals of the State concerned. Only then, it has been held, does there exist between the corporation and the State in question a genuine connection of the kind familiar from other branches of international law. However, in the particular field of the diplomatic protection of corporate entities, no absolute test of the “genuine connection” has found general acceptance. Such tests as have been applied are of a relative nature, and sometimes links with one State have had to be weighed against those with another.

In the present case, it is not disputed that the company was incorporated in Canada and has its registered office in that country. The incorporation of the company under the law of Canada was an act of free choice. Not only did the founders of the company seek its incorporation under Canadian law but it has remained under that law for a period of over 50 years. It has maintained in Canada its registered office, its accounts and its share registers. Board meetings were held there for many years; it has been listed in the records of the Canadian tax authorities.

Thus a close and permanent connection has been established, fortified by the passage of over half a century. This connection is in no way weakened by the fact that the company engaged from the very outset in commercial activities outside Canada, for that was its declared object.

By rejecting the argument in favor of granting standing to the state where *siège social* or, as the ICJ put it, a “genuine connection” exists, the ICJ effectively cut shareholder investors off from appealing to any nation other than the one in which the corporation is incorporated. We have already seen that no nation is compelled to exercise diplomatic protection on behalf of its citizens, it being a matter entirely within the discretionary authority of the sovereign. The reality of international business transactions is that many MNEs structure their business for tax and liability reasons through subsidiaries incorporated offshore. It follows that a country hosting a subsidiary of a parent company incorporated in some other state can be expected to feel reluctant when it comes to standing up for the interests of the “step-citizen” subsidiary. Be that as it may, the result following the *Barcelona Traction* case is that shareholders, who are the real parties in interest in foreign investment, are frequently left without protection under principles of public international law.³⁰

The case concerning Electronica Sicula S.P.A. (ELSI) (U.S.A. v. Italy, 1989)

Raytheon Company established ELSI in Palermo, Sicily to manufacture electronic components. Raytheon owned 99.16 percent of the shares of ELSI, with the remaining shares being held by Machlett Laboratories Incorporated, a wholly-owned subsidiary of Raytheon. ELSI operated a plant that manufactured electronic components and employed around 900 workers. It made an operating

profit from 1964 to 1967. However, the profit was not enough to offset the company's debt expenses and accumulated losses.

In early 1967, Raytheon made plans to make ELSI self-sufficient. Raytheon entered into discussions with the Italian government regarding possible government support for ELSI, or help in locating an Italian enterprise that might be interested in investing in the company. The negotiations proved unsuccessful and Raytheon and Machlett began planning for the dissolution and liquidation of ELSI in order to stem the red ink.

An asset evaluation conducted by the CFO of Raytheon indicated that the book value of ELSI's assets was 18,640 million lire, but that the company would be likely to realize only around 10,838.3 million lire in a "quick-sale." The total debt of ELSI was around 13,123.9 million lire. Raytheon charged the management of ELSI with conducting an orderly liquidation and paying off as much debt as possible either by selling the business *in toto*, or the assets separately. The company reckoned that an orderly liquidation would have a better chance of raising sufficient funds to pay the creditors than would a bankruptcy.

During the liquidation planning process, discussions with Italian officials continued. The government urged Raytheon not to close the plant or to terminate the workforce. These negotiations were likewise unsuccessful and ELSI sent letters of dismissal to all of its employees on March 29, 1968. The Mayor of Palermo, in response to ELSI's notice to its employees, issued an order on April 1, 1968, requisitioning the plant for a period of six months. The workers occupied the ELSI plant around the same time as the requisition order was issued.

A variety of domestic political and legal appeals were taken against the requisition order, and it was eventually repealed. Unfortunately, it was a case of too little, too late for the company. ELSI filed for bankruptcy on April 26, 1968, alleging that as a result of the requisition order the company was not able to pay its debts when they became due.

A bankruptcy decree was issued on May 16, 1968. A bankruptcy trustee was appointed and he brought an action in June of 1970 against the Minister of the Interior and the Mayor of Palermo claiming damages as a result of the requisition. The court awarded damages for the period of the requisition and the money was used to pay off creditors. There was no surplus from which to return any money to the shareholders.

The Government of the United States sought to exercise the right of diplomatic protection against Italy, claiming a violation of the Treaty of Friendship, Commerce and Navigation between the countries entered into in 1948, and a supplemental treaty entered into in 1951.³¹ Italy objected to the claim of the U.S. by contending, among other things, that local remedies had not been exhausted by the trustee in bankruptcy.

A five-judge chamber of the ICJ rejected the jurisdictional arguments of Italy and proceeded to hear the case on its merits. The substance of the U.S. contention was that the requisition by Palermo deprived ELSI of the benefit of an orderly liquidation and resulted in there being no chance at recovering enough money from the assets to pay the creditors and to make a distribution to the

shareholders.³² By a decision of 4 to 1, the Chamber concluded that the U.S. had failed to meet its burden of showing that the requisition was the cause of ELSI's inability to raise sufficient funds via the bankruptcy sale. The Chamber was of the view that, on the merits, ELSI was likely not in a financial position to conduct an orderly liquidation for reasons independent of any governmental action.

An interesting point in the *ELSI* case is that the Court did not clearly address the issue of standing in the same way as it did in *Barcelona Traction*. ELSI was an Italian corporation and, as such, the U.S. under *Barcelona Traction* arguably should not have had the right to assert diplomatic protection on behalf of either ELSI or the shareholders. Judge Oda, in a separate opinion, pointed out this problem in the Chamber's assumption of jurisdiction, but noted that in his view the purpose of the FCN Treaty was to grant to the U.S. the right to extend diplomatic protection to ELSI. By asserting the rights of the Italian subsidiary, the rights of its shareholders would indirectly be protected. Nevertheless, since he also concluded that the underlying cause of action had not been made, it did not matter to the outcome of the case.

Judge Schwebel, writing in dissent, observed that "the Chamber declined to hold that ELSI, an Italian corporation whose shares were owned by United States corporations, was outside the scope of protection afforded by the Treaty." To do so would have made the FCN Treaty virtually meaningless in the view of Judge Schwebel. He was of the opinion on the merits that the requisition was an arbitrary action taken in violation of the FCN Treaty.

The growth of arbitration in private law

At the same time as international investors were struggling to find an effective forum for resolving investor–state disputes, private commercial parties were also seeking ways to avoid the pitfalls inherent in relying on national courts to resolve private commercial disputes. The main thrust supporting the rise of commercial arbitration is the desire by private parties to control as much of the dispute resolution process as possible. Proponents of commercial arbitration point to a number of factors that make arbitration more desirable than resorting to the courts. The most commonly cited merits are as follows:

- 1 *Speed and Economy*. Since arbitration is essentially a private process, the parties are free to commence it and to make whatever procedural rules they desire. They can, for example, dispense with the need for live witness testimony in favor of written declarations. Many arbitral associations have guidelines for the length of time from commencement to issuance of a final award in order to maximize the speed and economy of arbitration. By way of contrast, lawsuits filed in the courts are bound to follow procedural and evidentiary rules that cannot be modified by the parties. It can take many years for a case to reach trial, depending on the volume of cases filed, and more years with the judgment tied up in appeals.

- 2 *Expertise and Competence.* Arbitration allows the parties to select either a single arbitrator or a panel (usually three) of arbitrators with specific expertise and competence in the area under dispute. For example, construction disputes can be decided by arbitrators with a deep knowledge of the practices in the construction industry. A civil trial judge (or worse yet, a jury) is not likely to have an in-depth knowledge of the issues in these technical areas. Other industries that have moved towards arbitration for this reason are real estate, securities, and manufacturers concerned with product liability claims.
- 3 *Counsel of Choice.* Virtually every jurisdiction places restrictions on who can appear in court on behalf of a party requiring counsel to be admitted to practice before appearing in court on behalf of the client. In arbitration, the parties are generally free to select their counsel of choice without regard to whether the lawyer is admitted in the particular jurisdiction.
- 4 *Confidentiality.* Arbitration proceedings, unlike lawsuits, are private. Even the fact that the arbitration is ongoing is not generally known to the public, and all evidence produced in the arbitral proceeding remains private.
- 5 *Neutrality.* The parties are free to select the place where the arbitration will be held and, therefore, neither party is required to go into the courts of an alien jurisdiction in an effort to enforce or defend its rights. This is particularly important in transactions involving countries with inadequate legal infrastructure and/or corrupt courts.
- 6 *Final, binding decisions.* Typically, there is no right of appeal from an arbitral award so, at least in theory, a decision can be rendered promptly and the parties can get on with their business without worrying about time-consuming and expensive appeals.

In the international context, the above-listed reasons apply with equal or greater force. The benefit of being able to avoid having to litigate in a foreign court is obvious to international business enterprises. This is true regardless of whether the national courts are perceived as being honest and fair. Many Japanese companies prefer arbitration in international contracts with American counterparts, for example, in order to avoid or minimize perceived onerous discovery burdens or unpredictable jury decisions. Added to this is an additional beneficial factor, i.e., the ability to designate the operative language of the arbitration, something which cannot be done when proceeding in national courts. International agreements are predominantly in English so by providing for arbitration in English the parties can avoid the time and expense of translation.

Arbitration has a particularly compelling advantage over litigation in the international commercial context because arbitral awards are enforceable under the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”). One hundred and forty-four nations are parties to the New York Convention as of this writing.³³ Every signatory state is obligated to:

recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may

arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.³⁴

Contracting states are also obligated to recognize and enforce arbitral awards, subject to some specified exemptions.³⁵ This is a significant selling point to private parties doing business internationally since there is no comparable treaty in force with respect to the enforcement of foreign judicial judgments.³⁶

The attractiveness of arbitration can be seen in its rapid growth throughout the world, especially in Asia. Both Singapore and Hong Kong have fashioned themselves as centers for regional commercial dispute resolution. In the past 25 years, the China International Economic and Trade Arbitration Commission (CIETAC) has seen its caseload grow from fewer than 40 cases in 1985 to nearly 1,500 in 2009.³⁷ The ICC International Court of Arbitration reports that it received 817 requests for arbitration in 2009. These arbitrations involved 2,095 parties from 128 countries.³⁸

The rush to arbitration has not all been positive. Many critics contend that it is no longer the speedy, efficient and cost-effective process that it was meant to be. Increasingly, international arbitration has come under the strong influence of common law practices and has become more classically litigation-like at every level. This has eroded, to a material degree, some of the core benefits of alternative dispute resolution. Additional concerns have been raised about the clubby nature of the international arbitration bar and the community of international arbitrators.³⁹

Notwithstanding concerns about the growth of arbitration and the implications it might have for domestic courts, the U.S. Supreme Court in *Mitsubishi Motors v. Soler Chrysler-Plymouth*, a case dealing with the question of whether matters traditionally within the realm of public law should be arbitrable as a matter of public policy, concluded as follows:

As international trade has expanded in recent decades, so too has the use of international arbitration to resolve disputes arising in the course of that trade. The controversies that international arbitral institutions are called upon to resolve have increased in diversity as well as in complexity. Yet the potential of these tribunals for efficient disposition of legal disagreements arising from commercial relations has not yet been tested. If they are to take a central place in the international legal order, national courts will need to “shake off the old judicial hostility to arbitration,” *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978, 985 (CA2 1942), and also their customary and understandable unwillingness to cede jurisdiction of a claim arising under domestic law to a foreign or transnational tribunal. To this extent, at least, it will be necessary for national courts to subordinate domestic notions of arbitrability to the international policy favoring commercial arbitration.⁴⁰

Mitsubishi Motors v. Soler Chrysler-Plymouth was decided in 1985. In the intervening 25 years, arbitration has firmly taken root as a desirable method of

resolving both domestic and international commercial disputes. For the most part, national courts have subordinated domestic considerations “to the international policy favoring commercial arbitration” by adopting strong policies favoring arbitration. This was a critical step in the privatization of domestic dispute resolution. With this as background, we are now ready to see how the same process was adapted to the arena of investor–state disputes.

The Washington Convention and the establishment of ICSID

The International Bank for Reconstruction and Development (World Bank) was established in 1944, to facilitate the reconstruction of economies devastated in the aftermath of World War II. Today, 187 countries are members. It is governed by a 24-member Board of Governors. The Bank holds an annual meeting that is attended by delegates from each member state. The delegates are made up of finance minister or development minister level officials.

Article 1 of the Article of Agreement sets forth the following five key purposes of the World Bank:

- i To assist in the reconstruction and development of territories of members by facilitating the investment of capital for productive purposes, including the restoration of economies destroyed or disrupted by war, the reconversion of productive facilities to peacetime needs and the encouragement of the development of productive facilities and resources in less developed countries.
- ii To promote private foreign investment by means of guarantees or participations in loans and other investments made by private investors; and when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, finance for productive purposes out of its own capital, funds raised by it and its other resources.
- iii To promote the long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members, thereby assisting in raising productivity, the standard of living and conditions of labor in their territories.
- iv To arrange the loans made or guaranteed by it in relation to international loans through other channels so that the more useful and urgent projects, large and small alike, will be dealt with first.
- v To conduct its operations with due regard to the effect of international investment on business conditions in the territories of members and, in the immediate postwar years, to assist in bringing about a smooth transition from a wartime to a peacetime economy.⁴¹

While the work of the World Bank remains largely focused on sustainable development and the elimination of global poverty, the Bank’s brief has never been

interpreted so narrowly as to exclude matters deemed necessary to support its core mission. One such area is facilitating the resolution of investment disputes even though this is not mentioned among the Purposes listed in Article.

The good offices of the President of the World Bank were, in fact, called upon a number of times in the post-World War II era to assist in the resolution of investment disputes. The former Vice President and General Counsel of the World Bank and Secretary General of the International Centre for Settlement of Investment Disputes, Ibrahim F.I. Shihata, described the *raison d'être* of the World Bank in this area, writing that “[a]s a financial intermediary between its capital-importing and capital-exporting members, the Bank has an institutional interest in promoting the settlement of investment disputes.”⁴²

Shihata recounts a number of instances where the Bank was called upon to assist in resolving investment disputes, among them being the nationalization by Iran of the assets of the Anglo-Iranian Oil Company in 1951–1952, the nationalization of the Suez Canal Company in 1956, a 1958 dispute among the City of Tokyo and certain bond holders, and the 1959 nationalization of British assets after a military intervention in 1956. According to Shihata, the President of the World Bank was not prepared to act as an arbitrator of investor–state disputes but was willing to engage in mediation and conciliation.⁴³

Demands on the time of the President and other limitations on the use of the President’s good offices led to a proposal being floated at the Bank’s annual meeting in 1961 to establish an international dispute resolution mechanism specifically for resolving investor–state disputes. Preparatory work was undertaken and by 1964 the Executive Directors of the World Bank authorized the drafting of a convention for this purpose. The Executive Directors and experts representing 61 member countries set to work and in March 1965 a draft Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the “ICSID Convention”) was submitted to member nations for review and approval.⁴⁴

On October 14, 1966, the ICSID Convention (sometimes referred to in the literature as the “Washington Convention”) came into force after being ratified by 20 states. One hundred and fifty-five countries are currently signatories to the ICSID Convention, 144 of which have become contracting states by virtue of having deposited their ratifications, acceptances or approvals. The ICSID Convention seeks to facilitate the free flow of capital in the form of private investment by removing the “non-commercial risks”⁴⁵ associated with foreign direct investment. The primary vehicle for accomplishing this objective is the establishment of the International Centre for the Settlement of Investment Disputes (the “Centre”).

The Centre is established pursuant to Article 1 of the ICSID Convention “to provide facilities for conciliation and arbitration of investment disputes between Contracting States and nationals of other Contracting States in accordance with the provisions of this Convention.”⁴⁶ It does not directly engage in conciliation or arbitration, but rather provides an institutional framework for alternative dispute resolution. The Centre is located in the same place as the principal office

of the World Bank, in Washington, DC. In short, the Convention sought to remove major impediments to the free international flows of private investment posed by non-commercial risks and the absence of specialized international methods for investment dispute settlement.

The Preamble to the ICSID Convention makes clear that agreements or awards produced by conciliation or arbitration constitute binding agreements that must be recognized and implemented. At the same time, the Preamble recognizes that joining the ICSID Convention does not in and of itself mean that a state party has an “obligation to submit any particular dispute to conciliation or arbitration.”

The Centre describes its jurisdictional parameters as follows:

Arbitration and conciliation under the Convention are entirely voluntary, but once the parties have given their consent, neither may unilaterally withdraw it. A further distinctive feature is that an arbitral award rendered pursuant to the Convention may not be set aside by the courts of any Contracting State, and is only subject to the post-award remedies provided for in the Convention. The Convention also requires that all Contracting States, whether or not parties to the dispute, recognize and enforce ICSID Convention arbitral awards.

There are several essential jurisdictional conditions for access to arbitration or conciliation under the ICSID Convention:

- The dispute must be between an ICSID Contracting State and an individual or company that qualifies as a national of another ICSID Contracting State. (ICSID Contracting States may designate constituent subdivisions and agencies to become parties to ICSID proceedings).
- The dispute must qualify as a legal dispute arising directly out of an investment.
- The disputing parties must have consented in writing to the submission of their dispute to ICSID arbitration or conciliation.

Under the ICSID Convention, the Secretary-General is vested with the limited power to “screen” requests for institution of ICSID conciliation and arbitration proceedings, and to refuse registration, if on the basis of the information provided in request, the Secretary-General finds that the disputes is *manifestly* outside the jurisdiction of the Centre.⁴⁷

A detailed analysis of the dispute settlement facilities, including the rules for arbitration, is beyond the scope of this chapter. Much has been written about the jurisdictional limitations imposed on the Centre, such as what constitutes “a legal dispute arising directly out of an investment.” The point for our purposes is that, with the ICSID Convention and the establishment of the Centre, an international institution supported by rules and procedures was finally brought into existence. Harkening back to the words of Professor Brierly, the solution to the problem of finding a suitable forum in investor–state dispute resolution was

found “by allowing individuals access in their own right to some form of international tribunal.” The form of international tribunal turns out to be a form of international arbitration closely modeled on international commercial arbitration.

Arbitration under BITs, MITs and FTAs

We have already seen in an earlier section how developed and developing nations alike have embraced BITs, MITs, and FTAs in order to create favorable trade conditions and to obtain leverage in negotiations with other trading partners. The existence of bilateral and multilateral trade agreements, primarily aimed as they are at reducing or eliminating tariffs and other barriers to free trade, does not fully ameliorate the problems faced by private investors inherent in the vagaries of diplomatic protection and the lack of standing in public international law.

To tackle this problem, most BITs, MITs and, to a lesser degree, FTAs contain dispute resolution provisions. The Office of the United States Trade Representative (USTR), and Executive Office of the President, lists the following six core targets of U.S. BIT policy:

- U.S. BITs require that investors and their “covered investments” (that is, investments of a national or company of one BIT party in the territory of the other party) be treated as favorably as the host party treats its own investors and their investments or investors and investments from any third country. The BIT generally affords the better of national treatment or most-favored-nation treatment for the full life-cycle of investment—from establishment or acquisition, through management, operation, and expansion, to disposition.
- BITs establish clear limits on the expropriation of investments and provide for payment of prompt, adequate, and effective compensation when expropriation takes place.
- BITs provide for the transferability of investment-related funds into and out of a host country without delay and using a market rate of exchange.
- BITs restrict the imposition of performance requirements, such as local content targets or export quotas, as a condition for the establishment, acquisition, expansion, management, conduct, or operation of an investment.
- BITs give covered investors the right to engage the top managerial personnel of their choice, regardless of nationality.
- BITs give investors from each party the right to submit an investment dispute with the government of the other party to international arbitration. There is no requirement to use that country’s domestic courts.⁴⁸

The U.S. has concluded 40 BITs with developing countries based on a model text.⁴⁹ The U.S. 2004 Model Text⁵⁰ contains a detailed dispute resolution process. Readers experienced in commercial arbitration will recognize the similarities of the Model Text to the standard provisions in international commercial contracts.

Article 23 calls for consultation and negotiation as the first step, including non-binding mediation utilizing the good offices of a third party. If either the private investor or the state concludes that the investment dispute cannot be resolved amicably, arbitration can be commenced under Article 24, provided a period of six months has lapsed since the events giving rise to the dispute. The default arbitral institution and rules are ICSID, but the parties are free by mutual agreement to select any other institution or rules. Pursuant to Article 25, consent to arbitrate is given by virtue of having entered into the BIT and such consent shall be deemed to satisfy ICSID jurisdictional requirements, the requirement of an “agreement in writing” under Article II of the New York Convention, and Article I of the Inter-American Convention. Article 26 provides a three year statute of limitations on claims. Three arbitrators are provided for under Article 27 with each party appointing one and the presiding arbitrator being appointed by agreement between the disputing parties.

The parties are free to select the place of arbitration under Article 28. The arbitral proceedings are required to be transparent with the elements of due process (notice, an opportunity to be heard, keeping of minutes/transcripts, and a final order, award and decision by the tribunal) being preserved by Article 29. Interestingly, arbitral proceedings are to be open to the public, with provision being made for the protection of “protected information.” Finally, the tribunal shall apply as governing law:

- a the rules of law specified in the pertinent investment authorization or investment agreement, or as the disputing parties may otherwise agree, or
- b if the rules of law have not been specified or otherwise agreed:
 - i the law of the respondent, including its rules on conflicts of law; and
 - ii such rules of international law as may be applicable.⁵¹

Article 14 of the Agreement between Japan and the Socialist Republic of Viet Nam for the Liberalization, Promotion and Protection of Investment provides in Articles 3 though 6 much the same (albeit in less detail) as the U.S. Model Text:

3. If any investment dispute cannot be settled through such consultation within three months from the date on which the investor requested the consultation in writing, the investment dispute shall at the request of the investor concerned be submitted to either:
 - (1) conciliation or arbitration in accordance with the provisions of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States done at Washington, March 18, 1965 so long as the Convention is in force between the Contracting Parties, or conciliation or arbitration under the Additional Facility Rules of the International Center for Settlement of Investment Disputes so long as the Convention is not in force between the Contracting Parties; or

- (2) arbitration under the Arbitration Rules of the United Nations Commission on International Trade Law, adopted by the United Nations Commission on International Trade Law on April 28, 1976.
4. A Contracting Party which is a party to an investment dispute shall give its consent to the submission of the investment dispute to international conciliation or arbitration referred to in paragraph 3 above in accordance with the provisions of this Article.
5. The decision of arbitration shall be final and binding upon both parties to the investment dispute. This decision shall be executed by the applicable laws and regulations concerning the execution of decision in force in the country in whose Area such execution is sought.
6. So long as an investor of either Contracting Party is seeking judicial or administrative settlement in the Area of the other Contracting Party or arbitral decision in accordance with any applicable previously agreed dispute settlement procedures, concerning an investment dispute, or in the event that a final judicial settlement on such dispute has been made, such dispute shall not be submitted to arbitration referred to in the provisions of this Article.⁵²

Jurisdiction in 63 percent of registered ICSID investor–state arbitrations is established via BITs.⁵³ Thus, it can be said that BITs like the U.S. Model Text or the Japan–Viet Nam Agreement represent the *coup de grace* to state sovereignty in the area of investor–state dispute resolution. Investors no longer require government sponsorship or approval in order to bring claims and they are not required to submit their claims to domestic courts.

Investment disputes and objections to investor–state arbitration

Disputes involving states and foreign investors arise in two main contexts. The first are disputes under what are known as state contracts. A state contract is an agreement entered into by a government, or a state-affiliated entity, and a foreign investor. These contracts can cover a wide range of activities including providing goods and services, lending money, and engaging in large scale infrastructure projects. A common form of the state contract is the concession agreement whereby a foreign investor provides much needed expertise relating extracting, processing and selling natural resources that the state might otherwise not be able to obtain on its own. These state contracts allow governments to obtain needed goods, expertise, and, most importantly in the case of concession agreements, revenue.

The United Nations Conference on Trade and Development (UNCTAD) publication entitled *State Contracts* has this to say about the difference between state contracts and commercial contracts:

State contracts are generally viewed as being different from ordinary commercial contracts. Given the strong public policy considerations that may

underlie governmental contracting, whether in relation to FDI projects or other State sponsored economic functions, an element of public law regulation and governmental discretion is often asserted in relation to the negotiation, conclusion, operation and termination of such contracts.⁵⁴

Additional factors complicating state contracts are regulations pertaining to the authority of governmental entities to enter into contracts (this is usually governed by statute and often there is a requirement for bidding), use of government funds (not infrequently it is the executive who will enter into the agreement but the legislative branch that must fund state obligations), the capacity of state actors to enter into legally binding obligations (this can be a particularly difficult issue when governments change), and the overriding demands of public policy and national interest. UNCTAD notes that many contracts in this category have come to be seen as “economic development agreements” and, as such, their validity at least as to formation must be judged under host country law. International investment agreements are often deemed not to be applicable to alleged breaches of state contracts. In the words of UNCTAD, international investment agreements:

are not normally designed to protect an individual contract, which is left for the parties to negotiate, but to ensure the stability of the operating structure of the investment within the host country (which may include investments covered by State contracts).⁵⁵

The second category arises not from the breach of a state contract *per se* but, rather, as the result of political and/or economic developments beyond the four corners of a specific investment contract. The foreign investor’s expectation of receiving national treatment, or compliance with an investment authorization is frustrated by government action or inaction. These disputes fall into four broad categories as follows: (1) expropriation; (2) less favorable treatment than nationals or other third country nationals (most favored nation treatment); (3) restrictions on the ability to repatriate funds; and (4) just compensation for damages as a result of war, insurrection, riot and the like. All of these clearly have the potential to wipe out a foreign investment. Nonetheless, the international commercial agreement model of arbitration does not fit comfortably given the inherently public nature of the state action leading to the dispute.

Dissatisfaction with investor–state arbitration in developing countries has been growing, primarily among Latin American countries. Bolivia⁵⁶ was the first country to withdraw its ICSID membership when it filed a notice on May 2, 2007, pursuant to Article 71 of the Washington Convention. Nicaragua and Venezuela have threatened to follow suit.

The primary objections appear to be twofold, one principled and the other less so. The first contends that privatization of dispute resolution is inconsistent with the public law nature of dispute resolution. The second comes from a perception that Latin American countries are bound to lose in private arbitration. This latter

assertion does not appear to be supported by the evidence and would not, in any event, provide an adequate justification for abandoning the ICSID regime.⁵⁷

Professor Sornarajah's chapter appearing in this volume is illustrative of the assault on the privatization of investor–state dispute resolution from the perspective of the right to development. The arguments are not without merit and they point out some legitimate concerns with the present system. Nevertheless, to the extent we are prepared to conclude that the system has shown fault lines, reform cannot reside in returning to the days when investors were shut out from unbiased *fora* and left to the vicissitudes of international politics.

The right to development is undoubtedly important and deserving of protection. But, it is neither fair nor balanced to give such a right (especially as ill-defined as it is) primacy over the legitimate interests of investors to due process, transparency and the protections associated with the concept of the Rule of Law. The difficulty comes when two absolutes are set up in opposition to each other in what amounts to a zero sum game, instead of cast in terms of win–win.

The ICSID regime is premised on the principle of consensual agreement to private arbitration via BITs, MITs and FTAs. Countries that do not want to risk submitting the legality of their behavior to neutral, albeit private, dispute resolution can elect not to enter into these agreements. This would involve making an informed cost-benefit analysis to determine whether the nation is best served by joining an international regime characterized by transparent rules and procedures, or retaining the maximum degree of autonomy and national sovereignty by remaining outside of the system. Nations are not required to join, but having elected to do so they should be bound by an equally fundamental principle of international law, to wit, *pacta sunt servanda*. Tweaking the system as it has unfolded will be far more productive than calling for a return to an age when states were free to disregard their obligations virtually at will.

Conclusion

The history of investor–state dispute resolution is one of private investors seeking Brierly's "access in their own right" to a forum capable of protecting commercial rights. Diplomatic protection failed to provide the needed certainty, predictability and fairness. At the same time, fundamental notions of standing in international law shut off recourse to international institutions such as the ICJ.

The failure of public international law to provide the legal framework and infrastructure required to support foreign direct investment necessitated the move towards a model based on private commercial arbitration. There will be flaws in the system and nations that lose disputes will feel the bite of having their sovereignty restrained. In the end, however, a system premised on the protection of private rights has the best chance of bringing long-term benefits to investor and state alike.

Notes

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- 1 It can be argued without too much hyperbole that FDI and globalization have contributed to world peace mainly as a result of the growing interdependence of economies. According to U.S. Treasury statistics, the top five foreign holders of U.S. government securities at the end of May 2010 in billions of dollars were China (\$867.7), Japan (\$786.7), the UK (\$350), the Oil Exporter Countries of Ecuador, Venezuela, Indonesia, Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates, Algeria, Gabon, Libya and Nigeria (\$235.1), and the Caribbean Banking Centers of the Bahamas, Bermuda, Cayman Islands, Netherlands Antilles and Panama (\$165.5). The total of all U.S. government debt held by foreign holders was \$3.97 trillion out of \$12.8 trillion. Available online at: www.ustreas.gov/tic/mfh.txt (last accessed on July 19, 2010). In the first four months of 2010, Chinese investors reportedly purchased the yen equivalent of approximately \$6.2 billion in Japanese government bonds. This was over two times the total amount of bonds purchased for the full year of 2005. The fact that countries are now linked more than ever by economic interdependence does not, of course, mean that war is a thing of the past. Economic competition for scarce and vital natural resources can heighten tension and some predict that future wars will be fought over a range of resources necessary for economic and human survival. See, for example, www.worldwaterwars.com/.
- 2 Of particular note in this regard, is the battle developing countries have fought with the pharmaceutical industry to ensure that life-saving drugs are made available at affordable prices notwithstanding the asserted primacy of intellectual property rights. See, e.g., Gumisai Mutume, "Health and 'intellectual property'" reprinted from *Africa Recovery*, Vol. 15 #1–2 (June 2001), page 14 and available online at: www.un.org/ecosocdev/geninfo/afrec/vol.15no1/151aids8.htm (last accessed on August 5, 2010).
- 3 See, www.state.gov/e/eeb/rls/othr/ata/j/ja/133510.htm (last accessed on July 19, 2010). For a simple explanation of the nine air freedoms see, www.crossingtheskies.com/the-freedoms-of-the-air/ (last accessed on July 19, 2010).
- 4 Although it is beyond the scope of this chapter, it is worth noting that even the definition of a multinational enterprise can be less than clear. To the extent the term suggests that MNEs are without a core sense of national identity it is a misnomer. MNEs such as Toyota, Nokia, Philips, Sony, Panasonic, GE, IBM, McDonald's, Microsoft and their like are MNEs by virtually every definition. At the same time, each unquestionably possesses the DNA of the nation where its ultimate parent company is headquartered.
- 5 John O. Haley, *Authority without Power* (Oxford University Press, 1991) ("Although regarded as natural in earlier eras when law was personal and legal rights and duties integral to nationality or religious identity, extraterritoriality during the nineteenth century reflected self-congratulatory judgments in the West that theirs were the 'civilized' systems of law. It followed logically that they should therefore claim protection for their nationals from inferior systems even beyond the territorial reach of national sovereignty.") at p. 68.
- 6 This issue is not unique to international disputes. Federal systems such as the United States provide for diversity jurisdiction in the federal courts so that a citizen of one state with a dispute in excess of \$75,000 will not be required to litigate in the state court of a defendant from another state. See, 28 U.S.C. § 1332.
- 7 By focusing on dispute resolution, there is a risk of drawing the false conclusion that disputes between developing countries and foreign investors are the norm rather than the exception. This is not the case. Trillions of dollars are invested annually across borders with both private investors and states obtaining the anticipated benefits.
- 8 Available online at: www.marad.dot.gov/documents/FCN_japan.pdf (last accessed on July 25, 2010).

- 9 See, www.state.gov/s/l/c7344.htm (last accessed on July 25, 2010).
- 10 Another variant is the Economic Partnership Agreement (EPA) that was favored at one point by Japan.
- 11 UNCTAD, “Key Terms and Concepts in IIAs: A Glossary,” available online at: www.unctad.org/en/docs/iteiit20042_en.pdf (last accessed on August 3, 2010). According to the Japan External Trade Organization (JETRO), Japan was a party to 180 trade agreements as of January 1, 2010. Of this number, 114 were entered into after 2000 and 63 after 2005. *The Nikkei Weekly*, “In FTA era, it’s sign or be left behind” (June 28, 2010), page 25. Recently, Japan has been discussing the possibility of forming an FTA with China and Korea that could later be expanded to include additional Asian countries.
- 12 *Id.*
- 13 Mainland Affairs Council, Economic Cooperation Framework Agreement (ECFA) Background, at p. 1, available at: www.mac.gov.tw/public/data/051116322071.pdf (last accessed on August 30, 2010).
- 14 This Framework Agreement was entered into between ASEAN and China in Phnom Penh on November 4, 2002. The text is available at: www.aseansec.org/13196.htm (last accessed on August 30, 2010).
- 15 See, *The Nikkei Weekly*, “Taiwan gears up for free trade pacts,” September 13, 2010, at p. 15.
- 16 *The Panevezys–Saldutiskis Railway Case*, Judgment No. 29 of 1938. Available online at: www.worldcourts.com/pcij/eng/decisions/1939.02.28_panevezys-saldutiskis/, at page 14 (last accessed on April 18, 2010).
- 17 In the broader context of international law, there is a growing recognition of the right of all states to intervene in the territory of failed states in order to protect the basic human rights of all people living there. The existence of such a right remains controversial and cannot be said to have achieved enough acceptance to amount to a rule of customary international law at this time. It certainly has not achieved a level of acceptance such as to protect commercial interests.
- 18 As the ICJ wrote in *Barcelona Traction*:
- Diplomatic protection deals with a very sensitive area of international relations, since the interest of a foreign State in the protection of its nationals confronts the rights of the territorial sovereign, a fact of which the general law on the subject has had to take cognizance in order to prevent abuses and friction. From its origins closely linked with international commerce, diplomatic protection has sustained a particular impact from the growth of international economic relations, and at the same time from the profound transformations which have taken place in the economic life of nations.
- Barcelona Traction*, Judgment of 24 July 1964. Available online at: www.icj-cij.org/docket/index.php?p1=3&p2=3&k=1a&case=50&code=bt2&p3=4PHPSESSID=63ee30ffa13f5c7d5d48bdf8e56f472d (last accessed on July 25, 2010).
- 19 Article 3, paragraph 1 (b) of the Vienna Convention on Diplomatic Relations 1961 lists among the functions of a diplomatic mission: “Protecting in the receiving State the interests of the sending State and of its nationals, within the limits permitted by international law.” Available online at: http://untreaty.un.org/ilc/texts/instruments/english/conventions/9_1_1961.pdf (last accessed on July 25, 2010).
- 20 The flip side of this problem is the intentional incorporation of subsidiaries in countries with favorable BITs and MITs in place with the target country of investment.
- 21 *Barcelona Traction Case*, *supra* note 14 at paragraphs 78 and 79.
- 22 J.L. Brierly, *The Law of Nations: An Introduction to the International Law of Peace* (6th edn, Oxford at the Clarendon Press, 1963, edited by Sir Humphrey Waldock) at p. 276.
- 23 *Id.* at p. 277.

24 *Id.* at pp. 277–78.

25 Article 34, Paragraph 1, The Statute of the International Court of Justice. Available online at: www.icj-cij.org/documents/index.php?p1=4&p2=2&p3=0 (last accessed on April 24, 2010).

26 Article 36, Paragraph 2 of the ICJ Statute provides that:

“The states parties to the present Statute may at any time declare that they recognize as compulsory *ipso facto* and without special agreement, in relation to any other state accepting the same obligation, the jurisdiction of the Court in all legal disputes concerning:

- a. the interpretation of a treaty;
- b. any question of international law;
- c. the existence of any fact which, if established, would constitute a breach of an international obligation;
- d. the nature or extent of reparation to be made for the breach of an international obligation.”

Paragraph 3 of Article 36 provides that declarations may be unconditional or on the condition of reciprocity and may be for a limited period of time.

27 The Court rejected the argument that Canada’s failure to exercise its right could convey authority on some other state holding that: “Since the claim of the State is not identical with that of the individual or corporate person whose cause is espoused, the State enjoys complete freedom of action. Whatever the reasons for any change of attitude, the fact cannot in itself constitute a justification for the exercise of diplomatic protection by another government, unless there is some independent and otherwise valid ground for that.”

28 The ICJ issued a decision on the First Phase of the case in 1964, on jurisdictional issues not relevant to this discussion, and allowed the case to proceed.

29 *Barcelona Traction, supra*, note 14.

30 In the era of BITs, international commercial lawyers are careful to advise their clients seeking to do business in countries where the risk of expropriation or other potentially harmful government action is possible to be certain to do their business in the host country through a subsidiary incorporated in a nation that is a party to a BIT with the host state. This strategy helps to averts any argument that the right of diplomatic protection, apart from direct treaty rights under the BIT, is not available.

31 The Treaty violation allegation relates to Article III of the FCN Treaty which gives nationals, corporations and associations of either nation the right “to organize, control and manage corporations and associations” in the other’s territory. In effect, the requisition order interfered with ELSI’s ability to manage its own orderly liquidation.

32 The U.S. also alleged violations relating to the Italian government’s failure to stop the occupation of the ELSI plant, for interfering with the procedures to overturn the requisition order and the bankruptcy procedures to the end that delay would result in the assets being available for purchase at a price far less than their fair market value.

33 See, www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html (last accessed on September 26, 2011).

34 New York Convention, Article II.

35 New York Convention, Article III. Article IV list the following seven reasons for declining to recognize and enforce an arbitral award: (1) the parties are under some kind of incapacity or the agreement is invalid; (2) the party against whom the award is to be enforced was not given proper notice of the appointment of the arbitrator, or of the arbitral proceedings or was otherwise unable to present its case; (3) the award deals with a matter not within the scope of the agreement to arbitrate; (4) the composition of the arbitral tribunal or the procedures were not within the agreement to arbitrate.

- trate; (5) the award is not final; (6) the subject matter of the award is not capable of being resolved by arbitration under the law of the country of recognition; and (7) the award violates public policy.
- 36 It should be noted that the Hague Conference on Private International Law has prepared a Convention on Foreign Judgments in Civil and Commercial Matters of 1971, dealing with the issue of recognizing and enforcing foreign judgments. As of this writing, however, only four states have joined the Convention. See, http://hchc.e-vision.nl/index_en.php?act=conventions.status&cid=78. The distinction between recognition and enforcement can be summarized simply by stating that the former gives the arbitral award the effect of *res judicata* as to the matter under dispute, while the latter allows the prevailing party to seek to obtain the benefit of the award against the losing party.
 - 37 www.hktdc.com/info/vp/a/profs/en/1/4/1/1X006N9U/Professional-Services/Arbitration-and-Mediation.htm (last accessed on September 26, 2011).
 - 38 www.iccwbo.org/court/arbitration/index.html?id=34704 (last accessed on September 26, 2011).
 - 39 In response to scheduling problems experienced by parties as a result of the relatively small number of well-known international arbitrators being regularly nominated by the international arbitration bar, the International Court of Arbitration of the International Chamber of Commerce has required since 2009 that potential arbitrators state not only their willingness to accept an appointment and their ability to be independent but also their availability. The ICC now requires potential arbitrators to list pending cases they are handling and to confirm their ability to spend the time necessary to handle cases in an efficient and timely manner. The ICC Commission on Arbitration in its “Techniques for Controlling Time and Costs in Arbitration” recommends as follows: “Whether selecting a sole arbitrator or a three-person tribunal, it is advisable to make sufficient enquiries to ensure that the individuals selected have sufficient time to devote to the case in question.” Available online at: www.iccwbo.org/uploaded-Files/TimeCost_E.pdf (last accessed on July 3, 2010).
 - 40 *Mitsubishi Motors v. Soler Chrysler-Plymouth*, 473 U.S. 614, 639–40 (1985).
 - 41 The World Bank’s Articles of Agreement are available online at: <http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20049563~pagePK:43912~menuPK:58863~piPK:36602,00.html#I1> (last accessed on July 3, 2010).
 - 42 Ibrahim F.I. Shihata, “The settlement of disputes regarding foreign investment: the role of the World Bank, with particular reference to ICSID and MIGA” 98 *Am. U.J. Int’l L. & Pol’y* Vol. 1:97 at p. 98. Mr. Shihata recounts a number of instances where the Bank was called upon to assist in resolving investment disputes, among them being the nationalization by Iran of the assets of the Anglo-Iranian Oil Company in 1951–1952, the nationalization of the Suez Canal Company in 1956, a 1958 dispute among the City of Tokyo and certain bond holders, the 1959 nationalization of British assets after a military intervention in 1956.
 - 43 *Id.* at pp. 99–100.
 - 44 *Id.* at p. 101.
 - 45 About ICSID, available at: http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=AboutICSID_Home (last accessed on July 5, 2010).
 - 46 The ICSID Convention is available online at: <http://icsid.worldbank.org/ICSID/Static-Files/basicdoc/partA-chap01.htm> (last accessed on July 5, 2010).
 - 47 ICSID Dispute Settlement Facilities, available at: http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=RightFrame&FromPage=Dispute%20Settlement%20Facilities&pageName=Disp_settl_facilities (last accessed on July 5, 2010).
 - 48 See, www.ustr.gov/trade-agreements/bilateral-investment-treaties (last accessed on August 30, 2010).

- 49 See, http://tcc.export.gov/Trade_Agreements/Bilateral_Investment_Treaties/index.asp (last accessed on August 30, 2010).
- 50 Full text available at: http://ustraderep.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf (last accessed on August 30, 2010).
- 51 Model Text, Article 30, paragraph 2.
- 52 Text available at: www.mofa.go.jp/region/asia-paci/vietnam/agree0311.pdf (last accessed on August 30, 2010).
- 53 The ICSID Caseload—statistics available on-line at: <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&CaseLoadStatistics=True&language=English12>, p. 10 (last accessed on August 30, 2010).
- 54 United Nations (New York and Geneva, 2004), *State Contracts I*, available online at: http://www.unctad.org/en/docs/iteit200411_en.pdf.
- 55 *Id.* at p. 6.
- 56 See, <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Announcement3> (last accessed on September 26, 2011).
- 57 For an excellent empirical exploration of this assertion, see, Susan D. Franck, “Development and outcomes of investment treaty arbitration” 50 *Harv. Int’l L.J.* 435 (2009). Professor Franck concludes as follows:

The overall results of the various statistical analyses demonstrate that, irrespective of the definition of development status, there was no statistically significant relationship among the development status of the respondent, the development status of the presiding arbitrator, and outcome. This held true for both (1) winning or losing an investment treaty arbitration, and (2) the amounts tribunals awarded.

Id., at p. 17.

12 Thailand and legal development

*Lawan Thanadsillapakul**

Introduction

The changing global legal and institutional framework governing the economic relations of nation states is the result of multilayered regulations made among those states in different spheres and at different levels. These have been enhanced by the ideology of neo-classical¹ economic theory, which has facilitated a process of global liberalization. This process is, in turn, propelled by the rapid advancement of technology.² Scientific and technological development mobilizes knowledge and innovation around the world, thus encouraging the standardization of intellectual property rights protection.³ However, the creation of a high standard of IP protection has led to a conflict between developed and developing countries on the relationship between IP protection and human rights.⁴

The failure or suspension of the Doha Trade Negotiation Round⁵ has caused developed countries to resort to the creation of FTA networks to maintain economic ties based on preferential trading arrangements with their developing trading partners. This phenomenon reflects, on one hand, the interdependence between developed and developing countries. On the other hand, it also reflects the need to strengthen the legal development of developing countries in order to accommodate such changes. There has recently been a surge in the number of FTA networks and clusters around the world.⁶ Thailand is also moving in this direction in order to ensure that the country can survive in the competitive global market. Law and development is an essential issue for the country's challenging road ahead.

The focal points of law and development in Thailand are what strategies should be employed, how goals can be achieved, and how Thailand can integrate itself into the global market so as to benefit from liberalization. This chapter will show the interaction of institutions, law, economic policy, and market function. All these ingredients have harmoniously played an important role in the strategic economic development of Thailand and other countries in the Asian region as they experienced rapid economic growth over the past four decades.

The role of law and economic development, the theoretical legal background, and institutional reforms that facilitate the globalization process have been hotly debated issues. The dynamic of universalism and regionalism has come to the

fore. Various schools of thought reflect the different viewpoints and perspectives that influence policy options and the implementation of legal reforms geared towards the ideological and economic development paradigm⁷ adopted by each country and region.

In Asia, a *de facto* Asian regionalism has been created by default. Currently, the innovative ASIAN Charter⁸ is in the process of being drafted separate from the ASEAN Charter. Asian regionalization encompasses the East Asian countries plus ASEAN members for the purpose of strengthening Asian economic regionalism and cushioning any negative impacts of global liberalization. The uniqueness of Asian regionalism reflects a new paradigm of legal and economic development paralleling the globalization process. Some might argue that the fragmentation of the global market is a result of the creation of various stumbling blocks while others argue that regionalization enhances the global liberalized market. This requires a deep understanding of the function of the market and the nature of state sovereignty. Is globalization a means of convergence and uniformity across nations and, if so, what is its ultimate goal? Do states have strategic options open to them to protect themselves from the global business sector if they so need? We now turn to a discussion of the rule of law and economic development in order to examine the interplay between law and economics in a development process that relates to global economic structure, globalization and regionalization. All of these elements provide an opportunity for Asian countries, including Thailand, to employ strategic legal and economic development in the pursuit of economic welfare goals.

The following part focuses on a discussion of the rule of law and economic development and an analysis of the relationship between the two. This will then lead into a discussion of the rationale behind the strategic legal development employed in Asia and ASEAN—in which Thailand is a member country—that also influences the direction of law and economic development in Thailand.

The rule of law and economic development

Law and economics can be defined as the application of economic theory and the basic concept of welfare economics in order to examine the formation, structure, process, and economic impact of law and legal institutions.⁹ Social norms and law and economics have been significantly interrelated with each other, and form the environment in which human beings individually, and the state and global community commonly, interact in economic, social, and political activities governed by legal and institutional frameworks. These harmoniously balanced factors create a welfare society, in which society exists; in turn such a favorable environment facilitates the creation of factor markets and product markets for the individual consumption of goods and services, and the effective allocation of scarce resources directed by the reasonably wise choices of consumers and producers.

The most influential proponents of law and economics theory, such as Richard Posner and Oliver Williamson and the so-called Chicago School of Economics

and lawyers including Milton Friedman and Gary Becker, are generally advocates of deregulation and privatization, and are hostile to state regulation or what they see as restrictions on the operation of free markets.¹⁰ The most prominent economic analyst of law is 1991 Nobel Prize winner Ronald Coase. His first major article, *The Nature of the Firm* (1937), argued that the reason for the existence of firms (companies, partnerships, etc.) is the existence of transaction costs.¹¹ Rational individuals trade through bilateral contracts on open markets until the costs of transactions mean that using corporations to produce things is more cost-effective.

His second major article, *The Problem of Social Cost* (1960), argued that if we lived in a world without transaction costs, people would bargain with one another to create the same allocation of resources, regardless of the way a court might rule in property disputes.¹² Coase used the example of the nuisance case *Sturges v. Bridgman*, where a noisy sweet maker and a quiet doctor were neighbors and went to court to see who should have to move.¹³ Coase said that regardless of whether the judge ruled that the sweet maker had to stop using his machinery, or that the doctor had to put up with it, they could strike a mutually beneficial bargain about who moves house that reaches the same outcome of resource distribution. Only the existence of transaction costs may prevent this.¹⁴ So the law ought to pre-empt what *would* happen, and be guided by the most efficient solution. The idea is that law and regulation are not as important or effective at helping people as lawyers and government planners believe.¹⁵ Coase and others like him wanted a change of approach, to put the burden of proof for positive effects on a government that was intervening in the market, by analyzing the costs of action. Economists require deregulation and free markets. They prefer the effectiveness of the allocation of resources in a market economy without any laws or regulations that distort free trade. Law is less important in this world perspective. On the other hand, the sociology of law remains highly relevant to social institutions.

Globalization and economic growth

Economic Globalization is a movement towards greater interaction, economic integration, liberalization and interdependence among people and organizations across national borders. The strongest manifestation of liberalization and globalization has been the increase in economic interactions among countries in trade and investment and in the international flows of capital, people, technology, and information.¹⁶ But globalization is also evident in the increasing levels of international political interaction and widespread social and cultural interchange that have occurred over the past quarter of a century.¹⁷

Dennis stated that economic liberalization and globalization has brought both benefits and challenges to countries around the world.¹⁸ Globalization brings not only new economic opportunities but also new political, social, technological, and institutional complexities, especially to poorer countries, which governments must address in order to stimulate economic competitiveness while pursuing

equity, sustainability, and poverty alleviation. In order to benefit from more open and widespread economic interaction, states must create and support an economic system that promotes and facilitates the ability of business enterprises to compete effectively in international markets.

According to the World Bank Report, the most recent surge of economic globalization, beginning at the end of World War II and accelerating in the early 1980s, was driven first by trade, then by foreign direct investment and now by both pervasive trade and investment accelerated by technological advances in communications and transportation. Between 1990 and 2000, trade in goods as a percentage of world GDP increased from 32 percent to 40 percent. Countries at all levels of income, on average, increased their participation in international trade and foreign direct investment (FDI). Gross FDI also increased as a percentage of GDP worldwide from 2.7 percent to 8.8 percent.¹⁹ The economic growth of many developing countries has been closely associated with the shift from inward-looking protectionist development strategies to outward export-oriented liberal trade strategies. Those countries that have diversified their exports and opened their economies to imports and investment have grown faster than countries that maintained protectionist policies or that continued to export only basic commodities and raw materials.²⁰

The manufacturing export shares of developing countries increased from about 5 percent in 1913 to nearly 25 percent in 1994. It is important to recognize developing economies as increasingly important players in the global trading system. Their share of world merchandise exports rose from 15 percent in 1990 to 31 percent in 2008.²¹ An important phenomenon is that merchandise trade within regions remains greater than trade between regions. For instance, in 2009, trade within Europe represented 72 percent of European trade. Fifty-two percent of Asia's exports remained within Asia. Some 48 per cent of North America's exports remained in North America.²² All regions of the world saw growth in manufactured exports, although countries within regions differed drastically in their rates of growth.

By the 1990s, economic globalization was being driven more by foreign direct investment (FDI) than by trade. Total world inward and outward FDI grew from 10 percent of world GDP in 1980 to 31 percent in 1999. The accumulated stocks of inward FDI increased from about \$14 billion in 1914 to about \$2.5 trillion in 1995, and to more than \$6.8 trillion in 2001.²³ However, the global FDI flows reached over 1.2 trillion U.S. dollars in 2010 before picking up to 1.3–1.5 trillion U.S. dollars in 2011. The year 2012 is expected to see the rise to 1.6–2 trillion.²⁴ Developing and transition economies absorb nearly half of global FDI inflows in 2000–2009. On the other hand, the share of FDI outflows is on the rise (25 percent), compared to 19 percent in 2008 during 2000–2009. We, therefore, see developing economies strengthening their global position²⁵

Both trade and investment were driven by the expansion of transnational corporations (TNCs). TNCs play a critical role in the new economic landscape. The constant growth is evident. Parent TNCs from developing and transition economies accounted for more than a quarter of the 82,000 TNCs (28 percent)

worldwide in 2008. This compares to a share of less than 10 percent in 1992. The sales of foreign affiliates doubled during the same period from \$6.4 trillion to \$18.5 trillion, growing to twice the size of world exports. The total assets of TNCs' foreign affiliates grew from \$8.3 trillion in 1996 to nearly \$25 trillion in 2000. The gross product (value of output) of TNC parents and affiliates grew to \$8 trillion in 1999, accounting for about 25 percent of world GDP. Despite the setback in 2008 and 2009, an estimated 80 million workers were employed in TNCs' foreign affiliates in 2009, accounting for about 4 percent of the global workforce.

Furthermore, in the domain of FDI, we see the increasing importance of "new actors" in the form of special funds, such as private equity funds and sovereign wealth funds. Special funds' combined FDI reached 129 billion (106 billion for private equity funds) and 23 billion for sovereign wealth funds—accounting for over one tenth of global FDI, up from less than 7 percent in 2000.

Most international economic studies conclude that the shift toward a more competitive global economy that accelerated in the early 1990s, and the opening of more countries' markets to world trade and investment over the past 50 years benefit not only richer nations but also developing countries that open their markets and those in transition from government-controlled economies to market systems. According to the World Investment Report 2010, foreign affiliates' share in global gross domestic product (GDP) reached a historic high of 11 percent.²⁶ OECD concludes that countries which opened their markets to international trade and investment have achieved double the average economic growth of those that did not. Open market economies have higher investment ratios, better macro-economic balance, and stronger private sector roles in economic development than do non-market countries.²⁷ The OECD's studies also indicate that freer and more open market economies can bring both economic and social benefits to countries at all levels of development.

Among the potential benefits are:

- 1 greater freedom of choice for individuals about what to buy and sell and at what price, where to obtain inputs, where and how to invest, and what skills to acquire;
- 2 comparative advantages in world trade that allow individuals and businesses to prosper by using their resources to do well compared to others;
- 3 higher incomes to those employed in jobs producing goods and services for international markets;
- 4 greater freedom for individuals to engage in specialization and exchange;
- 5 lower prices and a greater availability of goods and services;
- 6 opportunities to diversify risks and invest resources where returns are highest;
- 7 access to capital at the lowest costs;
- 8 more efficient and productive allocation of resources;
- 9 greater opportunities for firms to gain access to competitive sources of materials and inputs; and
- 10 inward transfer of technology and know-how.²⁸

The problems of market- and policy-failure

Economic liberalization, however, does not confer benefits on all countries automatically, nor does it generate benefits free of cost. All of the market failures that can occur in domestic economies also appear in the global economy. In reality, markets do not always operate as they are supposed to in theory. When they deviate from fundamental principles, market failures can produce economically and socially undesirable consequences. Even in the most advanced economy there are failures and imperfections. There are many obstacles that prevent a community's resources from being distributed among different user or occupations in the most effective way.²⁹

Dennis further argues that "market failures occur when consumers and producers do not bear the full costs of their actions, when prices do not reflect social costs and benefits, when consumers are manipulated or misled by advertising or do not have access to appropriate or sufficient information to make good economic decisions, and when unfair trading practices prevent prices from being set by market signals. Moreover, adjustments in market economies can produce cycles of economic decline, financial crises, and recessions or depressions, casting some groups of people into poverty. Strong inequalities in the distribution of income can put a large segment of the population at an economic disadvantage, preventing them from participating in or benefiting from market processes. Some segments of the population—the unskilled, the physically or mentally disabled, the aged, and those suffering from serious health problems, for example—may not be able to earn sufficient amounts of income to participate at all.

Firms acting in their own self-interest may exploit natural or common resources or dispose of their environmentally-harmful wastes without regard for human health or welfare and without paying the costs of the damage to the physical environment, thereby shifting costly burdens to society. But, often, what are called "market failures" are really "policy failures;" the problems result from either the unwillingness or the inability of governments to enact and implement policies that foster and support effective market systems and prevent countries from participating in world trade and investment. One example of policy failure often attributed to worldwide economic competition is the widespread inequality in the distribution of wealth and income which results in high levels of poverty.

The United Nations Development Programme's *Human Development Report* notes that nearly three billion people live in relative poverty on incomes of less than \$2 a day and that more than 1.4 billion people now live in absolute poverty based on a new poverty line of \$1.25 per day.³⁰ The social impacts of absolute poverty are devastating. In the poorest countries, about 20 percent of children die before their first birthday and nearly half of those who survive are malnourished. A significant percentage of the population in poor countries does not have access to clean water, sanitation facilities, basic health services, or adequate education. Most of those living in poverty do not have the opportunity to participate effectively in a market economy or to benefit from it. This state of affairs has to

be viewed critically when one considers the ambitious goal set forth in the United Nations Millennium Development Goals to eradicate poverty in the world by 2015.

Many of the political, economic, social and physical ills that are now attributed to globalization plagued the world long before the current cycle of globalization began. The problems often attributed to globalization may, in fact, be due to the failure of states to create the competitive national market systems that allow individuals and organizations to participate effectively in global trade and investment. It is now time to vigorously tackle the most important factors of competitive development, namely, capacity building and human resources development.

Legal framework for economic development

A rule is substantively efficient if it sets forth a precept that internalizes an externality, or otherwise fosters the efficient allocation of resources. A rule is procedurally efficient if it reduces the cost or increases the accuracy of using the legal system. Based on this presumption, Asian countries resort to the principle of efficient allocation of economic factors to maximize benefits of *the economy of scale* and the open market using multidisciplinary economic approaches, adjusting their economies to legal and institutional changes at the global level. Asian strategic economic development is therefore based on multidisciplinary economic approaches that relate to the regional socioeconomic infrastructure and influence legal development and legal reforms facilitating economic growth. This further encourages and enhances the regional economic pattern of idealistic de facto regionalism and regulatory networks for the implementation of concerted liberalization of trade and investment in an “Asian way.”

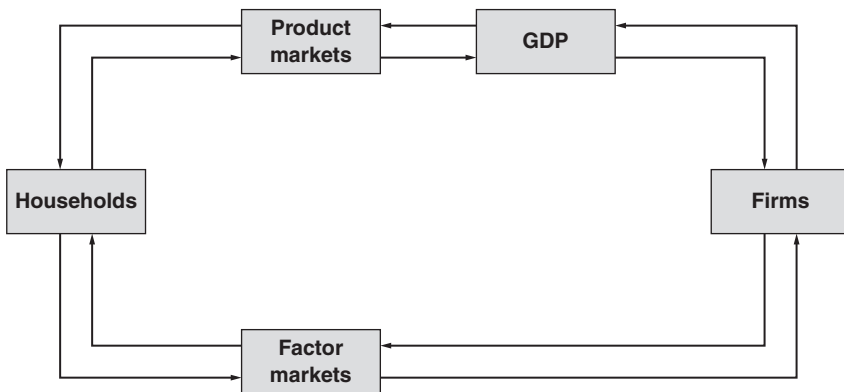


Figure 12.1 The circular flow of economic activity and the concept of efficiency (source: Mercurio, Nicholas and Medema, Steven G. (2006) *Economics and the Law* (Princeton and Oxford: Princeton University Press) at p. 21).

The ideal state of the economy is one of perfect competition. The purely competitive, perfectly functioning market has the following characteristics:

- 1 a large number of buyers motivated by self-interest and making the choices they expect will maximize their utility;
- 2 many sellers, also motivated by self-interest, and acting to maximize their profits;
- 3 individual buyers and sellers are unable to exert any control over market prices and are thus price takers;
- 4 prices serve as the guideposts for decision makers in the market to, among other things, communicate scarcity;
- 5 products are standardized, i.e., homogeneous;
- 6 there are no barriers to entry or exit, which means that consumers and producers are free to enter or leave all product and factor markets;
- 7 all buyers and sellers are fully informed as to the terms of all market transactions;
- 8 resources are held in private property with all rights defined and assigned;
- 9 prevailing laws and property rights are fully enforced through the state.

The circular flow diagram in Figure 12.1 shows the interrelationships and flows inherent in a perfectly competitive economy. The privately owned, scarce factors of production—land, labor and capital—are allocated through factor markets to firms that, in turn, produce goods and services to satisfy the demands of consumers. The prime concern is allocative efficiency. That is, with (i) the extent to which the allocation of inputs within the productive process results in the production of the combination of outputs that best satisfies the economic wants and desires of the individuals in society, and (ii) the extent to which the allocation of these outputs across the individuals in society generates the highest possible level of social well-being. If all factors of production and all goods and services are bought and sold in perfectly competitive markets, the outcome generated can be shown to be efficient. That is to say that the optimal amounts of land, labor, and capital goods will be allocated to the production of each and every commodity, resulting in the optimal output of each good and service so as to satisfy the desires of individuals and society as a whole. This means that the resources cannot be allocated so as to make one individual better off without making someone else worse off.

From society's perspective, the most efficient level of any activity is attained when that activity is engaged in up to the point where the marginal social benefit is just equal to the marginal social cost. Assuming that the market sector is society's sole means of social control for the allocation of society's scarce resources, all decisions are made by individual consumers and producers attempting to maximize utility and profits, respectively. The effect of this maximization process is that producers and consumers make their choices based on a weighing of marginal benefits and costs—that is, comparing the additional benefit from engaging in another unit of an activity with the additional cost of doing so.

Strategic economic development in Asia and the changing global legal and institutional framework

Over the past four decades, the success of East Asian economies in achieving rapid and equitable growth raised complex questions about the relationship between government, business firms and the market, and the interaction between laws, institutions and the economic policy used in East Asian countries. There was no single theory to explain the extraordinary growth of this region. Rather, successful outcomes had been achieved under a spectrum of policies and circumstances. The combinations of factors suitable for each economy and the favorable external environment during that period (1960s–1990s) were all ingredients of the success of East Asian economies.

Explanations for this phenomenon have been diverse and based on different theories. Neo-classical approaches³¹ have emphasized outward orientation and macroeconomic discipline; structuralist theories³² have pointed to government leadership in industrial policy and promulgating favorable laws and regulations for foreign investment; and finally, culturalist explanations have centered on governance and societal characteristics, as shaped by the region's Confucian traditions.³³ Confucian tradition stresses self-improvement and emphasizes education and facilitative bureaucratic control. In addition to these theories, an explanation based on the so-called "contagion of regional success" resulting from the "Flying Geese" economic pattern spearheaded by Japan has been broadly recognized as a cause of the East Asian miracle³⁴ due to economic proximity, intra-regional integration in East Asia and the strategic location of the countries in this region. Also, in this region, governmental intervention had an important influence on the process of industrialization, evolving from an import substitution to an export-oriented policy and moving towards an open or market orientation. Government intervention, economic policies, and the laws were therefore able to harmoniously play an important role in the process of industrialization in East Asian countries and enable these countries to take off in the international business sphere. Through these strategies ASEAN countries and the economies of East Asia were able to achieve a high rate of economic progress propelled by trade and the flow of investment into the region.

But the implications of the global environment are changing: while both neutral and interventionist outward oriented strategies worked well during the early East Asian miracle, it is doubtful whether all these strategies are still effective, as some are now prohibited under WTO regulations and others require revision. Today, East Asian exporters are increasingly pressured to follow trading rules negotiated under the WTO. More seriously, the increasing sophistication of East Asian industry has also made it difficult to pursue strategies that rely on importing technology through licensing rather than foreign investment. Although, there has been much foreign investment in East Asian countries, medium and small-scale firms, which also play an important role in each economy, generally rely on the transfer of technology through the traditional process of licensing. But firms in advanced countries are increasingly reluctant

to transfer technology outright to East Asian companies because they see them as potential competitors.³⁵

International competition increasingly favors transnational corporations with networks of complementary production subsidiaries. The surge of internalization of production through TNC networks and of internationally integrated production has dramatically changed the pattern of trade and investment, especially the shift of investment to the service sector and the more sophisticated technological industry.

Conceptualization of open regionalism in Asia: a new paradigm for Asian “de facto” regionalism

The growing importance of intra-Asian trade and investment since the mid-1980s has brought the topic of “regional cooperation and integration” to the top of the policy agenda for the countries of the region. Some argue that a de facto East Asian trading bloc is emerging “by default,” given the increased pace of the movement towards regional integration in Europe and the Western hemisphere. In recent years, the formation of regional trading arrangements (RTAs) has been gaining popularity among developing countries, including those in Asia, as these arrangements are increasingly seen as insurance against the further advancement of economic regionalism in the developed countries. Indeed, the Asian countries are beginning to embrace what they call “open regionalism,” and during the first half of the 1990s began adopting various regional cooperation and trade policy initiatives.³⁶

Regional trading groupings have three general aims: to generate welfare gains through economies of scale, efficiency effects, and the creation of trade; to increase negotiating leverage with external actors; and to promote regional political cooperation and possibly integration.³⁷ It is generally accepted that regional cohesion and interdependence exists for some time before being formalized in a regional free trade agreement (FTA) or other form of economic integration. De facto economic grouping generally takes place partly because of geographical³⁸ and economic proximity, as well as economic complementarities.³⁹ Because higher economic proximity and complementarities bring down costs arising from geographic distance (mainly transport and communication costs), cultural distance (differences in culture, language, business practices, etc.), and regulatory barriers (both border and non-border measures, including regulatory differences) that hamper the international movement of goods, services, and factors of production,⁴⁰ they are important determinants of trade.

East Asia has become progressively integrated as a trading entity. The pace of integration has quickened since 1985, and in 1993 intra-Asian trade amounted to U.S.\$859 billion (U.S.\$418 billion export and U.S.\$441 billion import), or approximately 11 percent of global exports and imports. It is also noteworthy that since the mid-1980s, East Asia’s global exports have exceeded imports, and the region as a whole has experienced a trade surplus with the rest of the world, resulting in increasing protectionism against exports from the region. This, in

turn, is also the rationale for enhancing intra-regional economic integration to facilitate and strengthen trade within the region if the world becomes fragmented. However, the success of the Uruguay Round facilitates a freer global trading system, enabling East Asian countries to pursue their traditional external trade linkages with North America and European countries. Hence, they may gradually implement intra-regional economic integration but maintain their openness to the rest of the world. Even though the region did not create any formal institutions for implementing this purpose, there is a major sub-regional grouping that has long existed: the Association of Southeast Asian Nations (ASEAN). Although economic cooperation implemented by ASEAN in the past has been modest, new economic integration schemes that have been implemented and show the move towards deeper integration include: the ASEAN Free Trade Area (AFTA), the Framework Agreement on ASEAN Investment Area (AIA), the ASEAN Framework Agreement on Trade in Service (AFAS), and the Framework Agreement on Intellectual Property Cooperation. AFTA, AIA, and AFAS will not only help promote economic integration within the region but will also help to integrate ASEAN with the world economy in the future.

Global trade patterns and economic integration in the Asia-Pacific

Traditional trade theories emphasize the way that international trade reflects and embodies a region's endowments of the primary factors of production—labor, capital and natural resources—relative to world standards. Thus, under normal conditions, a region's exports will tend to be those goods whose production intensively requires its abundant factors, and its imports those goods whose production intensively requires its scarce factors. However, the endowments-based explanation of trade patterns, while foundational, is inadequate in itself, as technology, scale, corporate structure, and policy all play important complementary roles.

Furthermore, there is growing international mobility of endowments such as machinery and equipment, research and development (R&D), managerial capital, and professionally skilled capital of all kinds: engineering, marketing, legal, and financial services. Their movement across borders can substitute for the goods that embody them, and they can be viewed as tradable themselves, rather than as endowments. Only immobile endowments should appear as explanatory variables in the traditional empirical estimation. And the primary vehicle for this increased international mobility factor is, of course, the transnational corporation.

The potential for policy to shape comparative advantages via its influence on endowments is obvious. More interesting is how policy's potential for shaping comparative advantages may be enhanced by a departure from the norms and assumptions of the traditional approach. Important factors are technological differences, scale and scope economies, externalities, and imperfect competition. These, in fact, all have significant roles in undergirding the case for "infant

industry” exceptions to traditional free-trade policy recommendations and in explaining the phenomena called intra-industry trade, intra-firm trade, technological-gap trade, and product life-cycle trade.

One of the most important characteristics of intra-industry trade is the distinctive benefits it provides in addition to the traditional gains from trade. Two distinctive benefits are “variety” and “precision.” Purchasers can buy items that meet their precise needs for quality, durability, serviceability, etc. This is especially beneficial when the buyer is another firm and the commodity is a machine, semi-processed goods, or a professional service. This is also a benefit to productivity due to the input cost-savings stemming from the ability of a niche supplier of goods to spread fixed costs over a global market or to realize scale economies at a global level. Another benefit is the constraint on oligopolistic market power that globally free entry or free trade allows. In sum, intra-industry trade enhances not only traditional efficiency and price performance, but also quality, productivity, selection, divisibility, competitiveness and so on. Intra-industry trade is also alleged to lower adjustment costs in the face of trade liberalization and political-economic stability. Pressure to protect some firms against imports is naturally resisted by other, more export-oriented firms in the same industry, fearing retaliation in their export markets.

Thus intra-industry trade emphasizes product differentiation and scale economies in contrast to the more conventional factor endowments. It also emphasizes technologically volatile products because of the way rapid technological change creates differentiated varieties of similar products and dynamic economies of scale.

The rationale for East Asian economic integration

The current changes in the direction of East Asian trade lead to the observation that intra-regional trade has been growing. However, although all three major world regions, the European Union, the Western hemisphere, and East Asia depend heavily on their respective intra-regional markets, the degree of regional inter-dependence differs significantly between the regions. It is highest in the European Union at 60.6 percent, and lowest in North America at 34.4 percent, while it is 39.4 percent in East Asia, slightly higher than in North America. The record also shows that East Asia is increasing trade with both North America and the European Union. This trend implies that there has been a steady regionalization of East Asia in terms of the increase in share of the intra-regional market, which has gone along with progress in the region’s global integration efforts. The East Asian economies have taken full advantage of the vast open market by launching and sustaining rapid export-led growth and aggressively seeking markets both outside and, gradually, inside East Asia.

Expansion of the intra-regional market would make the East Asian economies less reliant on the extra-regional markets and hence less vulnerable to discriminatory protection in those markets. In this way, an East Asian economic group could provide a safe haven⁴¹ for the regional economies, and supplement the weakened multilateralism. The very recent situation in Southeast Asia offers the

best illustration for why the countries in the region need a regional arrangement. These countries have successfully implemented export-push policies and this induces investors—especially Japanese investors—to heavily invest in export. But unfortunately the region faced severe protectionism in the European and North American markets, the biggest markets for the exports of Southeast Asian countries, due to the recent success of exports to these countries, and some countries (particularly the United States) experienced trade deficits with these Southeast Asian countries. An East Asian economic group could enhance East Asian economies' bargaining leverage vis-à-vis other economic groups.⁴²

The East Asian economies must respond to the two challenges of the new regionalism: competitiveness and protectionism. In order to cope with the former, it would be helpful for the East Asian economies to promote regional integration. To cope with the latter, the East Asian economies should strengthen their efforts to defend and improve the multilateral trading system. The East Asian economies should pursue these two objectives at the same time.

Preferential trade liberalization amounts to the formation of a trading bloc as it could involve serious welfare-reducing trade diversion and, more critically, it could work against the multilateral trading system. On the other hand, the harmonization of policies and infrastructural investment are two types of integration that are unambiguously welfare-improving and entirely consistent with the multilateral trading system. In this sense they represent open regionalism and define an area of action the East Asian economies may take in response to the worsening of the international environment. The importance of fully opening the domestic markets of East Asian economies to manufactured goods and services on unilateral bases, and in regard, not only to border measures, but also to trade-restricting domestic practices and institutions, should be emphasized.

Another rationale behind East Asian economic integration is to become more self-reliant⁴³ and to have an important role in rule-making. As a group, they will have more economic power and bargaining leverage, and be more carefully listened to in international forums, especially GATT/WTO. Developing countries believe that law reflects the interest of the ruling class, and that international law, as well as GATT/WTO, reflects the interest of the most prominent powers of the period concerned. The results of the Uruguay Round can be clearly seen as having been dictated by the United States and the European Union. Agricultural issues and multi-fiber arrangements were brought under the GATT/WTO umbrella because the United States, the European Union, and other developed countries needed to include new issues in GATT/WTO in which they have more comparative advantages and are far stronger competitors, and they would gain much more from the inclusion of these areas. Moreover, developing countries cannot compete with them in sophisticated technology industries and services, and they now have to pay much more for the technology, innovation and all intellectual property rights, raising their production costs as well as general consumption costs for other end use products such as pharmaceuticals.⁴⁴

In reality, regionalism does exist and regional integration can both foster global trade and impede it. Thus, the relevant issue is not whether regionalism is

a good thing or not, but how to design international laws that ensure they are structured so as to avoid harming the global economy. The best test for judging whether a regional grouping is harmful is asking whether the agreement results in less trade between member countries and outside countries. If the answer is no, then the regional grouping is consistent with open trade. The agreement makes its member countries better off without making outsider countries worse off, and member countries have an incentive to continue extending the integration by adding new members.

The WTO's trade rules, negotiating forum and dispute settlement system are not goals in themselves. They are necessary preconditions for free and predictable trade, but are not always sufficient to create results. WTO Members have recognized that the multilateral system needs to be accompanied by improvements in trade capacity.

Even though developing countries have adopted the principle of trade and investment liberalization and fully implemented the commitments made under the WTO in practice they cannot effectively improve their economies. This is because many countries simply do not have the human, institutional and infrastructural capacity to participate effectively in international trade. Without that, these countries will not be able to expand the quantity and quality of goods and services they can supply to world markets at competitive prices. The main areas of development that should be enhanced and strengthened are human capacity, institutional capacity and infrastructure.⁴⁵

Thailand and legal development

Thailand has implemented economic and legal development in accordance with the regional and global direction. Thailand has also entered into bilateral FTAs with its trading partners. Development has therefore been achieved at three levels: (1) bilateral; (2) regional; and (3) global/multilateral. Thailand has cooperated with other Asian countries, and implemented Open Regionalism under the framework of ASEAN as mentioned in the preceding section. The discussion of legal and economic development of Thailand at the regional and global/multilateral level under the umbrella of ASEAN therefore need not be repeated here. I turn, instead, to discuss legal and economic development at the bilateral level through FTAs.

It is clear that in recent decades the global trading system has become much more liberalized and world economies have become more integrated. On the one hand, this is due to the successive rounds of trade negotiations under the auspices of the WTO, which have resulted in the progressive liberalization of both traditional and new sectors, such as trade in agriculture and services, as well as trade-related investment measures and intellectual property rights protection issues. On the other hand, this is also attributable to the establishment of regional trading arrangements and free trade agreements, or RTAs and FTAs.

Since the latter half of the 1990s, due in part to the slowdown of the WTO trade liberalization processes, it is evident that there has been an exponential

increase in the number of RTAs and FTAs in every part of the world. Especially, after the failure of WTO meeting at multilateral level in Cancun, Mexico, industrial countries including some developing countries have attempted to initiate free trade agreements to promote international trade and have pushed some items⁴⁶ in the agreements, which cannot be achieved at the multilateral level, so as to be able to reach their goals at the bilateral and regional level. Thailand is no exception to this trend.

Thailand and FTAs

Thailand is active in the negotiation of many FTAs with its economic/trading partners both at the regional⁴⁷ and bilateral⁴⁸ level. Thailand has already signed free trade agreements with China, India, Bahrain, Peru and Australia and is in the process of negotiation with the United States, Japan and other countries, especially members of the European Union. As a strong supporter of free and fair trade, Thailand has been an active participant in the global trade liberalization process through the various regional and international fora, such as ASEAN, the Asia-Europe Meeting (ASEM), the Asia Pacific Economic Cooperation (APEC) and the WTO. It is now in the process of developing free trade arrangements and closer economic cooperation with countries across the world.

Thailand concluded an FTA with Australia at the end of 2004 and began to implement the Agreement on January 1, 2005. Thailand also signed an FTA Agreement with New Zealand in April 2005 so that the two countries will become an FTA by 2010, the content of which is similar to the agreement with Australia. An Agreement with Peru was also signed and Thailand and Peru have started the implementation process. The first phase of the FTA Agreement with India, or the so-called Early Harvest Agreement,⁴⁹ in 82 products started on September 1, 2005, and Thailand is currently negotiating the details of a full FTA with India. Thailand and Bahrain are also FTA parties. Thailand is now working with Japan on free trade arrangements: The Japan–Thailand Economic Partnership (JTEP). Thailand began FTA talks with the United States in June 2004.⁵⁰ Furthermore, Thailand has signed a Framework Agreements with the BIMSTEC⁵¹ countries so as to establish an FTA by 2015/2017, and formal consultations with EFTA⁵² commenced in mid-2005. Most recently, ASEAN and the European Union have completed a feasibility study on the possibility of FTA negotiation between the two regions. It was expected that the start of the ASEAN–EU FTA negotiation would begin in March 2007.⁵³

Moreover, apart from the establishment of AFTA, Thailand is now working closely with other ASEAN members, at a regional level, to establish a free trade area with its major trading partners, including India, China, Japan, Korea, and the CER or Australia and New Zealand. The negotiations between ASEAN and each of these countries are expected to be concluded within two years in order to become fully fledged FTAs by 2015 or at the latest 2020.⁵⁴

The Enterprise for ASEAN Initiative: a roadmap to FTAs

Under the Enterprise for ASEAN Initiative (EAI), the United States and individual ASEAN countries will jointly determine if and when they are ready to launch Free Trade Agreement negotiations. The EAI allows ASEAN countries the flexibility to move at their own speed toward an FTA with the United States. Therefore, the objectives of the creation of the EAI are to pave the way for ASEAN member countries to be ready for FTA negotiations with the United States. The process of FTA negotiation between the United States and ASEAN countries would be based on the following strategies:

- The United States would expect a potential FTA partner to be a member of the World Trade Organization (WTO), and to have concluded a Trade and Investment Framework Agreement (TIFA) with the United States—thus laying the groundwork for future FTA negotiations.
- The United States will continue to support the efforts of the three ASEAN members (Cambodia, Laos, and Vietnam) that do not yet belong to the WTO to complete their accessions successfully.
- The United States has Trade and Investment Framework Agreements (TIFA) with Indonesia and the Philippines—and has signed one with Thailand.
- FTAs with ASEAN countries will be based on the high standards set in the U.S.–Singapore FTA.

Under the EAI, the United States offered the prospect of bilateral free trade agreements with ASEAN countries that are committed to economic reforms and the openness inherent in an FTA with the United States. Any potential FTA partner must be a WTO member and have a TIFA with the United States. The United States now has TIFAs with Indonesia, Philippines, Thailand, Brunei Darussalam and Malaysia. The U.S. goal is to create a network of bilateral FTAs with ASEAN countries.

Trade and investment framework agreements

A TIFA is a consultative mechanism for the United States to discuss issues affecting trade and investment with another country. TIFAs have been negotiated predominantly with countries that are in the beginning stages of opening up their economies to international trade and investment, either because they were traditionally isolated or because they had closed economies. Although TIFAs are non-binding, the United States hopes that they can yield direct benefits by addressing specific trade problems and by helping trading partners develop the experience, institutions and rules⁵⁵ that advance integration into the global economy, creating momentum for liberalization that in some cases can lead to a FTA.

The United States pursues comprehensive free trade agreements with like-minded trading partners, to provide broad liberalization of trade relations in

goods, services, intellectual property, investment and other areas. These regional and bilateral FTAs are intended to complement U.S. global trade liberalization objectives and add momentum to the global drive for open markets. The agreements are consistent with WTO rules and cover substantially all trade between the parties, so as to avoid distortions to global trade. But they allow like-minded partners to go beyond WTO requirements, the so called “GATT Plus,” offering stronger protections for investors and intellectual property rights, for example, and incorporating obligations to uphold internationally recognized core labor standards and to protect the environment. Free trade initiatives give ASEAN countries the opportunity and framework to conclude FTAs with the United States, provided ASEAN members prepare their economies, as well as their legal and institutional framework, in advance of FTA negotiations.

FTA potential benefits and costs for Thailand⁵⁶

The basic reason that Thailand, like a majority of countries, has been actively engaged in trade liberalization efforts is due to the simple fact that free trade enhances the opportunity for economic growth and development. For instance, with the removal of tariffs and non-tariff measures and thus the creation of a more open trading environment, FTAs can greatly expand Thailand’s trade and exports, and thus growth opportunities. Thai companies, especially those within the manufacturing sector, can also expand and diversify their resource and production base and therefore gain the economies of scale, boost their productivity, and obtain specialization in order to develop the Thai economy. In this connection, the increase in competitive level which results from a more open business environment can also help to ensure the better use and allocation of existing resources, as well as encourage the restructuring and reform process both in the private and public sectors so as to create a more favorable business environment. Similarly, an open trade policy can also effectively raise the attractiveness of a country to foreign direct investment, thereby helping to inject greater capital and know-how into the economy, which are vital ingredients to improve efficiency and promote growth. Furthermore, with greater exchanges and better understanding through the creation of FTAs, Thailand will not only become better acquainted with partner countries—which is the basis of a long-term partnership—but will also develop joint cooperation to raise its international competitiveness and stature within the international trading fora.

With a more open market, Thailand is likely to be much more vulnerable to outside forces and global instabilities. With freer trade, Thai local companies will also encounter an increasing level of competition, which could result in the crowding out of less competitive firms and industries. And, the political, social, and cultural repercussions of a more open environment could also be high. Nonetheless, it is clear these negative ramifications can be effectively dealt with through proper preparations, adjustments, reforms, and through joint efforts and intensified cooperation from all sides. More importantly, the loss of opportunities from not participating in globalization and the trade liberalization process

can be extremely high—not only will Thailand’s trade and market opportunities be severely limited, or even diminished, but the country will also be shutting itself out from an enormous pool of global resources and capital needed for development.

Thailand’s FTA negotiating strategy⁵⁷

Thailand’s FTA negotiating strategy is based on the following points:

- FTAs should be comprehensive in scope, covering trade liberalization in goods, services, and investment, as well as the elimination of non-tariff barriers and cooperation to facilitate trade and development.
- FTAs should be based on reciprocity by taking into account the distinct levels of economic development of each country, and flexibility, such as a longer liberalization period, should be granted to accommodate necessary adjustments.
- FTAs should be consistent with WTO rules and conditions, which indicate that FTAs must cover substantially all the trade in goods and services between the FTA partners.
- FTAs should incorporate mechanisms to prevent/annul the negative effects on domestic industries, such as anti-dumping (AD) and counter-vailing duties (CVD) measures, safeguards, and dispute settlement mechanism (DSM)

In order to ensure that Thailand’s national interests are protected and Thai enterprises will fully benefit from the FTAs, Thailand has undertaken numerous steps and adopted several measures, which include the following:

- The establishment of FTA Working Groups consisting of the Negotiation Committee, which is made up of FTA Chief Negotiators, the Steering Committee on International Trade Negotiations, which consists of experts from the public and private sector to coordinate and serve as a think-tank on FTA matters, and the FTA Supporting Committee, which oversees the implementation, adjustment, and restructuring processes of the Thai economy.
- The reform and restructuring of the public sector so as to facilitate and lower the costs of trade and businesses, such as the reforms of tax and tariff structures, the simplification of customs procedures, and the expansion of finance and credit facilities.
- The development of infrastructures to facilitate trade, especially in the area of land, sea, and air transportation, as well as information and data to adjust to the new trade and market conditions.
- The strengthening of small and medium enterprises (SMEs) and the grass-roots economy through research and development, training, and marketing and skill development in order to raise the productivity, efficiency, and international competitiveness of Thai people, products, and the economy.

- The promotion of trade and economic relationships between Thailand and FTA counterparts, such as through the establishment of joint business councils, working committees, official visits, and trade fairs and exhibitions.
- The promotion of a modern productive and innovative workforce through training and investment in knowledge, skill, and entrepreneurship development, and e-literacy.
- The establishment of social safety nets, such as job training and retraining, alternative skill development, the upgrading of educational systems and facilities and a social and health care system.

Some concerns regarding FTAs

The FTAs in force that Thailand has, for example, with China and India, are mainly effective in the realm of tariff reduction and the opening of new markets. If Thailand follows the FTA framework that the United States has with Singapore and Chile, however, it will not only allow free investment but will also bring the further expansion of intellectual property rights to life forms and cultural goods. Such goods may end up falling into the hands of major commercial firms, as evidenced in the experience of Singapore and Chile. In this way such an FTA could have a tremendous impact on individual farmers, consumers, retailers and others. It also raises problems in relation to the issue of state sovereignty.⁵⁸

Another concern is that the process of decision-making with respect to free trade agreements up to this point has been centralized and dominated by governments working together with powerful and well-connected private interest groups. There has therefore been a tendency for such agreements to have a negative impact on wide-ranging groups of people within each country. As a result, the Thai people, academic institutions, NGOs and governmental institutes such as the House of Parliament need to play cooperative roles in studying the effects of FTAs. It is also essential that suggestions made by these groups push FTAs in the direction of genuinely benefitting the majority of people and that support and collaboration be sought both domestically and internationally.

Conclusion

There is no denying that Thailand, like many other countries, will encounter difficulties and obstacles as the country proceeds with the restructuring and adjustment processes so as to keep pace with the rapid changes of a more open trading environment. But it is also clear that, with appropriate adjustments, there can be considerable gains both in terms of increasing the resource base and expanding market opportunities and in terms of acquiring the technological know-how and expertise needed to further develop and prosper, provided that the FTA texts are fairly elaborated and mutually agreed upon based on equal bargaining power.

This being the case, Thailand will continue to intensify efforts so as to upgrade domestic resources and industries and prepare for the challenges ahead.

Thailand will also remain fully committed to the strengthening of economic cooperation and partnership with all trading partners and actively participate in the international trading fora in order to create a free and fair global trading system. Indeed, it is through this dual track approach that Thailand can assure itself of continual growth and development and succeed in fast-tracking and securing Thailand's position within the global arena. The important concerns for FTAs and RTAs are the need for a fair and equitable legal and institutional framework for implementing such economic agreements, especially in the texts of the agreements and the negotiation process. These need to be in conformity with the Constitution and other procedures.

To accomplish its objectives, Thailand needs to strengthen its legal and institutional framework to accommodate the changing global economy. In particular, laws relating to the implementation of open regionalism and FTAs, such as investment laws and regulations, competition law and policy, intellectual property protection and financial laws and regulations, need to be strengthened. Strengthening capacity building to enhance the competitiveness of Thailand both in term of human resources and endowments—natural and created—has also been a crucial strategy. Legal reforms in these areas, together with the development of the economic infrastructure, are necessary for the implementation of a multilayered legal framework governing the economic activity of Thailand.

Notes

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- 1 The exogenous growth model (or neo-classical growth model) of Robert Solow and others places emphasis on the role of technological change.
- 2 The original Solow (1957) study showed that technological change accounted for almost 90 percent of U.S. economic growth in the late nineteenth and early twentieth centuries. Robert Solow (1957) "Technical Change and the Aggregate Production Function," *Review of Economics and Statistics* 39 (August): 312–320.
- 3 The WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), negotiated in the 1986–1994 Uruguay Round, introduced intellectual property rules into the multilateral trading system for the first time. The areas covered by the TRIPS Agreement are copyright and related rights, trademarks, including service marks, geographical indications, industrial designs, patents, layout-designs (topographies) of integrated circuits and undisclosed information, including trade secrets.
- 4 Human rights refer to the basic rights and freedoms to which all human are entitled. Examples that may be considered human rights are civil and political rights, such as the right to life including the right to access proper medical treatment and medicine, and liberty, freedom of thought and expression, and equality before the law, and social, cultural and economic rights, such as the rights to participate in culture, the rights to work, and the right to education. Also see Declaration on the TRIP Agreement and Public Health, adopted on 14 November 2001 in the Ministerial Conference fourth Session on 9–14 November 2001. Also in UN Committee adopts Position on IP and Human Rights, the Committee strikes a balance between human rights and intellectual property, stated a very clear difference that they are two very different concepts, because human rights are not subject to any negotiation, while the other is economic.

- 5 The WTO Doha “Development” Round collapsed in 2006 as countries, especially the EU countries and the United States, could not agree on key issues such as agriculture, subsidies, intellectual property, and services. One of the most important issues at the nexus of trade and public health is the dispute that surrounds the WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) and access to essential medicines. Outbreaks of highly pathogenic avian influenza, caused by the H5N1 strain, have raised concerns that the world may be moving towards another influenza pandemic. As part of its response to this concern, the WHO is considering international responses to manage the epidemic and ways to expedite the development of pandemic vaccines. A legal brief forthcoming in the spring outlines the implications of a potential pandemic on relevant international legal regimes including patent and bio-safety laws.
- 6 Regional trade agreements (RTAs) have become in recent years a very prominent feature of the multilateral trading system (MTS). The surge in RTAs has continued unabated since the early 1990s. Some 380 RTAs have been notified to the GATT/WTO up to July 2007. Of these, 300 RTAs have been notified under Article XXIV of the GATT 1974 or GATT 1994; 22 under the Enabling Clause; and 58 under Article V of the GATS. At that same date, 205 agreements were in force. If taking into account RTAs which were in force but have not been notified, those signed but not yet in force, those currently being negotiated, and those in the proposal stage, the figure is close to 400 RTAs. They are scheduled to be implemented by 2010. Of these, RTAs, FTAs and partial scope agreements account for over 90 percent, while customs unions account for less than 10 percent. Also see “Spaghetti Bowl”: Multiple overlapping EIAs, June 2005 in UNCTAD (2005) *Investment Provisions in Economic Integration Agreements*, New York and Geneva: United Nations Publication, Figure 1.1, p. 10 (UNCTAD/ITE/IIT/2005/10), and World Bank (2005) *Global Economic Prospects: Trade, Regionalism and Development*, Washington, DC: The International Bank for Reconstruction and Development, Figure 2.2, p. 39.
- 7 For example, Open Regionalism has been implemented by ASEAN instead of economic integration based on a supranational organization, a conventional institutional framework of the European Union.
- 8 The drafting of the Asian Charter has been done by the Institute of Social Science, University of Tokyo under the Comparative Regionalism Project (CREP). The results of the project and the conference papers were published with the theme of “The Dynamics of East Asian Regionalism in Comparative Perspective—Private led Regionalism,” ISS Research Series No. 24.
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- 37 J.J. Schott (1991) “Trading Blocs and the World Trading System,” *The World Economy*, 14 (1) (March): 1–17.
- 38 Countries trade more with their neighbors when there are economic complementarities among them, and also trade with larger countries (economic size) because they have a greater variety to offer and because of specialization in production. East Asian countries became integrated through intra-regional trade, even in the absence of a preferential trading arrangement, because they are increasingly interdependent through intra-firm and intra-industry trade by TNCs (transnational corporations) located in the region.
- 39 Complementarities refer to the degree to which the export structure of one country matches the import structure of another country, whereas the index of residual bias in trade flows measures the degree to which the balance of resistance to trade favors bilateral trade relative to global trade.
- 40 GATT (1990) used the term “economic distance” to convey the same concept.

- 41 Safe haven from the discriminatory protectionism raised by, for instance, the United States and the European Union in trade in textile, shoes, steel, automobile, and electrical appliances.
- 42 Krugman and Summers argue that the division of the world into large trading blocs may be conducive to global trade liberalization because it would help eliminate the free rider problem and because inter-bloc trade negotiations may be an efficient way of reorganizing otherwise very complex multilateral trade negotiations. The increased bargaining power of the East Asian group also reflects the balance of economic power, and represents to the developing world as they see it, even in GATT/WTO, the results of the rounds as dictated by the United States and the European Union. See: P. Krugman (1991) "Is Bilateralism Bad?" in E. Helpman and A. Razin (eds.), *International Trade and Trade Policy*, Cambridge, MA: MIT Press; P. Krugman (1991) "The Move Toward Free Trade Zones," in *Policy Implications of Trade and Currency Zones, A Symposium Sponsored by the Federal Reserve Bank of Kansas City* (Jackson Hole, WY: Federal Reserve Bank of Kansas City), pp. 7–42; Lawrence Summers (1991), "Regionalism and the World Trading System," in *Policy Implications of Trade and Currency Zones, A Symposium Sponsored by the Federal Reserve Bank of Kansas City* (Jackson Hole, WY: Federal Reserve Bank of Kansas City), pp. 295–302.
- 43 If they are closely integrated they will be strong enough to exercise the use of economic force, which they never had before, as they were always under economic pressure from more powerful countries. Even in the Uruguay Round negotiation, the Malaysian representative resentfully said that "we were asked with which sauces we would like to be eaten."
- 44 For instance, the price of medicine in Thailand increased up to 300 per cent, so that one tablet alone cost more than the price of three meals for a poor person.
- 45 Source: WTO (2008) *Capacity Building*, Geneva:WTO.
- 46 This can be clearly seen from the FTA text proposed by the United States, which is a FTA template based on the United States FTA model, to its trading partners, especially the investment chapter, trade in service chapter and IP chapter.
- 47 For example, Thailand is a member of ASEAN and APEC. In both regional organizations, there are many economic integration programs that have been launched with the purpose of attaining the objective of liberalization, for example the ASEAN Investment Area, the ASEAN Framework Agreement on Trade in Services, etc.
- 48 See the current Thai FTAs partners.
- 49 An Early Harvest (EH) Agreement is a partial FTA on groups of products which the FTA partners have agreed to liberalize first and continue with negotiations on the rest of their products.
- 50 Thailand and the United States have negotiated the FTA for six rounds starting in 2004. These have taken place in Hawaii for the first and second round, in Bangkok, Montana, Hawaii, and Chiangmai respectively for the third to sixth rounds. The FTA negotiation was pending due to the *coup d'état* in Thailand, and the Thai–US FTA negotiation was postponed until the Thai government will have a formal legitimate government.
- 51 BIMSTEC, or the Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation, consist of Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka, and Thailand.
- 52 EFTA, or European Free Trade Area, consists of Norway, Switzerland, Iceland, and Liechtenstein.
- 53 Thansethakij, October 5–7, 2006.
- 54 Department of Trade Negotiation, The Ministry of Commerce, Thailand.
- 55 The new US FTA model has been designed to liberalize trade and investment, especially to protect the US investment and investor in a host country without host country's governmental intervention based on the mutual combination of the national

treatment and most-favored nation treatment as well as to highly protect IP and the environment. The new US FTA model is very similar to the MAI, aiming at the establishment of a very high standard of rules and regulations. Also, the FTA texts include an investor–state dispute settlement mechanism through an arbitration process. In recent years, the United States has concluded many TIFAs, including with the Central Asian countries: Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan, Thailand, Brunei, Saudi Arabia, Algeria, Bahrain, Malaysia, Qatar, United Arab Emirates, Kuwait, Yemen, Pakistan, Afghanistan, Mongolia, Indonesia, Philippines, Sri Lanka, Tunisia, Turkey, Nigeria, Ghana, South Africa, West Africa Economic and Monetary Union, Common Market for Eastern and Southern Africa (COMESA), and Oman.

- 56 Based on the report of the Department of Trade Negotiation, The Ministry of Commerce, Thailand.
- 57 Based on the report of the Department of Trade Negotiation, The Ministry of Commerce, Thailand.
- 58 For instance, the negotiation process of FTAs with the United States and other countries cannot conform with the Thai Constitution due to the fact that all the FTA texts are confidential. Therefore, it cannot be investigated and studied by the public and related sectors affected by the FTA.

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