form of neutral adjudication in the event of disputes as to their interpretation or application).

Objections to thick conceptions of the rule of law point out that such conceptions largely deprive the concept of the rule of law of any independent meaning by equating it with 'justice' in all its manifestations and hence particular conceptions of the ends of development rather than as a means of vindicating those ends.[11] Objections to thin conceptions of the rule of law point out that even grossly unjust or immoral societies, such as Nazi Germany or apartheid South Africa, might meet purely formalistic criteria, lacking, as these conceptions do, any elements of basic civil and political rights.[12] Intermediate conceptions of the rule of law are possible, which stress due process or natural justice values of the kind familiar to Western constitutional and administrative lawyers, as well as basic civil rights.[13]

It is important to identify the causal mechanisms that translate improvements in the quality of the rule of law into enhanced development outcomes. From an economic perspective, much of the literature emphasizes that protection of private property rights and enforcement of contracts translate into enhanced incentives to engage in productive investments and hence enhanced economic growth (as described in the next chapter). More generally, the stability and predictability of a legal system are regarded as having similar effects. From a non-instrumental or deontological perspective, such as that adopted by Amartya Sen in his book, *Development as Freedom*, an enhanced commitment to the rule of law may be justified as an end in itself. The rule of law provides greater protection of the freedoms of concern to Sen, and its existence does not need to be justified by reference to instrumental objectives but presumably can be empirically evaluated by how well these freedoms are in fact protected.[14]

III. THE RELATIONSHIP BETWEEN THE RULE OF LAW AND DEVELOPMENT

We have already noted recent empirical evidence that is often advanced to support the claim that the quality of a country's commitment to the rule of law significantly, even dramatically, impacts on its economic development

[11] Ibid., at 23–5.

[12] Ibid.

[13] For an argument along these lines, see Tom Bingham, *The Rule of Law* (London: Allen Lane, 2010).

[14] Amartya Sen, *Development as Freedom,* (New York: Anchor Books, 2000).

prospects. However, this claim is not new. An earlier version of this claim appeared in the 1960s in what became known as 'the law and development movement'. Based on an assumption that law is central to development, its proponents believed that educating the legal professionals of developing countries would advance the countries' reform efforts.[15] The movement did not prove enduring and shortly after its inauguration was declared dead by two of its founders, David Trubek and Marc Galanter, in a widely cited paper,[16] in which they extensively critiqued, in a development context, what they call 'the model of liberal legalism' that motivated the first law and development movement.

For Trubek and Galanter, the components of the liberal legalism paradigm are fivefold. First, society is made up of individuals, intermediate groups in which individuals voluntarily organize themselves, and the state. The state is the primary locus of supra-individual control in society, and thus state action involves coercion of individuals. Second, the state exercises its control over the individual through law – bodies of rules that are addressed universally to all individuals similarly situated. Third, rules are consciously designed to achieve social purposes or effectuate basic social principles. These purposes are those of the society as a whole, not of limited groups within it. Fourth, when the rules made through this process are applied, they are enforced equally for all citizens, and in a fashion that achieves the purposes for which they were consciously designed. Fifth, the legal order applies, interprets and changes universalistic rules. The courts have the principal responsibility for defining the effect of legal rules and concepts on individual and group behaviour and thus normally have the final say in defining the social meaning of laws. In this respect, the courts are the central institutions of the legal order. Finally, the behaviour of social actors tends to conform to the rules: officials are guided by the rules, not by personal, class, regional or other bases of decision making; and a large number of the rules will be internalized by most of the population.

However, according to Trubek and Galanter, this paradigm has little application or relevance to many, perhaps most, developing countries:

> The ethnocentric quality of liberal legalism's model of law in society is apparent. Empirically, the model assumes social and political pluralism, while in

[15] World Bank, 'Law and development movement', available at http://siteresources.worldbank.org/INTLAWJUSTINST/Resources/LawandDevelopmentMovement.pdf

[16] David Trubek and Marc Galanter, 'Scholars in self-estrangement: some reflections on the crisis in law and development studies in the United States' (1974) 4 *Wisconsin Law Review* 1062.

> most of the Third World we find social stratification and class cleavage juxtaposed with authoritarian or totalitarian political systems. The model assumes that state institutions are the primary locus of social control, while in much of the Third World the grip of tribe, clan, and local community is far stronger than that of the nation-state. The model assumes that rules both reflect the interests of the vast majority of citizens and are normally internalized by them, while in many developing countries rules are imposed on the many by the few and are frequently honoured more in the breach than in the observance. The model assumes that courts are central actors in social control, and that they are relatively autonomous from political, tribal, religious, or class interests. Yet in many nations courts are neither very independent nor very important.[17]

This line of critique of the relevance of even a relatively thin conception of the rule of law to many developing countries has in turn attracted criticism. For example, Tamanaha[18] points out:

> One of the major sources of oppression and rapaciousness in developing countries today is authoritarian governments. The central premise of the liberal rule-of-law system is the protection of individuals from the tyranny of the government. Law-and-development theorists should be striving to devise ways in which the rule-of-law model can be adapted to local circumstances and nurtured into maturity, rather than expending the bulk of their efforts in tearing this model down.
>
> Informative though it was, the legal liberal paradigm elucidated by Trubek and Galanter was seriously misleading insofar as it implied that all the elements described were prerequisite to a rule-of-law system. Even the United States, as they observed, did not satisfy the description. Operating around the world today are many variations of the rule of law, coexisting with individualist-oriented as well as with communitarian-oriented cultures. It has always consisted more of a bundle of ideals than a specific or necessary set of institutional arrangements.
>
> A minimalist account of the rule of law would require only that the government abide by the rules promulgated by the political authority and treat its citizens with basic human dignity, and that there be access to a fair and neutral (to the extent achievable) decision maker or judiciary to hear claims or resolve disputes. These basic elements are compatible with many social-cultural arrangements and, notwithstanding the potential conflicts, they have much to offer to developing countries.[19]

Tamanaha also points out that the critique of liberal legalism developed by Trubek and Galanter (and other scholars) often leads to a 'state law bad, folk law good' attitude, when in fact often 'folk law is the culprit'

[17] Ibid., at 1080–81.

[18] Brian Tamanalia, 'The lessons of law and development studies' (1995), 89 *Journal of International Law*, 470–86.

[19] Ibid., at 476.

in sanctifying various basic human rights abuses of, for example, women and ethnic or religious minorities.[20] This raises an important issue regarding the relative importance of formal and informal rules and norms. For reformers, this is often a chicken-egg problem: should informal rules come first and serve as the basis for formal rules and norms, or vice-versa? Trubek and Galanter seem to assume that informal rules should precede and support formal norms, and recent research seems to partially support their assumption. Katharina Pistor, Antara Haldar and Amrit Amirapu show, in a recent paper, that the status of women in society is relatively weakly associated with various rule of law indices and that in poor countries this association disappears altogether. They suggest that this occurs because the status of women in society is determined primarily by social norms about gender equality and that these norms are only weakly affected by legal institutions.[21] In contrast, in the excerpt above Tamanaha seems to suggest the opposite: formal rules can predominate over informal rules, even when they conflict with them. On the relationship between formal law and informal social norms, scholars such as Richard McAdams have argued that formal law and legal institutions have the potential to shape and modify social norms over time.[22] That is to say, social or cultural norms and practices should not necessarily be viewed as a timeless given.

IV. REASONS FOR THE CHRONICALLY POOR QUALITY OF THE RULE OF LAW AND RELATED LEGAL INSTITUTIONS IN MANY COUNTRIES

Rule of law deficiencies are persistent and serious in many developing countries despite the instrumental and intrinsic importance of the rule of law to development, and despite the fact that over the past 20 years external donors have invested billions of dollars in rule of law reform initiatives in many developing countries. The World Bank's Governance data on the status of the rule of law reported that only 3 out of 18 Latin American

[20] Ibid., at 481, 484.

[21] Katharina Pistor, Antara Haldar and Amrit Amirapu, 'Social norms, rule of law, and gender reality', in James Heckman, Robert Nelson and Lee Cabatongian (eds), *Global Perspectives on the Rule of Law* (London: Routledge, 2010).

[22] See Richard McAdams, 'The origin, development and regulation of norms' (1997) 96 *Michigan Law Review* 338; McAdams, 'The legal construction of norms: a focal point theory of expressive law' (2000) 86 *Virginia Law Review* 1649.

countries had positive rule of law ratings in 2008 (Chile, Costa Rica and Uruguay). In sub-Saharan Africa only 6 out of 47 countries had positive rule of law ratings in 2008 (Botswana, Cape Verde, Mauritius, Namibia, Seychelles and South Africa). In all 12 countries of the former Soviet Union, ratings were negative in 2008. On the other hand, the countries of Central Europe present a far more positive picture. Asian countries present a mixed setting with its huge diversity of countries, varying enormously in size, colonial history, legal heritage, political ideology and religious complexion. Notable exceptions to generally low rule of law ratings are Singapore and Hong Kong. Over the course of the prior decade, few countries with weak ratings significantly improved their ratings and some deteriorated further.

While rule of law measures used by the World Bank in its Governance database[23] are susceptible to methodological criticisms,[24] it is unlikely that the general conclusion about serious and persistent impediments to establishing the rule of law is unfounded. Many developing countries also perform poorly on a conception of the rule of law as encompassing the protection of various civil and political rights (as Sen's conception of development as freedom does),[25] and with respect to corruption.[26] Ratings on the rule of law, freedom and corruption indices are often highly correlated.

This body of experience has led some scholars to question the value and sustainability of the entire rule of law reform enterprise. We noted in Part III that the earlier post-war law and development movement was declared by some of its founders to be a failure by the mid-1970s.[27] The most recent law and development movement faces the risk of meeting the same fate. Indeed, according to Thomas Carothers,

[23] The World Bank defines the rule of law as: 'Rule of law captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.' Daniel Kaufmann, Aart Kraay and Massimo Mastruzzi, *Worldwide Governance Indicators 2010*, available at http://info.worldbank.org/governance/wgi/index.asp.

[24] See Kevin Davis, 'What can the rule of law variables tell us about rule of law reforms?' (2004) 26 *Michigan Journal of International Law* 141.

[25] See Freedom House, 'Decline in rule of law seen in new data released by Freedom House' (26 June 2007), available at http://www.freedomhouse.org/template.cfm?page=70&release=521

[26] See Transparency International, 'Global Corruption Report 2008', available at http://www.transparency.org/news_room/in_focus/2008/gcr2008 .

[27] See Trubek and Galanter, *supra* note 16.

> One cannot get through a foreign policy debate these days without someone proposing the rule of law as a solution to the world's troubles. The concept is suddenly everywhere – a venerable part of western political philosophy enjoying a new run as a rising imperative of the era of globalization. Unquestionably, it is important to life in peaceful, free, and prosperous societies. Yet its sudden elevation as a panacea for the ills of countries in transition from dictatorships or statist economies should make both patients and prescribers wary. The rule of law promises to move countries past the first, relatively easy phase of political and economic liberalization to a deeper level of reform. But that promise is proving difficult to fulfill.[28]

In a similar vein, Yves Dezalay and Bryant Garth claim that:

> The rule of law has become a new rallying cry for global missionaries. Money doctors selling competing economic expertises continue to be very active on the global plane but the 1990s also witnessed a tremendous growth in rule doctors armed with their own competing prescriptions for legal reforms and new legal institutions at the national and transnational level . . . So far the rule of law industry cannot claim too many successes in the latest campaign.[29]

According to Brian Tamanaha,

> For all but the most sanguine observers, the triumphalist confidence of the 1990s has dissolved . . . Amidst this host of new uncertainties there appears to be wide-spread agreement, traversing all fault lines, on one point, and one point only: that the 'rule of law' is good for everyone . . . This apparent unanimity in support of the rule of law is a feat unparalleled in history. No other single political ideal has ever achieved global endorsement . . . Notwithstanding its quick and remarkable ascendance as a global ideal, however, the rule of law is an exceedingly elusive notion . . . If it is not already firmly in place, the rule of law appears mysteriously difficult to establish.[30]

More recently, Tamanaha, in a pessimistic assessment of the effects of the law and development movement over the past fifty years, argues that the fundamental problem confronting rule of law reformers is that factors that influence law extend far beyond law itself and include:

- the history, tradition and culture of a society;
- its political and economic system;

[28] Thomas Carothers, 'The rule of law revival' (1998) 77 *Foreign Affairs* 95.

[29] Yves Dezalay and Bryant Garth (eds), *Global Prescriptions: The Production, Exportation and Importation of a New Legal Orthodoxy* (Ann Arbor, MI: University of Michigan Press, 2002) Introduction.

[30] Tamanaha, *supra* note 9.

- the distribution of wealth and power;
- the degree of industrialization;
- the ethnic, linguistic, and religious make-up of the society;
- the level of education of the populace;
- the extent of urbanization; and
- the geo-political surroundings.

He calls this the 'connectedness of law principle' and argues that discrete rule of law reform initiatives typically ignore or discount interconnections with their surrounding formal and informal institutions, and also the broader social context.[31]

Even adopting a relatively minimalist or procedural conception of the rule of law and adopting an eclectic conception of the ends served by the rule of law, recent studies provide extensive evidence of how little we know as to how to go about promoting the rule of law in developing countries.[32] After reviewing the evidence, Carothers concludes:

> The rapidly growing field of rule of law assistance is operating from a very thin base of knowledge at every level – with respect to the core rationale of the work, the question of where the essence of the rule of law actually resides in different societies, how change of rule of law occurs, and what the real effects are of changes that are produced.[33]

Michael Trebilcock and Ron Daniels, in a previous writing, hypothesized that the potential impediments that countries may encounter in implementing even a limited procedural conception of the rule of law fall into three crude (and often overlapping) categories.[34]

A. Resource Constraints

The first of these impediments may be of a technical or resource-related character where, despite political will generally on the part of their leadership and citizens, poor countries simply lack the financial, technical or specialized human capital resources to implement good institutions generally, including legal institutions. This lack of resources impairs a country's development prospects (whatever one's conception of development), by making it poorer (in some relevant normative sense) and, in turn, further diminishes its ability to implement good institutions, hence creating a vicious downward spiral.

With respect to impediments of this character, the general orientation of reform requires either more effective or efficient deployment of existing resources devoted to a country's legal system, a re-ordering of a country's domestic priorities and reallocation of resources from other areas of expenditure to the legal system, or the infusion of resources from external donors (in the form of financial assistance or technical advice and training, and so on). Indeed, on the narrowly instrumental economic rationale for rule of law reform, governments lacking the necessary resources should be prepared to borrow the money required to finance rule of law reforms and finance borrowing costs from future economic growth and increased tax revenues. However, other obstacles are likely to exist.

B. Social–Cultural–Historical Constraints

Another category of explanation for impediments to reform relates to a variety of factors that might loosely be placed under the rubric of social–cultural–historical factors that have yielded a set of social or cultural values, norms, attitudes or practices that are inhospitable to even a limited procedural conception of the rule of law.[35] In a recent paper in which they correlate scores on World Value Surveys with scores on rule of law, democracy and corruption indices, Licht, Goldshmidt and Schwartz argue that societies that accord higher weight to social embeddedness than individual autonomy, and social hierarchy than egalitarianism, exhibit lower commitments to the rule of law, democracy and non-corrupt governance, although there is significant unexplained variance around the mean.[36] Whether culture is conceived of as a form of consciousness or as a form of law-like social norms, the policy prescriptions entailed in overcoming this class of impediment are not nearly as obvious as in the case of technical

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[31] Brian Tamanaha, 'The primacy of society and the failures of law and development: decades of stubborn refusal to learn' (26 March 2010) Washington University in St. Louis School of Law, Faculty Research Paper Series.

[32] See Thomas Carothers (ed.), *Promoting the Rule of Law Abroad: In Search of Knowledge* (Washington: Carnegie Endowment for International Peace, 2006) Chapters 1 and 2; Erik Jensen and Thomas Heller (eds), *Beyond Common Knowledge: Empirical Approaches to the Rule of Law* (Stanford: Stanford University Press, 2003), especially Thomas Heller, Chapter 11: 'An Immodest Postscript'.

[33] Carothers, *supra* note 32 at 27.

[34] Trebilcock and Daniels, *supra* note 10, Chapter 1.

[35] See Rosa Ehrenreich Brooks, 'The new imperialism: violence, norms, and the rule of law' (2003) 101 *Michigan Law Review* 2275; Amy Cohen, 'Thinking with culture in law and development' (2009) 57 *Buffalo Law Review* 511.

[36] Amir N. Licht, Chanan Goldschmidt and Shalom H. Schwartz, 'Culture rules: the foundations of the rule of law and other norms of governance' (2007) 35 *Journal of Comparative Economics* 659.

or resource-related impediments nor is any impact likely to be immediate, dramatic or predictable. That is to say, changing culture, however conceived, may present at least as formidable a set of challenges as changing laws and legal institutions, if the purpose is to change human behaviour.[37]

An important historical perspective on the emergence of the rule of law is presented by North, Wallis and Weingast in a recent book[38] and in a recent paper by Weingast,[39] which has parallels with path dependence theories reviewed by us in a recent paper,[40] and overlaps with political economy constraints discussed below.

According to North et al., the most common social order throughout history is the limited access order or natural state, which solves the problem of violence through rent creation, granting powerful individuals and groups valuable rights and privileges so that they have incentives to cooperate rather than fight. The resulting rents, limits on competition, and limited access to organizations hinder the long-term economic and political development of these societies. In contrast, open access orders use competition and open access to organizations and institutions to control violence and are characterized by rent erosion and long-term growth.

The authors argue that the transition from a limited access order to an open access order is a difficult process, and only two or two-and-a-half dozen states have successfully completed it. They divide the transition into two parts: the doorstep conditions and the transition proper. There are three doorstep conditions:

- rule of law for elites;
- the perpetual state (the creation of perpetually lived organizations); and
- consolidated control over violence and the military.

The transition proper occurs when sufficient numbers of people become citizens in the sense that the state treats a large category of people impersonally and identically. At the same time, processes must begin that afford citizens access to organizations in both politics and economics, granting them the ability to compete as they wish in either system.

Weingast, in a subsequent paper, emphasizes two core aspects of the rule of law:

1. The impersonal aspects of law:
   - the certainty or predictability of the law, including the absence of arbitrary actions by the state against individuals;
   - transparency; and
   - the requirement that the state treats individuals as citizens with equality before the law.
2. A dynamic aspect of the rule of law which requires that the state be able to honour these aspects of the rule of law tomorrow even if it experiences turnover in officials.

By this definition, natural states have substantial difficulties in creating the rule of law. First, the rule of law contrasts with the typical natural state dominated by personal relationships. Second, natural states have difficulty in creating the predictability necessary for the rule of law. Third, natural states often seem to act arbitrarily. Finally, and perhaps most importantly, natural states have great difficulty in providing credible enduring commitments.

According to Weingast, rule of law reforms virtually always fail for two reasons: violence and the absence of perpetuity. Transplanting open access order institutions – such as markets, elections and legal systems – cannot create an open access order. The problem is that these reforms seek to dismantle the natural state systems of privilege and limited access; they therefore threaten violence and disorder. Rather than making everyone better off, as the reformers intend, these reforms threaten to make everyone worse off. Also central to creating the rule of law is creating a perpetual state whose institutions, rules and policies do not depend on the identity of current officials or dominant coalitions. The problem with natural states in the developing world is that almost none have perpetual states. Thus, in order to gain the rule of law, natural states must enter the transition from limited access order to an open access order. This means that fragile natural states must first become basic states; basic natural states become mature states; and mature natural states begin the transition with the doorstep conditions. Only at this stage of development are states capable of beginning to create the institutional and organizational basis for the rule of law.

Even though North, Wallis and Weingast present an important historical approach to the relationship between culture and institutions, their

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[37] See Cohen, *supra* note 35.

[38] Douglass North, John Wallis and Barry Weingast, *Violence and Social Order: A Conceptual Framework for Understanding Recorded Human History* (Cambridge University Press, 2010).

[39] Barry Weingast, "Why Developing countries prove so resistant to the rule of law'," in James Heckman, Robert Nelson and Lee Cabatingan (eds), *Global Perspectives on the Rule of Law* (Routledge, 2010).

[40] Mariana M. Prado and Michael Trebilcock, 'Path dependence, development, and the dynamics of institutional reform' (2009) 59 *University of Toronto Law Journal* 341.

argument exhibits a deterministic quality and has a strong modernization theory flavour to it, somewhat akin to Rostow's 'stages of growth' theory.[41] There are good reasons to call attention to the path dependence element of institutional development (which may have little to do with deep-seated cultural values), as is discussed further below. However, this does not mean that societies are stuck in a phased trajectory and will not be able to evolve unless they follow all the steps in this trajectory in a prescribed sequence. Instead, path dependence should not dissuade citizens and decision-makers in developing countries from pursuing institutional reforms, acknowledging that change will be difficult and protracted, and outcomes unpredictable. One of the core elements of path dependence is that there is no linearity: societies are complex and change will be rather unpredictable.[42] Thus, we do not subscribe to the sequence the authors offer (basic natural states, mature natural states, open access societies). There are likely to be multiple equilibria, and progress will not be as linear and predictable as North, Wallis and Weingast suggest.

C. Political Economy Constraints

A third class of potential impediments to the effective implementation of even a limited conception of the rule of law might be loosely characterized as political economy-based impediments, where lack of effective political demand for reforms, on the one hand, and vested supply-side interests, on the other, render these reforms politically difficult to realize even if (by assumption) they would render most citizens better off in terms of their own values.

On the demand side, a procedurally-oriented conception of the rule of law has many of the attributes of a public good – 'everybody's business is nobody's business' – creating a major collective action problem. In other words, diffuse citizen commitment to the rule of law is unlikely to translate into effective political mobilization for reforms. Also, one should not naively assume that all external constituencies are likely to benefit from rule of law reform. Indeed, those who derive benefits from corruption, cronyism, favouritism and so on in existing institutional arrangements and legal processes are likely to resist such reforms.[43]

[41] For a summary of the five stages of growth theory, see Chapter 1, Section III.A; W.W. Rostow, *The Stages of Economic Growth: A Non-Communist Manifesto* (Cambridge: Cambridge University Press, 1960), Chapter 2.

[42] See Prado and Trebilcock, *supra* note 40.

[43] See Daniel Kaufmann, 'Rethinking governance', The World Bank, discussion draft, March 2003; Joel Hellman and Daniel Kaufmann, 'The inequality of influence', The World Bank Institute: preliminary draft, December 2002; Karla Hoff and Joseph Stiglitz, 'After the Big Bang? Obstacles to the emergence of the rule of law in post-Communist societies' (2004) 94 *American Economic Review* 753–63.

In a recent book[44] Curtis Milhaupt and Katharina Pistor emphasize the importance of the demand side. They argue that the economic literature implicitly considers only the supply of law in a given society, largely neglecting the role of demand. In contrast, the authors suggest that the relationship between law and markets functions according to a continuous feedback loop, so the causal connection runs both ways and there is endogeneity in the relationship between law and markets. Also, law can play an important coordination function in markets and it can enhance the credibility of state-supplied governance structures. They conclude that the demand for law as a governance device is likely to be affected by the extent to which potentially effective constituencies are allowed to participate in lawmaking and law enforcement and to promote legal adaptations to changing economic and social conditions.

On the supply side, vested or incumbent interests in institutions or processes that do not comport even with a minimalist, procedurally oriented conception of the rule of law – for example, a corrupt or incompetent judiciary, public prosecution, police, correctional system, tax administration or other specialized law enforcement, administrative or regulatory agencies, members of the private bar and legal education institutions – are likely to resist reforms that threaten their interests.

The critical relationship between the rule of law and issues of political economy is insightfully articulated by Maravall and Przeworski:[45]

> To develop a positive conception of the rule of law one must start with political forces, their goals, their organization and their context. It is not stability that distinguishes the rule of law but the distribution of power. When power is monopolized, the law is at most an instrument of the rule of someone. Only if conflicting political actors seek to resolve their conflicts by recourse to law does law rule. Rule of law emerges when self-interested rulers willingly restrain themselves and make their behaviour predictable in order to obtain sustained, voluntary cooperation of well-organized groups commanding valuable resources. In exchange for such cooperation, rulers will protect the interests of these groups by legal means . . .

[44] Curtis J. Milhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal About Legal Systems and Economic Development Around the World* (University of Chicago Press, 2008).

[45] José María Maravall and Adam Przeworski (eds), *Democracy and the Rule of Law* (Cambridge and New York: Cambridge University Press, 2003), Introduction at 2–4.

> The difference between rule by law and rule of law lies in the distribution of power, the dispersion of material resources, the multiplication of organized interests; in societies that approximate the rule of law, no group becomes so strong as to dominate the others, and law, rather than reflect the interests of a single group, is used by the many. The rule of law is conceivable only if institutions tame or transform brute power. As organized interests multiply, a society will come closer to the rule of law, power will not be monopolized, and the law will not be used by the few against the many.

Holmes similarly argues:

> Why do people with power accept limits to their power? An even more pointed formulation is: why do people with guns obey people without guns? An economic twist is: why would the rich ever voluntarily part with a portion of their wealth? In legal theory, the parallel question runs: why do politicians sometimes hand power to judges? Why do politicians allow judges, who control neither purse nor sword, to overturn and obstruct their decisions and sometimes even to send office-holders to jail? . . . Societies may approximate the rule of law if they consist of a large number of power-wielding groups, comprising a majority of the population, and if none of them become so strong as to be able thoroughly to dominate the others. We may be able to loosen the grip of a few organized interests on power by forcing them to share political leverage with a variety of other groups. This is polyarchy; it is also rough justice, the only kind human beings will ever experience. Formulated differently, the balancing of many partialities is the closest we can come to impartiality. This may not sound particularly ideal, but it is nevertheless historically quite rare and very difficult to achieve.[46]

D. Legal Origins Constraints

Another line of explanation for the puzzle of differential legal performance is associated with the rapidly proliferating body of literature, principally in the financial development field, that focuses on whether legal origins have influenced the financial development of countries, which in turn is often asserted to be a major determinant of their rates of economic growth. Beginning with a widely cited paper by LaPorta, Lopez-de-Silanes, Shleifer and Vishny, in 1997,[47] followed by later papers by the same authors (frequently referred to as LLSV),[48] the authors assert a causal

[46] Stephen Holmes, 'Lineages of the rule of law', in Maravall and Przeworski, *supra* note 45.

[47] Rafael LaPorta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W. Vishny, 'Legal determinants of external finance' (1997) 52 *The Journal of Finance* 1131–50.

[48] Rafael LaPorta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'The economic consequences of legal origins' (2007) National Bureau of Economic Research Working Paper 13608.

linkage between legal origins and financial development and, indirectly, economic growth. This claim is largely based on cross-country studies which purport to show that common law jurisdictions have, in general, developed more sophisticated financial institutions and financial markets than civil law jurisdictions. Amongst civil law jurisdictions, the French civil law system has lagged behind other civil law systems such as the Germanic and Scandinavian systems. They conclude that countries with more sophisticated financial markets generally recognize more extensive rights of shareholders and creditors, and that common law jurisdictions are superior in these respects to civil law jurisdictions – in particular, the French civil law system.

LLSV rely on two inter-related mechanisms through which legal origin influences finance. The political mechanism holds that (a) legal traditions differ in terms of the priority they attach to private property, vis-à-vis the rights of the state (or, as they put it in their most recent paper, 'common law stands for the strategy of social control that seeks to support private market outcomes, whereas civil law seeks to replace such outcomes with state-desired allocations'); and (b) the protection of private contracting rights forms the basis of financial development. The adaptability mechanism stresses that (a) legal traditions differ in their formalism and ability to evolve with changing conditions; and (b) legal traditions that adapt efficiently to minimize the gap between the contracting needs of the economy and the legal system's capabilities will more effectively foster financial development than more rigid systems.

This literature[49] has been persuasively critiqued in a recent book by Kenneth Dam,[50] in which he points out that the regulation of shareholders' and creditors' rights in most jurisdictions (civil and common law) is a matter mostly of relatively recent statutes and not of the common law or private civil law codes, so that drawing sharp differences between civil and common law systems on this account is unwarranted.[51] Dam also points out that France generally enjoyed more rapid per capita economic growth than Britain from 1820 to 1998; that recent governance studies by the World Bank find legal origins to have a small to non-existent impact

[49] The surrounding empirical evidence that proponents and critics rely on is masterfully surveyed in a recent paper by Thorsten Beck and Ross Levine, 'Legal institutions and financial development,' in C. Menard and M. Shirley (eds), (2005) *Handbook of New Institutional Economics* 251–78.

[50] Kenneth Dam, *The Law-Growth Nexus: The Rule of Law in Economic Development* (Washington, DC: Brookings Institution Press, 2006) Chapter 2.

[51] See also Mark Roe, 'Legal origins, politics and modern stock markets' (2006) 120 *Harvard Law Review* 460.

on the quality of the rule of law or economic growth records, especially among poorer countries;[52] and that the much broader governance measures employed by the World Bank provide a much more helpful framework of analysis for an institutional reform agenda.

In a similar vein, Gillian Hadfield, in a recent paper[53] argues that the binary classification of legal systems as either common law or civil law obscures many institutional differences that do not closely track this binary categorization. Roe and Siegel argue that political economy factors best explain why some countries have weak protection of the rights of creditors and outside shareholders: incumbent firms fear that strong financial sectors will facilitate new entrants and hence intensified competition.[54]

We should also add that, drawing on recent comparative legal research with which Michael Trebilcock has been associated,[55] the performance of legal systems in former British colonies that inherited the common law from their imperial overseers varies markedly on various measures of legal activity, including contemporary measures of the rule of law. Thus, variations in performance within legal families are often much greater than variations between legal families. This suggests that many variables other than legal origins alone explain subsequent legal performance – in particular, we argue, the degree to which the British colonial authorities afforded representation to the indigenous population in legislative bodies, and the extent to which indigenous and British common law courts and animating values were integrated, fostering the development of a localized common law jurisprudence.

V. A BRIEF REVIEW OF RULE OF LAW REFORM EXPERIENCE

We now turn to a brief review (substantially elaborated on elsewhere)[56] of the efficacy of recent reforms to legal institutions in Latin America, Africa,

[52] See Kaufman, *supra* note 1.

[53] Gillian Hadfield, 'The levers of legal design: institutional determinants of the quality of law' (2006) 36 *Journal of Comparative Economics* 43; see also symposium, 'Economics and comparative law' (2009) 59 *U. of Toronto L.J.* 179–236.

[54] Mark Roe and Jordan Siegel, 'Finance and politics: a review essay based on Kenneth Dam's analysis of legal traditions in *The Law-Growth Nexus*' (2009) 47 *Journal of Economic Literature* 781.

[55] Ron Daniels, Michael Trebilcock and Lindsey Carson, 'The legacy of empire: the common law inheritance and commitments to legality in former British colonies' (2011) 59 *American Journal of Comparative Law* 111.

[56] See Trebilcock and Daniels, *supra* note 10.

Central and Eastern Europe, and Asia, relating these reform efforts to notions of path dependence which we have reviewed elsewhere.[57] Here we focus mostly on non-instrumental rationales for the rule of law, deferring until Chapter 3 an assessment of the empirical evidence on the efficacy of instrumental (especially economic) conceptions of the rule of law.

Although path dependence in its purest form is constraining and deterministic, this does not mean that it yields the conclusion that we are prisoners of our past. Instead, we have argued that it provides insights for those promoting institutional reforms. Indeed, the path dependence literature provides a wealth of information regarding institutional change that reformers would be wise to take seriously. First, the concepts of self-reinforcing mechanisms and switching costs, for instance, can be important because they show that reforms in key institutional nodes of any system are likely to fail if they do not address both the nature and scale of switching costs faced by internal and external actors engaged in or with these institutions. Second, to the extent that particular institutions have become embedded, over time, in a broader matrix of mutually reinforcing institutional interdependencies, nodal reform that ignores these interdependencies is likely to be further compromised. Third, the concept of critical junctures shows that comprehensive or ambitious reforms in minimally functional institutions (or networks of institutions) during 'normal times' can be disruptive and are likely to be strongly resisted by affected stakeholders. Yet defining or identifying 'critical junctures' *ex ante* where more ambitious reforms may be feasible is itself a highly speculative exercise. As path dependence theory emphasizes, much institutional change will be incremental and will occur on many small margins. Indeed, attempting too much may be a recipe for achieving too little.

A prominent focus of rule of law reforms has been judicial reform such as reducing court backlogs which have been large and growing in many developing countries. Reform efforts to this end have involved improving court record-keeping through enhanced information technology and more proactive case management techniques. Complementary reform initiatives have often involved externally supported judicial training programs.[58] In some cases, these initiatives seem to have had a positive impact on court backlogs, although various scholars have noted that enhancing judicial capacity by increasing the volume of cases processed says little or nothing about the quality of judicial decision-making.[59] Judicial corruption and

[57] See Prado and Trebilcock, *supra* note 40.

[58] Trebilcock and Daniels, *supra* note 10.

[59] See Jensen and Heller, *supra* note 32.

incompetence is endemic in many developing countries, particularly at lower levels of the court system and outside major urban centres. Reform efforts have barely penetrated these courts and are thus largely ineffective, since most citizens only have contact (if any at all) with courts at the lowest level of the system.[60]

One challenge confronting reforms is that they ignore self-reinforcing mechanisms at the individual level: belief systems or patterns of behaviour on the part of internal and external actors may have adjusted to the former institutional arrangement and might not readily adapt to the new regime. These forms of adaptive behaviour are likely to increase the switching costs of moving to a new system, generating resistance to reforms akin to the 'installed base problem' (for example, resistance to moving from an imperial to a metric system of weights and measures).[61]

For judicial reforms, individual belief systems or patterns of behaviour are reinforced by legal education. Historically such education in many developing countries has focused heavily on rote learning and regurgitation in exams rather than critical or interdisciplinary analysis of legal problems.[62] In Latin America, many public law schools also suffer from over-population with many part-time students and instructors.[63] While private law schools have recently proliferated in many developing countries, they are of highly variable quality, ranging from internationally recognized law schools to part-time degree or diploma mills. Legal education institutions in Central and Eastern Europe have historically been tightly controlled by the state, which has led to a standardized, inflexible and increasingly inappropriate legal curriculum.[64] In some countries in this

[60] Ibid.

[61] The term 'installed base' refers to early adopters of a technology, who will bear a disproportionate share of transient incompatibility costs and may therefore resist the adoption of a newer technology. The larger the installed base, the more inertia it will generate. Joseph Farrell and Garth Saloner, 'Installed base and compatibility: innovation, product preannouncements, and predation' (1986) 76 *Am. Econ. Rev.* 940.

[62] Trebilcock and Daniels, *supra* note 10, Chapter 9; Joseph Tome, 'Heading south but looking north; globalization and law reform in Latin America' (2000) *Wisconsin Law Review* 691; Cheng Han Tan et al., 'Legal education in Asia' (2006) 1:1 *Asian Journal of Comparative Law* at 17.

[63] Stephen Meili, 'Legal education in Argentina and Chile', in Louise G. Trubek and Jeremy Cooper, *Educating for Justice Around the World: Legal Education, Legal Practice and the Community* (Aldershot: Ashgate, 1999), 138–57 at 142.

[64] See George E. Glos, 'Soviet law and Soviet legal education in an historical context: an interpretation' (1989) 15 *Review of Socialist Law* 227 at 257; Susan Finder, 'Legal education in the Soviet Union' (1989) 15 *Review of Socialist Law* 197 at 207.

region, with the support of international NGOs and other institutions, efforts have been made to reform the curriculum in ways that are relevant to the new economic, social and political environments in which these countries find themselves, and to reduce or eliminate the ideological connection between law and the state that prevailed in the communist era.[65]

Legal education in Africa is extremely varied with respect to institutional support, funding and curriculum development. South Africa, a relatively rich nation on the continent, has considerable legal education infrastructure, but continues to suffer from under-funding and low quality of historically black institutions. Many other African countries have much weaker legal education infrastructures that suffer from a serious lack of resources, including such basic resources as teaching and library materials. As in Latin America, many African law schools continue to emphasize rote, black-letter learning, although significant recent efforts have been made to incorporate both clinical legal education and human rights dimensions into some law school curricula.[66] In many Asian countries there are a large number of legal education institutions of widely variable quality, with a recent dramatic proliferation of these institutions in China.[67]

Resistance to legal reforms in many developing countries seems attributable in part to the vested interests of professors, judges and existing practitioners who seek to insulate themselves from changes in curriculum or reforms of substantive or procedural features of the existing legal system,

[65] European Commission: Education and Training, 'ERASMUS and the University', available at http://ec.europa.eu/education/index_en.htm (accessed 28 June 2009); Associate Dean Louis F. Del. Duca, 'Cooperation in internationalizing legal education in Europe – emerging new players' (2001) 20:1 *Penn State International Law Review* 9.

[66] Manu Ndulo, 'Legal education in Africa in the era of globalization and structural adjustment' (2002) 20:3 *Pennsylvania State International Law Review* 489; Philip F. Iya, 'From lecture room to practice: addressing the challenges of reconstructing and regulating legal education and legal practice in the new South Africa (2002–3) *Third World Legal Studies* 144 at 151.

[67] Tan et al., *supra* note 62; Mei-Ying Hung, 'China's WTO commitment on independent review: an opportunity for political reform' (Carnegie Endowment for International Peace, Working Paper No. 5, 2002), citing Zhongguo Tongxun She, 'Beijing to introduce re-education through labour law this year', 19 February 2001; Vincent Cheng Yang, 'Judicial and legal training in China: current status of professional development and topics of human rights' (China-OHCHR National Workshop for Lawyers and Judges, 2002), citing 'Chinese legal aid system basically formed, 600,000 people aided in five years', *China News Net*, 29 September 2002, available at http://www.icclr.law.ubc.ca/Publications/Reports/Beijing_August_2002.pdf.

in part because these changes entail a depreciation of their existing human capital and require investments in new human capital. Lawyers who were trained and practise, adjudicate or teach in a socially dysfunctional legal system and have made substantial investments in human capital in learning how to function in such a system are often not a progressive force for legal reform.

A more general problem with judicial reforms, however, is that they do not account for relevant macro processes in a legal system that connect what happens inside the courtroom with a series of events that precede or succeed the courtroom proceedings (enforcement of judgments, for example). In particular, recent rule of law reforms have paid little attention to reforming the most relevant law enforcement agency, the police force, despite the fact that historically in many countries the police have been viewed as a form of paramilitary organization, primarily dedicated to regime maintenance in societies dominated by military or authoritarian governments.[68] This has made policing of secondary importance in many developing and transitional economies and has led incumbent political regimes to support, or at least acquiesce in, extensive human rights abuses by police forces, including torture, coerced confessions, indefinite detention without trial and rampant corruption.[69]

In an attempt to deal with these forms of abuse, modest efforts have been made in some developing and transitional economies to implement civilian police oversight mechanisms and reform of criminal procedure laws.[70] These laws, at least in theory, enable courts to act as a check on these forms of abuse through, for example, rules that deem evidence to be inadmissible where obtained illegally. However, in practice, courts in many developing and transition economies have not been assertive monitors of abuses of public office, in part because of their historical subservience to the executive branch of government in terms of appointments, promotions

[68] Article 1of United Nations Code of Conduct for Law Enforcement Officials, adopted by the General Assembly in 1979, G.A. Res. 34/169, UN Doc. A/34/46; Rachel Nield, 'Confronting a culture of impunity: the promise and pitfalls of civilian review of police in Latin America', in Andrew Goldsmith and Colleen Lewis (eds), *Civilian Oversight of Policing: Governance, Democracy and Human Rights* (Portland, OR: Hart Publishing, 2000).

[69] Mercedes S. Hinton, 'A distant reality: democratic policing in Argentina and Brazil' (2005) 5(1) *Criminal Justice* 75 at 95; Paul Chevigny, 'Defining the role of the police in Latin America', in Juan E. Mendez, Guillermo O'Donnell and Paulo Sergio Pinheiro (eds), *The (Un)Rule of Law and the Underprivileged in Latin America* (Notre Dame, IN: University of Notre Dame Press, 1999).

[70] Colleen Lewis, 'The politics of civilian oversight: serious commitment or lip service?' in Goldsmith and Lewis, *supra* note 68.

and resources.[71] Attempts to strengthen judicial independence through the creation of semi-autonomous Judicial Councils to vet appointments and promotions and to maintain a disciplinary regime for judicial misconduct have often been met with fierce resistance from the executive and legislative branches of government, as well as the judiciary itself.[72]

The problem of ignoring other elements of the legal system, like the police, in rule of law reforms is replicated in penal reforms.[73] These reforms seek to improve correctional institutions in many developing countries and transition economies, but ignore their relationship with the criminal justice system. Reform efforts in this context have focused on developing correctional institutions as professional public institutions, often through training programs for correctional personnel provided by international agencies and NGOs, and the provision of paralegal advisory services to inmates to advise them of their rights relating to abuses suffered within correctional institutions, and their related legal rights under the country's criminal justice system.[74] Some countries, especially in Latin America, have appointed official ombudsmen to investigate prisoners' complaints and report thereon to government, while in other countries (such as a number of countries in sub-Saharan Africa), pursuant to regional treaty commitments, official rapporteurs make periodic visits to and report publicly on conditions in correctional institutions.[75]

The role of prisons in many countries historically was not tied principally to crime, punishment or rehabilitation, but to suppressing political opposition and/or extracting labour from vast populations of captive workers (especially in the former Soviet Union). Severe prison overcrowding has been a chronic problem, leading to a very high incidence

[71] Nield, *supra* note 68.

[72] See Linn Hammergren, 'Do Judicial Councils further judicial reform? Lessons from Latin America', Carnegie Endowment for International Peace, Working Paper 28, 2002.

[73] *Standard Minimum Rules for the Treatment of Prisoners,* adopted by the First United Nations Congress on the Prevention of Crime and the Treatment of Offenders, held in Geneva in 1955, and approved by the Economic and Social Council by its resolution 663 C(XXIV) of 31 July 1957 and 2076 (LXII) of 13 May 1977, Article 10.

[74] 'Penal and prison reform in Africa', Vol. 13–14 (*PRI Newsletter,* April 2001) at 5.

[75] The United Nations Latin American Institute for the Prevention of Crime and Treatment of Offenders, ILANUD Activities makes the reports available on their website, at http://www.ilanud.or.cr/centro-de-documentacion/biblioteca digital/181-sistemas-penitenciarios.html.

of infectious diseases such as HIV/AIDS and TB.[76] However, reforms focused on correctional institutions often ignore the fact that a significant source of overcrowding in correctional institutions in many developing countries is the high percentage of inmates held on remand awaiting trial for often lengthy periods because of inefficiencies in the broader criminal justice system. Where reforms to the criminal justice system have been undertaken, providing judges with greater discretion to impose non-custodial forms of sentence, the judiciary has often shown a reluctance to invoke these powers, particularly in contexts of widespread public concern over high and rising violent crime rates.[77] Thus, penal reform efforts need to deal with their relationship to the broader criminal justice system.

Correction, dealing as it does with a small and marginalized sub-set of the population, is (perhaps more than any other institution) inextricable from the broader successes and failures of rule of law reform. It depends, at least, on the efficiency of court processes, the effectiveness of law enforcement, the broader complex of social factors determining crime rates more generally, a vigorous legal bar willing to defend prisoners' rights, and a culture of human rights robust enough to conceptualize prisoners within its ambit.

Other institutional interconnections that are relevant to rule of law reforms involve the bureaucracy. In many developed and developing countries important aspects of the administration of justice are vested in specialized law enforcement or administrative agencies that deal with matters as diverse as tax administration, public utilities regulation, environmental regulation, competition law enforcement, election management bodies, and so on. One of the advantages of these agencies is that they are more easily detachable from the existing bureaucracy, entailing less complex or sweeping reforms that may be less likely to suffer from path dependence problems.

Tax administration is an example of a specialized law enforcement or regulatory function which all developing countries must perform, and

[76] See UNAIDS, *Prisons and AIDS,* UNAIDS Best Practices Collection (1997), available at http://data.unaids.org/publications/IRC-pub05/prisons-pov_en.pdf; Centre for the Study of Violence and Reconciliation, 'Annual Report 2001/2002 Criminal Justice Programme' (2002), available at http://www.csvr.org.za/docs/2001.pdf; United Nations Press Release, 'UN expert warns of overcrowded prisons as breeding grounds for AIDS', 23 July 2010, available at http://www.unmultimedia.org/radio/english/2010/07/un-expert-warns-of-overcrowded-prisons-as-breeding-grounds-for-aids/.

[77] Mark Ungar, 'Prisons and politics in contemporary Latin America' (2003) 25:4 *Human Rights Quarterly* 909 at 912.

hence provides an important example of the challenges that developing countries face with the performance of such agencies.[78] In the case of tax administration, effective performance of this function is of critical importance to all developing countries because a constrained ability to collect revenues that are legally due also constrains governments in terms of expenditure on pressing development priorities. In many developing countries the gap between taxes nominally due and taxes actually collected is extremely large – often in the range of 40 per cent – which suggests the potential margins for improved performance in tax administration.[79]

To improve the tax system, a number of developing countries have set up large taxpayer units (LTUs), with a view to developing specialized and integrated expertise in tax assessment, given that large taxpayer units are where much of the effective taxable capacity in many developing countries resides. In addition, a number of developing countries have also set up semi-autonomous revenue agencies (SARAs), designed to ensure the fiscal autonomy of the organization and much greater freedom in personnel policies and IT development.[80] Many of these reforms appear to have been successful in broadening the taxpayer base and increasing the percentage of taxes nominally due that are actually collected. However, the experience with SARAs over time has been mixed: typically, these agencies appear initially to have a significant impact on the percentage of taxes actually collected, but subsequently their performance tends to deteriorate, in some cases because of rampant corruption within the agency,[81] and in some cases because of increasing political interference from the Ministry of Finance and other executive arms of the government in personnel and assessment processes.[82] This suggests that the ability of

[78] Malcolm Gillis, 'Tax reform: lessons from postwar experience in developing nations', in Malcolm Gillis (ed.), *Tax Reform in Developing Countries* (London: Duke University Press, 1989) at 493; for examples from India, Indonesia, Mexico, Singapore, Spain and the Philippines, see Arindam Das-Gupta and Dilip Mukherjee, *Incentives and Institutional Reforms in Tax Enforcement: An Analysis of Developing Country Experience* (Delhi: Oxford University Press, 1998).

[79] For examples from India; Indonesia, Mexico, Singapore, Spain and the Philippines, see Das-Gupta and Mukherjee, ibid.

[80] See Trebilcock and Daniels, *supra* note 10, Chapter 6.

[81] Susan Rose-Ackerman, *Corruption and Government: Causes, Consequences, and Reform* (Cambridge: Cambridge University Press, 1999) at 86 (showing that in tax reform incentive schemes can be used only if levels of performance can be measured by external monitors).

[82] Robert Taliercio, Jr., *Unsustainably Autonomous? Challenges to the Revenue Authority Model in Latin America Tax Agencies in Developing Countries* (Washington, DC: World Bank, 2001).

these agencies to maintain themselves over time as islands of virtue in an otherwise corrupt or incompetent general public administration may be quite limited without complementary reforms, over time, of the surrounding institutional matrix.

Another similarly motivated example of reforms is the implementation of independent regulatory agencies (IRAs) for infrastructure sectors such as telecommunications, electricity and water. During the 1990s US-style IRAs were adopted in many Latin American countries.[83] They were created to insulate regulatory decisions from electoral politics. To secure this insulation, IRAs were accorded a series of institutional guarantees of independence. For instance, in presidential systems these guarantees would include fixed terms of office for commissioners, congressional approval of presidential nominations, and alternative sources of funds to ensure their financial autonomy.[84] In the context of privatization of state-owned utility companies, this insulation was intended to provide a credible commitment by the government to existing rules and norms, supposedly protecting investors from arbitrary and unjustifiable subsequent modifications to the regulatory framework.

However, the implementation of IRAs has met with a series of obstacles.[85] In some cases, their creation was resisted by bureaucrats, who were also opposed to privatization and a competitive environment in infrastructure services. This resistance may exemplify high switching costs and the installed base problem. In other cases, the transfer of civil servants from the pre-existing bureaucracy to the IRAs brought deeply embedded practices that are difficult to change, impairing some of the institutional innovations adopted by IRAs, such as those designed to insulate these agencies

[83] Jacint Jordana and David Levi-Faur, 'Hacia un Estado Regulador Latinoamericano? La Difusión de Agencias Reguladoras Autónomas por Paises e Sectores' (2005). See also Giandomenico Majone, 'The rise of the regulatory state in Europe' (1994) 17 *West European Politics*, 77–101 (discussing the European experience).

[84] Warrick Smith, 'Utility regulators – the independence debate', in *Public Policy for the Private Sector*, note 127 (October 1997). Available at http://www-wds.worldbank.org/external/default/main?pagePK=64193027&piPK=64187937&theSitePK=523679&menuPK=64187510&searchMenuPK=64187283&theSitePK=523679&entityID=000009265_3980219162756&searchMenuPK=64187283&theSitePK=523679, but see Levi-Faur, 'The Politics of Liberalisation: Privatization and regulation-for-competition in Europe's and Latin America's Telecoms and Electricity industries', *European Journal of Political Research*, 42(5), 2003, 705–740.

[85] Mariana M. Prado, 'The challenges and risks of creating independent regulatory agencies: a cautionary tale from Brazil', (2008) *Vanderbilt Journal of Transnational Law* (March 2008), pp. 453–503.

from political and electoral interests. This illustrates the difficulty of mitigating self-reinforcing mechanisms, especially when they are embedded in the institutional culture. Finally, some of the institutional guarantees of independence in these agencies were not effective because they were operating in a different institutional matrix from the country of origin of the transplant. Thus, the creation of IRAs largely ignored the importance of institutional interconnections.

A related class of administrative agency is that of competition agencies.[86] Around 60 countries – mainly in transition or developing economies – have competition agencies that are 15 years or younger in age.[87] According to the World Bank, a 2000 survey found that, on average, competition authorities in industrial countries are 40 per cent more effective than competition authorities in developing countries.[88] The following challenges have been identified in recent surveys or evaluations of the experience of such agencies by the Competition Policy Implementation Working Group of the International Competition Network (ICN)[89] and the International Development Research Centre (Ottawa).[90]

First, many countries have borrowed heavily from developed countries in designing their respective laws, and the legislative framework does not address effectively the realities of the jurisdiction that these agencies are called upon to regulate. Some statutes fail to address important anti-competitive forms of conduct because of carve-outs or exceptions for industrial policy, political economy or other reasons. Others are expansive

[86] For a recent survey, see Michael Trebilcock and Edward Iacobucci, 'Designing competition law institutions: values, structure, and mandate' (2010) 41 *Loyola University Chicago Law Journal* 455.

[87] A recent survey and analysis of the competition laws of 102 countries finds mild preliminary support for the claim that competition law has a positive, albeit quite limited, effect on the intensity of competition within a nation. Much of the impact appears to be as a result of the strength of enforcement in particular areas rather than the scope of the substantive law, largely through reducing collusive practices. The study finds that merger or abuse of dominance law does not seem to enhance competition intensity: Keith N. Hylton and Fei Deng, 'Antitrust around the world: an empirical analysis of the scope of competition laws and their effects' (2007) 74 *Antitrust L.J.* 271.

[88] World Bank, *World Development Report 2002: Building Institutions for Markets* (Oxford University Press, 2002) at 141.

[89] International Competition Network, Implementation Working Group, 'Lessons to be learnt from the experiences of young competition agencies' (May 2006).

[90] Taimoon Stewart, Julian Clarke and Susan Joekes, 'Competition law in action: experiences from developing countries', International Development Research Centre, Ottawa, May 2007.

in their scope, but fail to establish any set of priorities for the agency consistent with its resources and capabilities. Others do not provide for compulsory *ex ante* notification of mergers, while others set notification thresholds so low that agencies are overwhelmed with merger notifications that they are not able effectively to review. In other cases, agencies are not invested with adequate investigative powers to unearth and eliminate anti-competitive conduct or are unable effectively to enforce compulsory disclosure laws, and lack powers to grant immunities to facilitate cartel investigations. In yet others, fines and other penalties are too low to induce effective deterrence, or cannot be effectively enforced.

Second, young agencies commonly report a lack of cooperation and coordination of policy and effort with particular government ministries and other regulatory bodies in their attempt to enforce and promote competition policy – in part as a result of the recent introduction of competition laws without provisions that address prior conflicting legislation or sectoral regulatory regimes. In some cases, these problems have been partly mitigated by memoranda of understanding with other agencies as to respective roles and responsibilities.

Third, many agencies in developing countries face major obstacles in dealing with cross-border anti-competitive conduct, especially international cartels, and often lack formal and informal cooperative mechanisms with other countries' authorities with more effective jurisdiction over potential wrongdoers.

Fourth, many agencies responding to the ICN survey indicated challenges relating to the interface between the competition authority and the judiciary and reported that cases have often taken years to process, partly as a result of a lack of specialized competence on the part of public prosecutors, attorneys and the local judiciary. An earlier ICN survey of competition agencies in developing and transition economies reported:

> The all but unanimous view expressed is that the judiciary is a major stumbling block in the path of effective competition enforcement – the judges do not understand competition law and are content to avoid the necessity to learn through diverting competition issues into a maze of esoteric administrative and procedural side-streets out of which the substantive matters at issue rarely emerge.[91]

Fifth, many new agencies suffer from extreme financial and human resource constraints that pose major challenges in setting priorities, as well as political cronyism in compromising the quality of key appointments. Developing and retaining specialized human capital within agencies and complementary educational and professional institutions is a pressing challenge.[92]

[91] ICN Working Group, 'Capacity building and technical assistance: building credible competition authorities in developing and transition economies', 23–25 June 2003, at 35.

Finally, the studies note the lack of a competition culture in many of the jurisdictions in which these new agencies operate. This is reflected in a lack of awareness by the business community, government agencies, non-government agencies, the media, the judiciary and the general public of the rules of competition law, and their overall responsibility to ensure that such rules are observed in the interest of competition and overall economic development. Many of these new agencies are operating in economies in transition (from command to market economies), dealing with major state-owned enterprises or only recently privatized SOEs often operating in highly concentrated sectors. Many others are located in developing countries with long histories of state-led development policies – including import substitution policies that severely restrict import competition and foreign investment. These agencies have to deal with extensive state-owned enterprises and highly concentrated economic sectors, which are often subject to extensive price, entry and exit regulation. In this context, both within and outside government there are substantial vested interests in policies that are antithetical to effective competition.[93] An earlier ICN Report concluded:

> In the end, we have been persuaded that the over-arching challenge confronting competition authorities in developing and transition countries relates to their stature and standing within the ranks of key stakeholders or interest groups, as well as the public at large. In other words, all struggle to make themselves heard and it is this that constitutes the gravest challenge confronting competition authorities in these countries.[94]

VI. IDENTIFYING FEASIBLE REFORM STRATEGIES

Approaches to rule of law reforms that do not take into account adaptive behaviour with respect to the particular institutional context in question,

[92] See Daniel Sokol, 'The development of human capital in Latin American competition policy', in Eleanor Fox and Daniel Sokol (eds), *Competition Law and Policy in Latin America* (Oxford: Hart Publishing, 2009).

[93] See Ignacio de Leon, 'A market process analysis of Latin American competition policy', UNCTAD Regional Meeting on Competition Law Policy, Costa Rica, 03 August – 1 September 2000.

[94] ICN Working Group, *supra* note 91 at 74.

as well as mutually reinforcing effects among interdependent institutions, are unlikely to be successful. If one takes path dependence seriously, future reform strategies will be significantly constrained and shaped by the legacies of history. The lessons of path dependence lead to a conundrum. Path dependence shows that isolated institutional reforms focused on micro-processes are likely to ignore both self-reinforcing mechanisms and institutional interdependencies, and are therefore often doomed to failure. However, system-wide ambitious reforms during 'normal times' are disruptive and likely to fail because of the serious switching costs that they are likely to entail (and the resistance that these will engender). Thus, despite institutional interdependencies, all-encompassing reforms are simply not feasible. This is true during normal times and there seems to be evidence that, even in post-conflict societies (which may present more opportunities or at least greater urgency for change), all-encompassing reforms often achieve very limited success.[95]

Are reformers then left only with windows of opportunity (critical junctures) in which major reforms can be implemented successfully? Is there any way that reformers can account for the lessons of path dependence theory without being in a potentially eternal waiting period for the right moment? As Rodrik puts it, 'the challenge for the empirical literature on institutions is to explore these [path dependent] patterns without falling into the trap of reductionism or of historical and geographical determinism'.[96]

There are two potential (and complementary) strategies for dealing with this conundrum. First, reformers may be able to identify some institutions that can be more easily detached from a broader mutually reinforcing institutional matrix or be created *de novo* (such as semi-autonomous revenue agencies, new constitutional or human rights courts or commissions, semi-independent regulatory agencies, one-stop government agencies (like the Brazilian Poupatempo)[97] for issuing, for example,

[95] Marina Ottaway, 'The post-war "Democratic Reconstruction Model": why it can't work'. Paper presented at United States Institute for Peace, 2002.

[96] Dani Rodrik, 'Feasible globalizations', KSG Working Paper Series RWP02-029 (Cambridge, MA: Harvard University, 2002), available at http://web.hks.harvard.edu/publications/workingpapers/citation.aspx?PubId=935 at 6–8. See also Dani Rodrik, *One Economics, Many Recipes Globalization, Institutions, and Economic Growth* (Princeton, NJ: Princeton University Press, 2007), Chapters 5 and 6; see also Francis Fukuyama, 'Development and the limits of institutional design', Global Development Network (St. Petersburg, Russia: 20 January 2006); Francis Fukuyama, *Statebuilding: Governance and World Order in the 21st Century* (Ithaca: Cornell University Press, 2004).

[97] See Mariana M. Prado and Ana Carolina Chasin, 'How innovative was the Poupatempo experience in Brazil? Institutional bypass as a new form of institutional change', *Brazilian Political Science Review* [forthcoming 2011].

passports, driving licences, ID cards and health cards, and alternative forms of dispute resolution).[98] This strategy may enable more ambitious stand-alone reforms that nevertheless have important showcase effects that demonstrate lower switching costs or greater benefits than sceptics had assumed, although even here the experience with semi-autonomous revenue agencies and independent regulatory agencies suggests that these institutions are likely to be fragile without complementary reforms, over time, to the surrounding institutional matrix.

The second strategy is to reform existing institutions that are interconnected and mutually reinforcing in a time sensitive manner by prioritizing a sequence of reforms, beginning with certain core reforms but recognizing that further complementary reforms will be necessary in the future to reinforce the initial reforms. This implies that reforms should be incremental, which is quite different from many current reform practices that are either stand-alone without being incremental or are so encompassing as to be infeasible.

One of the lessons of path dependence is that we are not writing on a blank slate. It is true that in abnormal times – 'critical junctures' (for example, the aftermath of economic collapse, civil war or military invasion) – the credibility and legitimacy of incumbent elites may be weakened by such crises, creating new political openings for marginalized constituencies.[99] At the same time, it is unlikely that all pre-existing economic, social and cultural factors that create costs for switching to new institutional regimes can be ignored entirely[100] (as contemporary challenges to institutional reform in, for example, Iraq and Afghanistan exemplify). Reformers should recognize not only the importance of switching costs, but also be sensitive to the different kinds of switching costs associated with reform.[101]

[98] See Thomas Heller, 'An immodest postscript', in Jensen and Heller, *supra* note 32; Mariana M. Prado, 'Institutional bypass: an alternative to development reform', (April 19, 2011). Available at SSRN: http://ssrn.com/abstract=1815442.

[99] See Michael Trebilcock, 'Journeys across the divides', in Francesco Parisi and Charles Rowley (eds), *The Origins of Law and Economics: Essays by the Founding Fathers* (Cheltenham, UK: Edward Elgar, 2005).

[100] This can be true even in post-conflict societies; see Susan Rose-Ackerman, 'Corruption and post-conflict peace-building' (2008) *Ohio Northern University Law Review* 405.

[101] This section draws on the analysis developed in Ronald J. Daniels and Michael J. Trebilcock, 'The political economy of rule of law reform in developing countries' (2004) 26 *Mich. J. Int'l L.* 99.

First, in terms of political economy considerations, switching costs may be high for those who benefit from the institutional status quo.[102] These costs may be mitigated by reforms that create or strengthen a countervailing political constituency that benefits from the reforms.[103] Alternatively, vested interests may need to be bought off or grandfathered in some way to mute opposition to the reforms. Second, switching costs may also reflect individual learning costs in adapting to a new regime (the 'installed base' problem). These can be mitigated by state-sponsored public education programs and gradual processes of transition that avoid the need for abrupt adaptation to a new regime. Third, switching costs may reflect the scarcity of financial and human resources required to implement new institutional regimes, which can be mitigated by external financial and technical assistance. Finally, switching costs may reflect deeply embedded cultural benefits or practices that are resistant to change.[104] Here, reforms that adapt traditional institutions (such as traditional forms of alternative dispute settlement or communal property rights) may mitigate problems of cultural dissonance. Moreover, institutional reforms implemented over time may in turn lead to modifications in cultural belief systems.

In this respect, various forms of alternative dispute resolution (ADR) make up a class of reforms that appears to have shown significant promise, largely through demonstration effects. ADR sometimes builds on traditional or community-based forms of dispute settlement, such as adaptations of the Lok Adalat system in India, the Shalish system in Bangladesh, the Gacaca Tribunals in Rwanda in the aftermath of years of civil war and genocide, the Casas de Justicia in Latin America and Alternative Law Groups in the Philippines. These have sought to marry indigenous methods of dispute settlement with broader rule of law norms,

[102] Resistance to reform can also be higher if there is uncertainty regarding the identity of potential beneficiaries. The uncertainty is higher in large-scale reforms: Dani Rodrik and Raquel Fernandez, 'Resistance to reform: status quo bias in the presence of individual-specific uncertainty' (1991) 81 *American Economic Review* 1148.

[103] How much instability these reforms should generate – i.e., how much room for constant contestation would be good for future reforms – is a topic that deserves further research. For an insightful analysis, see Susan Rose-Ackerman, 'Was Mancur a Maoist? An essay on kleptocracy and political stability' (2003) 15 *Economics and Politics* 163.

[104] See, for instance, how informal institutions for contract enforcement in the footwear industry resisted the changes brought by an open trade regime when NAFTA was implemented in Mexico: Christopher Woodruff, 'Contract enforcement and trade liberalization in Mexico's footwear industry' (1998) 26 *World Development* 979.

such as equality before the law, so as to minimize cultural switching costs. In these cases, reformers have struggled to navigate the difficult compromise between two, sometimes conflicting, models of dispute resolution and the respective roles of the formal court system and informal modes of dispute settlement. Despite these difficulties, these ADR reforms have a major benefit: they acknowledge and rely on context-specific forms of institutional vindication or instantiation of rule of law values, thus reducing cultural switching costs and nurturing an increasingly robust domestic constituency for rule of law reforms more generally over time. In this sense, these reforms enable a broadly representative range of social, economic and political interests to see their interests and values as aligned with the promotion and preservation of the rule of law.

VII. THE ROLE OF EXTERNAL ACTORS IN PROMOTING RULE OF LAW REFORM IN DEVELOPING COUNTRIES

We argue that a tailored approach, overtly attentive to the domestic political context of the countries in question, will enhance the likelihood of success of external efforts at promoting rule of law reform in developing countries. If, as many commentators have persuasively argued, the rule of law is ultimately a political phenomenon, we think that such political attention only makes sense. In this regard, Michael Trebilcock and Ronald Daniels have sketched a set of hypothetical political formations with varying degrees of support for rule of law reform that are useful in considering how reforms can be sensitive to different political contexts.[105] These paradigmatic formations, each of which can be related to real-life examples, will necessarily pose different kinds of challenges for rule of law reformers, and create different openings and opportunities for an international role. Thus, the relative salience of each of the three obstacles to reform discussed above will vary as between these different formations (and almost infinite variations on them) – and with them, the role of the international community.

The first stylized formation is characterized by an environment of broad political support for the rule of law. The state that we envision has progressive-minded political leadership at the highest levels, strong support from within the ruling party and broad popular support for legal reforms. The archetypal administration is that of Nelson Mandela in

[105] Trebilcock and Daniels, *supra* note 10.

South Africa, particularly in the early days after his election in 1994. Not only did Mandela himself have a strong mandate, but public support for legal reform was widespread as well. Another, perhaps more contentious, example is Lee Kuan Yew, Prime Minister of Singapore from 1959 to 1990 and senior government minister thereafter, who was strongly committed to a highly competent, meritocratic, non-corrupt public administration throughout his lengthy term as Prime Minister, although the independence of the judiciary in contexts involving government officials has been more problematic. Yet further examples include several countries in Central Europe following the collapse of the Soviet Union.

The second stylized formation is more ambiguous in its support for rule of law reform. This administration is marked by a strong desire for rule of law reform at the highest political levels, but more systematic opposition from a variety of complex economic and social relationships operating below the political surface. This kind of opposition might be rooted, for instance, in an entrenched ideological orientation inconsistent with the rule of law, or in powerful public or private interests with a stake in a general state of lawlessness. These administrations will often be identifiable by the rise of a charismatic or prominent leader in a time of general political or economic turmoil. Somewhat ironic examples include Mikhail Gorbachev, Boris Yeltsin and Vladimir Putin. At least in their early days, these leaders brought tremendous promise of reform, despite, among other problems, the meteoric rise of an oligarchic class of extraordinarily powerful organized criminals, rampant corruption and the pervasive influence of Communist ideology including, not least, a not insignificant degree of popular support for it.

The third stylized formation is marked by a highly corrupt political leadership with strong incentives for maintaining the status quo and no predisposition to reform. In such states there may be varying degrees of organized popular opposition in the form of NGO or other civil society activity, and there may be some degree of opposition from, or some tendency towards, or pockets of reform within, the leadership of some governing factions or government agencies. However, where the political leadership establishes any sort of lasting foothold, it will almost invariably have complex webs of support in military, administrative or judicial branches of government, and often among some segments of the public. There are myriad examples of authoritarian and kleptocratic administrations to pick from, including the long-standing regime of Robert Mugabe as Prime Minister and then President of Zimbabwe, President Mobutu in Zaire, the Duvaliers in Haiti or the stranglehold of the late Saparmurat Niyazov, self-anointed 'leader of the Turkmens', as President of Turkmenistan. While these states will very often be undemocratic or

authoritarian, we emphasize that it is not an absence of democracy per se, but rather hostility to the rule of law that will place an administration in this category. Governments with nominal election procedures in an otherwise repressive context may be hostile to rule of law reform – indeed, Mugabe is an example *par excellence*. More legitimate, popular elections may also produce governments hostile to many of the characteristics of the rule of law, as with the popular election of Yasser Arafat's Palestinian Authority in 1996.

There are several ways in which this trichotomy should be viewed as merely suggestive rather than exhaustive or definitive. First, the lines between these three categories are not strictly demarcated boundaries. States may slide in and out of each category, as governments change policy and character over time. Moreover, ruling parties in any given state may have differing interests across different institutions, and therefore support reform efforts in some institutions, and in some respects, but not in others. Second, there may be substantially different political formations within each of these categories, with significant implications for rule of law reform prescriptions. Our categories do not follow the markings of democracy but rather those of the rule of law. Consequently, within each category there are likely to be widely differing political contexts, to which reformers domestic and external will have to be attentive in selecting appropriate strategies for reform. For instance, in states with authoritarian governments – even those generally in favour of reform – it may be more difficult to pursue legal remedies against the state or its representatives in court proceedings (Singapore may be an example).

As one moves along the spectrum from Type I states to Type III states, top-down, state-centric reform strategies become less feasible, and bottom-up, community-based reform strategies become a more promising option.

Type I states

In these states, where broad political and popular support for rule of law reform exists, the role of the international community should be focused most heavily on alleviating resource constraints. While socio-cultural factors and various forms of vested interests may still act as important barriers to reform, in these states it will be domestic governments, rather than the international community, who will be best placed to address these concerns.

The preferred method of intervention in the most favourable cases (admittedly rare) should be unconditional aid, leaving to the domestic government concerned the choice of reform priorities and strategies and sources of technical advice unless, for credible commitment and signalling

purposes, the recipient government requests conditionality. The 'mallet'-like political pressure of accession conditions on membership of regional or multilateral economic or political associations will play little fruitful role, because the state is already generally politically aligned with the viewpoint of reformers. Similarly, because trade policy (preferences or sanctions) does not direct new resources to rule of law initiatives, it will be irrelevant in these circumstances. Because of their punitive nature, economic sanctions would be entirely misplaced.

While there is a case for conditional aid in more equivocal cases, it is important to emphasize again that government policy may be fluid, and that strongly pro-reform administrations can shift policies quickly, particularly where they come to power in a period of transition or during a key 'constitutional moment'. Donors must therefore be vigilant in monitoring the trajectory of Type I governments, and enforcing conditions where appropriate – an historical weakness of development agencies. Funding of non-state drivers of rule of law reform such as local NGOs can also play a role in these states, as they can in almost any situation. However, in these cases, NGOs that cooperate with, rather than oppose, government policies are likely to be more effective.

Type II states

In states with generally reform-minded political leadership but with a less secure political base and widespread opposition from vested interests within state agencies – including legal institutions and perhaps private sector parties who benefit from dysfunctional public institutions – a more diverse set of strategies will be necessary. In these cases, resources may still be scarce, but international agencies or external donors cannot responsibly commit to unconditional aid. Even where high-level political leadership supports reform, increased aid flows to antagonistic public or legal institutions can be misdirected and wasted, or used for regressive purposes. With respect to conditional aid, governments truly committed to reform may agree to conditional aid that binds them to a policy and protects them from internal special interests. A case can be made for conditionality through accession or trade preferences on similar grounds. Also, there may be a good case for non-state-led reforms through local NGOs or alternative law groups operating more independently from the state in institutional contexts where independence of legal institutions is likely to be problematic.

Type III states

Governments unequivocally opposed to rule of law reform will rarely be sensitive to state-level pressure mechanisms, such as trade or other

economic sanctions and forms of conditionality attached to aid, debt relief, trade preferences, or accession to regional or multilateral economic or political associations. As Preeg argues in respect of US sanctions (for example, denial of most favoured nation (MFN) trading status) against China, 'the basic reason why these unilateral economic sanctions are ineffective is that the foreign policy objective is to change the oppressive behaviour of an authoritarian or totalitarian government, which constitutes a direct threat to its control if not survival'.[106] While China is not our test case – US sanctions in this case were intended to stimulate democracy more than the rule of law – the point remains the same.

In these cases, the role of non-state actors should become a central aspect of rule of law reform efforts, with a particular focus on those local and international NGOs developing reforms independent of state agencies and the provision of financial and technical assistance to them. In China and Laos, for example, NGOs have played an important role as *de facto* monitoring mechanisms for correctional institutions where the state has denied access to formal state-level monitoring channels. Properly designed and implemented non-state dispute resolution mechanisms, often based on traditional forms of community-based dispute settlement, can also be a vital element of access to justice in circumstances where courts suffer from chronic backlog, corruption or bias, and hence a lack of legitimacy.[107]

VIII. CONCLUSION

It will be obvious that over time states may evolve either negatively or positively from one stylized type to another in the foregoing typology, requiring the international community continuously to reassess its strategies for promoting rule of law reform and to readjust its menu of strategies accordingly. However, even acknowledging this, and acknowledging further that all desirable rule of law reforms cannot be realistically embarked upon simultaneously – if only because of resource constraints and pressing demands on those resources – even in the most favourable (Type I) political environments issues of prioritization and sequencing

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[106] Ernest H. Preeg, *Feeling Good or Doing Good with Sanctions: Unilateral Economic Sanctions and the US National Interest* (Washington, DC: Center for Strategic and International Studies, 1999).

[107] UNDP, *Making the Law Work for Everyone: Report of the Commission on Legal Empowerment of the Poor*, volume 1 (New York, NY: United Nations, 2008) at 63.

will invariably arise. While these must largely be resolved by domestic constituencies committed to rule of law reform, as must the particular forms of institutional vindication or instantiation of rule of law values, nurturing an increasingly robust domestic constituency for the rule of law over time that reflects a demand-side perspective requires that a broadly representative range of social, economic and political interests come to see their interests and values as aligned with the promotion and preservation of the rule of law. In this respect, we question (along with others) the aptness of the relatively high priority often accorded to formal judicial reform by the international community in the rule of law initiatives that it has promoted in developing countries in recent years,[108] and the relative lack of attention to institutional reforms that are more likely to affect the day-to-day interactions of the citizenry with the legal system. These include police, prosecutors, specialized law enforcement and administrative agencies, including agencies of government that issue, for example, passports, driving licences, ID cards, health cards, building permits and business licences,[109] and access to justice initiatives – such as informal community-based dispute resolution mechanisms (often reflecting adaptations to and elaborations of traditional dispute settlement mechanisms) – where more visible and immediate material benefits from successful institutional reform are likely to be experienced by a wide cross-section of the citizenry. Civil justice surveys of representative samples of the population that have been undertaken in recent years in a number of developed countries[110] provide helpful examples of instruments for identifying the relative frequency and shortcomings of citizen interactions with state agencies.

While we acknowledge that the success of institutional reforms in one context ultimately often depends, to an important extent, on complementary institutional reforms in other contexts,[111] this does not realistically

[108] See Carothers, *supra* note 28; Stephen Golub, 'A house without foundation', in Carothers, *supra* note 32; Bryant Garth, 'Building strong and independent judiciaries for the new law and development: beyond the paradox of consensus programs and perpetually disappointing results' (2003) 52 *DePaul Law Review* 383.

[109] Famously described by Charles Reich as 'The new property' (1964) 73 *Yale L.J.* 733, lack of effective access to which in many developing countries is equally famously described by Hernando de Soto, *supra* note 4, and is increasingly well documented in various reports in the World Bank's 'Doing Business' Surveys.

[110] See, e.g., Jamie Baxter, Michael Trebilcock and Albert Yoon, 'The Ontario Civil Needs Project: a comparative analysis of the 2009 survey data', in Michael Trebilcock, Tony Duggan and Lorne Sossis (eds), *Middle-Income Access to Justice* (University of Toronto Press, forthcoming).

[111] See Rachel Kleinfeld, 'Competing definitions of the rule of law' (Carnegie Paper No. 55, Carnegie Endowment, Washington, DC, 2005).

mean that everything can be pursued at once. Judicial reforms (and, we should probably acknowledge, reforms to legal education) are likely to have longer-term and less visible social pay-offs to the citizenry at large and hence are less likely to engage their interest and support than other reforms noted above, given the many more pressing and immediate survival challenges citizens in developing countries often face. Thus, both domestic and international proponents of rule of law reform in developing countries face a hitherto under-acknowledged challenge of rendering rule of law reform politically salient to most citizens of these countries. Strategic choices on sequencing are important in addressing this challenge.

3. The property rights/contract rights development nexus

It has become conventional wisdom amongst most economists that, whatever else the state does, it should provide effective institutions and processes to protect private property rights and enforce contracts, which are regarded as prerequisites to efficient and dynamic market economies. In the words of two prominent law and economics scholars in a forthcoming book, *Solomon's Knot*, 'inadequate institutions to enforce property and contract law are the most fundamental defect in the legal framework of poor countries'.[1] On this view of the rule of law, law plays a critical instrumental role in promoting economic development and should be accorded the highest developmental priority. In the first part of this chapter, we address the property rights protection pillar of this conventional wisdom, then in the second part turn to the contract rights pillar.

I. PROPERTY RIGHTS[2]

A. Introduction

The significance of property rights for economic growth has been the subject of much writing by development theorists and policymakers alike. The so-called 'Washington Consensus' identified property rights protection as one of the major areas of reform for the developing world.[3]

[1] Robert Cooter and Hans-Bernd Schaefer, *Solomon's Knot* (Princeton University Press, forthcoming) (manuscript at 12); see also Kenneth W. Dam, *The Law-Growth Nexus: The Rule of Law and Economic Development* (Brookings Institution Press, 2006) at 91 ('Proponents of the rule of law in the context of economic development often express the core of their position . . . by emphasizing the need to "enforce contracts and protect property rights."')

[2] This discussion of property rights and development is largely derived from Michael Trebilcock and Paul-Erik Veel, 'Property rights and development: the contingent case for formalization' (2008) 30 *University of Pennsylvania Journal of International Law* 397.

[3] See John Williamson, 'What Washington means by policy reform' in John Williamson (ed.), *Latin American Adjustment: How Much Has Happened?* (Peterson Institute for International Economics, 1990) at 7, 17 (noting property rights as an area of insecurity that needs to be corrected in Latin America).

The World Bank also advocates this approach, and has supported and financed programs for the formalization of property rights and the creation of titling systems to secure such rights.[4] While some of the research emanating from the World Bank in recent years has advocated a more nuanced approach,[5] other documents have seemed to follow its traditional attitude that the formalization of property rights is virtually always desirable.[6]

Perhaps most reflective of the importance of property rights in contemporary thinking on economic development has been the success and influence of Hernando de Soto's *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, in which he argues that strong protection for private property rights is the key factor in explaining the economic success of the developed world.[7] Indeed, on de Soto's account, the potential benefits of formalization of property rights are significant. De Soto claims that 'the total value of the real estate held but not legally owned by the poor of the Third World and former communist nations is at least $9.3 trillion', which he characterizes as 'dead capital'.[8]

This broad assertion is unsatisfactory, however, as it leaves a great deal of indeterminacy in terms of the actual policies implied in achieving the objective of strengthening the protection of property rights. The theoretical and empirical literature which has emerged in support of this claim

[4] World Bank, 'World Development Report 2005: A Better Investment Climate for Everyone' (2004) at 2, available at http://siteresources.worldbank.org/INTWDR2005/Resources/complete_report.pdf; see also Ahmed Galal and Omar Razzaz, 'Reforming land and real estate markets' (World Bank Policy Research, Working Paper No. 2616, 1999) at 20–21, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=636201 (assessing the World Bank's experiences with formalizing property rights in developing nations).

[5] See Klaus Deininger, *Land Policies for Growth and Poverty Reduction* (Washington, DC: World Bank and Oxford: Oxford University Press, 2003) at 5–6 (finding 'a considerable evolution and increased sophistication' in the recent recommendations for property reform).

[6] See, e.g., World Bank, *supra* note 4 at 80–84 (portraying examples of the virtually unequivocal support for the formalization of property rights).

[7] Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (Basic Books, 2000) at 218; see also Madeleine Albright, 'It's time for empowerment, the world in 2007' (2006) *The Economist* at 65 (noting that property right reform is essential to economic success for the Third World).

[8] De Soto, ibid., at 35.

has been used by some to advocate titling and registration programs as a general solution to the problem of property rights insecurity. We argue, however, that this blanket approach towards the establishment of stronger property rights is unwarranted and counter-productive and instead that a more nuanced approach is required to craft successful development policies regarding property rights.[9]

B. The Benefits and Necessity of a Formal Property Rights Regime

1. The benefits of secure property arrangements

It is important at the outset to highlight briefly some of the reasons why property has occupied such a prominent place in the development literature in recent years. Although there have been many sweeping claims made about the benefits of private property, the literature has also disaggregated the benefits by analysing a number of distinct economic benefits that private property can bring.

Exclusive use leads to resources being used efficiently There are two mechanisms through which various bundles of private property rights can lead to resources being used in the most efficient way possible. The first mechanism assumes that because private property leads individuals to internalize fully the costs and benefits of their use of an asset, private property rights will lead people to use resources in the most socially efficient way.[10] When the protection of property rights over a given resource is weak, collective

[9] See David Kennedy, 'Some caution about property rights as a recipe for economic development' (2011) 1 *Accounting, Economics and Law*, Article 3, at 42–8.

[10] See Harold Demsetz, 'Toward a theory of property rights' (1967) 57 *American Economic Review* 347 at 348–9 (discussing how private property rights force owners to internalize the costs of their actions as compared to communal property rights); see also Armen A. Alchian and Harold Demsetz, 'The property right paradigm' (1973) 33 *Journal of Economic History* 16 at 24 ('[P]rivate rights can be socially useful precisely because they encourage persons to take account of social costs.'); R.H. Coase, 'The Federal Communications Commission' (1959) 2 *J.L. & Econ.* 1 (discussing the creation of the FCC and the social costs of public airwaves); Garrett Hardin, 'The tragedy of the commons' (1968) 162 *Sci.* 1243 at 1245 (discussing how communal property allows people to push social costs such as pollution onto society as a whole). Proponents of new institutional economics have also examined this claim. One proponent, Douglass North, argues that private property rights raise the private rate of return of an activity closer to the social rate of return, thereby spurring economic growth: Douglass North, *Structure and Change in Economic History* (New York and London: W.W. Norton, 1981) at 6 ('The existence of a positive return to savings is also dependent on the structure of property rights.')

action problems involving significant inefficiencies in the use and exploitation of that resource can arise. First, where numerous individuals are using the same resource, that resource may be overexploited, as individuals will not consider the detrimental effects on others from their own decisions related to resource use.[11] Second, where no property rights are assigned to a resource, individuals may have an incentive to appropriate that resource as quickly as possible lest others appropriate it first; this can lead to inefficient and wasteful resource mining.[12] Third, a lack of secure property rights over a certain type of asset may lead parties to make socially suboptimal asset allocations, investing in assets which have lower returns but which are easier to protect.[13] Thus, these claims suggest that the stronger private property is, in the sense of private ownership and allowing individuals to capture the returns from their efforts, the greater the efficiency in the exploitation and use of a resource will be.

It is important to note, however, that under certain economic conditions, both open-access systems, where no one is excluded, and communal property arrangements, where non-members are excluded, can be economically efficient arrangements.[14] For example, a system of open access

[11] Erik Furubotn and Rudolf Richter, *Institutions and Economic Theory: The Contributions of the New Institutional Economics* (Ann Arbor: University of Michigan Press, 2nd edn, 2005) at 111–16.

[12] See Thràinn Eggertsson, 'Open access versus common property,' in Terry L. Anderson and Fred S. McChesney (eds), *Property Rights: Cooperation, Conflict, and Law* (Princeton, NJ: Princeton University Press, 2003) at 77 ('In effect, the now-or-never motive drives actors to deplete nonrenewable resources without due attention to optimal time preferences and patterns of demand.'). For a formal demonstration of this point, see Louis Hotte, 'Conflicts over property rights and natural-resource exploitation at the frontier' (2001) 66 *Journal of Development Economics* 1, who models resource use in the case of insecure ownership and shows that where landowners believe that they may lose their access to a resource in the near future, they may exploit the resource in a socially wasteful manner.

On a related point, where individuals face tenure insecurity, they may not make socially optimal investments for the long-term protection or sustainability of a particular resource or the environment generally because they are uncertain *ex ante* about their likelihood of appropriating the benefits of such investments. For example, Gebremedhin and Swinton show that the probability of farmers making long-term investments in soil conservation measures in Ethiopia was related to their perceived degree of tenure security in their land: Berhanu Gebremedhin and Scott M. Swinton, 'Investment in soil conservation in Northern Ethiopia: the role of land tenure security and public programs' (2003) 29 *Agricultural Economics* 69.

[13] See Stijn Claessens and Luc Laeven, 'Financial development, property rights and growth' (2003) 58 *J. Fin.* 2401 at 2402 ('[O]ur idea of property rights is the degree of protection of the return on assets against powerful competitors.')

[14] See Dam, *supra* note 1 at 151 ('It would be a mistake, however, to conclude

to land could be a rational response to economic forces if land were not a scarce good, as in such circumstances there is no benefit in creating formal individual property rights, while there would be a cost.[15] Similarly, if land is only somewhat scarce and a community is relatively small, communal property arrangements may combine the benefits of socially efficient alternatives through collective action with lower enforcement and transaction costs than individual property rights.[16]

The second mechanism through which strong property rights promote efficiency is that when the land over which one has strong private property rights is also alienable, the land can be transferred from less efficient users to individuals who will put it to more efficient uses.[17] Because the land is more economically valuable to the more efficient user, mutually beneficial trades should be possible wherein land is transferred from less efficient users to more efficient users (implicating the contract rights pillar of the two pillars discussed in this chapter).

Security of tenure and easy transferability of property increase access to credit The linkage between property and access to credit is another economic aspect of property that has been extensively explored. Indeed, one of de Soto's main arguments in *The Mystery of Capital* is that secure property rights allow individuals to use their possessions as sources of capital.[18] As Feder and Onchan note, creditors will be much more likely to provide credit where that credit can be secured with collateral. Property, however, whether real or personal, can only be effective collateral if creditors believe

that all communal ownership is so inefficient that it is an obstacle to economic development.'). See also Robert Ellickson, 'Property in land' (1993) 102 *Yale L.J.* 1315 at 1332 (noting the advantages of communal ownership); see generally Deininger, *supra* note 5 at 29 (discussing generally some of the factors which can lead group rights to be more efficient than individual rights).

15 See Omotunde E.G. Johnson, 'Economic analysis, the legal framework, and land tenure systems' (1972) 15 *J.L.Econ.* 259 at 259 (arguing that in certain circumstances communal property systems allow for more cost savings than personal property).

16 See Gerson Feder and David Feeny, 'Land tenure and property rights: theory and implications for development policy' (1991) 5 World Bank Economic Review 135 at 143 (discussing how voluntary collective action in a communal property arrangement enabled an efficient solution to a problem).

17 See Klaus Deininger and Gershon Feder, 'Land institutions and land markets' (1999) World Bank Policy Research, Working Paper No. 2014, at 1 ('[T]here is some evidence that a higher degree of transfer rights provides additional incentives for investments and for more efficient use . . .').

18 De Soto, *supra* note 7 at 6 (noting that property rights allow Western nations to 'inject life into assets and make them generate capital').

that they will be able to gain possession of this collateral in the event of the debtor's default.[19] Thus, the debtor must have secure ownership of the property and have the ability to easily transfer it to the creditor.

A lack of access to credit can significantly impair economic development. Without access to credit, the requisite capital may not be available to finance investments. According to de Soto, in the United States 'up to 70 percent of the credit new businesses receive comes from using formal titles as collateral for mortgages'.[20] Even where creditors do not require property as collateral, the interest rate on that credit may be higher, reflecting the higher risk that creditors face when making unsecured loans. Projects which would have been financed at the lower interest rate available for secured loans may become unprofitable or may be deemed too risky at the higher rate for unsecured credit.

It should be noted, however, that while formal title can increase the supply of credit, it may not immediately lead to greater borrowing if demand for credit is limited. Even complete security and alienability of land may not improve access to credit if landholders are risk-averse and perceive a risk of losing their land if it is mortgaged.[21] This problem is especially acute when landowners have no access to insurance or alternative sources of wealth.[22]

Security of tenure increases incentives for investment The increase in investment is perhaps the most discussed beneficial effect of strong

19 Gerson Feder and Tongroj Onchan, 'Land ownership security and farm investment in Thailand' (1987) 69 *American Journal of Agricultural Economics* 311; see also Heywood Fleisig, 'Secured transactions: the power of collateral' (1996) 33 *Fin. & Dev.* 44 at 45 (discussing how barriers to the enforceability of security interest, such as those in developing countries, make lenders less likely to extend credit).

20 De Soto, *supra* note 7 at 84.

21 Jean-Philippe Platteau, 'Does Africa need land reform?' in Camilla Toulmin and Julian Quan (eds), *Evolving Land Rights, Policy and Tenure in Africa* (London: DFID/IIED/NRI, 2000) at 51. The ability to use land as collateral may actually be detrimental to smaller farmers. Eric van Tassel's model shows that where farmers have limited income, they may not be willing to risk losing their land in order to acquire loans. Creditors, however, may be unwilling to provide unsecured loans to such farmers, as they may perceive the farmer's preference for an unsecured loan over a secured loan as indicating that the farmer poses a high risk of default: Eric van Tassel, 'Credit access and transferable land rights' (2004) 56 *Oxford Econ. Papers* 151 at 153–5.

22 See Stephen R. Boucher et al., 'The impact of "market-friendly" reforms on credit and land markets in Honduras and Nicaragua' (2004) 33 *World Development* 107 at 111 (indicating that 'land-poor households' may be unwilling to take out loans without insurance because of the risk of collateral loss).

property rights.[23] There are three distinct ways in which stronger property rights can increase investment. First, where tenure is more secure, individuals will be more likely to invest significant resources to improve their property and make it more productive. Second, where property is alienable, individuals have greater incentives to improve property because they will be able to realize a gain from that improvement upon selling it. Finally, where property is secure and alienable, the supply of credit is increased, thereby giving individuals access to the capital necessary to improve their land.[24]

Security of tenure decreases inefficient competition for resources Where property is relatively secure, two types of socially wasteful activity can be eliminated. First, where property rights are insecure, individuals may attempt to invade land or steal assets belonging to other people. Second, and in response to this threat, individuals will have to expend resources to protect their own property from such actions; perhaps the most destructive version of this type of private protection is the property protection provided by organized crime.[25] Even where outright conflict does not occur, insecurity may induce individuals to expend resources on legal action in trying to assert ownership claims to contested property.[26] This reasoning implies that more secure and well-defined property rights may lead individuals to move away from unproductive conflict over property towards productive activities.[27]

[23] One of the most often cited papers in the contemporary literature on the theoretical and formal underpinnings of this effect is Besley's work, in which he formally models the relationship between security of tenure and investment: Timothy Besley, 'Property rights and investment incentives: theory and evidence from Ghana' (1995) 103 *Journal of Political Economy* 903.

[24] Platteau, *supra* note 21.

[25] See Curtis Milhaupt and Mark West, 'The dark side of private ordering: an institutional and empirical analysis of organized crime' (2000) 67 *University of Chicago Law Review* 41 at 43 ('Organized crime . . . is the dark side of private ordering – an entrepreneurial response to the inefficiencies in the property rights and enforcement framework supplied by the state.')

[26] See Tim Hanstad, 'Designing land registration systems for developing countries' (1998) 13 *American University International Law Review* 647 at 654–5 (suggesting that uncertainty over land interest, like ill-defined boundaries, often leads to litigation, especially in the absence of effective land registration systems).

[27] See Erica Field, 'Entitled to work: urban property rights and labor supply in Peru' (2007) 122 *Quarterly Journal of Economics* 1561 (suggesting that formal property rights will increase household labour supply since individuals will have to spend less time informally enforcing their property claims); see also de Soto, *supra* note 7; Hernando de Soto, *The Other Path: The Invisible Revolution in the Third World* (June Abbott, trans., Harper & Row, 1989) [hereinafter 'de Soto, *The Other Path*'] at 160.

2. The necessity for a formal property rights regime

Many development scholars and policymakers contend that the benefits of private property described above are best achieved by a formal state-run property system. Indeed, the intellectual tradition of viewing the state as being necessary for the enforcement of claims to private property has a long genesis.[28] Thomas Hobbes viewed the existence of a powerful state as necessary to overcome the anarchy that would prevail in a state of nature.[29] John Locke similarly viewed the primary purpose of the state as being one of protecting individuals' property – that is, their life, liberty and estate.[30] In *The Wealth of Nations*, Adam Smith viewed administering justice as an important role for government, which in part, for Smith, meant the protection of private property rights.[31] Although David Hume viewed property rights as conventions that all would respect for the benefit of society as a whole, he also recognized that the short-sightedness of individuals might inhibit their ability to respect such conventions. He thus argued that the principal purpose of government was to overcome this short-sightedness by enforcing conventions such as property and contract.[32]

A number of modern law and economics scholars have also emphasized the importance of strong property rights in economic development. Richard Posner emphasizes the importance of developing strong property rights regimes for fostering economic growth,[33] and Douglass

[28] For a brief intellectual history of property rights and economics, see Edwin West, 'Property rights in the history of economic thought: from John Locke to J.S. Mill', in Terry Anderson and Fred McChesney (eds), *Property Rights: Cooperation, Conflict, and Law* (Princeton, NJ: Princeton University Press, 2003) at 20.

[29] See Thomas Hobbes, *Leviathan* (1651) (Richard Tuck (ed.), Penguin Books, 1985) at 189–91 (describing a system of laws necessary to bring man out of a state of nature).

[30] See John Locke, *Second Treatise of Government* (1690) (Thomas Peardon (ed.), Bobbs-Merrill Co. 1952) (stating the necessity of the state for protecting private property) at §86–88.

[31] See Adam Smith, *The Wealth of Nations* (1776) (Edwin Cannan (ed.), Bantam Dell, 2003) at 901–2 (describing the importance of such government functions as taxing private property).

[32] David Hume, 'A treatise of human nature' in Henry Aiken (ed.), *Hume's Moral and Political Philosophy* (Hafner Publishing Co., 1964) at 69–80, 97–101.

[33] See Richard Posner, 'Creating a legal framework for economic development' (2003) 13 *World Bank Research Observer* 1 ('A modernizing nation's economic prosperity requires at least a modest legal infrastructure centered on the protection of property and contract rights.').

North suggests that strong property rights are one of the most important institutions for growth.[34] Similarly, Knack and Keefer claim that '[f]ew would dispute that the security of property and contractual rights and the efficiency with which governments manage the provision of public goods and the creation of government policies are significant determinants of the speed with which countries grow'.[35] McCloskey, in discussing England's economic development, states: 'If the word "precondition" as it is used in the literature of economic growth includes anything it must include the formation of the legal institutions of private property.'[36]

Perhaps the best-known contemporary advocate of strong formal property rights in spurring development has been de Soto.[37] Speaking of titling, he says that '[i]t is the unavailability of these essential representations that explains why people who have adapted every other Western invention, from the paper clip to the nuclear reactor, have not been able to produce sufficient capital to make their domestic capitalism work'.[38] Similarly, he writes that '[t]he formal property system is capital's hydroelectric plant'.[39]

Although these views reflect the prevalence of the belief that formal property rights are necessary for economic development, it is important to specify why formal property rights, rather than more informal property arrangements (as discussed at 3. below), are viewed as a *sine qua non* of development. Formal property regimes are considered by these authors to be essential to economic growth because, when fully functional and accessible, they provide clearer and more secure allocations of property rights than could any informal measures to protect private property.[40] Where there is a credible third party enforcer of property rights – in particular, the state – 'uncertainty is reduced or completely eliminated'.[41] Indeed, it seems intuitive that a state-backed title registry would have the capacity to provide the most secure property rights, given the extensive adjudicative and coercive capacities that one associates with a fully functioning state. Moreover, a formal property system can also reduce transaction costs in

[34] North, *supra* note 10.

[35] Stephen Knack and Philip Keefer, 'Institutions and economic performance: cross-country tests using alternative institutional measures' (1995) 7 *Econ. & Pol.* 207.

[36] Donald McCloskey, 'The enclosure of open fields: preface to a study of its impact on the efficiency of English agriculture in the eighteenth century' (1972) 32 *J. Econ. Hist.* 15 at 16.

[37] De Soto, *supra* note 7.

[38] Ibid., at 7.

[39] Ibid., at 47.

[40] Johnson, *supra* note 15; Dam, *supra* note 1.

[41] North, *supra* note 10 at 36.

market interactions by providing increased information to third parties about the rights that an individual has over land. Thus, many scholars contend that a formal property regime is necessary to provide the benefits of private property.

3. Informal mechanisms for securing the benefits of private property

However, a formal property rights regime may not be the only method of securing the benefits discussed above. Indeed, informal mechanisms may provide many of the same benefits as a private property rights regime. Within the literature examining informal mechanisms as a substitute for formal mechanisms, there are two strands that explore how this can occur. Although they are in many ways linked, they differ in some respects.[42] First, the *game theoretic literature* explores how cooperation can emerge as a result of repeated interactions among individuals. Second, the *law and social norms literature* examines the development of informal norms as a mechanism of social order and control. Both of these perspectives have strong implications for the possibility of efficient, informal property regimes, as they suggest that either spontaneous cooperation or informal norms can often substitute for a formal property regime maintained by the state.

Game theoretic analysis One theoretical perspective which examines the conditions under which cooperation will occur is the game theoretic perspective. The prisoner's dilemma is a quintessential model of a situation in which parties must choose whether to cooperate or not cooperate with each other based on the anticipated outcomes of each decision. While standard game theoretic models suggest that cooperative outcomes will not be achieved in a one-off prisoner's dilemma, Axelrod shows that mutually beneficial cooperative outcomes can arise in a repeated prisoner's dilemma.[43] The general requirement for cooperation is that such games

[42] One important difference between the game theoretic analysis of cooperation and the law and social norms literature is that while the former supposes no order and shows how people might rationally cooperate, the law and social norms literature examines some of the negative (e.g., gossip, violence) and positive (e.g., rewards) sanctions that groups may use to enforce compliance with a norm or convention. For a survey of this point as well as a substantial list of articles which examine a variety of negative sanctions, see Richard H. McAdams and Eric B. Rasmusen, 'Norms in law and economics' (7 July 2004) (unpublished manuscript).

[43] Robert Axelrod, *The Evolution of Cooperation* (Basic Books, 1984); see also Robert Axelrod, 'The emergence of cooperation among egoists' (1981) 75 *Am. Pol. Sci. Rev.* 306 at 307 (showing that '[w]ith an indefinite number of interactions, cooperation can emerge').

continue infinitely; however, David Kreps et al. show how informational asymmetries (for example, believing for some reason that the other players have a particularly cooperative disposition) can also generate cooperation in a finitely repeated prisoner's dilemma.[44] Moreover, while the models above have assumed repeated interactions between the same players, Glenn Ellison shows how even this assumption can be relaxed, as cooperation can also emerge among a small group whose members are anonymously matched in each round of the game.[45] Thus, various conditions under which cooperation have emerged are in many ways relatively robust. Experimental evidence has confirmed many of these results, showing, for example, that cooperation can occur even in a finitely repeated prisoner's dilemma as individuals try to build a reputation for themselves.[46]

These principles are readily applicable to a regime of respect for property. The issue of respecting land tenure can be thought of as a prisoner's dilemma: all parties gain when tenure is respected (because of the lower costs associated with defending one's land, and so on), but each party has an incentive not to respect other parties' tenure. The exploitation of communal resources has also been viewed in this way.[47] While the pessimistic predictions of the prisoner's dilemma have been used in the past to argue for a strong state to enforce order (dating back to Hobbes' *Leviathan*), if cooperation can emerge as discussed above, this problem can be overcome without the state's intervention.[48] Rational self-interest rather than the

[44] David M. Kreps, Paul Milgrom, John Roberts and Robert Wilson, 'Rational cooperation in the finitely repeated prisoners' dilemma,' (1982) 27 *Journal of Economic Theory* 245 at 245, available at http://www.edegan.com/pdfs/Kreps%20Milgrom%20Roberts%20Wilson%20(1982)%20-%20Rational%20Cooperation%20in%20the%20Finitely%20Repeated%20Prisoners%20Dilemma.pdf. While the repeated prisoner's dilemma has largely been viewed as involving a number (potentially infinite) of discrete stages, some modelling has shown cooperative results to be even more robust when the model is made continuous – something which is much closer to the reality of tenure questions addressed below. See also David M. Kreps and Robert Wilson, 'Reputation and imperfect information' (1982) 27 *Journal of Economic Theory* 253 at 275 (arguing that uncertainty about the motivations of one or more of the players in a finite game can affect cooperation).

[45] Glenn Ellison, 'Cooperation in the prisoner's dilemma with anonymous random matching' (1994) 61 *Review of Economic Studies* 567 at 568.

[46] James Andreoni and John Miller, 'Rational cooperation in the finitely repeated prisoner's dilemma: experimental evidence' (1993) 103 *Economic Journal* 570 at 571.

[47] Ellickson, *supra* note 14; Hardin, *supra* note 10.

[48] See Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action* (Cambridge, UK: Cambridge University Press, 1990).

coercive power of the state may lead parties to respect socially efficient property arrangements.

The evolutionary game theory approach also has implications for property rights considerations. Axelrod uses this approach and shows that a strategy of 'tit-for-tat' (cooperation in the first round followed by playing whatever strategy the other player played in the previous round) is a collectively stable strategy.[49] Axelrod also shows how a relatively small cluster of individuals playing 'tit-for-tat' can invade a population that is primarily comprised of defectors. In the context of property rights, this suggests a plausible mechanism for how cooperation and mutual respect can emerge and how it might be collectively stable. Cooperative play (that is, respect for land tenure) might emerge, since even small groups that decide to respect land tenure might be more successful than those groups that do not respect tenure, and thereby come to dominate larger populations.

The law and social norms literature In addition to the game theoretic framework discussed above, the law and social norms literature provides an alternative explanation of how efficient property arrangements could emerge outside of a formal, legal framework. An important perspective in this line of literature is Ellickson's examination of how various informal rules can emerge which, in certain circumstances, make the formal legal system irrelevant.[50] Ellickson predicts that when social relations are close-knit, informal norms will encourage people in non-zero-sum situations to make choices that will conjoin to produce the maximum aggregate objective pay-off to the group by minimizing deadweight losses and transaction costs.[51] This has led Ellickson to suggest that lawmakers should defer to these informal norms, as the norms are more likely to be welfare maximizing than centrally crafted rules.[52] Epstein reaches a similar conclusion, noting that 'custom should be followed in those cases in which there are repeat and reciprocal interactions between the same parties, for then their

[49] For a discussion of evolutionary stability in the biological context, see John Maynard Smith, 'The theory of games and the evolution of animal conflicts' (1974) 47 *Journal of Theoretical Biology* 209.

[50] Robert C. Ellickson, *Order Without Law: How Neighbors Settle Disputes* (Cambridge, MA: Harvard University Press, 1991).

[51] Ibid., at Chapter 10. See also Robert C. Ellickson, 'A hypothesis of wealth-maximizing norms: evidence from the whaling industry' (1989) 5 *J. L. Econ. & Org.* 83 at 84 (arguing that 'when people are situated in a close-knit group, they will tend to develop for the ordinary run of problems norms that are wealth maximizing').

[52] Ellickson, *supra* note 50 at Chapter 10.

incentives to reach the correct rule are exceedingly powerful'.[53] These arguments imply that customary arrangements can be sufficient to generate order between parties.

Although Ellickson's theory rather optimistically predicts that such norms will emerge, it does not provide a strong explanation of the processes that determine when and why these norms emerge and why individuals adhere to them. McAdams suggests an esteem-based theory of norms, whereby a norm arises if

> (1) there is a consensus about the positive or negative esteem worthiness of engaging in [an action], (2) there is some risk that others will detect whether one engages in [that action], and (3) the existence of this consensus and risk of detection is well-known within the population.[54]

These conditions change the costs and benefits of engaging or not engaging in an activity, and a norm will arise if the esteem benefit is greater than the cost of (not) engaging in the activity. Eric Posner presents an alternative signalling-based model of norms, whereby social norms arise from the actions of individuals who are trying to signal to others that they are a cooperative type in order to gain benefits from interactions with those individuals.[55] Although the two theories have differences, they both highlight that a cooperative and welfare enhancing norm can arise through the rational actions of a large number of individuals. Furthermore, over time these norms may become internalized such that individuals might adhere to a norm even in situations where doing so might not be economically or strategically rational.[56]

In the context of property, this would suggest that cooperation might be possible, which would lead to the emergence of norms that yield many of the benefits that are claimed to flow from formal property rights. This reasoning suggests that tenure security, for example, might arise among a close-knit group if this were a welfare maximizing rule. This type of reasoning is consistent with the literature that stresses that tenure security can increase in response to increasing relative scarcity of land,

[53] Richard Epstein, 'International News Service v. Associated Press: custom and law as sources of property rights in news' (1992) 78 *Virginia Law Review* 85 at 126.

[54] Richard H. McAdams, 'The origin, development, and regulation of norms' (1997) 96 *Michigan Law Review* 338 at 358.

[55] Eric Posner, 'Symbols, signals, and social norms in politics and the law' (1998) 27 *Journal of Legal Studies* 765; Eric Posner, *Law and Social Norms* (Cambridge, MA: Harvard University Press, 2000) at 18–27.

[56] Posner, *Law and Social Norms*, ibid., at 43–4.

since the welfare gains from secure tenure increase as the scarcity of land increases.[57] Similarly, Sjaastad and Bromley have noted the presence in many African societies of a norm that dictates that when an individual loses ownership of a piece of land, the individual taking ownership must compensate the individual losing ownership for the value of improvements made to the land.[58] This norm may provide the necessary incentives to make improvements to land without some of the costs associated with greater tenure security.

It is important to note that all of the informalist theories presented above relate to property relations among individuals; none of them relate specifically to tenure security in the sense of freedom from a reasonable apprehension of expropriation of land by the state. In terms of this aspect of property ownership, it seems unlikely that an informalist would contest the fact that tenure security vis-à-vis the state is important, but the perception of tenure security against the state might be accomplished in a variety of ways. All that is required for this type of tenure security is that the individual should not fear expropriation without compensation. To this end, predictability may be more important than formal rights.

4. The empirical evidence

In an extensive recent review of the empirical evidence relating to the case for formalization of private property rights, Michael Trebilcock and Paul-Erik Veel[59] find that the evidence tends to suggest that formal regimes may lead to more efficient use of property, but that in many contexts informal regimes are often a reasonably close substitute and that mechanisms for at least limited forms of alienability often evolve without formal property rights. As to whether formalization of property rights increases access to credit, the evidence is mixed. Where informal credit markets are strong, there appears to be little benefit from formalization in many contexts. Similarly, where credit markets are weak for other reasons, formalization is likely to have limited impact on access to credit. While formal property rights seem to lead to increased investment in productive asset enhancement, this depends to an important extent on the security afforded by

[57] Gershon Feder and Raymond Noronha, 'Land rights systems and agricultural developments in sub-Saharan Africa' (1987) 2 *World Bank Research Observer* 143 at 143–4 (arguing that scarcity of land encourages the development of mechanisms to secure such land); see also Demsetz, *supra* note 10.

[58] Espen Sjaastad and Daniel Bromley, 'Indigenous land rights in sub-Saharan Africa: appropriation, security and investment demand' (1997) 25 *World Development* 549 at 553.

[59] Trebilcock and Veel, *supra* note 2.

informal norms.[60] Similarly, formal property rights seem to reduce inefficient forms of resource competition, but here the evidence is relatively fragmentary.

While there may be some benefits in the formalizing of property rights regimes, such regimes also entail various costs:

1. The costs are significant in setting up a land registration or recordation system, including initial surveys and the cost of updating the registry or recordation system through time to reflect changes in the composition of land-owning groups or intervening transactions.
2. Formalization and individualization of land tenure may seriously undermine the possibility of communal tenure providing an insurance role for members of the land-owning group, and through time may result in the emergence of a landless class with few, if any, other economic opportunities, sources of insurance or social safety nets.
3. Formal rules may undermine effective informal institutions by creating dysfunctional conflicts between the two classes of regime in ignoring the significance of cultural switching costs.[61] This problem is likely to be particularly acute if formal mechanisms are predicated on spatial notions of ownership, while informal regimes recognize a much more functional conception of property rights, including a wide variety of usufructuary rights, such as the right to gather firewood, collect water, gather fruit, or hunt, fish or traverse land owned by other groups or individuals.
4. Formalization programs, depending on how they are designed and implemented, can expose latent divisions between or among claimant groups that had previously lain dormant, but are likely to be provoked or exacerbated by the relative finality of formalizing property rights, and hence lead to increased social conflict.
5. Flaws in the titling process are likely to be exploited by politically or economically powerful groups at the expense of women and other marginalized groups who face various barriers to accessing a formal property rights system.
6. Even assuming that a formal property rights system is well designed, deeply entrenched informal norms may impede the successful implementation of a formal property rights regime where they are sharply antithetical to the latter and may result in the latter being largely ignored or becoming quickly outdated.
7. As in the case of rule of law reforms, there are important institutional interconnections: a land titling system is predicated on effective complementary institutions, including the judiciary, the legal profession and the police. Formalizing property rights without complementary reforms to these other institutions may therefore achieve very little.

This is not to say that informal regimes are always efficient. For example, they may only be efficient for members of close-knit groups and may entail negative externalities for non-members. Informal regimes themselves may also reflect path dependence and time lags in responding to changes in the economic or technological environment, so that there may well be efficiency gains to be realized, at least potentially, from a more formal property rights regime.

This discussion of the costs and benefits of a formal property rights regime suggests that the picture is much more complex than many commentators and policymakers have assumed. The creation of a formal property rights regime is not without cost, and it will not necessarily be the case that the benefits of such a regime will clearly outweigh the costs. Given, however, that formal property regimes are ubiquitous in the developed world, there are reasons to believe that, at a certain stage in a country's economic development, a formal property rights regime is necessary to secure further economic development. China has experienced rapid, market-driven economic growth over the past three decades without a well-defined or enforced formal property regime,[62] but

[60] For a recent review, see James Fenske, 'Land tenure and investment incentives: evidence from West Africa', Department of Economics, Yale University, Working Paper, 2009.

[61] See Daniel Fitzpatrick, 'Evolution and chaos in property rights systems: the Third World tragedy of contested access' (2006) 15 *Yale Law Journal* 996, who argues that the greater the divergence between state law and local norms, the more likely it is that attempts to enforce exclusionary claims will lead to open access rather than an authoritative property rights regime. He argues that legal and normative pluralism is a particularly common phenomenon in the Third World and is often accompanied by institutional pluralism – a fragmentation of the state into competing agencies and levels of government, and that in circumstances of legal, normative and institutional pluralism efficient property rights regimes will not necessarily emerge. He argues that the problem of establishing and enforcing property rights is closely connected to the problem of social order. Unless social order is established, most commonly through legitimate and capable government, the process of allocating and enforcing property rights will tend to cause conflict because claimants will resort to competing legal, normative and coalitional enforcement mechanisms.

[62] See Frank Upham, 'From Demsetz to Deng: speculations on the implications of Chinese growth for law and development theory', *NYU Journal of International Law and Politics* (forthcoming).

has recently been devoting increasing attention to formalizing property rights.[63]

At relatively low levels of development, an informal regime may be adequate to realize many of the benefits of private property. Where economic life is largely organized around small units such as the village, the mobility of the population is low and resources such as land are not overly scarce, informal mechanisms are likely to be sufficient to provide the benefits of private property. Put differently, if individuals expect to be living in the same location, the expectation of repeated interactions will create the conditions necessary for cooperation. At this point, informal mechanisms are likely to suffice to bring the benefits of private property, so a formal property regime would entail significant social and economic costs without significant benefits.

As countries undergo economic changes, however, the relative benefits of a formal private property regime are likely to increase. There are three broad reasons for this consequence. First, as development increases, communities are likely to become less close-knit, leading informal norms to be less effective in maintaining order. As Feder and Feeny note, '[w]ith more advanced stages of development and increased mobility of individuals and entrepreneurs, transactions among individuals who are not members of the same community are more frequent'.[64] Where the proportion of one-off encounters increases relative to continuing encounters, traditional methods of social cohesion are likely to be strained. Moreover, as Eric Posner notes, while informal norms can often result in a strong degree of security for items which can be easily possessed, such norms will be inadequate to protect goods which individuals cannot directly possess, such as land or capital dispersed throughout a number of locations.[65]

Second, at higher levels of economic development, the value of land, goods, and investments may increase substantially, leading to more substantial benefits from more secure property rights. While informal mechanisms may be sufficient to provide an individual with the incentives to make minor investments, more capital-intensive, asset-specific investments are likely to require greater certainty and security. Moreover, as the capital-intensiveness of activities increases, formal credit is likely to play a greater role in economic development, thereby increasing the benefits of clear and secure title.

[63] Trebilcock and Veel, *supra* note 2 at 397; Klaus Deininger and Songqing Jin, 'Securing property rights in transition: lessons from implementation of China's rural land contracting law' (2009) 70 *Journal of Economic Behavior & Organization* at 22–38.

[64] Feder and Feeny, *supra* note 16 at 140.

[65] Posner, *Law and Social Norms*, *supra* note 55 at 179.

Third, at higher levels of economic development, the relative costs of creating a formal property regime may be lower. As a country's tax base increases, it will be relatively easier for the state to make the expenditures required for creating a formal property regime. Where insurance markets are likely to be more developed, the loss of the insurance function of customary land tenure is likely to be less severe. Similarly, where the state takes an increasingly large role in providing social benefits to its population, the equity concerns of potential landlessness are likely to be mitigated. Finally, the very forces that undermine informal tenure can also mitigate the effects of increased landlessness and social unrest. As mobility and migration opportunities increase, individuals will be more able to seek alternative economic opportunities elsewhere, thus lowering the cost to individuals of changes to property arrangements.

The above considerations suggest that the focus of certain previous titling programs may have been misguided both in terms of the targets of these titling programs as well as in the content of the formalization program. First, while many titling programs have focused on providing formal title to agricultural landowners, the above discussion suggests that, with the exception of newly settled frontier land, established social norms in rural areas may be sufficient to provide an adequate degree of informal property rights protection. Urban titling programs, especially those aimed at newly developing squatter settlements, may yield a greater social return. The greatest return from titling programs may come, however, from providing formal ownership to firms' land and assets, as informal norms may be lacking in such circumstances or inadequate to provide the certainty required for large investments or transactions entailing significant sunk costs and long pay-off periods.

Second, to the extent that there are substantial benefits to providing stronger land rights to agricultural landowners in a given case, those benefits may be largely realized through the recognition and formalization of customary land tenure.[66] This model of formalization in the agricultural sector may bring about the benefits of security of tenure at a lower social cost than would the *de novo* creation of an individual-centred system of land rights. Both of these conclusions, however, should be taken only as general propositions, as the above discussion highlights the extent to

[66] For an insightful exploration of many of these issues of institutional design, see Daniel Fitzpatrick, 'Best practice options for the legal recognition of customary tenure' (2005) 36 *Development and Change* 449; see generally, Deininger, *supra* note 5 at 62–5. For proposals along these lines, see UNDP, *Making the Law Work for Everyone: Report of the Commission on Legal Empowerment of the Poor*, vol. 1 (New York: United Nations, 2008) at 65.

which the analysis of the relative costs and benefits of formalization is a highly context-dependent exercise.

Finally, it should be noted that, while the above discussion has largely focused on titling, in some cases the primary source of insecure property rights is not the threat of expropriation by other households or landowners, but rather expropriation by the state.[67] Where this is the main source of insecurity, formal title per se may not be necessary to increase individuals' perceptions of tenure security. Moreover, under such circumstances, formal title may not actually improve perceptions of tenure security if individuals believe that they will not be able to enforce their property rights against a predatory state.[68] Rather, what is required in such cases to create the perception of strong property rights is a credible commitment by the state not to expropriate land or other assets.[69] This can be a significantly less costly and more effective mechanism for gaining the benefits of private property rights than formal titling programmes.

5. Gender and property rights

Giving women access to property and guaranteeing their property rights is regarded as a strategy to increase efficiency, improve the well-being of women and other family members, promote gender equality and empower women.[70] While some of these objectives favour society as a whole (efficiency and well-being), others (equality and empowerment) are specifically targeted at women, who represent the largest percentage of the world's poor. This concern with gender equality and women's empowerment was officially included in the development agenda reflected in the Millennium Development Goals. Access to land plays an important role in promoting these goals because it can provide women with income and a source of subsistence if they are able to commercialize their produce. In this context, women could potentially benefit from private property and secure title in

[67] See Timothy Frye, 'Credible commitment and property rights: evidence from Russia' (2004) 98 *Am. Pol. Sci. Rev.* 453 at 456 (noting that one of the largest threats to property rights in Russia was a fear that the state would expropriate private property); see also Omar M. Razzaz, 'Property rights and investment in informal settlements: the case of Jordan' (1993) 69 *Land Econ.* 341 at 352.

[68] Frye, ibid., at 457–8 (explaining a survey of Russian businessmen finding that many believe that they will not be able to enforce their property rights against the state).

[69] Furubotn and Richter, *supra* note 11 at 97–100 (discussing the implications of state ownership of land and incentives for farmers to work).

[70] Carmen Diana Deere and Magdalena León, *Empowering Women: Land and Property Rights in Latin America* (Pittsburgh: University of Pittsburgh Press, 2001), Chapter 4.

the same way as men, for the reasons set out in the previous sections of this chapter – namely, more efficient use of land, increased access to credit, incentives for investment and decreased incentives for inefficient competition over scarce resources. Thus, some of the reforms discussed earlier have the potential to help women more specifically, and to benefit society as a whole by benefiting women.

However, the proposed reforms that guarantee the benefits of private property still generate tensions and ambiguities from a gender perspective. Shahra Razavi provides a map of these tensions and ambiguities, highlighting three main areas of concern:

1. Formalization of title and liberalization policies do not consider the difficulty faced by women in accessing land through markets.
2. Context-specific reforms can be troublesome if they endorse customary systems and land management structures that are not compatible with, or conducive to, gender equality.
3. Once granted access to land, women still need equal access to non-land resources (such as credit) to benefit equally from land tenure.[71]

We discuss each of these in turn.

Formalization of title to secure land tenure is normally promoted through ostensibly gender neutral reforms. Although formalization does have the potential to increase the economic security of women by contributing to wealth creation and accumulation, such reforms alone, however, may not be conducive to increased living standards of women in developing countries. This is because inheritance, not markets, is the predominant method by which women acquire property, and markets also embody gender structures and hierarchies that are found in society.[72] As Razavi puts it, 'although the empirical base is far from comprehensive, judicious reading of the existing evidence points to the severe limitations of land markets as a channel for women's inclusion'.[73] In some cases, formalization reforms are coupled with broader legal changes. In Latin America, for instance, one of the main achievements of the women's rights movement has been the elimination of civil code provisions designating the husband as legal head of the household.[74] However, these broader reforms do not

[71] Shahra Razavi, 'Liberalization and the debates on women's access to land' (2007) 28 *Third World Quarterly* at 1479–500; see also World Development Report 2012, Gender Equality and Development, Chapter 5 (World Bank: 2012).

[72] Ibid., at 1487.

[73] Ibid., at 1486.

[74] Ibid., at 1481.

overcome the fact that opportunities for women to acquire land through markets are far more limited than they are for men. 'The fact that women enter the market system with no property, little cash income, minimal political power, and a family to maintain, works to their disadvantage.'[75] This suggests that gender neutral reforms based on markets might not be sufficient to promote inclusion and improve the condition of women.

In addition to limited access to the market, legal reforms to promote gender equality might not be effective for other reasons. For instance, reforms promoted in Latin America have established co-ownership of land for men and women. This provides a guarantee for women that they will also have the title to the land if they become divorced or widowed. Women's movements have pressed for the adoption of such provisions in Africa, mostly to no avail.[76] In contrast, Brazil and Colombia were pioneers in implementing co-ownership provisions for land reform titling in 1988. These countries have implemented largely successful land reforms because they relied on innovative, community-driven approaches in which communities are given grants and access to credit and 'the beneficiaries identify the land, negotiate the price, and purchase it, rather than relying on the government to hand them land acquired through expropriation'.[77] However, by the mid-1990s there was a significant discrepancy between these two countries: while in Colombia 45 per cent of the beneficiaries of land reform were women, in Brazil they were only 12.6 per cent.[78] According to Carmen Diana Deere, this discrepancy was caused by three factors: (i) co-ownership was mandatory in Colombia and optional in Brazil; (ii) the bureaucracy in charge of implementing land reform in Brazil adopted very discriminatory practices against women; (iii) it was not until recently that the land reform movements started to promote an agenda to foster gender equality.[79]

As a result of popular pressure from social movements, in 2001 the Brazilian government adopted a series of regulations aimed at promoting the inclusion of women in the land reform, but while these changes make co-ownership clauses more effective in protecting married women,

[75] Ibid., at 1486.

[76] Ambraeja Manji, *The Politics of Land Reform in Africa* (London: Zed Books, 2006) at 105–9 (analysing the case of Uganda).

[77] Nancy Birdsall and Augusto de la Torre, *Washington Contentious: Economic Policies for Social Equality in Latin America,* Commission on Economic Reform in Unequal Latin American Societies (2001) at 57.

[78] Carmen Diana Deere, 'Women's land rights and rural movements in the Brazilian agrarian reform' (2003) 3:1&2 *Journal of Agrarian Change* at 257–88.

[79] Ibid.

there is still a lack of efforts to promote inclusion of female-headed households.[80] Other Latin American countries have promoted affirmative action in this context to overcome the barriers imposed by past discrimination.[81] In sum, the details of institutional design matter because they will affect the incentives created by the formal law (a mandatory or optional provision can make a significant difference).[82] Moreover, governmental authorities might adopt discriminatory practices in implementing or enforcing laws[83] and unless there are institutional guarantees of public participation in the reform process and its implementation phase, there might not be effective pressure from non-governmental groups for legal changes that better reflect social values.[84]

These obstacles show that policies to promote gender equality in access to land cannot be considered isolated projects. As in the case of formalization projects and institutional reforms, policies to promote gender equality need to be part of a general framework to promote gender equality in society. In the case of formalization, we suggested above that a general framework for formalization should include a set of reforms aimed at the promotion of the rule of law. In contrast, in the context of gender equality, recent research casts doubt on the effectiveness of such reforms. Katharina Pistor, Antara Haldar and Amrit Amirapu[85] show that positive rule of law indices do not correlate with the status of women in society. The correlation *does* exist in high-income countries, but disappears in poor countries. The explanation offered by these three authors is that the status of women in society is determined primarily by social norms, which are only weakly affected by legal institutions. This resonates with many of the gender-related concerns in the context of land reforms.

The second issue raised by Razavi is the extent to which women can fully benefit from context-specific reforms that endorse customary rights and

[80] Ibid.

[81] Deere and León, *supra* note 70 at Chapter 6.

[82] *Ibid.*

[83] Razavi, *supra* note 71 at 1486.

[84] Curtis J. Milhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal About Legal Systems and Economic Development Around the World* (Chicago: University of Chicago Press, 2008).

[85] Katharina Pistor, Antara Haldar and Amrit Amirapu, 'Social norms, rule of law, and gender reality: an essay on the limits of the dominant rule of law paradigm', in James J. Heckmann, Robert L. Nelson and Lee Cabatingan (eds), *Global Perspectives on the Rule of Law* (New York and London: Routledge, 2009). For a more optimistic view of the virtues of constitutionalizing fundamental universal rights (capabilities) of women, see Martha Nussbaum, *Women and Human Development: The Capabilities Approach* (Cambridge University Press, 2000).

local land management systems. From a gender perspective, these rights and local systems can be 'too closely intertwined with social institutions and existing power structures'. Customary law and social practices often are not gender neutral, and patriarchal tendencies can be exacerbated when formalization of title and privatization of communal land increase competition for scarce resources. Evidence from Uganda, Tanzania and South Africa illustrate the difficulties faced by women in dealing with local authorities and overcoming inequitable social practices. In this context, formalization of property and land markets can sometimes be positive, as they provide a way for women to circumvent traditional authorities.[86] Similarly, dispute resolution systems outside customary practices may also provide a beneficial option for these women. In such circumstances, a combination of formal systems and customary practices allow women to 'forum shop', combining different claims and using dispute mechanisms that will be most favourable to them on a case-by-case basis. Obstacles to the effective use of these options, however, are lack of information and low levels of education. In this regard, again, gender equality reforms need to be combined with initiatives that are conducive to granting women equal access to other resources beyond land.

The previous two concerns cast doubts on the potential for land markets, both formal and informal, to serve as effective mechanisms for the inclusion of women. Once access to land is guaranteed, yet another concern is identified by Razavi: the ability of women to create and accumulate wealth through land depends on their access to a series of non-land resources. If women hold title individually, one important obstacle for them to benefit from private property comes from the fact that women might not have equal access to fertilizers, equipment and labour. This is often connected to lack of access to credit, which is reflective of greater social practices of discrimination against women. Microcredit initiatives in Bangladesh (and other countries), such as the Grameen Bank, were created to overcome this obstacle, but this option is not available in all countries.[87] In 2001, the Brazilian land reform program established an affirmative action program in which 30 per cent of all governmental credit given to land reform beneficiaries would go to women and 30 per cent

[86] Razavi, *supra* note 71 at 1489.

[87] The World Bank, 'Using microcredit to advance women' (1998) *PREMnotes* 8; Norman MacIsaac, 'The role of microcredit in poverty reduction and promoting gender equity' (June 1997) South Asia Partnership Canada, Strategic Policy and Planning Division, Asia Branch Canada International Development Agency, available at http://www.microfinancegateway.org/gm/document-1.9.28404/3247_3247.pdf

of the positions in training programs for land reform beneficiaries are reserved for women.[88] A further related problem is that in many countries land is a complementary source of income, being combined with employment outside the household. In these cases, barriers for women to obtain jobs can hinder their ability to benefit from land tenure. This can be overcome with anti-discrimination laws in other sectors of the economy.

C. Conclusion

Because of the complex interactions between a property rights regime and the social, economic, political and legal framework within which such a regime operates, it is not fruitful simply to argue for or against the formalization of a property rights regime or for 'strong and clear' property rights. Rather, the relationship between property rights and development is much more complex, and a more nuanced approach to these issues is required. As David Kennedy writes,

> 'clear and strong' property rights is a misleading recipe. Property rights have no ideal form which will be rendered clear and strong. Their allocation everywhere is a matter of economic, social and political choice for which no formula can substitute.[89]

The context dependence of successful property regimes leads to three important considerations. First, property formalization programs cannot be considered as isolated economic development projects as one might consider certain physical infrastructure projects. Rather, such programs must be considered as part of a general framework for economic development, typically including a wider set of reforms aimed at the promotion of the rule of law.[90] Contrary to the optimistic rhetoric of de Soto's work, property formalization programs are not, standing alone, the key to unlocking the potential of the developing world.[91]

Second, in determining what role outsiders can play in helping to promote a state's formal property regime, it is essential to ask a broader question about the similarities among optimal property regimes. If the optimality of a property rights regime is context-independent, then a titling program developed by theorists in Washington or from elsewhere in the developed world may indeed be applicable and beneficial to extremely

[88] Deere, *supra* note 78 at 257–88.

[89] Kennedy, *supra* note 9 at 53, 54.

[90] Dam, *supra* note 1.

[91] De Soto, *supra* note 7.

diverse countries. However, while the functions performed by property rights may be similar in many countries, the characteristics of a property regime are in fact highly dependent on local context and thus it is unrealistic to expect that one model of a successful regime would be applicable across various states. In fact, one would expect that the characteristics of such regimes, as well as strategies for their implementation, will differ substantially across states. This suggests that, in practice, local or regional models of property regimes may be more successful than Western models.[92]

Finally, significant changes to property regimes should be approached with caution and drastic, uniform top-down property changes should be avoided.[93] Contrary to conventional economic thinking, the formalization of property rights is not necessarily desirable at all stages of development or for all property owners. Formalization programs can have far-reaching social and economic consequences and, under certain conditions, formalization programs can have negligible or deleterious impacts. The context specificity of property rights regimes is not, however, a reason for inaction or a reason to counsel against the formalization of property rights in all cases. As noted above, under some circumstances, formal property rights have increased efficiency and led to economic growth, and it would thus be poor policy never to support the formalization of property rights.

Because of these considerations, unless there is clear and compelling evidence pointing to the need for a systematic state-led formalization program, the optimal response may be a voluntary and sporadic system of title registration. Although a sporadic program of title registration is not without its own costs,[94] such a program brings substantial benefits relative to a systematic formalization program. As Michael Trebilcock has argued elsewhere, in the face of limited resources and state capacity, a sporadic system of land registration has the benefit of providing the additional security and clarity of formal property rights to those desiring it most.[95] By simply providing an additional vehicle for owning property, a sporadic

[92] See Sharun Mukand and Dani Rodrik, 'In search of the Holy Grail: policy convergence, experimentation, and economic performance' (2005) 95 *Am. Econ. Rev.* 374 (which argues for implementation of appropriate policies and institutional arrangements at the local level).

[93] For a classic paper exploring the importance of avoiding drastic imposed changes see Charles Lindblom, 'The science of "Muddling Through" (1959) 19 *Pub. Admin. Rev.* 79. See also James C. Scott, *Seeing Like a State: How Certain Schemes to Improve the Human Condition Have Failed* (New Haven: Yale University Press, 1998).

[94] See Michael Trebilcock, 'Communal property rights: the Papua New Guinea experience' (1984) 34 *University of Toronto Law Journal* 377.

[95] Ibid., at 412–13.

registration programme does not require disturbing the arrangements of those groups that are content with the status quo. Where customary arrangements limit individuals' economic opportunities, the option of formalization is present. Moreover, a voluntary system overcomes the collective action problem of providing the machinery for the enforcement of property rights by having the state provide it and allowing people to opt into it.

Perhaps the strongest benefit, however, of a sporadic and voluntary formalization system is that it avoids the myriad unforeseeable and potentially negative consequences that can result from the top-down imposition of a uniform system of property arrangements. As we have stressed, a property rights regime is not an isolated institution, but rather an institution which has strong interrelationships within a variety of other institutions. In such circumstances, and where policymakers have imperfect or limited information, it may be impossible to predict all the potential consequences flowing from drastic institutional changes, and unpredictable negative consequences may emerge from imposed changes.[96] A gradual and reversible process of voluntary change at the individual level can mitigate such potentially harmful consequences.

Even in situations where a systematic program is clearly superior to a voluntary program, drastic and irreversible changes should be avoided. Rather, changes should be incremental in nature. For example, where communal property is prevalent, rather than registering individual titles to specified plots of land to the exclusion of all others, a rudimentary titling program could be undertaken utilizing simple compass and chain surveys rather than full-scale cadastral surveys where only the base group title would be registered without prejudice to the various functional or usufructuary rights that others might possess under customary law. Land-owning groups might also be given a more formal legal structure and clearer decision or governance rules (akin to private corporations with restrictions on share transferability), while maintaining some limits on outright alienability of group land.[97] Such programs lessen the potential for serious social conflict or disruption from abrupt legal change and

[96] For interesting examples relating to this point, see Scott, *supra* note 93. See also Rachel Kranton and Anand Swamy, 'The hazards of piecemeal reform: British civil courts and the credit market in colonial India' (1999) 58 *J. Dev. Econ.* 1 (discussing how reform led to increased competition among lenders, and the resulting effects on the farmers of India).

[97] See generally Fitzpatrick, *supra* note 66; Trebilcock, *supra* note 94; Kathrine Dixon, 'Property: mobilizing land in Papua New Guinea the Melanesian way' (2007) 31 *Harvard Environmental Review* 219.

facilitate an evolutionary process for the emergence of strong private property rights.

While the foregoing discussion has focused on property rights in land, it is worth noting that somewhat parallel issues arise with respect to movable (or personal) property. In many developing countries, the ability to offer movable property (plant and machinery, inventory, accounts receivable, livestock) as security for credit is severely constrained by the absence of an efficient centralized, comprehensive registry system for all security interests in movable property (both specific and generic, present and future), the lack of efficient, low-cost enforcement regimes with respect to security interests, and the absence of efficient credit information systems (for example, private or public credit bureaux). According to the World Bank's annual 'Doing Business' Reports, these constraints in turn often severely constrain the cost and availability of credit to small and medium-sized business.[98]

II. CONTRACT RIGHTS[99]

A. Introduction

Nobel Laureate Douglass North advances the strong claim that 'the inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World'.[100]

Oliver Williamson proposes that economic activity is best understood and explained by 'an examination of the *comparative costs of planning, adapting, and monitoring task completion under alternative governance structures*'.[101] He argues that neither spot market transactions nor transactions within vertically integrated firms require formal enforcement mechanisms, because both entail minimal transaction costs.[102] Conversely, the vulnerability experienced by at least one party to long-term, non-simultaneous transactions creates a significant need for a credible third party enforcement mechanism.[103] Credible third party enforcement addresses the reluctance of private sector agents to participate in non-simultaneous economic transactions, which often entail significant sunk costs, because of a lack of assured protection of the parties' economic interests. Williamson contemplates a continuum of microeconomic activity: at either end of this continuum are types of activity that do not require a formal mechanism for contract enforcement, while in the middle lie economic activities that require some degree of external enforcement.[104]

From the perspective articulated by Williamson and North, and given the existence of transaction costs, individuals require assurances that those transaction costs will not negate the benefits they seek to derive from the transaction itself. Recalling that institutions include both the formal and informal constraints that shape human interaction,[105] and that enforcement is an important factor in determining transaction costs,[106] North first identifies self-enforcement as the primary feature of contracts used in tribes, primitive societies and close-knit small communities – settings in which personal knowledge of transacting parties about one another is extensive, and repeat dealings are pervasive.[107] North then points out the limits of self-enforcing contracts in a world of increasingly impersonal exchange. In such a world, simultaneous exchange and repeat dealings are no longer the prevailing norm; thus, self-enforcing contracts become insufficient because there no longer exists a dense social network of interactions to enable transacting to take place at low cost.[108] Instead, individual specialization and exchange expansion in both time and space require additional contract enforcement mechanisms to assure compliance.

North thus concludes that the lack of low-cost, effective contract enforcement mechanisms (in particular, effective state enforcement through coercion) is the most important contributor to economic inefficiency and low growth rates in the developing world.[109] He then cautions, however, that no one has yet successfully proposed how to develop the state into a coercive force able to protect property rights and enforce contracts effectively without also risking abuse of its coercive power to the

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98 World Bank, *Annual Doing Business Reports*, 'Getting credit'; Frederique Dahar and John Simpson (eds), *Secured Transactions Reform and Access to Credit* (Cheltenham, UK: Edward Elgar Publishing 2008).

99 This section is largely derived from Michael Trebilcock and Jing Leng, 'The role of formal contract law and enforcement in economic development' (2006) 92 *University of Virginia Law Review* 1517.

100 Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge, UK: Cambridge University Press, 1990) at 54.

101 Oliver E. Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985) at 2.

102 Oliver E. Williamson, *The Mechanisms of Governance* (New York: Oxford University Press, 1996) at 332.

103 Ibid.; see also Dam, *supra* note 1 at 124–8.

104 Williamson, *supra* note 102.

105 North, *supra* note 100 at 4.

106 Ibid., at 54 note 1.

107 Ibid., at 55.

108 Ibid.

109 Ibid., at 54.

detriment of society.[110] As we have noted, the last two decades have seen extensive efforts by international agencies and external donors to promote rule of law reform in many developing countries and transition economies; these efforts are, in part, predicated on the instrumental, economic rationales espoused by North. Is this prioritization warranted, at least on instrumental grounds?

While the contract-formalist approach to development taken by North regards formal contract enforcement as fundamentally important for a nation's economic development, an alternative school of thought has emerged that downplays the need for a formal third party mechanism for contract enforcement. Relying on empirical evidence that emphasizes the fundamental role played by social norms and relational networks in rendering private transactions self-enforcing, scholars have argued that many economic activities that foster economic development do not need a means of formal third-party enforcement.[111] According to Avner Greif, for example, 'many exchange relations in historical and contemporary markets and developing economies are not governed – directly or indirectly – by the legal system'.[112] Greif argues that, in fact, much of the world's economic development has occurred in the absence of a legal system to govern private economic transactions.[113]

[110] Ibid., at 59–60.

[111] See, e.g., Lisa Bernstein, 'Opting out of the legal system: extralegal contractual relations in the diamond industry' (1992) 21 *Journal of Legal Studies* 115; see also Marcel Fafchamps, *Market Institutions in Sub-Saharan Africa: Theory and Evidence* (Cambridge, MA: MIT Press, 2004) (reviewing empirical evidence suggesting that contract agreements in sub-Saharan Africa are highly dependent on social networks and personal trust); Lisa Bernstein, 'Merchant law in a merchant court: rethinking the Code's search for immanent business norms' (1996) 144 *University of Pennsylvania Law Review* 1765 (studying the self-enforcing private ordering in the American grain industry); Lisa Bernstein, 'Private commercial law in the cotton industry: creating cooperation through rules, norms, and institutions' (2001) 99 *Michigan Law Review* 1724; Avner Greif, 'Contracting, enforcement, and efficiency: economics beyond the law,' in Michael Bruno and Boris Pleskovic (eds), *Annual World Bank Conference on Development Economics 1996* (1997) at 239 (challenging the neoclassical theory that only legal contract enforcement facilitates exchange); Janet T. Landa, 'A theory of the ethnically homogeneous middleman group: an institutional alternative to contract law' (1981) 10 *Journal of Legal Studies* 349 (discussing the business practices of ethnically Chinese middlemen in Malaysia and Singapore): Janet Landa finds that the tightly knit, ethnically based business community among ethnically Chinese middlemen in Malaysia and Singapore facilitated a mutual trust that obviated any need to take measures to lessen uncertainty in transactions, while exchanges between the Chinese and the indigenous non-Chinese employed primarily cash (rather than credit) in order to reduce contract uncertainty (at 350); see also Janet T. Landa, *Trust, Ethnicity, and Identity: Beyond the New Institutional Economics of Ethnic Trading Networks, Contract Law and Gift-Exchange* (Ann Arbor, MI: University of Michigan Press, 1995) 164 at 205 (proposing a theory of informal contract enforcement institutions in achieving 'ordered anarchy').

B. Empirical Evidence

A provisional reading of the evidence (extensively reviewed elsewhere by Michael Trebilcock and Jing Leng)[114] is that the proponents of contract formalism and the proponents of contract informalism can both point to supporting bodies of theory and empirical evidence, but both risk overstating, or at least over-simplifying, their cases.

To take first the case made by the contract formalists, it is clear that in both developed and developing countries, many contracts are self-enforcing. Often because of ethnic, religious or cultural ties, informal transacting norms arise and are enforced through informal, extra-legal sanctions. Even in the absence of such contracting networks, long-term, incomplete contingent claims contracts are commonplace between arm's length business parties in both developed and developing economies. Where these contracts include substantial investments in relationship-specific assets, there are strong incentives to maintain the relationship. Of course, even long-term relational contracts eventually come to an end and, depending on the nature of the dependencies or interdependencies that they create, these contracts are vulnerable to problems of hold up and opportunism ('end-game' problems). These problems can sometimes only be solved by complete vertical integration, although this may not otherwise be efficient.[115]

[112] Greif, ibid., at 241.

[113] Ibid., at 241–2.

[114] Trebilcock and Leng, *supra* note 99 at 1517.

[115] See, e.g., Robert Cooter and Thomas Ulen, *Law and Economics* (Scott Foresman & Co., 4th edn, 2004) at 225–35; Lawrence M. Friedman, *Contract Law in America* (University of Wisconsin Press, 1965) at 89; Paul Milgrom and John Roberts, *Economics, Organization and Management* (Prentice Hall, 1992) at 131–40; Charles Goetz and Robert E. Scott, 'Principles of relational contracts' (1981) 67 *Virginia Law Review* 1089 at 1090–91; Benjamin Klein and Keith B. Leffler, 'The role of market forces in assuring contractual performance' (1981) 89 *J. Pol. Econ.* 615; Stewart Macaulay, 'Non-contractual relations in business: a preliminary study' (1963) 28 *Am. Soc. Rev.* 55 at 58–9; Ian R. Macneil, 'Contracts: adjustment of long term economic relations under classical, neoclassical, and relational contract law' (1978) 72 *Northwestern University Law Review* at 889–90; Ian R. Macneil, 'The many futures of contracts' (1974) 47 *S. Cal. L. Rev.* 691 at 758–9; Anthony

As noted above, Williamson argues that both spot market and hierarchical (corporate integration) transactions require little support from the formal legal system; in contrast, middle range transactions (long-term contracting) are particularly vulnerable in the absence of credible third party enforcement mechanisms.[116] Williamson's claim implies a continuum of forms of economic coordination or cooperation, with complete vertical integration at one end, spot markets at the other, and a large vacuum in the middle.

Even with respect to Williamson's two polar cases, however, it is not true that vertical integration can completely avoid the problems of a weak formal legal system. As a number of commentators have argued, and corroborated empirically, countries with poorer investor protection, measured by both the character of legal rules and the quality of legal enforcement, have smaller and narrower capital markets; this is particularly evident when minority shareholders are subject to serious agency costs (opportunism) by managers or controlling shareholders.[117] Moreover, employment contracts and collective agreements often require a formal enforcement mechanism. In any event, as Williamson himself acknowledges, vertical integration may be less efficient than other forms of economic coordination that an effective formal contract regime may facilitate.[118] At the other pole, even spot transactions (for example, commodity contracts) may raise quality or product defect problems that require resort to the formal legal system, at least in the absence of industry or trade associations with their own codes of conduct, norms and alternative dispute settlement mechanisms.[119]

Between these two poles, Williamson exaggerates the importance of formal contract enforcement by giving insufficient weight to the role of relational contracting[120] and contract enforcement by private sector third

Kronman, 'Contract law and the state of nature' (1985) *Journal of Law, Economics and Organizations* 5.

116 Williamson, *The Mechanisms of Governance*, *supra* note 102 at 332.

117 See, e.g., Thorsten Beck and Ross Levine, 'Legal institutions and financial development', in Claude Menard and Mary M. Shirley (eds), *Handbook of New Institutional Economics* 251 (Springer, 2005) at 253–4; Bernard S. Black, Reinier Kraakman and Anna Tarrassova, 'Russian privatization and corporate governance: what went wrong?' (2000) 52 *Stanford Law Review* 1731; Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W. Vishny, 'Legal determinants of external finance' (1997) 52 *Journal of Finance* 1131 at 1136–9.

118 Williamson, *supra* note 102 at 235, 332.

119 See Bernstein, 'Opting out of the legal system: extralegal contractual relations in the diamond industry', *supra* note 111 at 130–35.

120 See George Baker, Robert Gibbons and Kevin Murphy, 'Relational contracts and the theory of the firm' (2002) 117 *Quarterly Journal of Economics* 39.

parties – such as credit bureaux, bourses, exchanges, arbitrators and industry associations – in both personal and impersonal relationships.

The contract informalists, in turn, risk overstating their case to the extent that they imply that most contracts are self-enforcing, rendering formal third party enforcement unnecessary or unimportant for economic development. As noted above, long-term relational contracts may lead to end-game problems that require resort to the courts for resolution. Moreover, in many contracts for large investments in non-salvageable assets (sunk costs) – such as infrastructure or complex technology – parties will seek a fully specified, contingent claims contract.

Often the investors will not share a common ethnic, cultural or religious network with counterparties to these transactions; nor will investors wish to leave subsequent negotiation of contract details or enforcement to the vagaries of arbitrary domestic political, regulatory or legal processes. For example, circumstances that arguably have facilitated Japan's economic success in the post-war years and, more recently, China's, do not readily generalize to most other developing countries.[121] Japan is a remarkably culturally homogeneous society where reliance on informal social norms and sanctions may be particularly effective.[122] In addition, Japan has been strikingly non-dependent on large-scale foreign direct investment for its economic success. While China has recently relied on large infusions of foreign direct investment, much of this investment has come from ethnic Chinese business networks (*guanxi*) outside of China or has relied on rather unique kinds of corporatist ties to local governments.[123] China's success in attracting foreign investment cannot easily be replicated in other developing economies that do not have a huge diaspora, members of which are not only capital-rich but also willing to invest in their home countries.

121 Frank K. Upham, 'Speculations on legal informality: on Winn's relational practices and the marginalization of law' (1994) 28 *Law & Society Review* 233 at 237; Frank Upham, 'Mythmaking in the rule of law orthodoxy', Democracy and Rule of Law Project at the Carnegie Endowment for International Peace, Rule of Law Series, Working Paper No. 30, 2002, at 21–31.

122 See Robert Klitgaard, *Adjusting to Reality: Beyond 'State versus Market' in Economic Development* (ICS Press, 1991) at 169–74; Pranab Bardhan, 'Method in the madness? A political-economy analysis of the ethnic conflicts in less developed countries' (1997) 25 *World Development* 1381; William Easterly and Ross Levine, 'Africa's growth tragedy: policies and ethnic divisions' (1997) 112 *Quarterly Journal of Economics* 1203 at 1206–7.

123 Huang Shaoqin, 'A study of contract enforcement mechanisms in China during transition (zhongguo zhuangui shiqi hetong zhixing jizhi yanjiu)' (2006) 3 *J. Legal & Econ. Studies* (Hong Fan Ping Lun) 184 at 192.

For developing countries, long-term economic growth is significantly dependent on expanding international trade and on attracting large-scale foreign direct investment from parties who do not share common ethnic, cultural or social characteristics. Here, the absence of effective formal contract enforcement mechanisms is likely to entail a number of adverse implications for investment and international trade.[124]

While, as Dixit notes, '[r]elation-based governance works well in small groups that are connected by extended family relationships, neighborhood structures, and ethno-linguistic ties, because such links facilitate repeated interactions and good communication',[125] relational contracting has the potential to create significant adverse, external effects. McMillan and Woodruff acknowledge the economic weaknesses of exclusionary business networks, observing, for example, that private ordering 'sometimes harms efficiency by excluding new entrants from trading or by achieving price collusion'.[126] Gray notes a similar effect with ethnicity-based business networks, which can render it nearly impossible for an outsider to enter the circle on a business level.[127] This 'shortage of new firms and new people' and 'inability to enter into long-term contracts can inhibit the adoption and development of complex technologies'.[128] Thus, Greif recognizes that 'reputation-based institutions that support personal exchange [may] have a low fixed cost but a high marginal cost of exchanging with unfamiliar individuals'.[129]

In a tightly knit community, Bardhan notes another obvious trade-off of private ordering: 'transaction costs are low, but . . . production costs are high, because specialization and division of labour are severely limited by the extent of a market defined by the personalized exchange process of the small community.'[130] As a result, Dixit suggests, in a relation-based contract enforcement system, 'diversified conglomerates whose component

[124] See Daniel Berkowitz, Katharina Pistor and Johannes Moenius, 'Legal institutions and international trade flows' (2004) 26 *Michigan Journal of International Law* 163 at 166–8.; Shaoqin, ibid.

[125] Avinash Dixit, *Lawlessness and Economics: Alternative Modes of Governance* (Princeton, NJ: Princeton University Press, 2004) at 79.

[126] John McMillan and Christopher Woodruff, 'Private order under dysfunctional public order' (2000) 98 *Michigan Law Review* 2421 at 2423.

[127] Cheryl W. Gray, 'Reforming legal systems in developing and transition countries' (September 1997) *Fin. & Dev.* at 14.

[128] Ibid.

[129] Avner Greif, *Institutions and the Path to the Modern Economy* (Cambridge, UK: Cambridge University Press, 2006) at 58–90.

[130] Pranab Bardhan, 'Institutions matter, but which ones?' (2005) 13 *Economics of Transition* 499 at 511–12.

parts have nothing in common except common ownership by a closely knit extended family or similar network' may eventually emerge.[131] Aside from trade and production, relational contracting may also create high costs for corporate finance because, under such a system, capital markets tend to be compartmentalized among linked firms through potentially inefficient related borrowing and lending.[132]

Fafchamps notes, in an African context, that 'whenever business communities are built along ethnic, religious, or gender lines, network effects result in apparent discrimination'.[133] Not surprisingly, he finds that an ethnic bias in assigning trade credit has been 'detrimental to entrepreneurs of African descent and favorable to entrepreneurs originating outside of Africa'.[134] Thus, while ethnicity-based business networks may provide the predictability that helps facilitate certain economic transactions, such transactions may come at the cost of both discrimination against individuals outside that network and inefficiency from potentially mutually beneficial exchanges forgone. Indeed, in Greif's example of the medieval Maghribi trading networks, the coalition of traders that facilitated contract enforcement 'was not dynamically efficient' because '[t]he same factors that ensured its self-enforceability prevented it from expanding in response to welfare-enhancing opportunities'.[135]

McMillan and Woodruff usefully distinguish between formal contract law in dysfunctional and functional legal systems.[136] They note that in a functional legal system, relational contracting tends to complement the formal state-enforced contract framework, while in a dysfunctional legal system, relational contracting may be an imperfect substitute for a system of formal contract enforcement.[137]

C. Conclusion

The mix of mechanisms that are likely to ensure both a fair and efficient domain of contracting in developing countries is a function of highly context-specific factors that defy easy generalizations. This caution has also been strongly voiced in recent development literature that stresses the need to adopt highly context-specific analysis in studying

[131] Dixit, *supra* note 125 at 79.

[132] Ibid., at 80.

[133] Fafchamps, *supra* note 111 at 347.

[134] Ibid., at 368.

[135] Greif, *supra* note 129 at 88.

[136] McMillan and Woodruff, *supra* note 126 at 2425.

[137] Ibid.

institutions.[138] Two considerations may be of particular relevance to this exercise.

First, as noted above, growth modes and income levels matter to the extent that catch-up economies starting from low-level economic equilibria have different demands for institutions from those of middle-income economies. As Rodrik argues, while '[t]he onset of economic growth does not require deep and extensive institutional reform[,] ... [s]ustaining high growth in the face of adverse circumstances requires ever stronger institutions' and 'the institutional requirements of ... growth in a middle-income country can be significantly more demanding'.[139] Similarly, Daniel Klerman finds that, historically, 'economic growth often starts without strong courts, and efforts to improve the quality of the judiciary are often the consequence, not the cause, of economic development'; but, if economic growth starts without good judicial institutions, it may create a demand for quality courts at higher levels of development.[140] Moreover, new evidence from patterns of international trade also generates support for this discriminating treatment of institutional dependency. The findings of Berkowitz, Moenius and Pistor suggest that the nature of traded goods (of varying levels of complexity) can influence the relative importance of formal, as compared to informal, contracting.[141] This conclusion corroborates the view that the requirements of formal institutional quality become

[138] See, e.g., William Easterly, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*, 77, 100–101, 345–7 (Penguin Press, 2006); Greif, *supra* note 129 at 350– 52; Rohini Pande and Christopher Udry, 'Institutions and development: a view from below', Yale University Economic Growth Center, Discussion Paper No. 928, 2005, at 2–3, available at http://www.econ.yale.edu/growth_pdf/cdp928.pdf; Francis Fukuyama, 'Development and the limits of institutional design', presentation at the Seventh Annual Global Development Conference of the Global Development Network 2 (20 January 2006), available at http://www.gdnet.org/pdf2/gdnlibrary/annualconferences/seventhannualconference/Fukuyamaplenary1.pdf.

[139] Dani Rodrik (ed.), *In Search of Prosperity: Analytic Narratives on Economic Growth*, Introduction, (Princeton, NJ: Princeton University Press, 2003); see also Kenneth W. Dam, 'China as a test case: is the rule of law essential for economic growth?' (University of Chicago John M. Olin Law & Econ., Working Paper No. 275, 2nd series, 2006), available at http://www.law.uchicago.edu/Lawecon/WkngPprs_251-300/275-kd-china.pdf , at 41(stating that Rodrik's argument is supported by the example of China).

[140] Daniel Klerman, 'Legal infrastructure, judicial independence, and economic development', Univ. S. Cal. Ctr. in Law Econ. & Org., Research Paper No. C06-1, 2006, at 1, 4; see also Edward L. Glaeser, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Do institutions cause growth?' (2004) 9 *Journal of Economic Growth* 271 at 298.

[141] See Berkowitz et al., *supra* note 124.

more demanding as economies move up the development curve. This view is also corroborated by recent evidence from China that the quality of contract adjudication and enforcement has dramatically improved in rapidly growing urban centres but continues to languish in more economically backward rural areas.[142]

Second, prevailing societal structures for organizing the behaviour of individuals in the early stages of market development – such as the different modes of social interaction in communalist and individualist societies – also matter. Communalist societies tend to rely more on relation-based contract enforcement institutions that emphasize informal intra-group sanctions. Individualist societies, by contrast, tend to support more transactions across different groups with formal contract enforcement institutions.[143]

With regard to policy considerations, building contract enforcement institutions that support markets takes time.[144] In this process of institutional evolution, alternative informal solutions, although transitional at particular stages of development, can serve value-adding and welfare-improving functions before formal institutional reform has taken hold and become effective. This is especially true for countries at early stages of industrialization, as East Asian economies have demonstrated. As Dixit has observed, 'it is not always necessary to create replicas of Western-style state legal institutions from scratch; it may be possible to work with such alternative institutions as are available, and build on them'.[145] Thus, there is a legitimate justification for incorporating efficient indigenous institutions of contract enforcement into contemporary legal regimes, rendering formal and informal enforcement institutions complementary rather than substitutional, and making the law more legitimate in the perceptions of the general population, thereby facilitating its implementation on the ground.[146]

[142] See Xin He, 'Formal contract enforcement and economic development in urban and rural China', Working Paper, School of Law, City University of Hong Kong, 2008.

[143] See Avner Greif, 'Commitment, coercion, and markets: the nature and dynamics of institutions supporting exchange', in Menard and Shirley, *supra* note 117 at 727, 762.

[144] John McMillan and Christopher Woodruff, 'Dispute prevention without courts in Vietnam' (1999) 15 *J. L. Econ. & Org.* 637 at 637–8.

[145] Dixit, *supra* note 125 at 4.

[146] In this context it is worth noting that, regarding legal transplant as an alternative path toward legal reform in developing countries, some authors propose that 'adaptation' of the transplanted law to local conditions is important for achieving legality in the recipient countries – an assessment consistent with our argument

Another transitional strategy that has already become widespread practice in international business transactions is, in effect, to outsource contract interpretation and enforcement. Many major international transactions are now negotiated in English, contracts are written in English, and choice of law and/or choice of forum clauses in such contracts stipulate that they are to be governed by the law of New York or England and that disputes will be resolved by international commercial arbitration (with arbitral awards enforceable in domestic courts where countries are signatories to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards).[147] This strategy, reflected in the rise of global law firms, largely bypasses domestic legal institutions (except for residual risks associated with the enforcement of foreign arbitral awards) and has raised several caveats on that account: it largely removes foreign investors as a political constituency for domestic legal reform while leaving many domestic parties captive to the frailties of domestic legal institutions, including abuses of human rights beyond the domain of commercial transactions, and risks rendering a transitional strategy the permanent status quo (a low-level equilibrium trap).

here. See, e.g., Daniel Berkowitz, Katharina Pistor and Jean Francois Richard, 'Economic development, legality, and the transplant effect' (2003) 47 *European Economic Review* 165 at 192; Gillian K. Hadfield, 'The many legal institutions that support contractual commitments', in Menard and Shirley *supra* note 117 at 175, 181–200.

[147] See Jens Dammann and Henry Hansmann, 'Globalizing commercial litigation' (2008) 94:1 *Cornell Law Review* at 1; Kevin Davis and Michael Trebilcock, 'The demand for bijurally trained Canadian lawyers', in Albert Breton and Michael Trebilcock (eds), *Bijuralism: An Economic Approach* (Aldershot: Ashgate, 2006).

4. Political regimes, ethnic conflict and development

I. INTRODUCTION

This chapter focuses on the role that political institutions can play in promoting development. Does democracy promote economic development (growth), or vice-versa? This has been a contested terrain over the last several decades, and the evidence in favour of democracy is inconclusive at best. Evidence suggests that democracies tend to do better than autocracies on other social indicators such as infant mortality rates and access to basic education, although the correlation is not tight. The chapter also analyses the role that political institutions can play in reducing ethnic conflict. This is a pervasive problem in developing countries that takes a serious toll on social and economic development. These conflicts have complex causes, but there are reasons to believe that political institutions can play a role in mitigating ethnic tension and violence.

After reviewing the arguments and evidence that support the idea that political institutions can play a role in promoting development and reducing ethnic conflict, we analyse institutional reforms – and political reforms in particular – to show that they pose formidable challenges. Reform efforts need to acknowledge that there is no one-size-fits-all solution to the problem of governance in general and design of political institutions in particular. As with the rule of law and other institutional reforms, path dependence and institutional interconnections may significantly constrain a society's feasible reform options with respect to its political reforms. Thus, institutional change is more likely to succeed if adapted to a country's particular context and history.

II. POLITICAL REGIMES AND DEVELOPMENT

Most of the rich countries in the world are democracies and most of the poorest countries are not, or have not been for most of their histories.[1] Recently, however, this reality seems to be changing. The last quarter-

century has seen a wave of democratization,[2] the most recent examples being the revolutions in Tunisia and Egypt in 2011. In 2010, some 116 countries claimed to be democracies, compared to only 39 in 1974.[3] Many of these countries have also adopted new constitutions, entrenched bills of rights and made provisions for constitutional judicial review (the so-called 'new constitutionalism').[4] Carothers identifies seven trends in the last quarter-century that were responsible for this wave of democratization.[5] They are:

(1) the fall of right wing authoritarian regimes in Southern Europe;
(2) the replacement of military dictatorships by elected civilian governments across Latin America from the late 1970s through the late 1980s;
(3) the decline of authoritarian rule in parts of East and South East Asia starting in the mid-1980s;
(4) the collapse of communist regimes in Eastern Europe at the end of the 1980s;
(5) the break-up of the Soviet union in 1991;
(6) the decline of one-party regimes in many parts of sub-Saharan Africa in the first half of the 1990s; and
(7) a weak liberalizing trend in some Middle Eastern countries in the 1990s (stronger currently).[6]

Does this wave of democratization provide a basis for optimism that these countries are now on a much stronger development trajectory?

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[1] Adam Przeworski, 'Democracy and economic development', in Edward D. Mansfield and Richard Sisson (eds), *The Evolution of Political Knowledge: Democracy, Autonomy, and Conflict in Comparative and International Politics* (Columbus: Ohio State University Press, 2004). For the African experience, see Martin Meredith, *The Fate of Africa – A History of Fifty Years of Independence* (New York: Public Affairs, 2005); for the Latin American experience, see Michael Reid, *Forgotten Continent* (New Haven: Yale University Press, 2007); and for the Asian experience, see Minxin Pei, 'The puzzle of East Asian exceptionalism' (1994) 5:4 *Journal of Democracy* 90.

[2] Larry Diamond, *The Spirit of Democracy: The Struggle to Build Free Societies Throughout the World* (New York: Henry Holt, 2008).

[3] Freedom House, *Freedom in the World 2010: Global Erosion of Freedom* (Washington, DC: Freedom House, 2010).

[4] Kevin Davis and Michael Trebilcock, 'The relationship between law and development: optimists versus skeptics' (2008) 56 *Am. J. Comp. L.* 895.

[5] Thomas Carothers, 'The end of the transition paradigm' (2002) 13:1 *Journal of Democracy* 5.

[6] See also Samuel P. Huntington, *The Third Wave: Democratization in the Late Twentieth Century* (Norman: University of Oklahoma Press, 1991). According to Carothers, the 'third wave' of democratization is over: see Thomas Carothers, 'A quarter-century of promoting democracy' (2007) 18:4 *Journal of Democracy* 112.

The relationship between political regimes and development is highly contested terrain, both theoretically and empirically. The fact that most rich countries are democracies while most poor countries are not, or have not been for most of their histories, establishes a correlation but not necessarily causation between democracy and development.

A. Some Elements of Consensus: Markets and Democracy

There appears to be some consensus on the following four propositions.[7] First, almost all modern democracies have been market economies. (Chile under Allende was an exception; India, until the early 1990s, may have been another partial exception.) Second, there are numerous cases of non-democratic market economies. Third, it seems to follow that a market economy is (almost) a necessary condition for a political democracy, but that democracy is not a necessary condition for a market economy. Fourth, when market economies are successful over a substantial period of time, pressure for democratization tends to ensue.

There also appears to be a reasonable degree of consensus in the academic literature concerning the reasons why a market economy or economic liberalization is likely to promote the emergence or survival of a democratic regime. For a market economy to function efficiently, there must be:

- reasonably broad latitude for free economic association;
- reasonable access to private and public economic information upon which investment and contracting decisions are made; and
- a level of transparency, stability and predictability in the enactment and enforcement of laws in order to reduce risk, transaction costs and information costs.[8]

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[7] For discussion of these four propositions, see Peter L. Berger, 'The uncertain triumph of democratic capitalism', in Larry Diamond and Mark F. Plattner (eds), *Capitalism, Socialism and Democracy Revisited* (Baltimore: Johns Hopkins University Press, 1993); Jagdish Bhagwati, 'Democracy and development', in Diamond and Plattner, ibid.; Robert A. Dahl, 'Why free markets are not enough', in Diamond and Plattner, ibid.; Jose M. Maravall, 'The myth of authoritarian advantage' (1994) 5:4 *Journal of Democracy* 17; and Andrei Shleifer, 'The age of Milton Friedman' (2009) 47 *Journal of Economic Literature* 123.

[8] See Bhagwati, *supra* note 7; Dahl, *supra* note 7 at 76; Adam Przeworski and Fernando Limongi, 'Political regimes and economic growth' (1993) 7 *Journal of Economic Perspectives* 51; and J.D. Sullivan, 'Democratization and business interests' (1994) 5:4 *Journal of Democracy* 146.