

THE IMPORTANCE OF LEGAL INFRASTRUCTURE FOR REGULATION (AND DEREGULATION) IN DEVELOPING COUNTRIES

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1. Introduction

As the globalisation of markets has grown apace, so Western ideas of regulation and deregulation have had a growing influence on governments in developing or “transitional” countries. Indeed, donor institutions, such as the World Bank and the International Monetary Fund, have applied pressure for Western models to be adopted. The assumption, sometimes explicit, sometimes implicit, is that these models serve to improve economic performance. Yet actual or attempted applications of Western models have often, it seems, been insensitive to a key question, whether the legal infrastructure present in the recipient country is appropriate to integrate the models.

In considering regulation and deregulation in developing countries, we therefore need to address a question which crucially must be addressed alongside the selection of an appropriate regulatory approach: what is the significance of the legal infrastructure to that selection and what adaptation (if any) to that infrastructure is necessary to accommodate such an approach.

I address the issue of legal infrastructure, first (in section 2), by reviewing the literature on the relationship between economic growth and legal systems. The predominant (though by no means unanimous) view which has emerged is that legal structures, particularly those relating to the “rule of law” (section 3) have an important influence on economic development; and that the failure of attempts to reform those structures, particularly by adopting Western models, has impeded growth. Attempts to eradicate corruption, another fetter on economic performance (section 4), have also foundered. In the remainder of the paper (section 5) I seek explanations for these failures by reference to cultural tensions, political influence and inappropriate goals formulated by donor institutions and Western commentators..

2. Economic Growth and Legal Systems

The question of the causal relationship between economic development and the legal system and its supporting institutional framework has given rise to a huge debate and also much disagreement. In this section I attempt to survey key contributions to the debate.

(a) Law-and-economics theory

Some early writers on political economy perceived the importance of law for economic welfare. Hobbes, for example, recognised that if entrepreneurs lacked confidence in the coercive power of the state to enforce contracts, they would not enter into trade (Hobbes, [1651], 1996, ch. XIV) and Adam Smith recognised that “a tolerable administration of justice” was an important condition to “carry a state to “the highest degree of opulence” (Smith [1755], 1980, 322). More from an historical and sociological perspective, Weber found that economic development was a consequence of formal and “rational” legal systems (Weber, [1925], 1954). The systematic study of the relationship between legal principles and institutions and economic behaviour is, nevertheless, a relatively recent phenomenon (Ogus, 1998).

The so-called “law-and-economics” movement has tended to concentrate on the micro-economic impact of law (Posner, 1998a), but one branch of it (“neo-institutional economics”) has shown how transaction costs, the costs of negotiating and enforcing legal arrangements, impede economic growth (Williamson, 1985). In particular, institutions which can, at low cost, adjudicate on, and enforce, long-term contractual arrangements are crucial for development. Another branch, led by Douglass North (see especially North 1990 and 1991), has attempted historically to find positive correlations between economic development and the evolution of legal institutions, the basic premise being that such institutions reduce uncertainty. Some of the institutions in question are constitutional; for example, it has been shown how the evolution of capital markets is linked to the emergence of democratically elected legislatures which limit arbitrary government power (North and Weingast, 1989). Other economic historians, developing an original insight of Adam Smith relating to patents (Smith [1776], 1976, 754) have focused on the importance of securing legal entitlements, such as intellectual property rights (Merges, 1995). And, of course, more generally, the effectiveness of the legal mechanisms for the enforcement of rights has been a significant variable in economic growth (North, 1990).

As yet, law-and-economics has failed to engage seriously in normative analysis of how legal institutions and principles should be selected and adapted to conditions in developing countries where the resources invested in the legal system are modest. An exception is to be found in a paper published by Posner (1998b). He contrasts rule-formulation with legal institutional arrangements. The marginal costs of the former

are negligible; the latter requires relatively heavy investment in terms of labour costs. In consequence, he argues for a policy of selecting rules which reduce the institutional costs. Such a policy may affect the content of specific rules, for example, that contracts have to be in writing to be legally enforceable; and that certain types of disputes must be submitted to binding arbitration. It may also guide the general character of the rules which ought to be relatively straightforward to apply, and not requiring a significant exercise of discretion (see also Schaefer, 2002). Elsewhere I have made equivalent suggestions as to how administrative costs may be reduced in the selection of regulatory instruments and processes (Ogus, 2003a).

(b) Law-and-development theory

The diversity of views held on the relationship between law and economic development by scholars engaged in studying law in developing countries is very striking (Tamanaha, 1995; Davis and Trebilcock, 2001). The first wave assumed that underdevelopment was the result primarily of a failure to adopt Western styles of liberal democracy, including independent courts ready to uphold well defined property rights and contractual entitlements. In consequence, inspired by Weberian analysis (e.g. Trubek, 1972), they envisaged that the import of Western models would be the key to success. A number of legal scholars, mainly from the USA, and under the aegis particularly of US AID and the Ford Foundation, became involved in devising legal reform programmes for developing countries and actively promoting American “legal style” (Merryman, 1977).

The movement proved a to be a failure. After closer study of what actually happens when simple transplants of Western models were attempted, there was a quite radical change of opinion by those involved (Trubek and Galanter, 1974). It was now recognised that the matter was more complex and that the role of law and legal institutions in such societies could only be understood by reference to their cultural and political environment.² Legal reforms without due regard to these factors were doomed to failure (Faundez, 2000). One obvious example – to which we will in due course return – is that in many developing countries informal means of resolving disputes are more important than formal methods. And that is just part of the more

² The political science and public administration literature had reached analogous conclusions: Almond and Coleman, 1960; Esman, 1972.

general question of reconciling Western-style legal institutions with customary law, a problem which survives from the colonialist period (Seidman and Seidman, 1994).

Another perspective on law and development reflected the collectivist ideology current in the 1960s and 1970s. On this view, the mistake was to import legal institutions designed primarily for liberal “capitalist” economies. What was needed was a strong state interventionist approach, capable of invigorating economic development by Keynesian measures, rendering development less dependent on external forces (Snyder, 1980) and also (according to some) redistributing the resources more equitably (Ghai, 1993)). Understandably in vogue at a time when the Soviet Union and other socialist countries were able to offer political and financial support, this approach in its turn became outmoded, not the least as it did not, in most cases, seem to yield the promised degree of economic growth. Indeed it served more obviously to reinforce the position of the political elite and the bureaucratic classes (Ghai, 1986).

What may be described as the “third wave” of theories concerning law and development was a consequence of politico-economic changes most obviously in Eastern Europe and the former Soviet Union, but also in the West with the policies of privatisation and deregulation. Initiated by the oil crisis and the problem of escalating public sector budgets, governments felt constrained to review and the restructure state-market relationships. As the economic crisis extended to developing countries, so their dependence on donor organisations grew. Legal reform occupied a prominent place on their agenda for two reasons. First, because, consistent with policy analysis in the industrialised world, economic stagnation was identified with notions of “state failure” and the regeneration of the private sector was considered to require new legal definitions and processes for delimiting the role of the state (Tshuma, 1999). Secondly, influential voices were becoming increasingly convinced that “good governance” was a crucial variable in explaining differential rates of economic growth. Since donor organisations were reluctant, or not allowed, to address the political dimensions of good governance, the focus shifted to strong legal frameworks and effective principles of accountability (World Bank, 2002). Loans and other forms of aid were thus made conditional on progress with legal and judicial reform.

No doubt some lessons had been learned from previous failures (World Bank, 2002, 11-16). Less was attempted by way of transplanting particular models of legal

organisation, and there was a compensating focus on the basic essentials necessary for the rule of law. This involved, notably: a relatively stable body of rules, known in advance and enforced by independent adjudicators; and basic systems of property and contract rights (World Bank, 1992 and 1997). Of course, the attraction of foreign investment played a key role and therefore there has been an increasing emphasis on such features as: an adequate system of company law; clear rules for joint ventures and public-private partnerships; effective insolvency provisions; and fair and predictable tax laws (Perry, 2001).

The third wave of “law and development” is still very much in evidence, but it has been subject to several criticisms, not the least from within the World Bank itself, voices being heard that the focus on “rolling back” the state diverts attention from the more urgent need to make governance more effective (Minogue, 2002). There is, it has been alleged, an important difference between “legality” and “the rule of law” (Ghai, 1987). A legal system may have many or most of the attributes required by the World Bank and bilateral donors, and executive action may thus be clothed with legal validity, but it often masks tyrannical or arbitrary government. Perhaps the emphasis has been too much on law as enacted, and too little on law in action. (Faundez, 2000, 32). Carothers (1998, 103) argues that there has been insufficient attention to monitoring government compliance with the law and judicial independence.

(c) Comparative economics and empirical studies

Another field of study impacting on the relationship between law and economic development is derived from comparative economics (Barro, 1997). Originally focused on comparisons between capitalist and non-capitalist systems, it now concentrates on the relationship between institutional structures and phenomena occurring at the end of the twentieth century, notably the collapse and subsequent transition of the political systems in Eastern Europe (Shleifer, 1997) and the Asian crisis of 1997-98 (Johnson et al, 2000).

Surveys of empirical studies undertaken on the relationship between legal and institutional variables and economic growth in developing countries reveal very mixed results (Messick, 1999; Davis and Trebilcock, 2001; Djankov et al 2002). Perhaps surprisingly, the evidence that higher levels of democracy lead to higher growth rates appears not to be conclusive (Barro, 1997).

More germane to this paper is the rule of law and the quality of legal institutions. Studies of this dimension (e.g. Keefer and Knack, 1995) do report positive correlations, the evidence suggesting that effective protection of the property rights of investors and officials operating within a framework of known legal rules are conducive to stronger economic development (World Bank, 1997, Beck et al, 2001). A key variable is the perceived vulnerability or invulnerability of institutions to subversion by powerful citizens (Glaeser and Shleifer, 2003). On the other hand, a study based on the interviewing of foreign investors found that this group were not deterred from investing by the realisation that the legal system of fell well short of the ideal typically asserted by Western commentators (Perry, 2001).

Some studies suggest that countries that have adopted legal institutions from within the common-law tradition have experienced faster growth than those countries that have drawn on civil law systems (La Porta et al, 1997 and 1998; Mahoney, 2001; Glaeser and Shleifer, 2002). But another study suggests that it is the facility with which the transplants from another system has occurred, rather than the nature of that system, that is the crucial factor (Berkowitz et al, 2002).

The quality of the judicial process is assumed to be related to economic performance, and attempts have been made to derive reliable quantitative data on key variables and their impact on costs (Sherwood et al, 1994). However, these findings should be treated with caution because there have been difficulties in devising adequate proxies for such variables as judicial independence³ and the effectiveness of enforcement, the researchers often relying on the subjective opinions of potential entrepreneurs as to risks of business in the relevant country (Messick, 1999).⁴ There is also a causal ambiguity: the quality of the legal institutions may be a consequence of, rather than a reason for, economic growth – richer countries may simply be able to invest more in the legal system (Posner, 1998b).

Attempts have also been made to relate particular aspects of legal systems to economic development. Commercial law should lend itself well to analysis of this kind, but there has been a paucity of empirical work in the area. It has been shown

³ For a recent sophisticated attempt to measure judicial independence, see Ramseyer and Rasmusen (2003).

⁴ For attempts to devise performance indicators for the quality of government and law, see Center for Democracy and Governance, 1998.

that growth occurs in countries where secured creditors are guaranteed repayment of their loans (Levine, 1999) and where corporate shareholders are adequately protected (La Porta et al, 1998). However, these and other studies (e.g. Fafchamps and Minton, 2001; Kamarul and Tomasic, 1999) show that, in the absence of effective formal mechanisms for resolving disputes, there will often be resort to informal systems which in the context may be equally, if not more, effective. Indeed, a paper by Kranton and Swamy (1999) chronicles the loss of welfare resulting from the introduction in colonial India of civil courts to enforce credit contracts. There is documentation of similar outcomes in other areas of contractual behaviour (e.g. Bigsten et al, 2000) and also in relation to attempts to impose Western-style land title systems (Platteau, 1996).

Finally, it should be noted that the so-called “East Asian miracle” occurred notwithstanding the failure of many legal reforms, based on Western models, to penetrate commercial life (Pistor and Wellons, 1999). Resort was had, instead, to arrangements made between business elites and the governments and sometimes by discretionary executive rulings, disputes being dealt with usually by informal negotiation aided by mediators.⁵ “Formal law was used to the extent it complemented or supported this arrangement, but was ignored by economic and government agents alike and substituted with alternative rules, if it ran counter to it” (Pistor, 1999).

(d) Conclusion

From the divided opinions, and large but often contradictory empirical findings, it is difficult to draw generalisations. However, at the risk of over-simplification, we can accept the generalisation that legal infrastructure is connected to economic growth, even though the causality of this connection is difficult to substantiate. What appears also to emerge is that the technical aspects of the law, as applied to for example, business and finance, are less important than the general, and fundamental, features of the legal system; those that are generally included in the expression “rule of law”, a concept which I explore in the next section.

⁵ As Posner notes, one of the hidden costs of these alternatives is bias against newcomers who are not part of the informal network: Posner, 1998b, 3.

3. “Rule of Law” and its Reform

There are, of course, different interpretations of the “rule of law” (Grote, 1999). Clearly, most reformers do not take this to mean simply “rule *by* law”, that is a system, operating in a number of Asian countries, where law is used primarily as a mechanism for exerting governmental power, with dispute resolution as a subordinate function (Carothers, 1998, 96). As linked to the familiar concept of “law and order”, a system so characterised may be one subservient to tyrannical and arbitrary government. On the other hand, although democratic processes are in practice often linked to rule of law variables, it seems preferable to exclude this area of governance from the definition, not the least as, in recent years, the World Bank and others have been seeking to induce rule of law reforms in countries where movement away from undemocratic systems of government is highly unlikely (Messick, 1999).

Central to the generally accepted conception of the “rule of law” is, nevertheless, the notion that government is itself the subject of law (Frischtak, 1997). More specifically, we can identify the following as commonly stated requirements⁶ (World Bank 1992; Sherwood et al 1994; World Bank 1997; Faundez, 1997; Carothers 1998; Perry, 2001).

- rules published and thus readily accessible
- rules which are reasonably certain, clear and stable (thus excluding decisions of unconstrained discretion)
- mechanisms ensuring the application of rules without discrimination
- binding decisions by an independent judiciary
- limited delay in judicial proceedings
- effective judicial sanctions
- compliance by, and accountability of, the government and its officials in relation to relevant rules

A list of this kind may appear rather trite and also superficial. The requirements are objective and thus may be applied relatively easily to a given jurisdiction by examining its formal content. But, for that same reason, they may also reveal too little as to the actual working of the system in practice and this has led to more ambitious

⁶ Some Americans would (inappropriately) extend the list to include requirements reflecting their own political culture, such as jury trial, an entrenched constitution and a strong separation of powers doctrine: Carothers, 1998, 97.

types of definition (Stephenson, 2001). Of course, ideally one would wish to test the quality of outcomes in terms of, for example, justice or fairness, but this is subject to the obvious difficulties that such judgements are necessarily subjective and cannot be made without accepting some prior understanding of what constitutes “justice” and “fairness”, as to which, particularly in a cross-cultural context, there may be little agreement. Another possibility is to fasten onto some key functions, such as the extent to which judicial decisions constrain executive discretion, and measure a system’s performance accordingly (see e.g. Ramseyer and Rasmusen, 2003). But this too has its problems: can the assumption be made that it is the legal institution, rather than some other phenomenon, which induces the observed outcome? Is it possible to generalise sufficiently from the chosen function or functions?

In the light of these difficulties, empirically based judgements on the quality of the rule of law in developing countries are hard to make. That has not inhibited Western commentators, and donor institutions in particular, from advocating major reforms of the legal system. Alongside modifications to substantive law, with the adoption or modernisation particularly of contract and commercial law, intellectual property and financial and securities regulation (Arner, 2000; World Bank, 2002), these have focused on improvements to the institutional base of law, notably to courts, judges, government law enforcers and bureaucracies and attempts to render government institutions more compliant with, and accountable to, the law.

In many developing countries the reforms have failed, to a greater or lesser extent, to achieve the desired objective. The veneer of legal institutions and applicable legal principles may have been substantially altered, but what went on beneath was often stubbornly familiar (Ghai, 1986). The literature furnishes us with several possible explanations.

- It may have been partly a question of resources: models of sophisticated legal principles and institutions borrowed from the industrialised West presuppose people technically adept at carrying out decision-making responsibilities created by them (Posner, 1998b).
- It may have been partly a clash of cultures. For example, even if there were an adequate infrastructure to adjudicate on, and enforce the key aspects of, (say) a set of regulatory principles inspired by a predominantly American model, judges and litigants in the adopting country may behave

quiet differently from their American counterparts⁷ (Seidman and Seidman, 1994). There may have been little or no previous experience of some institutions, such as quangos (Paliwala, 2000). And the very notion of *considering* the legal implications of an activity or a transaction, let alone invoking the law in some practical way, might be alien to all but a small proportion of the population.

- It may have been partly attributable to bureaucratic failure. The Weberian model has not easily been transplanted to developing countries (Seidman and Seidman, 1994). Bureaucrats, especially in the higher ranks, have tended to be tightly knit with offices often being linked by political and ethnic ties with the ruling elite. This means that it has often been impossible to draw a clear line between what is political activity and what is bureaucratic activity.⁸ And it may too easily have been assumed that, in an autocratic state governed by a ruling elite, it would be relatively easy to secure obedience from junior officials. In fact, even within such political systems a great deal of political conflict and tension between different groups occurs within bureaucracies (Rondinelli, 1993, chap. 6).
- It may simply have been a matter of lack of political will fully to see through the necessary reforms (Ghai, 1986). For reasons already examined, it suited the ruling elite to maintain the rhetoric and images of significant legal reforms but it remained in their own interests for the reforms to be “paper” reforms only.⁹

To consider the validity of these various hypotheses, we need to explore further the nature of legal cultures and their possible impact. Before doing so, however, I shall turn to an important related matter which seriously impinges on economic performance but which is often excluded from discussions of legal infrastructure:

⁷ For a valuable study on the contrast between American and non-American (particularly European) approaches in this respect, see Kagan 2001.

⁸ “In practically every third world country, barely an eye-blink after independence, increasing numbers of senior government officials joined in building a new oligarchy of power and privilege”: Seidman and Seidman, 1994, 152.

⁹ The proposition is formally modelled in Hoff and Stiglitz, 2002.

corruption. What we learn here will provide some signposts for addressing the larger question of failure to adapt to Western models.

4. Corruption

(a) Nature of corruption

There is a strong connection between the rule of law, or rather its absence, and corruption, but surprisingly they have generally been treated as discrete issues, the substantial literature on corruption (reviewed in Bardhan, 1997, Rose-Ackerman, 1999, and Bowles, 2000) making little reference to that on the rule of law and vice versa. This may have something to do with ambiguity concerning the meaning of corruption. I will be using it here to refer to “the use of public office for private gains where an official... entrusted with carrying out a task by the public ... engages in some sort of malfeasance for private enrichment” (Bardhan, 1997, 1321). But it may be given a broader interpretation in some jurisdictions than in others, for “[w]hat is lawful, and therefore what is unlawful, depends on the country and culture in question” (Klitgaard, 1988, 3).

Another possible explanation of the separation between rule of law and corruption is the fact that the latter is often represented as a problem endemic or peculiar to developing countries, Western industrialised countries being largely free from it. This is obviously a gross distortion of reality, empirical, as well as impressionistic, evidence revealing that some developing countries have a better record in this respect than some developed countries¹⁰ (Mauro, 1995). In any event, it is not always clear where to draw the line between corruption and “rent-seeking” behaviour (Mbaku, 1992). “Rent seeking”, the process by which interest groups use (lawful) means to secure competitive advantages from the political process is a phenomenon widely acknowledged to influence law and legal institutions in industrialised societies and the subject of a huge, but again distinct, literature (surveyed in Tollison, 1982 and Rowley et al, 1988).

¹⁰ See also the perceived corruption rankings recorded in Transparency International, 2002, based on perceptions of the degree of corruption as seen by business people, academics and risk analysts: Singapore (5th), Hong Kong (14th), Chile (17th) and Botswana (24th) come ahead of France (25th) and Italy (31st) and Greece (44th) in terms of freedom from corruption.

(b) The economic impact of corruption

Commentators may too easily take a moral stance on corruption and in consequence fail to recognise its objective value, particularly in developing countries. We may begin by identifying incidents of corruption which may, in certain contexts, generate economic benefits (Klitgaard, 1988, chap. 2; Bardhan, 1997, 1322-1324; Rose-Ackerman, 1999, 10-21).

Some regulation may be inefficient, in the sense of generating welfare losses. The losses may be reduced by private transactions modifying the regulatory requirement. Secondly, corruption may reduce the administrative costs of regulatory processes. If an official is able to reach the desired outcome by a shorter route, consequent on the briber's intervention, then those costs may be reduced. We may note, thirdly, that unlawful payments to an official may enable some of the regulatory administrative costs to be internalised to the regulated industry. This argument is distinct from the distributional, and therefore non-economic, justification for corruption, that regulatory officials tend to be underpaid.

That corruption generates costs to the economy is more intuitive, but it is still important to identify them and specify how they arise. And it makes sense to start by recognising that some of the assumption in the identified benefits may not hold: private transactions may modify an efficient, rather than inefficient, law; and, as regards "short cuts", the outcome may not be that which would have been reached in the absence of the bribe. Moreover the identified benefits may create perverse incentives to generate inefficient regulatory outcomes and to delay decision-making. The resources used in seeking to bribe an official, or by the official in attempting to secure corrupt payments, give rise to dead-weight losses, in that they are activities which, from a social point of view, are entirely unproductive. A good example is the resources used to keep a transaction secret (Rose-Ackerman, 1999, 12).

It is generally assumed that there are large negative externalities arising from corruption, facilitating, for example, crime (particularly organised crime – Rose-Ackerman, 1999, 23-24) and other illegal activity¹¹. An uncertain business environment may also be included, although the same problem may of course arise

¹¹ "Whereas an occasional act of corruption may be efficient, corruption once systematised and deeply engrained never is": Klitgaard, 1988, 42.

from a system free from corruption if, for example, legal enforcement machinery is ineffective.

Viewing the matter from a dynamic, rather than static, perspective suggests further costs (Bardhan, 1327-1334). There are likely to be increasing returns to bribing officials, relative to productive investment. This is because, as the level of corruption grows, so the returns on productive investment decline, thus reducing the opportunity cost of further corruption - an argument derived from the rent-seeking literature (e.g. Murphy et al, 1993). The cycle then becomes difficult to break; and a reputation of corruption may be inherited from previous generations, with little incentive for successors to become honest (Tirole, 1996).

(c) Constraining corruption by traditional legal devices

Since the weight of evidence, theoretical (section (b) above) and empirical (Tanzi and Davoodi, 1998), suggests that corruption hinders economic growth, it is not surprising that pressure has been brought to bear on developing countries, particularly by donor organisations, to combat it (Huther and Shah, 2001; Hodessed, 2003). The pressure takes a variety of forms but we should note, in particular, arguments and efforts to depoliticise the civil service, increase the transparency and accountability of decision-making, improve monitoring and audit systems, and the raise the sanctions of those apprehended under anti-corruption legislation systems (Rose-Ackerman, 1999, chap. 5; Lederman et al, 2001).

Elsewhere (Ogus, 2003b) I have suggested that much of this typical “Western” response is futile because the cost of securing major changes to deeply embedded cultural attitudes is simply too large. The second point seems insufficiently to be grasped in some of the literature, including those papers which treat corruption like any other illegal activity which is to be inhibited by use of the criminal law and other familiar law enforcement devices (Bowles, 2000). But if the law enforcement system is itself subject to corruption, or for other – including political - reasons, ineffective in these cases, then not even draconian sanctions will achieve the deterrence. As regards which strategies require more fundamental changes to be effected, such as those involving increased transparency and accountability, these require a strong degree of support from political leaders. This may be forthcoming in principle but less evident in practice.

(d) Reducing corruption by institutional design

The import of the last section is clear: there may be aspirations to use traditional legal devices to create highly sophisticated anti-corruption regimes, but if there is difficulty in finding individuals to prosecute, and judges to condemn, the policy will not succeed. The quest then becomes a less ambitious one, that of ascertaining how institutional structures and procedures may be designed so as to reduce opportunities for (rather than to eliminate) the behaviour which is undesirable (Ogus, 2003b). It will suffice here if I list possible strategies.

- Promoting some form of competition through the creation of a series of alternative individuals or offices providing the same service, or perhaps overlapping services (Rose-Ackerman, 1978); however simply adding further layers of bureaucratic decision-making would simply exacerbate the problem (Lederman et al, 2001).
- Using committees instead of single decision-makers; and regularly moving bureaucrats between various offices (Klitgaard, 1988, chap.3).
- Removing regulatory devices that are surplus to requirements, in the sense that they do not further the regulatory goal, but rather create additional opportunities for corruption: the classic case is that of business licences which have tended to proliferate in developing countries (Guasch and Spiller, 1994), no doubt because prior to independence they facilitated control by the colonial governments and since have served the same function for the succeeding political elite.
- Reducing the amount of discretion and informal rules, both of which create more opportunities for corruption than where regulatory requirements are the subject of clear and precise rules (Seidman and Seidman, 1994, 178; Lederman et al, 2001, 30-31).

(e) Conclusion

What this short excursus into corruption teaches us that well-intentioned attempted to control corruption by Western types of legal devices (transparency, audit, accountability; and stiff sanctions) is unlikely to succeed in an environment where, culturally, corruption is well embedded. The policy would be better served by concentrating on limiting the opportunities for corruption by institutional measures

(for example reducing the levels of discretion) some of which do not sit easily with modern Western regulatory thinking.

5. Legal Cultures and Developing Countries

(a) Nature of Legal Culture

As we have seen, one important hypothesis explaining the failure of a legal infrastructure to buttress economic development is derived from legal culture. What constitutes “legal culture” is a matter of some controversy and a large literature (Ogus, 2002, and the references there cited). In a broad sense, it is taken to mean “those historically conditioned, deeply rooted attitudes about the nature of law and about the proper structure and operation of a legal system that are at large in the society” (Merryman and Clark, 1978, 29). In a narrower sense, it refers to networks of language, conceptual structures and procedures which are not easily transplanted from one jurisdiction to another (Ogus, 2002, 423). In investigating the potential importance of the legal system to economic growth in developing countries, it thus becomes essential to understand, in relation to developing countries, how legal culture has evolved and, in particular, the relationship between different or competing legal cultures.

In the following pages we shall see how, within developing countries, problems have been created by tensions arising between colonially-imposed legal cultures and native traditions; and between Western developed versions of those cultures and political and bureaucratic opposition.

(b) Colonial impositions

Where developing countries have been colonised, much of their legal traditions are derived from systems imposed by their colonial rulers. comparative law scholars classify Western legal systems into two broad categories: common law systems, identified with England and the many countries, mainly ex-colonies, which absorbed that culture; and civilian systems which, to a greater or lesser extent, had their origin in Roman law (David and Brierley, 1985; Zweigert and Kötz, 1998). Although there is a risk of over-generalisation, we can identify the main differences between the two traditions as follows.

- Most of the law in civilian systems is codified; although much of the law in common law jurisdictions is in statutory form, there is a long tradition of principles evolving through judicial decisions, or customary law. It follows that common law judges are considered to be more creative and have greater independence than their civilian counterparts who are expected to have more of a subsidiary role in the development of the law.
- Civilian systems have a more developed, and more coherent, notion of public law, which is distanced, often quite rigidly, from private law, by a separate set of courts, as well as principles. This is a consequence particularly of the tradition of a strong, centralised role for the state. Public law within the common law tradition has focused on the power of the ordinary courts to constrain executive activity through judicial review.
- Although the question is not free from controversy, it has been asserted that the principles and institutions emerging in common law jurisdictions have been more conducive to unregulated economic activity than those from civilian systems (Hayek, 1973-1979). The argument is based on the alleged greater flexibility of common law principles to adapt to changing economic circumstances.

An obvious consequence of this classification is that, when confronting legal systems outside of Western Europe and North America, these same scholars focus on the legal institutions established or imposed by colonial settlers, and thus from either the common law or the civilian tradition. This is, however, subject to important qualifications. First, successive colonisations often gave rise to hybrid legal cultures like those in, for example, South Africa and Sri Lanka. (Smits, 2001). Secondly, some of the characteristics which distinguish the two traditions may have been softened as a consequence of perceived colonialist needs or, on independence, on the desire to break from some aspects of the colonial heritage. It is striking how, in British colonies and former colonies, there was much greater reliance on formal codifications (e.g. the famous Indian Penal code – Rankin, 1944) and formal constitutions (De Smith, 1964) than in the Mother Country.

The third qualification is by far and away the most important: account has to be taken the relationship between the imposed colonial system and indigenous law which has tended to be classified into religious (e.g. Muslim or Hindu) law or traditional/customary law. It was almost never the intention of the Europeans to suppress or totally override indigenous law - this would, in any event, have been an impossibility geographically, since effective colonial power was generally restricted to the coastal areas. There were variations between the different colonial powers (Mommsen, 1992, 6-7): the Germans were the most ambitious in their attempt to impose their legal order; the French concentrated on the adoption of their administrative structures; the British preferred flexible, and often informal, arrangements; the Dutch aimed more explicitly at a pluralistic approach, with a complementarity between their law and the indigenous system. But, in general, there was a reluctance to interfere in the arrangements used by the indigenous population to order their own affairs, except where that was deemed necessary for effective colonial power, or for furthering the settlers' economic interests.¹²

What, then, of indigenous law itself? Its main characteristics are: a strong foundation in particular, often significantly hierarchical, social structures; family or kinship groups, rather than individuals, as the principal legal "units"; and a high level of discretion in decision-makers (Mattei, 1997, 39; Read, 2000). In many societies, indigenous law has not been static, clinging inexorably to tradition, but rather flexible and, in particular, adaptable to the changing political and economic circumstances of the colonial presence (Chanock, 1985).

There is an evident danger in making a comparison with Western law, based entirely on Western preconceptions of "law" (Nader, 1969). The arrangements for dealing with disputes might not have incorporated the Western notion of legal logic, nor have been transcribable as a system of rules, and thus knowable in advance. But the same can be said for many types of informal dispute settlement procedures used in Western societies and complementing formal legal arrangements (Pistor, 1999). In almost all societies there is in operation, at any one time, a complex combination of different normative systems, formal and informal, although the balance between formality and informality will, of course, vary according to the society and its

¹² This occurred, and not without conflict, particularly in relation to landholding, traditional law often knowing no system of individual property rights: Mommsen, 1992, 9.

circumstances. To appreciate how the legal structures impacted on economic development, it is therefore, necessary to have regard to this combination and the “legal symbiosis” to which it gave rise (Benda-Beckmann, 1992).

A failure to appreciate the balance between the colonial law and indigenous law, and too energetically to push towards domination of the formal over the informal may actually have retarded economic growth. “[I]t is rather obvious that the expansion of economic activities of indigenous populations was much more inhibited by the ‘Western’ laws and the political and economic practices legitimated by reference of [*sic*] these laws than by their adherence to the mutilated and transformed indigenous normative systems” (Benda-Beckmann, 1992, 323).

(c) Post-Independence Developments

Independence from colonial rule generated less change in the relationship between the formal, mainly Western, systems and the informal systems than might have been expected. For most of the population, the substitution of the ruling elite for colonial masters had little impact; and that was true also for the institutions (Seidman and Seidman, 1994). The ruling elite had little enthusiasm for revitalising indigenous law at the expense of the colonial legacy. In the first place, colonial law had generally enabled them to obtain political power and could, at any rate, be used by them to block claims by their opponents (Ghai, 1987). Secondly, indigenous law was not perceived to be consistent with a strong centralised state, nor with modernisation of the economy (Mommsen, 1992, 13).

Of course, the very fact of major political change, invariably involving the establishment of, or radical amendment to, the constitution necessarily implied some institutional change and, in many cases, formalising what had previously been informal (Seidman and Seidman, 1994). But the instrumental impact of these changes may have been muted: those with power might be able to side-step them by “using existing network relations to negotiate exemptions from the application of the formal law, or simply ignore the formal law and hold on to existing control rights backed by informal institutions” (Pistor, 1999).

Interesting parallels may be drawn between these developments and those in jurisdictions governed by socialist totalitarian regimes which often adopted the veneer of Western-style legal arrangements to impose notions of “socialist legality” (Hazard, 1969). To accommodate what may be described as the political dimension

to legal culture, Mattei (1997) for a new classification which bypasses the classical distinction between common law and civilian traditions. His three categories are as follows.

- The *rule of professional law* is characterised by the recognition that legal principles are independent of religious and social norms and that they constitute the most important method for ordering society and resolving disputes.
- The *rule of political law*, in contrast, implies that the legal and political processes cannot be separated and that political power infiltrates legal decision-making at almost all levels.
- The *rule of traditional law* occurs where, to a greater or lesser extent, legal relationships and their adjudication are governed by informal, non-professional institutions, which may be religious or customary in origin.

While he identifies Western legal systems (though not exclusively) with law of the first category, there is typically to be found in developing countries some mixture of all three and it is a matter often of sensitive judgement which particular category dominates. And, of course, the relationship between the three will not be stable, but may vary over time, reflecting internal; political developments, as well as external pressures.

(c) Conclusions: adapting legal infrastructure to cultural-political differences

Where does this survey of legal cultures lead us? Primarily, I think, to the recognition that legal infrastructures should not, as seemingly assumed by many “rule of law” and anti-corruption advocates, be considered in the abstract, but rather as inextricably linked to their historical origins. That immediately suggests that Western models of legal systems cannot easily be transplanted, at least by means of rapid integration. No doubt many within the donor community want their legal reforms to achieve perceptible results in the short-term, as well as the long-term, but a slower, incremental approach may be more effective (McAuslan, 1997, 33-34). This argument may be particularly apt in relation to deregulating measures, the concept of the market in an industrialised economy being too easily transposed to an environment characterised by oligopolies, immobility of factors of production and extremes of income inequality (Seidman and Seidman, 1994). And, although in Weberian terms it

may be appropriate to draw from the history of Western economies a clear relationship between markets and liberal democracy, it is wrong to abstract this from the long processes of change, conflict and adaptation which were also involved (Frischtak, 1997, 101).

A second important lesson relates to traditional law. In the past, legal scholars have adopted a simplistic attitude: indigenous law was regarded appropriate, not for trade and commerce, but rather for areas of law involving personal and family relationships and inheritance and it was caricatured as “law of closed societies, turned in upon themselves” and thus “suitable to static peasant societies” (David and Brierley, 1985, 569-570). Hopefully, we are now wiser. As we have seen, less formal means of resolving commercial disputes have, in appropriate contexts, been very effective and in some jurisdictions, for example Japan, conducive to (or at least not incompatible with) high levels of economic growth.

Thirdly, realism needs to hold sway in relation to the political dimension of legal culture. In many jurisdictions, the colonial heritage has meant that the power of the ruling elite, and of their supporting bureaucracy, is linked to, and sometimes dominates, the legal infrastructure. It is, therefore, naïve to assume that there will be the political will to achieve any radical changes to the system. As our analysis of the corruption problems reveals, a policy of chipping away at the margins may prove to be more effective.

The fourth conclusion needs further analysis. It follows from the perception that inadequacies of the legal infrastructure may be a consequence, rather than a cause, of retarded economic development (Khan, 1998). Once it is recognised that in developing countries the proportion of national resources available to the legal system is much smaller than in industrialised countries, then the focus of reform should be on changes which are compatible with that economic reality. So, for example, judicial and regulatory procedures should aim at simple, rather than complex, administrative requirements (Posner, 1998b).

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