

WORKING P A P E R S

MYTHMAKING IN THE RULE OF LAW ORTHODOXY

Frank Upham

Rule of Law Series

**Democracy
and Rule of
Law Project**



CARNEGIE ENDOWMENT
for International Peace

Number 30
September 2002

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EXECUTIVE SUMMARY

As governments and donor agencies struggle over questions of aid and international development, a growing consensus is emerging regarding the connections between poor governance and underdevelopment. An increasing number of initiatives, from the U.S. Millennium Challenge Account to the New Partnership for African Development (NEPAD), explicitly link improving governance with pursuing sustainable development and poverty alleviation. Lack of pluralism and transparency, inefficient bureaucracies, and underdeveloped public institutions contribute to corruption, reduce governmental responsiveness to citizens' needs, stifle investment, and generally hamper social and economic development. A frequent donor favorite on the laundry list of "good governance" reforms advocated for developing countries is rule of law reform. The new development model contends that sustainable growth is impossible without the existence of the rule of law: a set of uniformly enforced, established legal regimes that clearly lays out the rules of the game.

However, this new rule of law orthodoxy linking formalist legal regimes and economic development ignores the empirical evidence and is ultimately counterproductive. Not only does the formalist rule of law as advocated by the World Bank and other donors not exist in the developed world, but attempting to transplant a common template of institutions and legal rules into developing countries without attention to indigenous contexts harms preexisting mechanisms for dealing with issues such as property ownership and conflict resolution.

Two countries commonly heralded for their economic success—the United States and postwar Japan—do not themselves embody the formalist rule of law ideal that is supposedly so essential for growth. The United States clearly violates the requirement—embodied in the mantra "the rule of law, not men"—that the rule of law must be apolitical. It is no secret that U.S. judges are routinely elected or appointed based on their ideological views, and it is wrong to completely separate politics—which is absolutely essential to the functioning of democratic governments—from law. Additionally, federalism, the jury and adversary systems, and the effects of economic class on access to the law ensure that rules will not be applied or evaluated consistently, marking further deviations from the formalist rule of law ideal.

Far from relying on a formalist rule of law to foster economic growth, the Japanese system kept the formal legal system out of economic policy making. Aggrieved firms, citizen groups, and individuals had little judicial recourse to challenge the policies of the powerful developmental state. Additionally, the settlement of individual disputes occurred through a broad system of informal mechanisms that kept most disputes out of the court system altogether.

The examples of the United States and Japan suggest not only that remarkable economic growth can occur in a system without formalist rule of law but also that societies must develop a mix of formal and informal mechanisms that can produce optimal results given their respective social, political, economic, and cultural contexts. Introducing foreign-constructed, formal legal systems may exact tremendous costs from recipient developing societies. Not only are formal legal systems expensive in terms of the capital and talent necessary to operate them effectively, but such transplants may displace valuable indigenous institutions.

The Carnegie Endowment gratefully acknowledges the financial support provided by the William and Flora Hewlett Foundation for Carnegie's work on rule of law issues, including the rule of law series of working papers.

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PROLOGUE: MRS. SANDERSON

In 1868, Mrs. Eliza Sanderson purchased a tract of land on the banks of Meadow Brook in Scranton, Pennsylvania. Two years later, she finished the construction of a house on the property, as well as dams and pipes to bring water from the brook to a fish and ice pond, a cistern, and a fountain. In choosing this location, Mrs. Sanderson was attracted by the flow and purity of the water in Meadow Brook for both her domestic uses and the commercial purposes of the pond.

Almost simultaneously with Mrs. Sanderson's purchase, the Pennsylvania Coal Company opened a new mine three miles upstream. In the course of their operations, the company so polluted Meadow Brook that not only did Mrs. Sanderson's pond become unusable for either fish or ice, but her entire system of pipes was corroded and destroyed. Much of her investment in the property was made useless. She sued.

The law was clear, at least in the sense of the applicable legal rules. The water law of Pennsylvania at the time, called the *natural flow doctrine*, not only guaranteed her access to the water in Meadow Brook but also the right to receive the stream in its natural state, in purity and impetus, as well as in amount. The natural flow doctrine had been developed in the water-rich countryside of England to suit the needs of an agrarian society and economy and then brought to North America with the first British colonists. It suited Mrs. Sanderson's needs to a tee, and she undoubtedly relied implicitly if not explicitly on it in her decision to purchase and develop her land.

What was to a layperson like Mrs. Sanderson an easy question, however, was not so easy for the courts. In fact it would take eight years and six trials, including three opinions by the Pennsylvania Supreme Court, for the judiciary to decide that she did not have a right to clean water under these circumstances. It took that long because Pennsylvania judges, like their counterparts all over the world, did not see the issue as the simple application of legal rules. Instead, they were vitally concerned with the social, political, and economic repercussions of their decision. And in the final analysis, those repercussions were strong enough to outweigh the value of maintaining the rule of law, as defined as the faithful application of legal rules to facts, consistently, and uninfluenced by politics.

Judge Clark's opinion for the Pennsylvania Supreme Court in its third and final ruling on the issue is painful to read. He attempts to explain why the vast increase in the amount of flow and the poisoning of the water caused by the coal mine was "natural" and therefore unobjectionable from the perspective of the natural flow doctrine. As one would expect, the general intellectual dishonesty of the opinion is awesome, but at one point in the opinion, Judge Clark does allude to the real reason for the decision. He points out that enforcing current doctrine would end coal mining in Pennsylvania and destroy the sole source of "population, wealth, and improvements" in the region. Although the court evinced the "greatest reluctance" to change the law so dramatically, it was convinced that even the majesty of the law could not protect Mrs. Sanderson's "mere private personal inconvenience" if that meant destroying "a great public industry, which although in the hands of a private corporation, subserves a great public interest."

INTRODUCTION

IN THIS PAPER I DISCUSS CRITICALLY THE CURRENT ATTEMPTS by various institutions of the developed world, ranging from the World Bank to the U.S. Congress, to encourage and sometimes compel developing countries to create the “rule of law.” Proponents of the introduction of formalist rule of law—that is, regimes defined by their absolute adherence to established legal rules and completely free of the corrupting influences of politics—contend that such reforms are essential to establishing stability and norms that encourage investment and sustainable economic growth in the developing world. In evaluating this new rule of law orthodoxy, I question the assumptions that provide the intellectual underpinnings of the attempts to introduce the rule of law into the developing world. I begin with Mrs. Sanderson’s story because it illustrates several points I want to make. First, it complicates the simple image of the rule of law that dominates current rhetoric in the law and development movement. Most participants in this movement assume that economic development demands the preservation of property rights in the face of social or political pressures. Mrs. Sanderson’s story illustrates the occasional necessity of destroying clear property rights and individuals’ legitimate investment expectations in the name of greater economic development. Second, it illustrates that even in the United States, the home of rule of law rhetoric, the courts do not always enforce the law, at least when defined narrowly as the faithful application of rules. Third, it brings out the deeply political nature of law and legal institutions. Much of the rhetoric from the new rule of law orthodoxy emphasizes the goal of a judiciary that is free from political influence, a goal that I argue has not been attained anywhere in the developed world and that is not necessarily desirable even if it were possible. These and other truths are often overlooked by rule of law advocates in their earnest haste to create regimes in developing countries that will supply the transparency, accountability, and stability that they are certain hold the keys to economic growth.

The foundation of my argument is that law is deeply contextual and that it cannot be detached from its social and political environment. This is just as true in countries such as the United States as it is in the developing world, but this truth is absent from the new rule of law orthodoxy. Two important consequences follow from this failure to acknowledge the political nature of law, particularly of U.S. law. First, it leads to an underestimation of the difficulty and complexity of legal development.¹ If law can be seen as a set of neutral rules, or at most institutions, different national legal systems can be

¹ The record of externally imposed law reform is dismal. For recent commentary on Russian failures, see Merritt B. Fox and Michael Heller, “Corporate Governance Lessons from Russian Enterprise Fiascoes,” *New York University Law Review*, vol. 75, no. 6 (December 2000), pp. 1720–80. For more comprehensive accounts see Thomas Carothers, *Aiding Democracy Abroad: The Learning Curve* (Washington, D.C.: Carnegie Endowment for International Peace, 1999); and Yves Dezalay and Bryant Garth, *The Internationalization of Palace Wars: Lawyers, Economists, and the International Reconstruction of National States* (Chicago, Ill.: Chicago University Press, 2002). For a human rights perspective, see Lawyers Committee for Human Rights, *Building on Quicksand: The Collapse of the World Bank’s Judicial Reform Project in Peru* (New York: Lawyers Committee for Human Rights, 2000).

formally compared and modeled, and successful models can be transplanted into countries with failed systems, much as businesses adopt “best practices” in manufacturing processes, inventory management, and so on. Law, in other words, is seen as technology when it should be seen as sociology or politics. Second, the denial of the universally political nature of law has led aid providers to act as though law is good and politics is bad. Besides the irony of a movement that advocates democracy while denigrating politics, the result is the quixotic quest for an impossible ideal where impoverished developing countries are expected to strive for a pristine rule of law that their developed counterparts have not achieved. More important, the distaste for politics has led legal reformers to avoid it and to try to build legal systems outside of and in opposition to it, where property and contract rights are seamlessly enforced without reference to their political and social consequences. Not only will such an enterprise inevitably fail, but also it would often be undesirable even from the largely economic perspective of the institutions that dominate the law and development movement.

In the first section of this paper, I develop a model of the ideal that typifies the new rule of law orthodoxy and related development discourse. While simplified, the model is representative of the aspirations of the international institutions that are at the forefront of legal reform and can serve as the template against which I pose, in the next two sections, what I believe to be a more complicated description of the role of law in the developed world. In describing this experience, I concentrate on the United States and postwar Japan. In the final section, I look at the implications of the political nature of law for developing countries.

THE RULE OF LAW MODEL

One study estimates that from the 1980s to the early 1990s, entities such as the U.S. Agency for International Development (USAID) and the World Bank spent over \$1 billion on legal-reform efforts.² Given the attention and money now directed to legal-reform efforts, one would assume that there is a carefully elaborated model of law and development based on empirical evidence from the developmental periods of Western economies, what has worked and not worked in the developing world over the last fifty years, and the experience of the previous period of law and development in the 1960s. If such a model exists, however, I have not found it.³ Instead, one finds a series of assumed legal systems that seems to have emerged fully formed from the pages of a high school text on U.S. democracy, and not a very sophisticated text at that. Advocates of rule of law extrapolate from Weberian sociology and the imagined experiences of Western capitalism to the rest of the world. Universal theories of the interdependence of legal form and economic activity lurk behind the rhetoric of the rule of law without a great deal of intellectual agonizing over exactly what this form of law entails, how it relates to economic activity, or how it fits in different political, social, and institutional contexts. The result is a formalist model of law detached from the social and political interconnections that form actual legal systems everywhere.

This view of law rests on two assumptions about law and society. The first is that the description of law as a system of rules can be a reliable guide to understanding legal systems. The second

² Conversation with David Trubek of Wisconsin Law School. For a more precise estimate, see Thomas Carothers, “The Rule of Law Revival,” *Foreign Affairs*, vol. 77, no. 2 (March/April 1998), pp. 95–106; and Carothers, *Aiding Democracy Abroad*.

³ There are excellent studies of past experience, such as Kevin Davis and Michael Trebilcock, “What Role Do Legal Institutions Play in Development?” (Draft October 1999, prepared for the IMF Conference on Second Generation Reforms, Washington, D.C., November 8–9, 1999), but they do not yet rise to the level of accepted guides for lending institutions.

assumption has two parts: that law's primary role in society is dispute resolution, and that society depends on formal legal adjudication for stable and predictable dispute resolution. I examine each of these assumptions in turn, not in the abstract but by drawing on the writings of two prominent advocates for legal reform in the developing world: Ibrahim Shihata, former general counsel of the World Bank, and Hernando de Soto, Peruvian author of *The Other Path*.

Shihata and the World Bank Model

At the end of the 1980s, in an effort to increase the effectiveness of the World Bank's development loans, its legal staff began to address what it calls "governance" issues in borrowing countries. Concerned that the way power is exercised in developing countries may contribute to the inefficient use of World Bank funds, yet constrained by its Articles of Agreement from considering political criteria in its lending, the general counsel of the World Bank, Ibrahim Shihata, drafted a memorandum that distinguished governance from politics and identified the former as a legitimate consideration in the awarding of bank loans.

Most generally, Dr. Shihata equated governance with "good order"; in more specific terms, he called it the rule of law, which he defined at one point as a "system based on abstract *rules* which are actually applied and on functioning *institutions* which ensure the appropriate application of such rules" [italics in original]. Such a system, Shihata claimed, provides a legal foundation for social stability and economic growth and is a prerequisite for the effective use of World Bank assistance:

Reforms cannot be effective in the absence of a system which translates them into workable rules and makes sure they are complied with. Such a system assumes that: a) there is a set of rules which are known in advance, b) such rules are actually in force, c) mechanisms exist to ensure the proper application of the rules and to allow for departure from them as needed according to established procedures, d) conflicts in the application of the rules can be resolved through binding decisions of an independent judicial or arbitral body and e) there are known procedures for amending the rules when they no longer serve their purpose.⁴

Shihata went on to state that, in the absence of such a system, the fates of both individuals and enterprises will be left "to the whims of the ruling individual or clique" and that only such a system can provide the "general social discipline" that makes economic reform possible.

Shihata's views are echoed throughout subsequent World Bank literature. A few excerpts from its web site are illustrative:

Legal and Judicial systems that work effectively, efficiently, and fairly are the backbone of national economic and social development. National and international investors need to know that the rules they operate under will be expeditiously and fairly enforced.

⁴ Ibrahim F. I. Shihata, "The World Bank and 'Governance' Issues in Its Borrowing Members," in *The World Bank in a Changing World*, vol. 1, ed. Franziska Tschofen and Antonio R. Parra (Boston, Mass.: Martinus Nijhoff, 1991), p. 85. For similar ideas, see Edgardo Boeninger, "Governance and Development: Issues and Constraints"; Pierre Landell-Mills and Ismail Serageldin, "Governance and the External Factor"; and Denis-Constant Martin, "The Cultural Dimensions of Governance," in *Proceedings of the World Bank Annual Conference on Development* (Washington, D.C.: World Bank, 1991), p. 267; and Clive S. Gray, "Reform of the Legal, Regulatory, and Judicial Environment: What Importance for Development Strategy?" Development Discussion Paper No. 403 (Cambridge, Mass.: Harvard Institute for International Development, September 1991).

Ordinary citizens need to know that they, too, have the surety and protection that only a competent judicial system can offer.⁵

Without the protection of human and property rights, and a comprehensive framework of laws, no equitable development is possible. A government must ensure that it has an effective system of property, contracts, labor, bankruptcy, commercial codes, personal rights law and other elements of a comprehensive legal system that are effectively, impartially, and cleanly administered by a well-functioning, impartial and honest judicial and legal system.⁶

A competitive business and corporate sector is built on the foundation of strong property rights, ease of company formation, corporate governance, the availability of flexible collateral mechanisms to support the availability of credit, and reliable insolvency systems to minimize lender risk and encourage the rehabilitation of viable firms in financial difficulty. Laws and legal institutions also underpin fund raising and securities trading through well-regulated securities markets.⁷

It is hard to argue that an effective, efficient, and fair judicial system is not a good thing or that a country will be better off without a “an effective system of property, contracts, labor, bankruptcy, commercial codes, personal rights law and other elements of a comprehensive legal system that are effectively, impartially, and cleanly administered by a well-functioning, impartial and honest judicial and legal system,” and I will not attempt to do so. Later in this paper, I will elaborate on my objections to the type of rhetoric exemplified by the above quotes, but at this point, three observations will suffice. First, these statements are platitudes, with no more precise meaning than “a well-educated citizenry is the first guardian of democracy” or “ask not what your country can do for you, but what you can do for your country.” Second, they present an exclusive path to development, using phrases like “a government *must* ensure” and “investors *need* to know” and statements that legal systems “are *the* backbone of national economic and social development” without which “no equitable development is possible.” They leave no sense that there may be other paths to development other than through an effective, efficient, and fair legal system, and they imply that nothing can happen until these institutions are perfected. There is no acknowledgment of the variety of types of development or the possibility of different sequences within the development process. Third, these statements are evangelical. They advocate a course of action based on faith in social perfection, in this instance, a perfect legal system, which in turn produces a transparent and equitable order. There is no room for ideological compromise, no hint that building such a system might be difficult and costly, or that other necessities of development might have to be sacrificed to build it.⁸

The World Bank is by no means alone in this embrace of the new rule of law orthodoxy. “The rule of law, not men” may be the least-contradicted maxim of American politics. Politicians of every stripe repeat it as a mantra, perhaps sincerely, while running on platforms that explicitly promise a political makeover of the current judiciary. Law professors urge the protection of the fragile institution of the rule of law in the face of centuries of political manipulation of the American judiciary. “Rule of men” has the connotation of arbitrariness, corruption, and instability; “rule of law” promises procedural fairness, honesty, and consistency. Justice Antonin Scalia has also weighed in favor of a rule of law that is a “law of rules,” as opposed to a more sloppy law that allows “men” to

⁵ From World Bank, <http://www1.worldbank.org/legal/legop_judicial.html>.

⁶ James D. Wolfensohn, president of the World Bank, available at <<http://www.worldbank.org/legal/ljrconference.html>>.

⁷ From World Bank, <<http://www4.worldbank.org/legal/legps.html>>.

⁸ For a description of this urge for order across subject matters and ages, see James C. Scott, *Seeing Like a State: How Certain Themes to Improve the Human Condition Have Failed* (New Haven, Conn.: Yale University Press, 1998).

influence outcomes.⁹ There is also a general agreement that markets and rule of law go hand in hand. Without the slightest textual basis in the Constitution, the Supreme Court of the United States has declared that special efforts should be made to preserve economic rights because markets require stability.¹⁰ For other types of rights, stability is apparently less important. Returning to the law and development context, the U.S. Congress has most recently put these sentiments in statutory form in the African Growth and Opportunities Act.¹¹ In other words, the World Bank and other international financial institutions are not plowing new ground; they are simply attempting to put into action some of the central platitudes of American legal and political ideology.

De Soto and the Evils of Informalism

The rhetoric of the rule of law does not emerge solely from Washington sources. It has eloquent advocates elsewhere, the most powerful of whom is Hernando de Soto.¹² De Soto has provided an empirical basis for the assumptions of Shihata and the World Bank model of the rule of law, but he has done so in a deeply paradoxical way—not by describing the failure of development without law but by describing its triumphs. As such, de Soto provides an extremely revealing example of how the imagined world of the rule of law blinds us to the reality of economy and society and makes it impossible to imagine alternative sources for the stability and fairness that all the participants in this debate desire.

In *The Other Path*, de Soto describes the success of informal elements in Peru's economy in achieving economic growth and social mobility, despite the lack of formal legal protections. De Soto convincingly claims that Peru's official economy had become so encrusted with legal and regulatory formalities that virtually all economic growth within the official sector had ceased. He describes the success of informal actors, usually poor immigrants to Lima from rural areas, in establishing stable systems of production and exchange without rules to define entitlements or formal institutions to settle disputes. Although de Soto sees informality as ultimately limiting growth, he contrasts the vitality of the informal sector with the stagnation of Peru's formal economy.

The phenomena that de Soto describes provide powerful evidence of the possibility of sustained and complex economic activity, at least on an individually small scale, without structure or protection provided by a formal legal system. The lesson more commonly drawn from de Soto's work, however, is that the isolation of poor Peruvians from law has seriously limited their economic opportunities and, in turn, the general economic growth of Peru. Instead of weakening their faith in the need for formal law, de Soto and those influenced by him call for the official recognition of the informal economy and its inclusion within a dramatically restructured formal legal system. They argue that legalization of the rights of those in the informal sector under this new regime would give them greater access to credit and legal protection for large-scale investment.

⁹ Antonin Scalia, "The Rule of Law as a Law of Rules," *University of Chicago Law Review*, vol. 56 (Fall 1989), pp. 11754–88.

¹⁰ Six justices—Rehnquist, Kennedy, O'Connor, Scalia, Souter, and White—agreed that "Considerations in favor of *stare decisis* are at their acme in cases involving property and contract rights, where reliance interests are involved..." *Lawyer's Edition* (2nd), vol. 115 (1996), p. 737.

¹¹ Available at the African Growth and Opportunities Act web site: <http://www.agoa.gov/About_AGOA/agoatext.pdf>.

¹² Hernando de Soto, *The Other Path: The Invisible Revolution in the Third World*, trans. June Abbott (New York: Harper & Row, 1989). De Soto has since written a sequel, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000). Although significantly more sophisticated in its description of the nature and role of property rights in the informal economy, his emphasis on the importance of formal legal institutions remains fundamentally unchanged.

De Soto envisions a legal system that would operate within a deregulated economy stripped of virtually all of the government intrusion that has stifled the Peruvian economy and outside of which the informal economy flourished. It would be an economy much like that envisioned by Shihata. The market would allocate resources efficiently through the operation of Adam Smith's invisible hand. Individuals and corporations would have clear property and contract rights that would be more or less seamlessly interpreted and enforced by the courts. Government's role would be limited to responding to instances of market failure.

So far, so good. It would be hard to dispute that vigorous entrepreneurs who have thrived under a thoroughly corrupt regime without any legal rights whatsoever would not do even better under an honest pro-market regime. I may argue that de Soto and his followers are naive in dreaming the same dreams as Shihata or the U.S. Congress, but that is not what is most perplexing about this school of thought. What is most perplexing is that they have amassed rich empirical data about economic and social success in the real world of corruption and government incompetence and yet appear totally uninterested in the lessons that these data may hold for developing countries. More specifically, they seem uninterested in the possibility that a formal legal system of the type they advocate could stifle growth or that courts would face the apparent conflict between the application of rules and economic growth, as in *Sanderson*. Nor do they consider the possibility that the formal legal system that they envision could not exist within the context of real-world politics. They seem to assume that those whose interests would suffer from the mechanical operation of the market and the rule of law either would not have legitimate avenues to oppose its operation or would choose not to do so out of an appreciation of the greater good. Also left out of the calculus is any cost-benefit analysis. Even if one assumes that a formal legal system of this type is possible and that it contributes to economic growth, it remains an open question whether it is worth the cost, including of course, the opportunity cost of the financial and human resources necessary to establish and maintain such a system.

The apparent disinterest in investigating the practices that have provided the social stability and investment security and fostered growth in the informal sector in Peru, however, is the most surprising omission of de Soto and his followers. In seeming defiance of their own evidence, they leave untouched the assumption that productive capitalism cannot develop without formal adjudication, scrupulously enforced contracts, and inviolable property rights. They are not interested in whether the informal practices that supported growth in Lima could be replicated elsewhere or whether they might be superior, at least in a cost-benefit sense, to a formal legal system. De Soto never considers, for example, whether it might be more cost effective to introduce some of the successful informal mechanisms into the stultified formal sector, instead of formalizing the informal sector.

Equally striking is the failure, not only of de Soto but also more puzzling of Shihata and the World Bank, to investigate examples of informal economic growth in other parts of the world. There is a substantial literature on the possibility of social order and economic growth in the absence of formal law in the United States¹³ (we will discuss Japan in the next section), but it is worth noting here the experience of the People's Republic of China (PRC) and the Chinese diaspora. It is difficult to imagine a developing country of any size that has outperformed the PRC economically or socially over the last two decades. China's economy grew on average 9.7 percent from the beginning of

¹³ Robert C. Ellickson, *Order without Law: How Neighbors Settle Disputes* (Cambridge, Mass.: Harvard University Press, 1991).

economic reforms in 1978 to the late 1990s.¹⁴ Nor has China had any difficulty attracting foreign capital, with more than \$45 billion in foreign direct investment in 1998 alone. Furthermore, although China is suffering from growing social dislocation, disparities of wealth, and official corruption, its record in these areas is better than that of most developing countries. Most important for our purposes, the PRC has achieved this growth without a legal system worthy of the name. No one would claim that China has had the legal institutions envisioned by the World Bank during most of this period, and yet, except for a series of conferences by the Asian Development Bank, there has been little interest in finding out how this has been done or whether it can be replicated elsewhere.¹⁵

Nor has the rule of law movement paid much attention to the economic success of ethnic minorities. Although this general topic is too extensive to deal with here, the experience of the Chinese in Southeast Asia presents an example of “lawless” growth that is even more striking than China’s recent successes. In China, at least the economic growth was legal in the sense of taking place with the approval of the regime; for the overseas Chinese, economic success has frequently taken place in defiance or circumvention of formal legal norms, so much so that one commentator has referred to the Chinese in Malaysia as “guerilla capitalists.”¹⁶ Some observers of overseas Chinese capitalism share de Soto’s concern that doubtful legal status limits growth and technological innovation, but it is unclear whether these problems arise from legal informality or the constant political uncertainty and racial hostility that the Chinese have faced in most of Southeast Asia. What is clear, however, is that the overseas Chinese within these societies have had economic success despite legal uncertainty and that their success has often, if not universally, outpaced that of the ethnic majorities, who have enjoyed full legal protection.¹⁷

It is possible, of course, that overseas Chinese and the PRC might have enjoyed even greater economic success had they had the advantage of a fully functioning legal system of the World Bank type.¹⁸ Indeed, it may be impossible to argue in the abstract with the desirability of the characteristics and results that Shihata and de Soto ascribe to the rule of law: that contracting parties should be required to perform the substance of their promises or pay compensation, that business people should be able to predict the requirements of licensing procedures and to receive the license when they are able to meet those requirements, or that investors should not be surprised by rule changes that deprive them of a return on their investment or, worse, the value of the investment itself. But even if we assume that these are theoretically attractive attributes, before we conclude that the rule of law should become an immediate goal for developing societies, we must be convinced that it is a possible goal and the benefits of achieving it will be greater than the cost. Rule of law building is not worth spending money on unless the imperfect institutions created by such expenditures will have beneficial effects that outweigh their costs and any harm they create. To investigate the possibilities,

¹⁴ Official Chinese government date, reported by the World Bank, *World Development Report* (New York: Oxford University Press, various years).

¹⁵ The failure to investigate has not been total—see Katharina Pistor and Philip Wellons, *Role of Law and Legal Institutions in Asian Economic Development, 1960–1995* (Manila, Philippines: Asian Development Bank, 1998).

¹⁶ K. S. Jomo, “A Specific Idiom of Chinese Capitalism in Southeast Asia: Sino-Malaysian Capital Accumulation in the Face of State Hostility,” in *Essential Outsiders: Chinese and Jews in the Modern Transformation of Southeast Asia and Central Europe*, ed. Daniel Chirot and Anthony Reed (Seattle and London: University of Washington Press, 1997), pp. 237–57.

¹⁷ Gary G. Hamilton and Tony Waters, “Ethnicity and Capitalist Development: The Changing Role of Chinese in Thailand,” in Chirot and Reed, *Essential Outsiders*, pp. 258–84.

¹⁸ It is also possible that minority status, if not illegality, was instrumental in the success of overseas Chinese. For several reasons that minorities may be culturally and structurally advantaged in economic activities, see Hamilton and Waters, “Ethnicity and Capitalist Development.”

costs, and varieties of the rule of law, in the next two sections I examine two highly successful economies of the twentieth century, the United States and Japan. Through an examination of their legal systems and their relationship to the rule of law ideal, we can get a more sophisticated sense of what the role of law is, what it entails, and what alternatives may exist. I start with the United States, the most vigorous advocate and practitioner of the rule of law development model.

MYTHS AND REALITIES OF LAW AND PRACTICE IN DEVELOPED COUNTRIES (I): THE UNITED STATES

The rule of law ideal might be summarized as universal rules uniformly applied. It requires a hierarchy of courts staffed by a cadre of professionally trained personnel who are insulated from political or other nonlegal influences. The decision-making process must be rational and predictable by persons trained in law; all legally relevant interests must be acknowledged and adequately represented; the entire system must be funded well enough to attract and retain talented people; and the political branches must respect law's autonomy. To casual observers, the epitome of the rule of law is the United States, and the United States is a leading exponent of the new rule of law orthodoxy. When we look closely at the U.S. legal system, however, we find few of these characteristics.

Politicized Legal System

Rule by Politicized Judges, Not Law. The judiciary is a good place to begin. The U.S. judiciary is permeated by politics, especially when compared with the judiciary in legal systems influenced by the civilian tradition of continental Europe. Most state judges are elected and serve for a term of years. They belong to political parties and are chosen for their allegiance to partisan platforms. If they are not constantly aware of the effect of their important rulings on the electorate and their party's leaders, they will not be reelected, and they will cease to be judges.

The case of Rose Bird, the Chief Justice of the California Supreme Court who was removed from office by California voters for her stubborn opposition to the death penalty, is one of the best-known instances of judges being punished for fidelity to their vision of the law, but more typical is the recent transformation of the Texas judiciary at the hands of competing commercial interests.¹⁹ In the early 1980s, wealthy trial lawyers succeeded in transforming the historically pro-business Texas Supreme Court into an "all-Democratic, lawsuit-friendly court that began upholding enormous jury verdicts against corporate and medical defendants." In response, corporations and doctors struck back and reversed the court's politics, again through partisan elections, so that by the mid-1990s, the winning record of defendants before the court had risen from 40 to 83 percent. By 2000, with a governor running for president as a "compassionate conservative" using his interim appointment powers to portray a picture of moderation, the pendulum had swung back once again toward the center.

All parties to such controversies claim that their position is faithful to the correct interpretation of the law and that their opponents' positions are politically motivated distortions of the law. What is striking about these arguments and vital to understanding the psychological hold of the rule of law

¹⁹ Jim Yardley, "Bush's Choices for Court Seen as Moderates," *New York Times* (July 9, 2000), p. A1. Also representative are William Glaberson, "Fierce Campaigns Signal a New Era for State Courts," *New York Times* (June 5, 2000), p. A1; and Kevin Sack, "Judge Trades on Renown in Race," *New York Times* (June 5, 2000), p. A22.

orthodoxy is that many, if not most, of the participants on both sides sincerely believe that their side alone is being faithful to the letter of the law and that the other side, most charitably put, is mistaken. The sincere belief in these claims and their effectiveness as political tactics do not, however, make them true.

If we move from the state to the federal judiciary, the picture is more complicated but fundamentally similar. Federal judges are appointed, not elected. They serve for life, subject only to impeachment for egregious misbehavior, and the story of the politically conservative judge becoming a liberal on the bench (or the reverse) is rare. The inspiring stories of life tenure giving judges the security to grow in their jobs or to adhere to principle should not blind us to the reality of the appointment process, however. It is overwhelmingly political, and, the occasional Earl Warren or Hugo Black notwithstanding, federal judges rarely experience substantial conversions. It would be difficult to imagine it otherwise, since they are usually appointed when they are in their fifties, after decades of professional and political activity. Of course the ultimate proof of the infrequency of judicial bench conversions is the role of judicial appointments in federal politics, both during presidential elections and in the relationship between the president, who nominates federal judges, and the Senate, which must confirm them. If judges often acted inconsistently with their prior political views, judicial appointments would not loom so large in political campaigns.

More striking, if less obvious and well known, than the open political behavior of those appointing judges is the political engagement of sitting U.S. judges. Judge Richard Posner of the Court of Appeals for the Seventh Circuit, for example, recently published a book arguing for the prosecution of President Clinton for perjury in the Monica Lewinsky affair while the Office of Independent Counsel was considering that very issue. Although controversial, this action was not generally criticized as crossing the bounds of judicial propriety. Indeed, after the remarkable case of *Bush v. Gore* that decided the 2000 presidential election, several Supreme Court justices took to the road to discuss the decision.

Less flamboyant, but more common, is the identification of sitting judges with a political philosophy and a commitment to implementing that philosophy through the courts. While usually done quietly and perhaps unconsciously, one aspect of this approach to judging—the cultivation of young lawyers who share your philosophy—is well illustrated by the dialogue between Judge Alex Kozinski of the Court of Appeals for the Ninth Circuit and his clerk, Fred Bernstein. Recently published in *The Green Bag*, which bills itself as “An Entertaining Journal of Law,” the dialogue begins where Kozinski is explaining why a conservative like him would hire liberal clerks like Bernstein:

Kozinski: The reality is that law schools are pumping out liberals. Not every law school, obviously, but the overwhelming number of students at the top-notch schools tend to be liberal. I can't afford to cross liberals off my list, the way Judge Reinhardt crosses conservatives off his.

Bernstein: Does he?

Kozinski: Judge Reinhardt says, “I'm not interested in hiring conservatives. I'm not even interested in hiring people who are moderately liberal. I'm only interested in hiring committed liberals, who are going to spend their careers promoting liberal causes. I don't train corporate lawyers.” That's a paraphrase, but it's accurate.

Bernstein: How do you feel about that?

Kozinski: *He justly sees himself as providing a unique opportunity to advance the careers of young lawyers. And I feel the same way. I think I owe an extra measure of consideration to conservative and libertarian law students. First of all, I feel an obligation to train conservative and libertarian lawyers.* There are a lot of liberal judges out there, not as many conservatives and libertarians. Second, there are a lot of cases, and having a clerk who basically agrees with me makes for an easier year. In my heart of hearts, I know it's a good thing to have dissent in chambers, but sometimes I'd just as soon have an easier year [emphasis added].²⁰

Nowhere in the dialogue is there any sense that either participant fears that the use of a judicial position to “advance the careers of young lawyers” with certain political opinions would be considered illegitimate. Indeed, at one point Judge Kozinski remarks that although doing so may sometimes be hard, “following the law is good practice.”²¹ So one must presume that Kozinski considers the politicization of legal decisions either desirable or unavoidable in following the law. In either case, he would be keeping company with the vast majority of American social scientists, if not law professors, who long ago rejected the possibility, if not desirability, of the apolitical nature of the new rule of law orthodoxy advocated by Shihata and de Soto. The notion that political beliefs affect one's interpretation of the law, and hence judicial decisions, is not limited, therefore, to politicians running for office and those voting for them; the judges themselves and others within the system recognize it as well.

The result is easy to see in judges' behavior on the bench. Despite unending proclamations of fidelity to precedent, political neutrality, judicial restraint, and other legal virtues, U.S. judges overwhelmingly follow their political preferences when the opportunity presents itself. As mentioned above, the most powerful evidence of this fact is the amount of attention given to judicial appointments in presidential campaigns and Senate confirmation hearings, but more direct examination of judicial behavior bears out this common-sense observation. A 1993 study by social scientists Jeffrey Segal and Harold Spaeth on the implementation of judicial restraint by Supreme Court justices between 1953 and 1989 serves as an example.²² The authors studied the voting patterns of justices on the Warren, Burger, and Rehnquist courts in cases involving labor rights, civil liberties, federalism, and economic regulation and compared them with the justices' professed fidelity to judicial restraint. The result was that justices, whether liberal or conservative, were only restrained when it suited their preexisting political preferences. Otherwise, they found some reason to overcome their devotion to restraint. In a testament to the power of the myth of the apolitical, formalist rule of law, one of the worst “offenders” was Justice Felix Frankfurter, an icon of judicial restraint in the eyes of generations of law professors and students.²³

²⁰ Alex Kozinski and Fred Bernstein, “Clerkship Politics,” *The Green Bag*, 2nd series, vol. 2, no. 1 (Autumn 1998), pp. 57–64. Although it might be said that the publication of this dialogue is evidence of the rarity of its subject (that is, of the open desire of judges to support young lawyers with similar political sympathies), *The Green Bag* is not an academic journal, and the subject is not treated as controversial. It is treated as entertaining and of interest to potential clerks, especially liberal ones facing the prospect of serving conservative judges.

²¹ Kozinski and Bernstein, “Clerkship Politics,” p. 61.

²² Jeffrey A. Segal and Harold J. Spaeth, *The Supreme Court and the Attitudinal Model* (New York: Cambridge University Press, 1993). See also Jonathan D. Casper, “The Supreme Court and National Policy Making,” *American Political Science Review*, vol. 70, no. 1 (March 1976), pp. 50–63; and Robert Dahl, “Decision-Making in a Democracy: The Supreme Court as National Policy-Maker,” *Journal of Public Law*, vol. 6 (1958), pp. 279–95.

²³ Segal and Spaeth, *The Supreme Court*, pp. 316–9. Segal and Spaeth discovered a number of other interesting surprises. For example, despite the rhetoric of state sovereignty and federalism, justices were less deferential to state government decisions than to those of the federal government, p. 311.

Structured Irrationality. It is not just the politicization of the judiciary that contradicts the formalist model. Four fundamental aspects of the structure of the U.S. legal system make the World Bank version of the rule of law literally impossible. First, federalism guarantees, indeed celebrates, national inconsistencies in legal rules and results. Each state enjoys its own legislative and judicial sovereignty, limited only by the supremacy clause of the federal Constitution. As a result, most laws governing commercial or financial activity are state laws and vary throughout the fifty-one jurisdictions. Model codes such as the Uniform Commercial Code substantially reduce the disparities in many areas but do not eliminate them. Nor do they touch the procedural and institutional differences that make “forum shopping” an integral part of much commercial and products liability litigation.

It is not, for example, coincidence that the vast majority of large American corporations are incorporated under the laws of Delaware. Nor is it because most major corporations are headquartered in Delaware. Delaware has triumphed in the interstate competition to attract corporate registration fees and related business because it created a legal regime that most corporations have found more attractive than those found in their states of origin. Far from being condemned by legal scholars or politicians, this type of interstate legislative competition is valued as creating a series of laboratories of legislation on the one hand and preventing states from stifling economic activity by creating legal regimes less favorable to corporations on the other.

The second structural aspect of the U.S. legal system that deviates substantially from the rule of law orthodoxy is the jury system. As with federalism, there are myriad reasons why one might want a jury system, particularly in criminal trials, but fidelity to the rule of law is not one of them. Whether one defines the rule of law as the rational application of rules to facts or more abstractly as the rule of law, not men, juries simply do not fit. Juries are in theory limited to deciding questions of fact and are generally prohibited from relying on their own interpretation of legal rules. Even if the distinction between law and fact were clear—and dozens of scholarly careers have been made disputing that point—it is quite likely that many juries do not even understand the law that they are to apply.

This lack of understanding has nothing to do with intelligence or good will. It is structural and, at least in that sense, intentional. Lawyers spend three postgraduate years learning the techniques necessary to analyzing, interpreting, and applying legal rules in a professionally acceptable manner. Judges usually have decades of practice honing these skills. To expect a jury to understand legal rules in the same way and depth just because a judge patiently explains them borders on the fantastic. A jury may well have a good, common-sense understanding of the judge’s instructions, and hence a good, common-sense understanding of the legal rules, but it is imperative to note that a common-sense understanding of the law is most definitely not what is required by the rule of law. Common sense varies from person to person and context to context; it is not a sound basis for the rule of law, however defined. Indeed, the supposedly “common-sense” decision making of the anthropological stalwart village elder or neighborhood boss is precisely the image against which the rule of law is most frequently contrasted. If one argues for a common-sense application of the law, one is arguing against the rule of law.

The third structural aspect of the U.S. legal system that leads to deviations from the rule of law orthodoxy is its system of civil procedure, specifically the adversary system. Here there are two aspects that deviate from fidelity to rules: the lawyers’ obligations to their clients and the passive role of judges. Ethical rules require lawyers to represent their clients zealously, to keep virtually all information received from clients confidential, including information of illegal acts, to work to

discredit the opposing party's evidence regardless of its truth, and, perhaps summing up the result of all the other duties, to give their primary loyalty to their client, not to truth or law.

As with federalism and juries, there are powerful arguments for requiring attorneys to give their primary loyalty to their clients. Many of these, however, relate to political theory, rather than the rule of law as defined as an accurate mechanism for the uniform application of rules to facts. It is true that many attorneys and law professors defend adversarial procedures by arguing that zealous advocacy by two equally talented partisans is the best path to truth. Even if one accepts this position in theory, the social reality is that opposing sides are rarely represented by equally talented lawyers with equal resources. All too often one side has vastly more talent and money than the other, so much so that the weaker party is not likely even to bring the matter to litigation, much less win if it did.

One might expect in instances in which one party has markedly greater resources or a clearly more effective attorney that the judge would have an obligation to step in to correct the imbalance. Such is not the case in common law legal systems, in which the judge plays a role more akin to a referee than to a seeker or guarantor of justice or fidelity to rules. The judge is not ethically required to redress inequalities of resources, talent, or dedication that threaten to lead to inaccuracy or injustice. Nor is he or she to structure the trial so that truth will emerge or prevent an advocate from misleading the jury with a deceptive cross examination that remains within the bounds of legitimate zealotry. The judge's role is to create a space where the opposing lawyers can compete, within the rules to be sure, but with their primary obligations to their clients, not to the law. Then, at the end of the competition between frequently mismatched lawyers, the judge turns the result over to a group of citizens whose legal education is usually limited to television shows.²⁴

A final anomaly of the U.S. legal system as an exemplar of the new rule of law orthodoxy is the extreme reluctance on the part of federal or state governments to make the law available to people with little or no means.²⁵ Perhaps the most fundamental norm of the rule of law ideal is the uniform application of the law, without which the universality of norms, their rationality, indeed their substantive content, mean nothing. Society will not reflect the benefits of the rule of law if the rules are not enforced evenhandedly or if one side to a dispute does not have the resources to bring the matter to the attention of the law. Despite the simplicity of this concept, the U.S. government has never devoted even a fraction of the resources necessary to ensure that the poor have access to the courts. In recent decades, the United States, for example, spent approximately one-ninth as much per capita on civil legal services for lower-income persons as England.²⁶ The implication is that the uniform application of law is not important enough to spend significant resources on, which is a policy judgment that seems unlikely if Americans were as convinced as Shihata and de Soto that the rule of law is indispensable to economic growth or stability.

²⁴ The reader should not take from this comment any bias against television dramas. As indicated in the text, the television version of law may have a great deal more to do with common concepts of the rule of law than does the professional version.

²⁵ I am referring here to civil cases only. Legal representation is provided to criminal defendants, although with varying degrees of success. Civil cases are of more direct interest to the present topic, because civil law largely shapes the economy and provides the framework that economic actors rely on for their activities. For a comparison of U.S. provision of civil legal services with those of European countries, see the symposium issue of the *Maryland Journal of Contemporary Legal Issues*, vol. 5, no. 2 (1994). Statistics in this paper are drawn from Earl Johnson Jr., "Toward Equal Justice: Where the United States Stands Two Decades Later," *Maryland Journal of Contemporary Legal Issues*, vol. 5, no. 2 (1994), p. 199.

²⁶ The comparisons with some of the other North Atlantic societies were better, but the United States was still outspent by a factor of 2.5:1 by France and Germany, the next lowest two countries on the list of per capita expense. Johnson, "Toward Equal Justice," p. 212. On the other hand, Japan through the 1990s spent even less than the United States.

Such a great deviation from the rule of law ideal is not a failure of execution, the inevitable falling short of an ideal. On the contrary, it is the result of the conscious choice to subordinate the rule of law, at least as seen as fidelity to rules, to other institutional goals or political values. First, for the substance of legal rules, the interstate competition and the freedom to experiment afforded by federalism are preferred to universality. Second, for the judiciary, democratic control via elections and political appointment processes and a judiciary with broad social experience are preferred to professionalism and legal expertise. Third, in the realm of process and procedure, the drama of the lawyer as gunslinger and the democratic symbolism—and high tort judgments—of the jury are chosen despite the knowledge that they will substantially impair if not destroy uniformity and consistency even within a single jurisdiction. And finally, the provision of adequate or even minimal access to justice for the majority of individuals is simply not a powerful political issue, even for the left.

Legitimately Politicized Institution. The foregoing is intended to convince the reader that the U.S. legal system is a thoroughly and intentionally politicized institution. It is emphatically not intended to portray the legal system as in any way illegitimate, ineffective, or undeserving of political or intellectual support. It is important in this context to remember several aspects about politics. Politicization is not equivalent to corruption. Also, politics is the lifeblood of all regimes, especially democratic ones. Unfortunately, the rule of law orthodoxy equates politics with corruption. Law and judging are supposedly clean, procedurally transparent, and stable; politics is dirty, procedurally opaque, and chaotic. Consequently, the sins of corrupt judges in developing countries and elsewhere are conceived of as the result of political interference, and an “independent judiciary” is defined as one free of any political influence, without any consideration of whether such a judiciary is even possible or advisable. Instead of this focus on the depoliticization of the judiciary, international financial institutions and other international purveyors of the new rule of law orthodoxy should be concerned with the judiciary’s legitimacy and effectiveness, not its political purity.

The question then becomes not whether courts play a political role but how that role is structured and managed. In the United States, it appears to be handled very well. Politics in the U.S. judiciary has not led to the “telephone justice” of Russia, where the judges sometimes change their minds at the order of a politician, or the “local protectionism” of the PRC, where the courts favor local enterprises because local governments control their budgets. U.S. justice is a deeply institutionalized form of politics that operates over relatively long time spans—either the terms of elected state judges or the political cycles of presidentially appointed federal ones. More fundamentally, it operates within a very narrow political spectrum. The difference between Democrats and Republicans is tiny compared to the differences among political interests in many other countries, and judges, whether elected at the state level or appointed at the federal, are likely to be moderates within their parties. In most U.S. jurisdictions, it is also true that parties rotate in power, so that the judiciary is not totally dominated by one party or one political view. Although this mix of political preferences on the bench makes the political dimension of decisions more apparent in cases like *Sanderson* or *Bush*, it probably has the long-term effect of moderating political swings within the law.

Important consequences flow from political stability. Because judges’ political preferences are concentrated at the middle of the political spectrum, their socialization to their roles as judges, although superficial compared to civil law countries such as Japan, is more successful in overcoming personal preferences than it would be if political differences among them or within society were more

dramatic. Equally important, most cases will not pose issues that appear political to most judges. As opposed to persons at more extreme ends of the political spectrum, they accept the legitimacy of both positions in the vast majority of cases brought before them. The result is a stability of doctrine that appears like “the rule of law” but owes more to the political stability of the United States than to the political independence of the U.S. judiciary.

The difference between U.S. judges on the one hand and Russian or Chinese judges on the other, therefore, is more complicated than might first appear. If the “telephone justice” of Russia is motivated by a financial interest in one of the litigants’ success, the issue is one of corruption and is distinct from questions of the neutrality of the judiciary, politics, or the rule of law. For example, corrupt Russian judges who affirm the decision of a corrupt bureaucrat are more like that bureaucrat than they are like an honest judge. If, however, judges decide for one litigant over the other because they are convinced that that decision is better for society and will strengthen their political allies, then the comparison with U.S. judges becomes more a matter of degree and institutional style than one of principle. Similarly, if Chinese judges decide for a local litigant because otherwise their budget will be reduced or they will not be able to get desirable housing, this is corruption, and it is the equivalent of a bureaucrat denying a license because the licensee would compete with local industry. If, on the other hand, the conference of judges within the particular court discusses the case and decides that one result is more consistent with the guidelines set out by the National People’s Congress as interpreted by the Chinese Communist Party, then we again have an institution that is comparable to U.S. courts and particularly to appellate courts, where negotiated, collegial decisions are the norm and where political preferences are arguably even clearer than at the trial level.

This discussion may seem both shocking and wildly implausible. How could the Russian or Chinese judiciaries be compared to the American? I agree that the U.S. legal system is incomparably better, but the reason is not that the U.S. judiciary is independent of politics and the Chinese and Russians are enmeshed in it. It is because the Chinese and Russian judges are much more likely to be corrupt, to be part of corrupt institutions, and to be so poorly paid and educated that resisting corruption simply does not make practical sense. Although this distinction may make little difference if you are a politically naïve and unconnected litigant—as most foreign enterprises or financial institutions are likely to be—it makes a great deal of difference if one is prescribing a formula for China or Russia to use in building an effective judiciary.

Hard Cases: Law and Economic Growth in Nineteenth-Century America

At this point, it may be useful to return briefly to *Sanderson* and the judiciary’s role in the United States’ growth. The fate of Mrs. Sanderson’s fishpond is typical of what was happening to agrarian interests across the United States in the first half of the nineteenth century, as courts had to choose between new and old industries. In the face of technological change, the courts could either enforce established property rights as exemplified by Mrs. Sanderson’s right to the natural flow of her stream or they could destroy those rights in favor of what must have appeared to be the greater good of mining and industry. The rhetoric and prescriptions of de Soto, Shihata, and the law and development movement would argue for an injunction against the coal mine, with the result that the mine would have to buy out the injunctive rights of every downstream owner, a task that would have been economically efficient in terms of market theory but almost certainly impossible to achieve in

practice. On the other hand, to rule against *Sanderson*, as the Pennsylvania Supreme Court did, would mean not only a radical departure from the formalist ideal of a law of rules but also the deliberate embrace of instability and opacity in law: instability because the decision reversed settled doctrine, opacity because an intellectually dishonest judicial opinion is far from the transparency considered necessary for growth. Given the consequences, one wonders whether the adherents to the new rule of law orthodoxy, from Justice Scalia to the senators who voted for the African Growth and Opportunities Act, would really prefer stability and predictability.

Of course, one could argue that the first half of the nineteenth century was an exceptional time, that technology does not change substantially at frequent intervals, and that what really matters is a highly competent, independent judiciary for the majority of times. Even if, the argument might go, it is occasionally necessary to change the law judicially as in *Sanderson*, such decisions should be recognized as exceptional, and all efforts should be made to ensure that disputes during the rest of the time will be decided by the rule of law. It follows that, if necessary, resources should be diverted from other productive activities to building that rule of law. Unfortunately, this argument has two difficulties for developing countries. First, their economies are likely to encounter technological changes of precisely the *Sanderson* sort. It was, after all, economic growth that precipitated the *Sanderson* dilemma. To insist on developing countries installing a legal system that would have decided for Mrs. Sanderson on the ground of fidelity to law may be attractive in the abstract, but it would be the height of folly if it prevented the very growth that those advocating the rule of law development model want.

Paradoxically, if developing countries—or any countries—do not grow or if the growth were somehow to take place without any significant technological or structural changes, the rule of law looks much more attractive. Judges can follow the dictates of the doctrine without any worry that they will be thwarting beneficial developments. But even here where we postulate social and economic stability, the rule of law, when examined closely, loses much of its luster, at least when one remembers that a formalist legal system does not come cheaply. In stable times, when the political interests and economic structures remain more or less unchanging, it may not be necessary to create an elaborate system of professional jurists. Decisions can be made by bureaucrats or police, village or ward political committees, private commercial associations, formal or informal mediators, and a unlimited variety of other lay persons and organizations. One need not have three to four years of formal legal education, maybe an LLM from Oxford or New York University, a year of articles or apprenticeship with a firm, and a staff of court officers to apply stable rules to disputes occurring within stable societies. When norms, political interests, or markets change, specially trained and socialized judges, possessing a professional jargon and backed up by elaborate institutions, are needed. But they are needed, I argue, not to enforce the law in the Shihata or Scalia sense of the rule of law, not men, but because they have the practical wisdom to recognize the need to change the rules and the political legitimacy to get away with doing so.

MYTHS AND REALITIES OF LAW AND PRACTICE IN DEVELOPED COUNTRIES (II): JAPAN

One would think that postwar Japan would be an obvious model for the rule of law movement. Japan was the first non-Western economy to develop, it did so relatively quickly, and it did so under

a democratic regime. To my knowledge, however, legal reformers seldom consult the Japanese experience. A possible reason is lack of knowledge about Japan, but rule of law advocates are not generally known for letting a lack of local knowledge stop them from advising on appropriate strategies. A more likely explanation is the institutional structure of the movement, particularly its fragmentation into national factions. A U.S. aid organization is not likely to approve a contract for the dissemination of the Japanese model. Perhaps most important, however, is the general sense, often encouraged by the Japanese themselves, that Japan is culturally unique and that whatever happens there is of little practical use to others. Closely related is the argument that consulting Japan's legal experience would be worthless because Japanese life is hardly affected by law, that law is irrelevant to most Japanese and disfavored as a means of dispute resolution, and that the Japanese economy is ruled by powerful bureaucrats unhindered by legal restrictions.

I agree that law has played a less visible role in Japan than in the United States but not for the cultural reasons assumed. Much of this conventional wisdom is either exaggerated or simplistic, and I will try briefly to correct some of these misunderstandings in the next section.²⁷ My purpose here, however, is not to argue that Japan should be a model for legal development, although I see no reason why Japan should be less relevant than the United States. My primary point here is that the Japanese experience stands, as does the American, in sharp contrast to the assumptions of the rule of law development discourse.

I attempt to make two main points. First, the Japanese developed an economic and political system that kept the formal legal system out of the process of priority setting and policy making in the economic sphere to a much greater extent than has been considered true of the United States. Second, for the settlement of individual disputes, as opposed to the development of policy, the Japanese developed a broad system of informal mechanisms to keep most disputes out of the courts altogether. It is the success of this system of informal alternatives, along with artificial barriers to litigation, that has kept the legal system in the background and given empirical weight to the rhetoric that Japanese culture does not support legal action.²⁸ As we will see, however, the marginal role of formal legal institutions has been the result of clear government decisions and is no more the result of unique historical conditions than is the legal system of the United States. As such, Japanese policy choices may have some relevance to developing countries and may be considerably easier to follow than those of the United States.

Inadequacy of a Cultural Explanation

In the Middle Ages, when the English were still throwing litigants into rivers to see if they would float, Japan had developed a legal system to adjudicate competing land claims that valued procedural regularity, the right to confront hostile witnesses, and objective third-party adjudication based on

²⁷ It is also outdated, more representative of the first three decades of the postwar period than of the last two, but since we are concerned primarily with Japan's period of high growth, the outdated nature of these assertions is largely irrelevant to us.

²⁸ I will not describe the judiciary that Japan has created, and is now considering substantially expanding, for those few disputes that persist or which fall outside the informal mechanisms. The Japanese judiciary is more like a highly structured and closely monitored bureaucracy than like the U.S. judiciary and therefore has created a much more predictable and stable set of doctrines and decisions. In many ways, it may be more readily reproduced in the developing world than its U.S. counterpart, but it has not been central to the Japanese story, and a full explication of its creation and structure is beyond the scope of this essay.

evidence instead of magic or divine ritual.²⁹ Even during the Tokugawa period, seen largely as the heyday of neo-Confucian authoritarianism and the flat prohibition of the legal profession, formal legal institutions were overloaded with lawsuits, legal advice was a significant industry, and legal justice was not impossible for even the most downtrodden. By number of cases, commercial matters and debt collection cases dominated, but the courts were used for disputes concerning property rights and personal status as well.

Law continued to play a significant role in the eighty years of Imperial Japan, and not solely as a superficial ornament borrowed from the West. Legal rules and litigation to enforce them became an important tool in defending privilege and challenging it.³⁰ Landlords exploited their rights under the Civil Code, demanding rent legally, although perhaps not morally, due, and tenants sued landlords for overreaching. Husbands exercised their rights to quick and simple divorce, and wives countered with suits for damages suffered because of their husbands' adultery. Contracting parties sued each other for default, and neighbors sued each other for irritating and harassing land use practices. Lawyers were numerous, litigation was common, and the results were not always to the liking of the political elite. The one exception was litigation against the government, especially any direct challenge to the legality of government action. There the courts were more circumspect. Some courts provided relief in the nature of torts, but success against the government in administrative cases was rare.

The leading politicians within the Imperial Diet reacted to this blossoming of legal activity with horror. By the 1920s, they were passing progressively harsher statutes to restrict litigation and protect the "beautiful customs" of Japan's imaginary past from the corrupting influences of law, individualism, and modernity, but to little avail. Eventually the onset of militarism brought litigation rates, and not incidentally the number of lawyers, down drastically, but it was not until the advent of postwar democracy that the government's efforts bore fruit in a more conventional sense. The number of lawyers relative to population or gross national product plummeted through the simple device of a legal limitation on their number. For most of the second half of the twentieth century, the government simply set the maximum annual production of legal professionals, including judges and procurators, at five hundred. The result was dramatic but entirely predictable: A country that had over 7,000 lawyers in 1932 had less than 7,000 thirty years later, which, given population growth over that period, meant that the number of attorneys per one million people dropped by over one-third, from 107.1 to 71.3.³¹ The number of attorneys rose slowly but steadily thereafter and by 1995 had more than doubled in absolute numbers, although the increase in per capita terms was significantly less. Litigation rates are harder to characterize, but by one count they dropped by over

²⁹ The reference is to the *shiki* system of land rights adjudication developed during the Kamakura Period. See Jeffrey Mass, *The Development of Kamakura Rule, 1180–1250* (Stanford, Calif.: Stanford University Press, 1979). For discussions of the role of law and legal institutions in later periods of Japanese history, see, for example, Frank K. Upham, "Weak Legal Consciousness as Invented Tradition," in *Mirror of Modernity: Invented Traditions of Modern Japan*, ed. Stephen Vlastos (Berkeley, Calif.: University of California Press, 1998), pp. 48–64; and Herman Ooms, *Tokugawa Village Practice: Class, Status, Power, Law* (Berkeley, Calif.: University of California Press, 1996).

³⁰ Sources include J. Mark Ramseyer, *Odd Markets in Japanese History: Law and Economic Growth* (New York: Cambridge University Press, 1996); and John O. Haley "The Politics of Informal Justice: The Japanese Experience, 1922–1942," in *The Politics of Informal Justice*, vol. 2, ed. Richard Abel (New York: Academic Press, 1982), pp. 125–47.

³¹ The precise figure was 7,136. Dan Fenno Henderson, "The Role of Lawyers in Japan," in *Japan: Economic Success and Legal System*, ed. Harald Baum (Berlin: Walter de Gruyter, 1997), p. 40.

75 percent between 1883 and 1990.³² The absolute number of cases, as opposed to per capita rates, varied during that period, ebbing and flowing in rough but clear positive correlation with economic recessions. The number of judges and procurators remained virtually constant from the immediate postwar period through the 1990s.

What is remarkable about this shrinking of the legal sector is that it occurred at a time of rapid economic expansion and demographic dislocation. That is well illustrated by the share of the national budget spent on the court system, which went from an already low 0.91 percent in 1955 to an infinitesimally small 0.36 percent in 1999.³³ Also striking is the fact that from 1950 to 1970, the percentage of Japanese living in cities practically doubled, presumably increasing the need for the social ordering of formal law.³⁴ Put simply but accurately, during the very same period that the economy boomed and society underwent substantial changes, the number of legal professionals per capita declined, the litigation rate fell, and the size of the formal legal system relative to the economy shrank substantially. It is difficult to exaggerate the importance of the juxtaposition of these phenomena to the topic of this essay. If formal legal institutions were necessary for either social order or economic growth or even just weakly associated with it, one would expect the deemphasis of formal law to have hindered growth. Instead, in Japan a shrinkage of legal institutions is positively correlated with growth, although no causal connection—that the lack of attention to formal legal institutions created growth—can be proved.

In the next two sections, I attempt some explanation of how the Japanese economy could have flourished in the face of a set of formal legal institutions that were steadily shrinking in relationship to the level of economic activity, social change, and population. In the next section, I deal with economic policy and the relationship between the government and business. Although rule of law advocates would not argue that broad economic policy should be governed by courts and policy decisions made through litigation, an important claim of Shihata and others is that there should be a clear separation between private and public in the economy. Most centrally, firms must be able to rely on government intervention in the market being governed by open political processes at the policy level and by legally controlled regulation at the implementation level. As we will see in the next section, however, this separation did not exist in Japan. Policy formation was largely in the hands of bureaucrats and was conducted in a manner that fully informed and consulted insiders but left the outside world considerably less well informed. Direct regulation, arguably more crucial for investment decisions, was carried out in many instances by a practice of delegation of public power to private actors (principally members of the regulated industries) that departs substantially from any model of formal law. In the following section, I look briefly at the way Japan has dealt with the day-to-day social conflict that characterizes all societies. Here we find a set of informal institutions that processes most disputes without the use of formal legal procedures.

³² I cite these statistics for dramatic purposes only. Comparing lawsuits is as good an illustration of the adage, “lies, damn lies, and statistics,” that I know, especially when the comparison crosses eras or jurisdictional borders. The most recent attempt to evaluate Japanese litigiousness that I know of is Christian Wollschläger, “Historical Trends of Civil Litigation in Japan, Arizona, Sweden, and Germany: Japanese Legal Culture in the Light of Judicial Statistics,” in Baum, *Japan*, pp. 89–142. The figures for the 75 percent drop come from Wollschläger, Figure 1, p. 94. The specific figures are virtually meaningless, but they express both the direction and degree of litigation rates.

³³ Curtis Milhaupt and Mark West, “Law’s Dominion and the Market for Legal Elites in Japan,” unpublished paper.

³⁴ Japan Access, “The High Growth Era,” Mainichi Interactive. Available at <<http://www.jinjan.org/access/economy/grow.html>>.

Regulatory Environment

Investors assume that certain characteristics are most conducive to economic growth in capitalist settings. They must expect to capture a reasonable return on their investment, with part of the expectation being that the government will not take property or allow others to do so without good reason and compensation. They must also have adequate knowledge of the markets to allocate their resources to pursue the greatest gain and know that those markets will be stable and relatively free of ad hoc or unpredictable public intervention or private manipulation. Government's role is to create open and stable markets, correct market failures through clear and predictable regulation, and otherwise stay on the sidelines. For most observers of most successful economies, certainly those within the rule of law development movement, the easiest and most common way to achieve these characteristics is through a set of incentives that directs private behavior toward activities with public benefit. The mechanism for establishing these incentives is most commonly law and the formal legal institutions that apply and enforce legal rules.

For Japan, however, a legally established and maintained system of private incentives is not the dominant explanation for the rapid economic growth over the last fifty years. Although there are forceful exceptions, the conventional explanation is that the Japanese economy developed under the strong guidance of a dedicated and talented cadre of powerful central governmental bureaucrats that created what has become known as the developmental state.³⁵ In this world, the bureaucrats of the Ministry of International Trade and Industry (MITI) and the Ministry of Finance (MOF) decided where Japan's resources should be invested. In the argot of industrial policy, they picked winners and then did their best to make sure their choices were correct. The market played a crucial but passive role; it was there to ratify MITI's choices and to reward the winners, but it did not allocate investment resources as assumed by economists. On the contrary, according to this view, the market had to be bypassed and distorted both to provide emerging sectors the necessary resources and to provide a soft landing to the losers. For the proponents of the developmental state model of Japan, the law played virtually no role.

The accuracy of this characterization of the Japanese state and economy is strongly debated, with a major focus being the role of the bureaucrats and whether they deserve credit for Japan's success or whether they acted at the behest and under the control of Japanese politicians. Although potentially crucial for a general model of development and the question of the relative roles of democracy and expertise, this issue is not central to our immediate purposes. In fact, I would argue that these two viewpoints underestimate the role of private third parties in the formation and implementation of economic policy.³⁶ Whether Japanese bureaucrats acted on their own, as agents of elected politicians, or in cooperation with the private sector, the crucial point is that they largely acted outside of and were unaffected by the formal legal system. Again, it is important to note that I do not mean that they deprived individuals or corporations of property or profits, although this did happen on occasion.³⁷ My point is that economic policy was discussed, formed, and implemented largely

³⁵ Chalmers Johnson, *MITI and the Japanese Miracle* (Stanford, Calif.: Stanford University Press, 1982) is the classic. Ironically, Johnson and his followers are known as revisionists, but within Japanese studies, both of the academic and popular varieties, it is those who argue that economic orthodoxy works as well with Japan as with anywhere else that are the outsiders. A prominent example of this heterodoxy is J. Mark Ramseyer and Frances McCall Rosenbluth, *Japan's Political Marketplace* (Cambridge, Mass.: Harvard University Press, 1993).

³⁶ Frank K. Upham, "Privatized Regulation: Japanese Regulatory Style in Comparative and International Perspective," *Fordham International Law Journal*, vol. 20, no. 2 (December 1997), pp. 396–511.

³⁷ Frank K. Upham, "The Man Who Would Import: A Cautionary Tale about Bucking the System in Japan," *Journal of Japanese Studies*, vol. 17, no. 2 (Summer 1991), pp. 323–43.

through informal mechanisms that were consciously shielded from the interference of the formal legal system.

The administrative actors in this process were MITI and the MOF, for industrial and financial policy, respectively, and whatever other ministries were involved in a particular question. The private actors were the trade associations of the involved industry or some similar ad hoc group, in some cases bridging two or more affected industries or sectors. The implementing agents were most frequently cartels, facilitated by MITI but directly enforced by the trade associations. These cartels were sometimes legal, formally approved by MITI or the Fair Trade Commission (FTC). At other times, the cartels were legally informal, created through consultation between the industry and MITI, sometimes with the understanding of the FTC, sometimes without. On rare occasions, the FTC would object to a cartel's formation or attack an existing one. The most famous example of the latter was the *Oil Cartel Cases* of the late 1970s, which confirmed that business activity that violated the terms of the Anti-Monopoly Act (AMA) was criminal even if taken in compliance with direct instructions from MITI or other government agency. The short-run effect of the *Oil Cartel Cases*, however, was not to eliminate informal cartels but simply to improve the FTC's bargaining power vis-à-vis MITI.

What was almost completely missing during the entire postwar period through the 1980s was intervention by the courts in the implementation of economic policy on behalf of private parties. Individual banks undoubtedly chafed under some of the restrictions of the MOF, and industrial firms certainly disagreed with the cartel allocations of MITI and trade associations and with the need for cartels in general. Disagreements led to fierce and bitter battles among the players in a given industrial field, but they rarely took their grievances public and even less frequently to the courts. In fact, those few times when firms went public, much less litigated, became legends known by nicknames like "the Naphtha War," the "Lions Oil Incident," and the "Sumitomo Metals Incident" and are recounted in the popular media in the breathless terms usually reserved for sports or soap operas.

A brief example of how these arrangements routinely worked in practice may be useful, especially for readers not familiar with the literature on Japanese regulation, although no single example will be representative because of the informality and often technical illegality of these schemes. The Large-Scale Retail Stores Law (LSRSL) and its predecessor, the Department Store Law, were intended to protect small- and medium-sized retailers from new forms of competition, first department stores, then high-volume discount stores. They gave MITI what amounted to permit power over the establishment of new stores. The LSRSL required operators of prospective stores to submit plans to the appropriate regional office, and then it set a timeline and procedure for MITI to follow in determining whether to grant the permit, deny it, or request changes in the plans. The statutory language contemplated a government decision-making process not dissimilar to permit processes in the United States. Large retailers would make their expansion plans based on market forces and then apply to open a new store whenever those calculations indicated that it would be successful. MITI would then evaluate the new store's impact on neighborhood small- and medium-sized retailers according to the statutory criteria and make its decision. If dissatisfied, the large retailer (or the local merchants) could sue.

In practice, the statute operated in an entirely different manner. First, the large retailers formed a cartel to allocate annually the number of new stores and floor space for each of its members. Then,

when a retailer was ready to put one of its allocated stores in a particular location, MITI refused to accept its application unless it contained a written statement by existing local merchants that they did not oppose the opening of the new store. The result was a severely restricted market run directly by a combination of local merchants and established national chains, not by MITI. The LSRSL was a great success: Profits skyrocketed for the large firms, and small retailers were given some respite from the incursion of more efficient competitors. Despite the total distortion of the statute's formal intent and language, virtually no one sued. Why would they? The only losers were new entrants to the market and consumers, neither of whom had any specific knowledge of what was going on and neither of whom would have had standing to sue even if they had. This system was stable and predictable, and it was not until the law became a trade issue with the United States that change occurred.

The dominant reason for the stability of such arrangements in the retail sector under the LSRSL and elsewhere was that it was not in the long-run interest of most firms to fight the system. Cartels were usually organized by and for the industry, with the relevant ministry policing the industry's agreement. Since the ultimate losers of these arrangements were usually Japanese consumers, there was no immediate reason for firms to resist, which of course would have meant fighting not merely the bureaucracy but also the other firms in the industry, the trade association, and the relevant politicians from the long-ruling Liberal Democratic Party (LDP). It often would have meant bad publicity as well, since they would be portrayed as greedy renegades, destroying the economic order that had brought prosperity to postwar Japan. The economic system undoubtedly harmed individual companies from time to time, but they were not without recourse. If they had significant political power, they could go to the politicians or battle within the framework of policy making and, even if they lost, could be assured that their interests would not be ignored forever. They could also cheat, which individual firms certainly did, sometimes openly, sometimes covertly.

When these arrangements were working well, the formal legal system was irrelevant. Even when things went wrong—when technology or market structures changed as in the Naphtha War or when a renegade entrepreneur tried to cheat as in the Lions Oil Incident—law was potentially important, but it was hardly what Shihata or de Soto would argue was necessary. Because the government's own actions were often legally indefensible, the threat of litigation was an option for aggrieved or greedy firms. It was not easy, however. Litigation could proceed only if the firm satisfied the administrative law doctrines governing who can sue the government for an official decision. The first of these, the requirement that the government act constitute an official act that immediately and directly infringed on one's legal rights, known technically as an administrative disposition, meant that all informal activities of administrative agencies, including important decisions such as cartel allocations, were immune from suit. The second doctrinal requirement was standing, which focused on who could sue to challenge those relatively few government acts such as requests for permits, licenses, and so on that constituted an administrative disposition. Standing was limited to the direct applicant, which meant that the interests of competitors, consumers, and the general public were beyond judicial scrutiny. Thus, both consumers and local merchants were excluded under the LSRSL.

Even with standing and an administrative disposition, winning was more complicated than it might appear to a casual observer. In the first place, the firm had to convince the agency to accept the application officially. It was common bureaucratic practice to refuse to accept troublesome

applications.³⁸ Instead of accepting and then denying such a request, the agency would engage in a bargaining process called “window guidance,” denoting the “window” through which the agency spoke to those under its jurisdiction. Unless the applicant agreed to amend its application to fit agency policy, the agency would not accept it and therefore would not deny it. As long as the application had not been denied, it was impossible to challenge the policy or its application in this case because legally there had been no officially cognizable act. The firm had to sue the agency on its refusal to accept the application. Only after it had won on that level could it resubmit and get official action, presumably a denial. Then and only then could it sue on the merits of that denial, and given the breadth of discretion granted under administrative statutes and the agency’s opportunity to craft its decision to withstand judicial review, victory was not assured. With this tortuous and risky path and considering that the regulatory structure was as much a product of the industry as of the government, it is not surprising that such suits were rare and more often driven by ideological rather than commercial motives.³⁹

More curious from a rule of law perspective was the absence of lawsuits brought by consumers, Japanese firms excluded from the deals cut by industry and the bureaucracy, or foreign firms, who were underrepresented in policy formation and were the real losers in industrial and financial policy. The reasons were simple and had little to do with Japanese preferences for consensus or submissiveness to authority. First, these policies were on the whole at least implicitly approved by LDP politicians and frequently taken at their explicit direction. Although informal approval could not transform an illegal cartel into a legal one, it did give the activity institutional and political legitimacy.⁴⁰ Second, the formation and enforcement of informal cartels were never transparent in the sense of being part of the public record and were often totally opaque, as is usually the case for behavior that is at least theoretically open to criminal prosecution. Knowing exactly what was going on was hard; gathering evidence was even more so. Third, civil plaintiffs had little chance of success in court. Although the AMA explicitly authorizes a private cause of action for its violation, the courts made the requirements of proof of causation and damages so onerous that no consumer ever won a case under it during this period. In other consumer areas, procedural hurdles and the broad scope of bureaucratic discretion made litigation generally unattractive.

These factors—the long-term self-interest of the insiders, the legal invisibility of the mechanisms used, their political legitimacy, and the doctrinal difficulties of challenging them—combined to create a system that heavily discouraged opposition through the formal legal system. It did not mean of course that the legal system ceased operation or that it was irrelevant. In the *Big Four Pollution Cases* undertaken at the heart of this period, largely poor victims of industrial pollution started a process that resulted in the eventual reform of Japan’s environmental policy and law. So even for the most marginalized of outsiders, the legal system remained a guarantor of some measure of justice. For relatively weak insiders, such as the FTC or a renegade firm inside a cartelized industry, the formal legal system provided a tool that could be used to increase one’s bargaining power. They may not win the

³⁸ It was illegal for an agency to refuse to accept an application that was seemingly complete. The courts established this in at least one case in the affirmative action context, but the practice continued up to the 1990s, so much so that the Diet had to restate the law in the Administrative Procedure Act of 1993.

³⁹ The land-use case also Kinoshita in affirmative action context. This is the exception that proves the rule. The plaintiff was not an insider, and going along would not benefit him in the long run.

⁴⁰ The prohibition on sales of refined petroleum products by anyone other than refiners was justified by the need to offset low kerosene prices with high gasoline prices. Although I know of no poll of the general population on this precise policy, the policy was part of a general energy conservation policy that was at least politically plausible.

litigation, but the mere threat of exposing the informal deals struck by the insiders was embarrassing enough to provide important leverage. But when the system was stable and operating within the norms of fairness of its participants, there was simply no reason for anyone to resort to law.

This portrait of the role of the legal system falls well short of the role portrayed by the current rule of law development discourse. To paraphrase Shihata, a working system requires that rules governing the state's intervention in the market are known in advance, properly interpreted, and vigorously enforced; that exceptions to a rule's application occur only according to established procedures; and that conflicts in the application or interpretation of the rules are formally adjudicated by an independent judicial or similar body.⁴¹ In other words, a working system requires transparency, uniform application, and arms-length conflict resolution. It is hard to argue that the regulation of the Japanese economy for the first three to four decades of the postwar period had many of these characteristics. Yet it would be equally difficult to argue that the Japanese system was not successful, not only in achieving economic growth but also in preserving civil order and a high degree of social justice.

Although this essay is not the place to discuss in depth the factors that made this possible, a few are worth mentioning. First, the actors involved in economic policy formation and implementation were stable institutions staffed by dedicated and competent private and public bureaucrats. Whether it was the corporations themselves, the trade associations that represented them, or the ministries that had responsibility for their regulation, their staffs were well educated and trained and usually stayed at or close to the institution for their entire career. Second, there were pervasive and institutionalized means of communication between the public and private institutions. The most famous is the *amakudari* ("descent from heaven") system—the process through which top ministry bureaucrats receive senior management positions in the private sector upon retirement from public service. There was also informal interaction on an almost daily basis between regulated and regulator. Third, there was little direct corruption in the public sector. *Amakudari* might be interpreted as a form of corruption, but its effect was indirect and in any case far from the massive and explicit corruption of many public bureaucracies. Fourth, the politicians and the voters behind them always had a veto power if policy failed disastrously or important interests were ignored.⁴² Fifth, in cases such as the *Big Four Pollution Cases* or the *Oil Cartel Cases*, the courts intervened at crucial times and provided an outside limit to the flexibility and arrogance of the insiders. Finally, as we see in the next section, these regulatory institutions existed within a society where most conflict was handled by informal mechanisms consciously created to channel it away from the courts and other public institutions that might bring it into the public sphere.

Dispute Resolution

In this section, I outline how Japan has managed conflict that fell outside of the regulatory context described above. The focus is on the myriad informal mechanisms generally lumped under the rubric of alternative dispute resolution. Japan is rightfully renown for such devices, but it will suffice here to look briefly at two instances: one in the politically charged area of environmental disputes and the other in the routine area of automobile accidents. They will give us some sense of the way that Japan

⁴¹ Shihata, "The World Bank and 'Governance' Issues," p. 85.

⁴² The seemingly total failure of financial policy throughout the 1990s and the political turmoil that followed may be illustrative of this democratic oversight, although the changes in electoral rules may be more directly responsible.

has dealt with the inevitable social dislocation of economic growth without a legal system that fits the new rule of law development model.

Prior to the current decade-long recession, perhaps the greatest social crisis faced by Japan in the postwar period was the environmental degradation of the 1950s and 1960s. The Japanese government was unable to respond decisively to pollution, despite clear evidence that unrestrained industrialization was destroying Japan's social fabric. The postwar pro-development consensus made protest unpopular, and pollution victims had few allies in the Diet or the powerful ministries. Opposition parties were able to control many local governments but unable to take effective action. In the end, it was a litigation campaign that broke the political logjam and forced the central government to respond. The result was effective and comprehensive regulation of industrial pollution that was stricter than that of the U.S. and most of Europe, including schemes for the compensation of pollution victims that for a time were considered models for the rest of the developed world. What interests us here, however, is the mode that Japan chose to deal with environmental disputes subsequent to that era. Despite the demonstrated success of tort litigation in exposing and redressing pollution, the Japanese government explicitly rejected using the legal system for future conflict. Instead it established bureaucratically managed compensation and mediation schemes to channel disputes out of the courts.

The environmental dispute system was a direct response to a political crisis, but it is representative of similar informal systems that cover virtually every field of social interaction conceivable in a modern polity. From divorce or adoption to human rights or employment, there is a government-created conflict resolution scheme ready for potential litigants. They range from conciliation attached to family courts to local human rights committees under local government supervision. Many casual observers of Japan attribute these devices to a cultural preference among the Japanese for harmony and consensus over the divisiveness of litigation. Others see a political conspiracy to use references to culture and tradition to keep political issues out of the courts, where they may escape elite control. Undoubtedly both views have some currency: There are historical antecedents for mediation in the Tokugawa period, and the political advantage of bureaucratically administered mediation is clear. What is of interest to us, however, is the success of these devices in managing social conflict without direct resort to the formal legal system.

Traffic accidents provide an excellent example of how this has been achieved in Japan. As Tanase Takao, a leading Japanese sociologist of law, put it:

[W]hile in the United States, except in minor injuries, people routinely bring their claims to lawyers, in Japan nearly all the injured parties handle compensation disputes themselves without the aid of lawyers. Only when they encounter extraordinary difficulty and feel that, as a very last resort, they will have to use the court, do the Japanese ask the help of lawyers.⁴³

In his account, less than one percent of total accidents end up in court and no more than two percent involve private attorneys at any stage. For those who believe that harmonious dispute resolution is the natural result of Japanese culture, it is striking that such was not always the case. Litigation was

⁴³ The system for automobile accidents is beautifully described by Japanese legal sociologist Tanase Takao in "The Management of Disputes: Automobile Accident Compensation in Japan," *Law & Society Review*, vol. 24, no. 3 (1990), p. 662. His article puts the automobile accident scheme in the context of general conflict control and is an excellent source for understanding the Japanese approach to litigation and social conflict.

common in the 1960s and peaked in 1971. Thereafter the government, the police, insurance companies, bar associations, and the courts took measures that reduced the number of absolute cases by two-thirds in a decade. It is not necessary to go into the details of how this was accomplished, but it is important to note that there was nothing spontaneous or uniquely Japanese about the process. On the contrary, it was carefully structured to provide adequate compensation to accident victims without the expense of the formal legal process. Nor was it developed without attention to legal rules. A key aspect of the process is the provision of free legal consultation by police, insurance companies, and even bar associations, but the emphasis in these consultations is on the ability of the parties to handle the vast majority of accident claims without litigation or professional involvement. The judiciary played a role by carefully and consistently simplifying liability rules and compensation formulas, a task well suited to the Japanese judiciary because it more closely resembles a tightly controlled and regimented bureaucracy than it does its American counterpart.

As is implied by the involvement of the bar and the judiciary in the automobile accident scheme, legal institutions can play important supporting and enabling roles in Japan's informal dispute-resolution mechanisms. Family court conciliation is another such example, although in this instance the goal has often been the processing of complaints rather than even rough fidelity to legal rights. In other areas, especially those under the jurisdiction or policy sphere of particular ministries, processes are conducted with considerably less involvement of legal rules, institutions, or personnel. The common denominator for all dispute procedures, however, is a concerted and largely successful effort to avoid the cost and formality of litigation, and, to this extent, informal mechanisms such as these and similar ones in every developed country, may be a more attractive route for developing countries to pursue than relying on the creation of a full-blown "rule of law" legal system. Again, it is necessary to stress that these systems have not arisen spontaneously from the depths of Japanese culture but were specifically designed by the government to discourage parties from litigation. They are not, in other words, uniquely Japanese; nor do they depend on a culturally submissive population, ready to compromise its interests in the name of harmony. They may depend, however, on a degree of internal social cohesion that many developing countries do not currently have. Even more important, they clearly require an effective bureaucracy, another state institution that is in short supply in much of the world. Even so, informality may still be preferable to the formality of a rule of law judiciary, which is at least equally dependent on social conditions and vastly more expensive.

IMPLICATIONS FOR DEVELOPING COUNTRIES

Both the formal legal mechanisms of the United States and the largely informal mechanisms of Japan have served these two societies well in the period under review, despite deviating from what the new rule of law orthodoxy would assume is necessary for economic growth.⁴⁴ In this concluding section, I address what lessons these two examples might have for contemporary developing countries.

The first and most important lesson may be that neither the Japanese nor the U.S. legal system is likely to provide a useful model for other societies. The U.S. legal system deviates substantially from the rule of law ideal; it is massively expensive in terms of human capital, as well as in purely financial terms; and its

⁴⁴ Of course, it is theoretically possible that both societies developed despite their respective modes of economic ordering and that legal systems more closely resembling the rule of law would have resulted in even more impressive performance. Because this possibility is purely hypothetical and speculative, I do not address it here. It is also possible that the respective legal systems played a minor role in economic growth.

primary features are at least as attributable to political goals, ideals, and compromises as they are to efforts to promote economic growth. The Japanese system was certainly created with economic growth in mind and has operated with that goal foremost, but the institutional requirements of the Japanese system seem almost as historically dependent as the American. The relatively balanced interaction of political, governmental, and private institutions, each component of which was characterized by competence and stability, seems more suitable as a goal of development efforts than the means.

Furthermore, each system has substantial flaws. The details of the U.S. legal system are as likely to be cited as a politically created impediment to economic efficiency than as a foundation for it. Indeed, the Japanese government has repeatedly claimed that the U.S. legal system is so ineffective and unfair that it constitutes a nontariff trade barrier. The Japanese system is also currently under siege, blamed for contributing to the decade-long recession that has tarnished the country's economic "miracle." Indeed, it could be argued that the very institutions that served Japan so well while it was a fast-growing economy are no longer suitable now that it is a mature one.

A second lesson is that the creation of a formal rule of law system of the type advocated by Shihata and other adherents to the new rule of law orthodoxy may well not be worth the cost. As I have argued, even the United States, the country most insistent on the virtues of the rule of law for developing countries, has chosen to depart from the model in fundamental ways, and Japan was able to grow economically with a relatively shrinking legal sector. If these societies grew without a formalist rule of law, why should a developing country consider it a necessity? Of course, this does not mean that the protection of basic rights is not necessary. Nor does it mean that an effective formal legal system may not be politically desirable or that political stability may not be a prerequisite to growth, but it does not appear that the formalist rule of law has been a major immediate factor in economic growth in these two countries. In fact, if one had to choose, it would be the informal systems of Japan that would seem most useful to developing countries. One would urge caution, therefore, before recommending that a developing country divert significant resources from more directly productive activities or, more important, attempt to replace effective and inexpensive means of social order with any formalist rule of law.

The last point—that legal transplants may displace indigenous institutions—deserves elaboration. The cost of importing a formalist legal system is not solely the expense of courthouses and legal education or the diversion of human talent into the legal profession. A more important cost is the risk to existing informal means of social order, without which no legal system can succeed. Although it is highly unlikely that the transplanted system will operate as it did in its country of origin or as intended by the borrowing country, it does not follow that it will have no social effect.⁴⁵ A legal system provides a powerful set of resources, and those who see themselves as benefited will use such resources to their own advantage. That is, of course, precisely what the creators of a legal system wish for. But if the social context of a legal system is not able to support the individual exercise of rights or if the incentives governing the utilization of the resources are not finely calibrated, the results can be far from those intended. In other words, unless the creators of the legal system get it exactly right,

⁴⁵ The experience of Japan's Civil Code of 1889 is illustrative. The Meiji leaders may well have intended their new legal system as primarily a demonstration to foreign powers of their modernity, but the code was taken seriously by the Japanese people. They used its provisions in the courts to pursue their own interests in ways that political leaders of Japan had not anticipated and did not welcome. The result was a flurry of legislation in the 1920s to "correct" the excessive individualism of the Japanese by limiting the peoples' rights under the code and requiring prospective plaintiffs to use "traditional" means of dispute resolution in place of litigation.

unexpected consequences will occur. In a mature system, established institutions can deal with negative consequences. However, in countries with new legal systems, especially ones imposed or imported from abroad, preexisting institutions often lack the experience, expertise, and, most seriously, political legitimacy necessary to deal with unforeseen consequences of reform. Legal anarchy can result in a society that has a new, formal legal system but lacks the social capital, institutions, and discipline to make use of it.

The reason that advocates of the new rule of law orthodoxy are willing to take this risk, in my opinion, is that they view the rule of law as an indicator of social development.⁴⁶ Such advocates hold a relatively unvarying vision of the end product of legal reform efforts, without requisite attention to the social, cultural, economic, and political contexts within which such efforts take place. Legal systems are so complex and so intertwined with these contexts that the chances of large-scale legal transplantation performing in the way intended, especially right off the bat, are slim. Because the reformers are focusing on the expected result—the formalist rule of law—rather than the new institutions' interaction with the social context, it is difficult for them to perceive problems and react effectively to the inevitable surprises, which are certain to arise, particularly if contextual factors are ignored.

I do not intend to discourage legal reform or the borrowing of legal rules or institutions from other countries. Indeed, some have argued that legal transplants are the main source of legal change, not only in the developing world, but everywhere. It would be foolish and futile to argue against it, and it would mean arguing against transnational legal learning. My point is a much more limited one and one that seems self-evident to most students of the actual role of law in society. A legal system is too complicated to be planned from the top down. Any group of competent legal scholars with the necessary audacity could devise a formal legal system that would work well on paper, making the various assumptions about human behavior, institutional capacity, and incentive structures necessary to implement their worldview.

Unfortunately this exercise is akin to what the planners of the former Soviet Union did with their economy. I doubt that we can expect any greater success from the proponents of the new rule of law orthodoxy. The problem with centralized economic planning, after all, was not that the planners were stupid, ignorant, or corrupt; it was that an economy is too complicated to be effectively directed over the long term by a central authority. The design of a legal system faces the same issues. Even if the assumptions about human behavior are correct, the knowledge of social context is insufficient to calibrate perfect rules, and the legal institutions are too weak to implement them on their own. As Robert Putnam has eloquently demonstrated about Italy, legal rules do not operate in a social vacuum. Identical rules can exist in dramatically divergent societies.⁴⁷ The secret to legal borrowing and to legal reform in general, therefore, is not merely attention to the foreign model or the institutional goal; it must include close attention to, genuine respect for, and detailed knowledge of the conditions of the receiving society and its preexisting mechanisms of social order.

⁴⁶ I have borrowed this idea from Michael Dowdle, "Rule of Law and Civil Society: Implications of a Pragmatic Development," unpublished paper.

⁴⁷ Robert D. Putnam, Robert Leonardi, and Raffaella Y. Nanetti, *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton, N.J.: Princeton University Press, 1993).

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