

# RULE BY LAW

The Politics of Courts  
in Authoritarian Regimes



Edited by Tom Ginsburg and Tamir Moustafa

CAMBRIDGE

between the rule of law and growth. We accept that clear property rights and rule of law reduce transactional friction and facilitate economic activity. Insofar as they effectively enforce property rights and contracts, courts serve as an institutional intermediary between commercial interests and the leadership of autocrat and democratic regimes alike.

On the surface, promoting a safe investment environment may appear to foreign investors and policy advocates as a progressive liberal improvement. The liberalization of foreign investment, however, may be linked to strategies of coalition building that increase economic inequality and limit local access to the political process. The links between economic and political liberalization are more difficult to establish than is generally understood in the literature on modernization.

Business surveys based on investor perceptions typically identify judicial reforms as a positive step toward advancing political stability and political openness. But perceptions can overstate the synchronicity of institutional reforms to outcomes. They disregard the prospect that judicial reforms may constitute a parallel system of regime legitimacy that rarely serves as an ultimate check on the power of the executive. Although an obvious advantage exists for investors to seek and support the building of effective systems of commercial law around the world, such institutions may have originated for entirely different political reasons, and may buffet authoritarian regimes by enhancing the tools available to the incumbent to buy loyalty.

A fundamental tension exists between the financial incentive of the ruler to attract foreign investment and the autocrat's political incentive to use property rights selectively. Growth is only indirectly linked to the ruler's revenue stream. From the autocrat's perspective, property rights are another tool to facilitate political and economic enrichment of regime followers in which loyalty, not consumer surpluses, is being optimized. Foreign investors may have valuable links to members of the winning coalition, or they may have resources that help leaders circumvent rivals. The ruler has an incentive to maintain a stable policy for enforcing property rights for financial elites because avoiding a financial crisis is essential to ensuring regime survival. But the autocrat may be less gracious with political opponents, and may direct the courts to practice selective enforcement. For example, Singapore's Lee Kuan Yew is alleged to have used the courts to bankrupt political opponents (Mauzy and Milne 2002: 132–136). The courts in Singapore were effective in processing commercial litigation and could identify the asset flows and resources of opponents, and then prosecute them with targeted tax enforcement. Coupled with effective administrative follow-up, the efficiency of the court system made threats to opponents more credible. The institutions that give Singapore a reputation for

clean business practices also enable its leaders to intimidate political opponents (see Chapter 3).

In Indonesia, after export and import markets were freed from controls, the best contracts have often depended on partnerships with politically connected figures. Fisman (2001) has quantified this dynamic in Indonesia after liberalization and found that the value of political connections actually increased with liberalization. The distinction between broad growth and targeted economic interventions that reward political allies with investment opportunities is difficult to observe in aggregate growth statistics, which do not show the market distortions resulting from the reward of monopolies to political supporters and other forms of political rents collected in exchange for economic privileges. With their control over natural resources, Indonesia's leadership can establish narrow coalitional foundations by selectively distributing market access as private benefits to regime supporters. Control of these resources relieves it of the need to develop a clean business environment to attract adequate capital to sustain a broad-based governing coalition. Narrowing the winning coalition allows top leaders to keep the maximum returns for their own consumption and to ward off rebellion.

In short, some but not all autocrats will seek to empower courts to attract investment. The key variable is whether foreign investment capital – and judicial institutions that are useful to attract it – can be co-opted to ensure regime survival.

### *Dilemma 2: Financial Credibility and Debt Repayment*

A second dilemma faced by relatively unconstrained rulers concerns the need to borrow to finance the regime itself. Institutions that promote rules over discretion provide political leaders with access to private capital at lower cost than would otherwise be the case. This insight is derived from the work of Kydland and Prescott (1977), who focused on the advantage of rules over discretion in monetary policy and the related role of central banks. In one extension of their model Root (1989) explores how the state can enjoy better credit terms, reflected in a lower interest rate, when able to borrow from intermediaries that are subjected to independent courts for enforcement of nonpayment of financial arrears. Such institutions reduce the costs of credit to the state by enabling leaders to draw upon the credibility of intermediary bodies that are themselves subject to a rule of law, even when the head of state may not be. Constraining sovereign discretion with regard to financial activity actually strengthens the ability of leaders to raise funds from private sources at more attractive rates than those available if the leader attempted

to borrow directly from capital markets. Surprisingly, modern-day regimes with access to sources of external finance have a weaker incentive to develop effective commercial courts than did the kings of early modern European states.

The necessity to secure funds for war from domestic sources drove much of the legal, administrative, and fiscal institutional innovation that occurred in feudal France and England. Revenue collection required laws to strengthen collective identities and to define collective liability, effective administration was needed to implement the laws, and effective debt repayment was necessary to gain loans from the private groups that enjoyed legal protection and liability under the law. Many developing countries can substitute international sources of capital for domestic capabilities that require investments in state-building. With a much weaker technical capacity to track and monitor wealth, the kings of Old Regime France and England were able to collect a far greater percentage of their subject's wealth than can many emerging but weak states today (Root 1994).

When the French or English monarchs were above the law, they could not be compelled to repay their debts, and so had more difficulty finding sources of credit. As a result of royal discretion, monarchs enjoyed credit that was weaker than that of many of their subjects. The kings' onerous cost of capital could be mitigated by new institutional arrangements that benefited financiers and investors while ensuring a steady supply of government financing. Kings could not borrow against their own discretion, so they were compelled to create a legal regime that ensured repayment after they themselves left the scene.

In England the Crown needed to raise revenues from elites and designed a court system that gave rise to a constitutional monarchy, with strong protection of the property rights of the landholders and bondholders. North and Weingast (1989) have pointed out that the English kings benefited from the rise of Parliament, by allowing it to raise taxes to fund the kings' debts. The British Parliament had an interest in preventing the king from raising money through sources other than the Parliament itself. The Glorious Revolution placed limits on the Crown's ability to unilaterally change the terms of its financial agreements, which enhanced its credibility. In exchange for purse strings, the king gained a source of revenue at lower cost than was available to any other government in Europe, which allowed England to become the master of the oceans and eventually of international commerce. In addition, strong domestic commercial law was necessary to generate the funds for Parliament to tax. In England, the need for credibility led to the rise of constitutional monarchy and a liberal economy. Ironically, when international donors provide bilateral or multilateral funds to present-day autocrats, they reduce incentives for

the government to provide strong domestic protection for commercial transactions.

In France the intermediary was not a legislative body, but rather a private body chartered by the king with the privilege of collecting royal taxes. The collectors often advanced their own funds to the Crown, knowing they could access the king's courts and army to draw upon the collective resources of the village communities, guilds, and provincial estates. The corporations were subject to the jurisdiction of the courts and could therefore offer credible financial commitments. In return for official recognition and privileges, these corporate groups acted as bankers for the king, providing funds at lower rates than the king could find on his own.

Taxing peasants also required that their collective village property be protected, which had corollary political benefits. By granting peasants access to the courts to protect the tax base, the king used the courts to build up constituent support from groups that might otherwise be marginal. His direct political objective was to supplant peasant allegiance from local seigneurs to the agents of the king. Indirectly the subordination of seigniorial authority to royal supervision may have had unintended revolutionary implications, creating a process that would lead toward the revolutionary events of 1789. The law of the king's courts became a venue in which a contest between peasant villages and their traditional seigniorial masters could be waged. The courts fanned the animosity toward seigniorial dues by hearing the grievances of peasant communities against their lords. The contests became more adversarial by virtue of the fact that the seigneurs enjoyed tax-exempt status, dating from the days they provided military service to the king. But by the eighteenth century, it was the taxes on the peasantry that financed the king's wars. In Great Britain, by contrast, the lords shouldered the burden of paying local taxes, and their authority grew in proportion to the burdens of national security that they bore for the entire community. Hence there was more justification for the English lords' economic status, and their enterprises gained protection in national law.

Today the heads of government rarely enjoy incentives to protect the enterprises of productive sectors of the population similar to those of the monarchs of eighteenth-century Europe because they can substitute international loans for capital drawn from sources of domestic taxation. This is true for both developed and developing countries. For developing countries, international financing often means an absence of a commitment to protecting the property rights of majorities, in favor of selectively distributed economic privileges that provide a loyalty premium to the head of state. If the ruler is lucky, natural resources such as oil or diamonds may be enough to finance the regime, and the messy business of negotiating tax revenue can be avoided. International

financing from multilateral development banks and donors is another attractive source of funding, allowing the ruler autonomy from society.

If the regime does require tax revenue to survive, a unique set of incentives arise that can lay the groundwork for democratic transitions. This transformation can be seen in the practice of effective government by China's KMT after it lost the mainland. With a much smaller population and few economic resources on Taiwan, the KMT developed better governance systems, including higher quality courts, tax authorities, and administrators than they had operated on the Chinese mainland. There was not enough population or wealth on Taiwan for the KMT to maintain sufficient military capacity to ward off an attack from the mainland simply through corruption and extortion. After losing the mainland the KMT understood that wealth had to be husbanded by economic policies and incentives if Taiwan was to survive.

While the change process occurred at different rates, both France and England's innovations in the institutions of participatory governance were driven by the fiscal necessity of the state. With the advent of international financial institutions, domestic taxation is not the only option for securing government resources. Yet, foreign debt has caused further rifts between rulers and citizens, as foreign policy concessions made by dictators are often granted by developing countries to donors in exchange for extended credit.

### *Dilemma 3: Secrecy, Central Authority, and Administrative Discipline*

The autocrat's third dilemma is driven by information. The secrecy inherent in the extremely hierarchical nature of autocratic regimes generates internal contradictions regarding the use and abuse of information by administrators at lower levels of the regime. Effective authoritarian governance requires that information be passed up and down the ladder of authority; however, there tends to be an overload of information at the top that creates opportunities to hoard information at the lower level, progressively diminishing the authority of the ruler. Low-level administrators can strip regime assets to create personal fiefdoms obscured from the purview of central government actors.

Layers of authority exist between the head of state and local administrators, creating ample opportunity for orders to be confused or mishandled. Judicial decisions and censures from senior officials are further constrained by protests, excuses, and appeals pitched to central authorities. Administrative complexity and overlapping responsibilities slow communication and result in the loss of timely information, facilitating the stripping of state assets for private gain.

Many autocrats depend on local notables whose resources constitute an independent power base. They must be co-opted into supporting the regime,

but their loyalty can never be counted upon. Imbued with local biases, they seek to guard local or regional privileges, and their scope for hiding information and action is considerable. The policy decisions that are directed toward them are often construed in ways that fit their own needs. There is no easy way to solve this problem of local nonconformity; creating administrative law, and using central courts to watch over local communities, risks confrontation. Military force is always an option, but it complicates the prospects of future local cooperation. Inevitably when local big men are well entrenched, money spent locally will further perpetuate their control over local patronage networks. The leader can demarcate areas of local jurisdiction that fall under central control and slowly erode localized power, but the risks of hidden action and information will persist.

Kenneth Arrow's insights concerning "hidden information" and "hidden action" in corporate structures (Arrow 1979) offer useful parallels to the information asymmetries in authoritarian governments. As the agent of the stockholders, corporate management may pursue a project it knows to be unprofitable if it produces perks or salary benefits that management can enjoy. Likewise, an agent of the government may distort information (hidden information) about the performance of government policies and avoid passing along information about local economic conditions or the potential for governmental revenue generation. Agents can trade on information about planned government policies or projects (hidden action), striking black market side deals with other administrators or with private parties. Local officials become adept at stripping the value of the government assets at their disposal to earn private profits.

The autocrat may create or reinvent the courts to address this principal-agent problem – preventing the erosion of power and imposing supervision on agents in order to constrain their ability to conceal information for their private benefit. The administrative discipline administered by the courts helps build legitimacy for the regime because the visible effects of re-centralizing authority are perceived as reducing corruption to the benefit of society, recovering lost economic surpluses, and removing secondary officials who have distorted rule enforcement by distributing opportunities to their own local networks.

A significant literature has emerged that attributes the fall of the Soviet Union to the loss of hierarchical discipline at lower levels (Frye and Shleifer 1996). The corruption that was unleashed after the end of the Cold War was just the extension of a process that had already been underway. Local officials had been hiding information about the efficacy of policies from the central government and taking hidden actions that enabled them to gain control over government assets. Only the local officials knew about side deals among each

other. Today, one of the most trenchant criticisms leveled at Communist Party officials in China is that lower ranking representatives are using their authority to collect rents through fees and licenses at the local level, which are then retained locally instead of being transferred upward. Resources are being diverted away from the center, making it difficult for Beijing to provide government services demanded by local populations.

It is well established that monitoring, such as that provided by court systems, can help solve information asymmetries and reduce the scope for corruption. Monitoring alone, however, does not contribute to the liberalization of the regime. Typically, monitoring is a way to exert central authority over the periphery. A side effect may be new avenues of contestation, but that is not the goal of such reforms.

It is also possible that the autocrat has no incentive to enforce administrative discipline. A weak court system and lack of transparency allow rulers more options for amassing private wealth. Although overall economic productivity and the social surplus may be compromised, the distributional impact may still be favorable to regime longevity. As mentioned earlier with the Indonesian example, autocrats may overlook opacity and corruption in order to guarantee that the state intervenes on behalf of favored investors, thus ensuring central economic control. If the autocrat does not need the courts to secure income or reward the winning coalition, resources will be diverted away from the courts and they will suffer accordingly. When courts are appended to stand-alone legal ministries, they rarely have funding to undertake their core responsibilities and are often prone to bribe-taking, ultimately undermining their legitimacy.

#### LINKAGES BETWEEN POLITICAL DISCIPLINE AND COMMERCIAL LAW ENFORCEMENT

What is the incentive of an autocracy to adequately finance the courts? In some authoritarian regimes such as South Korea during the 1960s and 1970s, the courts were under the direct supervision and control of security forces, and in fact became an arm of the state security apparatus. Paradoxically, leaders who create judicial institutions that improve internal security for defense against enemies of the state can use these same institutions to establish effective courts that enjoy the respect of the population. In weak states, by contrast, legal institutions are viewed as protecting the private interests of the wealthy. Attaching the court system to the security function has a strong effect on the ability of the courts to function effectively. The security apparatus of the state is the most important disciplinary agent of an authoritarian regime. Ironically, a connection with the regime's security function may be the source



of funding that allows the courts to disregard the power of external influence over contract enforcement, and to establish a reputation for professionalism. This relationship explains in large part the reputation for professionalism enjoyed by the judges of South Korea during the martial law period. The courts of Nazi Germany enjoyed the same high status. Court systems that are effective in disciplining political opponents are likely to be well resourced and efficient in enforcing property rights and commercial legislation. Judges who are directly responsible for the survival of the regime are likely to enjoy greater esteem than judges who are members of stand-alone judicial ministries that tend to be underfunded and prone to corruption. If judicial personnel are well paid, they have little incentive to hoard information and collect rents that divert economic activity.

The security connection also comes into play after court decisions are made, when credible enforcement is required to render court decisions effective. Enforcement is more easily provided if the courts are attached to the security apparatus, but when courts are stand-alone institutions, their authority can be circumvented.

Courts often seek to preserve their autonomy in some spheres by avoiding challenges to the regime on core issues, but such a strategy does not always work. For example, when Thaksin was elected prime minister of Thailand, the opposition questioned his eligibility to rule based on accusations of tax evasion. The Constitutional Court ruled in Thaksin's favor, arguing that the electorate already knew of these charges and elected him anyway, and it was not the mandate of the court to contradict the electoral mandate of the population. When Thaksin was deposed in a coup in 2006, the Constitutional Court was disbanded. In the Philippines, Marcos declared martial law, which the courts accepted on the grounds that he had been a democratically elected president. This initial rubber stamp became a turning point in the loss of independence for the courts, which had previously been perceived as meritocratic and professional. Celozza (1997: 82) explains,

As he expanded the role of the military, Marcos limited the power of the judiciary. To ensure that his policies were implemented as he saw necessary, Marcos needed to curb the independence and review powers of the Supreme Court. Directly or indirectly, Marcos exerted pressure on the Supreme Court to give him a free rein; in turn, the court exercised a great deal of self-regulation to avoid confrontation with Marcos.

Frequently, a dual reality develops in authoritarian regimes in which a separation occurs between the regime's questionable moral legitimacy and its effective performance of routine daily civic functions, further reducing the court's

capacity to effectively challenge the moral legitimacy of the regime. But the existence of judicial review may create a space in which the forces for contesting the regime will gather and in which they will learn how to coordinate using tools provided by the regime itself to later challenge the status quo.

#### THE LAW AND REGIME CHANGE

When considering how the courts can contribute to political liberalization, one must recognize that legal reform is part of a broader context of social reform. The courts mirror that larger process, whether they enhance or retard it. The courts can have a dual nature, providing legalistic justification for regime legitimacy and the ruler's arbitrary discipline of political opponents, while remaining more independent when dealing with contract or family law.

The evolution of institutions does not always optimize broad social welfare. Political and economic evolution is a process of adaptation and survival in the face of external pressure and competition, and the result is often policy volatility. In newly emerging states in particular, weak institutions can cost elites the opportunity to reap the rewards of power. Judicial institutions adjust to an equilibrium strategy, facilitating enough economic activity to optimize resources for the winning coalition while serving the ruler's political security.

The courts can play a stabilizing role by providing a mechanism for resolving administrative disputes, so as to release tensions and instabilities before they erupt. If the courts support the denial of citizens' right to assemble, mobilize, and organize for political purposes, open and inclusive administrative processes are unlikely to stimulate long-term political reform. Alternatively, in their role of reinforcing central authority, the courts may provide a venue to expose contradictions that can lead to disintegration of the regime. In such cases, the courts rarely initiate change, but rather provide a forum to voice changes already underway.

Political discourse may or may not evolve in an administrative court system that is primarily used to impose supervision on local leaders, as in China. At the base, citizens may perceive a dual court system as one in which grievances can be legitimately aired and potentially resolved, giving the appearance of inclusivity and effectiveness, which contributes to regime legitimacy and survival.<sup>2</sup> Autocrats who rule inclusively with a combination of strong political security and some access to arbitration to resolve local disputes may be able to cushion their rule from shocks in the economy or external environment.

<sup>2</sup> Jeanne Kirkpatrick subscribed to the notion that the most resilient autocratic regimes are the most totalitarian. This doctrine was clearly discredited after the fall of the Soviet Union.

In many of the case studies in this volume, the law furnishes a set of categories in which new ideas can be crafted and a vocabulary in which new concepts of civic responsibility can be described. But the creation of the vocabulary and the political options for mobilizing citizens to use that vocabulary for public criticism of the regime are two separate matters.

### *Dualism and Inclusivity as a Steady-State Equilibrium*

As noted earlier, today's autocrats have several channels to circumvent reliance on domestic taxation to secure revenues for the regime. By far the most effective is the possession of valuable resources, such as oil or diamonds, that can be controlled by regime leaders. Without the fiscal incentive to protect taxable assets of regime citizens, the process of political liberalization will stall. Another channel that facilitates rule without domestic accountability is bilateral or multilateral bank lending to the sovereign. The loans most frequently benefit the incumbent leadership and the interests they represent, despite lending guidelines established by international law. The possession of revenues that come from sources that enhance an autocrat's independence from accountability to societal groups allows the leadership to shape those groups according to its own interests. Both the resource curse (Ross 1999) and the foreign aid curse give rise to large selectorate-small winning coalition systems in which political competition is stifled and some measure of judicial independence is lost.

Regimes that rely on peasants or other marginal groups for legitimacy do have an incentive to provide access to the legal system. The opportunity for poor farmers to appeal to the courts, however, does not imply that the autocracy will disintegrate; in fact it is more likely to contribute to stability by giving rulers ways to supplant the traditional powers of local elites. Thaksin in Thailand became well known for programs that benefited the poor. He did this expressly to circumvent local patronage networks that empowered local leaders. Thaksin had centralized political funding, letting big money politics overcome local political influence; once their power base was attenuated, local leaders had to support Thaksin or risk losing elections.

In China, the Communist Party has been strengthened by increased growth, but as a result of dynamic economic activity, the coalitional structure shifted toward a new class of financial elites, forcing a formal change in the party constitution. China scholar Hongying Wang discussed the CCP's adaptation strategy in a recent interview with Fareed Zakaria (Wang 2006):

The CCP, the Chinese Communist Party has reinvented itself. That's the key; they're . . . not the Communist Party that you know about or people

idealize about. There's nothing communist about it except that it is a one-party system and it is determined to do everything, including changing its own nature to stay in power. The new principle as it is written in the Party Constitution now – the Party represents the most advanced production force, which means the capitalists or the capital owners; it represents the most advanced culture, which means professionals, intellectuals, and advanced “everybody's interests,” which is just . . . covering every aspect.

The adaptation of judicial independence within a limited sphere of activity does not imply that political liberalization will ultimately result. Local dispute resolution may contribute to growth as a strategy to ensure continued centralized authority, but growth may also increase inequality, which works to the advantage of the ruler. Inequality can be exploited by the autocrat to further cement control by increasing the loyalty premium the ruler can extract from the winning coalition. When being cut off from the winning coalition means mediocre access to resources, the cost to the ruler of gaining loyalty is reduced. Thus, members of the winning coalition have more to lose when the society is more unequal – so loyalty can be purchased more inexpensively. The courts can become effective as vehicles for the activism of opposition only once the regime has already started to weaken. Hongying Wang continues as follows:

People [are] looking at their neighbors, their urban cousins getting rich. . . . Some of these protests are about local environment issues, . . . unemployment. . . about half of [college students] them end up graduating not immediately finding jobs. . . . I think on the one hand it does represent a serious challenge to the legitimacy of the government; on the other hand I don't think in the near future it's going to generate the kind of collapse that people are sometimes talking about, because the Chinese Communist Party has been very smart from its own point of view in that you can protest as long as you guys don't get organized. You can talk all you want, so there is much more freedom now in China in terms of people's ability to express their discontent – just don't get organized. And the problem is if you are thinking of a revolution or any kind of meaningful upheaval without organization these protests are not going to cause any major change.

The Chinese example demonstrates that the granting of limited freedoms can be a strategy for legitimizing the regime without sacrificing central authority. As an instrument of that authority, the courts can still rule in favor of local plaintiffs in cases of low-level corruption without jeopardizing the political security of central leadership. Judgments that favor selectorate members reduce the threat of potential challengers from within to the winning coalition. In China, for example, Jiang Zemin rarely challenged the Shanghai Gang and