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## Law and Economic Development

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# FACULTY COMMENT

## Law and Economic Development\*

LEONARD J. THEBERGE\*\*

The role of law in the development of the Third World countries is of great intellectual interest and considerable political importance. In this Comment, I would like to review some of the themes in the literature dealing with this topic.

We in the American Bar Association, and our clients, have good reason to value the predictability and stability to which Max Weber and other authors refer in the passages I shall be quoting. The general legal framework in a country, and the specific investment laws to which foreigners may repair, are part of the investment climate which prospective investors examine in developing and developed countries alike.

With the emergence of scores of new nations in the Third World over the last twenty years, governments, foundations, and legal scholars have been trying incessantly to determine the extent to which the role of law influences economic development in less developed countries (LDC's). Empirical evidence is elusive. Nevertheless, the foreign investor and his lawyer act upon the assumption that there is such a relationship, and they rank it in importance next to economic opportunity, political stability, and investment incentives. Early on, it was recognized that the rapid economic development sought by Third World countries would require an effective legal framework.<sup>1</sup> But conceptions of how such a framework can be created have changed over the course of two decades' research in the field of law and development.

Law, it has been suggested, can have three possible functions in soci-

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1. Harvard Law School, International Legal Studies, *Report of the Director 1954-1961* at 3, quoted in Burg, *Law and Development: A Review of the Literature & a Critique of "Scholars in Self-Estrangement,"* 25 AM. J. COMP. L. 492, 495 (1977).

etal development: "tinkering," "following," or "leading."<sup>2</sup> During the colonial period the tinkering and following functions prevailed in most Third World countries. Independence and the desire for rapid development fostered the idea that law could lead in the process of growth.

This concept was the outgrowth of Western economic development. It stemmed from Max Weber's formulation that consistency and reinforcement of norms provided by the law were essential elements in the industrial development of Europe.<sup>3</sup> Burg's study of the law and development literature cites five qualities in law which render it conducive to development: (1) stability; (2) predictability; (3) fairness; (4) education; and (5) the special development abilities of the lawyer.<sup>4</sup> The first two qualities are prerequisites for any kind of economic system to function. In the words of one scholar,

the law's greatest encouragement to economic development lies in its protection of the fruits of labor. . . . It is the security of expectations, assured by law in the form of institutions of property, that leads men to work, save, and invest. . . . The concern for security, *i.e.*, the concern for a development-conducive *state of mind*, must be a primary one for any government engaged in a massive social reform.<sup>5</sup>

The need for predictability is especially great in countries where most people are entering for the first time into economic relationships beyond their traditional social environment.<sup>6</sup> Included in the stability function is the potential of law to balance and accomodate competing interests.

Aspects of fairness, such as due process, equality of treatment, and standards for government behavior, have been emphasized by other writers as necessary for both the maintenance of the market mechanism and the prevention of bureaucratic excesses.<sup>7</sup> A lack of standards of fairness is said by some scholars to be one of the greatest problems confronting LDC's. In the long run, the lack of such standards may be the chief cause of loss of legitimacy by their governments. Conversely, by codifying societal goals, then creating new habits and responses,<sup>8</sup> law can foster feelings of nationality in many LDC's whose inhabitants previously were only conscious of belonging to a family or tribe.

Two means by which the lawyer's talents can be utilized for the purposes of economic development have been suggested.<sup>9</sup> For example, in the

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2. Merryman, *Comparative Law and Social Change: On the Origins, Style, Decline, and Revival of the Law and Development Movement*, 25 AM. J. COMP. L. 457, 462 (1977).

3. M. WEBER, *ECONOMY AND SOCIETY* (G. Roth and C. Wittich eds. 1968), discussed in Trubek, *Toward a Social Theory of Law: An Essay on the Study of Law and Development*, 82 YALE L.J. 1, 11-16 (1972).

4. Burg, *supra* note 1, at 507.

5. Karst, *Law and Developing Countries*, 60 LAW LIB. J. 13, 15-16 (1967).

6. Nyhart, *The Role of Law in Economic Development*, 1 SUDAN L.J. 394, 400 (1962).

7. Burg, *supra* note 1, at 508-09.

8. Nyhart, *supra* note 6, at 401.

9. See generally Friedmann, *The Role of Law and the Function of the Lawyer in the*

United States, the unique role of the judiciary has provided lawyers with opportunities to debate and decide policy issues in the courts. Also, lawyers' general ability to apply reasoned analysis to situations in all conceivable aspects has led to their serving in non-legal roles as community and national leaders. Indeed, this situation also seems to have occurred in the Third World, where many of the leaders of independence movements of India and elsewhere were trained as lawyers.<sup>10</sup>

The prevalent view in the 1960's was that law, particularly the legal system of the West, was a valuable instrument of development in LDC's. Customary law in the Third World was "antithetical to development."<sup>11</sup> Throughout the Third World there was clamor for new programs aimed at rapid development to take effect immediately.<sup>12</sup> And it was thought that the enactment of massive new legislation would be the most direct and inexpensive means of satisfying this need. As René David, the French legal scholar who was invited to Ethiopia to draft an entirely new civil code, explained: "Ethiopia cannot wait 300 or 500 years to construct in an empirical fashion a system of law which is unique to itself. . . . The development and modernization of Ethiopia necessitate the adoption of a 'ready made' system. . . ."<sup>13</sup> Western lawyers were told that they had an opportunity and duty to serve these new nations and bring them the fruits of their knowledge.<sup>14</sup> Governments and foundations of the United States and other Western countries soon took on this challenge and assigned lawyers to their foreign aid missions.

Unhappily, the wholesale importation of Western-style law has not measured up to expectations. Hindsight suggests that the major difficulty encountered might have been anticipated, had there been a serious comparative examination of the law/development relationship in Western countries. Such an analysis almost certainly would have revealed the extent to which the law depends on the sociocultural circumstances of the society it is supposed to govern.

Though early development lawyers were aware of the need to orient law reform to the societies they were trying to transform,<sup>15</sup> they did not foresee the extent to which their sensible-sounding reforms would be resisted.<sup>16</sup> That Europeans and Americans brought their own cultural biases to the developing world can be inferred from a glance at European recommendations for civil law systems in Turkey and Ethiopia, and at American recommendations for U.S.-style legal education in Brazil, India, and

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*Developing Countries*, 17 VAND. L. REV. 181 (1963).

10. See generally Friedmann, *On Legal Development*, 24 RUTGERS L. REV. 11 (1969).

11. Burg, *supra* note 1, at 502, 524.

12. *Id.* at 505-06.

13. David, *A Civil Code for Ethiopia: Considerations on the Codification of the Civil Law in African Countries*, 37 TUL. L. REV. 187, 188-89 (1963).

14. Burg, *supra* note 1, at 496.

15. Nyhart, *supra* note 6, at 407.

16. See generally Merryman, note 2 *supra*; Trubek, note 3 *supra*.

Korea.<sup>17</sup> Not only were the small groups of foreign experts unfamiliar with their target cultures, they also enjoyed an artificially privileged access to power. Together with immunity to the consequences of their actions, this may have led them to innovate in inappropriate ways.<sup>18</sup>

Development lawyers also underestimated the difficulties that new laws would encounter because of lack of infrastructural and educational facilities.<sup>19</sup> Moreover, lawyers in many LDC's are in a comparatively poor position to serve as agents for economic change because their fellow citizens regard them as "manipulators," "fixers," "professional liars," and "spouters of legalism," concerned only with their own financial gain.<sup>20</sup> Lawyers in many Latin American countries retain little popular trust because they historically have been seen as servants of the vested interests.<sup>21</sup> Even the most well-meaning lawyers may be ill-equipped to use the law for development purposes, since their training has generally involved memorization of statutes and principles without a broader understanding of law and society.<sup>22</sup>

Western legal concepts have not been much use in Third World development, according to Trubek, because of the fundamental differences in economic structure between the West and the Third World.<sup>23</sup> The Western legal systems are designed for a market economy, with law's role being to set limits on the behavior of actors so as to provide the necessary predictability for market transactions. Most LDC's see too much of a pressing need for rapid development to wait for the market to work, and the state is naturally looked to as the leader in achieving economic growth. Trubek suggests that aspects of a legal system for a "command economy" might be appropriate for many of these countries.<sup>24</sup> In such a system, legalism is generally replaced by state directives in production; law's function in the economy is mostly a regulatory one of controlling bureaucratic abuse.

Law reformers also do not seem to have taken into account the historical resentment of Third World inhabitants to colonial rule. The populations of many LDC's resented the imposition of unfamiliar foreign laws over their own traditional laws and have clung to their preindependence attitudes of resistance to authority.<sup>25</sup> What made this pattern especially

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17. See, e.g., Trubek, note 3 *supra*.

18. Merryman, *supra* note 2, at 480-81.

19. Burg, *supra* note 1, at 516-19.

20. *Id.* at 518.

21. See, e.g., Hager, *The Role of Lawyers in Developing Countries*, 58 A.B.A. J. 33 (1972); Rosenn, *The Jeito: Brazil's Institutional Bypass of the Formal Legal System and its Developmental Implications*, 19 AM. J. COMP. L. 514 (1971).

22. Murphy, *Legal Education and the Development of Law in Traditional Cultures: Learning from the Korean Experience*, 27 J. LEGAL EDUC. 234, 239 (1975); Hager, *supra* note 21, at 37.

23. Trubek, *supra* note 3, at 15-16.

24. *Id.* at 35-37.

25. Myrdal, *The "Soft State" in Underdeveloped Countries*, 15 UCLA L. REV. 1118,

difficult to overcome was the precarious leadership position of most LDC governments. They could not survive politically if strong measures were taken to compel adherence to new laws.<sup>26</sup>

Given these difficulties, advocacy of Western-style laws in LDC's has led to predictable results. A wide discrepancy, referred to as "the Gap" by Burg, has developed in these countries between the laws on the books and actual practices, and its manifestations can be seen throughout the Third World.<sup>27</sup> Seemingly sound and valuable programs in such areas as land reform either have not been enforced by complacent courts (aided by a complacent bar) or have brought little benefit, and sometimes harm, to agricultural sectors.<sup>28</sup> When the only legal precedents were from the West, the rule of stare decisis was of no more value to common law LDC's such as Tanzania and India than were the doctrines of Henry IV to Mr. Justice Holmes. Without relevant precedents to rely on, cases were often decided in these countries "based on expediency rather than law."<sup>29</sup> In Brazil, the gap between the law and actual practice has been so vast that it has given rise to a new class of people called *despachantes* (expeditors), whose professional duties are to help clients evade bothersome laws.<sup>30</sup>

The overall concept of the role that law can play in development has, therefore, narrowed in the minds of most analysts since the 1960's. This does not mean, however, that countries of the Third World need not endeavor to improve their legal systems. To the contrary, the lack of an effective legal framework has been a major factor in the continued stagnation of many of these countries. For example, the lack of observance or enforcement of the law in India may, according to Gunnar Myrdal,<sup>31</sup> be the root cause of that country's prolonged malaise. The heavy increase in corruption and terrorism that has affected so many LDC's is a natural result of this lack of an effective legal system. The drafting of a new legal code in China, intended to guarantee equality before the law and due process after thirty years of arbitrariness, is yet another indication that no society can mature without a legal framework that provides some degree of fairness, predictability, and stability.<sup>32</sup>

Thus, the problem that will continue to face LDC's is determining what type of improvements in their legal systems will speed the development process. Although lawyers experienced in economic development have not yet come up with any definitive answers, it is evident that some

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1123 (1968).

26. *Id.* at 1123-24.

27. Burg, *supra* note 1, at 511.

28. *Id.* at 514; Hager, *supra* note 21, at 34-35.

29. James, *Implementing the Arusha Declaration—the Role of the Legal System*, 3 AFRICAN REV. 179, 180 (1973), quoted in Hiller, *The Law-Creative Role of Appellate Courts in Developing Countries: An Emphasis on East Africa*, 24 INT'L & COMP. L.Q. 205, 245 (1975).

30. Rosenn, *supra* note 21, at 536.

31. Myrdal, *supra* note 25, at 1126.

32. CHINA BUS. REV., Nov.-Dec. 1979, at 45.

kinds of changes will be more effective than others. There is general agreement, for example, that a stable legal framework will tend to encourage foreign investment.<sup>33</sup> South Korea is one of several countries in East Asia which has successfully attracted foreign capital to assist in its development.<sup>34</sup> The Koreans offered not only a stable system of foreign investment laws but complete tax exemptions to all foreign firms for their first five years, as well as exemptions from foreign exchange restrictions.<sup>35</sup> Yet, as a 1970 study<sup>36</sup> of the effect of Ethiopia's modern code indicated, modern laws by themselves are not sufficient to attract foreign investment: "the existence of a modern legal system will not produce investment unless there are economic reasons for such investment, reasons that investment laws attempt to enhance."<sup>37</sup>

In other areas, LDC law reformers will have to pay more attention to the factors mentioned earlier which diminish the utility of Western-style law. It seems reasonable to suggest that in societies whose precepts are being shaken to their foundations, lawmakers should hesitate before discarding traditional laws. Admittedly, many of these rules are rooted in subsistence economies and do not address themselves to development needs.<sup>38</sup> Nevertheless, to replace these rules with unfamiliar and possibly inappropriate modern laws might undercut the stability that had existed previously. According to one commentator:

[G]iven the extent of rural-urban ties in Africa and the pluralistic behavior patterns of the African townsman, the *processes* of customary court dispute-settlement and the *nature* of customary law may be peculiarly well-suited to solving many of the legal and social (adjustment) problems encountered by individuals involved in the transition from rural to urban environments. In brief, customary courts and customary law may be important links in the modernization and urbanization processes.<sup>39</sup>

The astonishing success in economic development exhibited by Taiwan, Japan, Hong Kong, Korea, and Singapore may have some instructive value for development lawyers elsewhere. With the possible exception of Singapore, the economic booms experienced were unaccompanied by rapid changes in law.<sup>40</sup> In fact, the Chinese, Japanese, and Korean cul-

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33. Seidman, *Law and Economic Development in Independent, English-Speaking, Sub-Saharan Africa*, 1966 WIS. L. REV. 999, 1021, 1062 (1966).

34. Yoon, *Legal Aspects of Foreign Investment in the Republic of Korea*, 10 INT'L LAW. 729, 730 (1976).

35. *Id.* at 742, 745.

36. McCarthy, *African Investment Laws and Development Institutions—An Analogy to the Problems of the Ghetto*, 50 B.U. L. REV. 360 (1970).

37. *Id.* at 391.

38. Hager, *supra* note 21, at 34.

39. Smith, *Man and Law in Urban Africa: A Role for Customary Courts in the Urbanization Process*, 20 AM. J. COMP. L. 223, 237 (1972).

40. Burg, *supra* note 1, at 520. See also HAHM, *THE KOREAN POLITICAL TRADITION AND LAW* (1967); LAW IN JAPAN (A. von Mehren ed. 1963).

tures all are distinctively "non-legalistic." As late as 1972, Japan and Korea had only 8,000 and 700 practicing lawyers respectively;<sup>41</sup> moreover, much of the work of these attorneys is in international practice.<sup>42</sup> The lesson to be learned from this experience is not that law is unimportant in development. Order and obedience to authority, two of the hoped-for consequences of a rule of law, have been fundamental precepts in East Asia since the time of Confucius. Rather, the lesson is that law can be a useful tool in development as long as it makes use of the popular senses of fairness and stability that already exist in a society.

In countries where these developed senses of order and fairness do not yet exist, there will be a greater need for the promulgation of new laws. If these reforms are to be successfully implemented, there will have to be a means of bringing them to the general populace. One way of accomplishing this is to open up legal services clinics in poor or middle-class areas. The United States Government and some American foundations have recently become involved in funding legal services programs in Latin America. It is hoped that such programs will help to bridge the gap between "real" and "paper" laws in such areas as land and labor reform.

Another goal is to sensitize local law students to the legal problems of their society by instilling a greater sense of due process and the need for appropriate laws. The next generation of lawyers may then build a more responsive legal system. This idea is subject to the caveat that an improvement of the skills and capacity of lawyers could lead to more effective resistance to development from the still conservative legal profession.<sup>43</sup> Critics on the left view such programs as mere "Band-aids" to patch up substantive "infections" in existing laws, or leading merely to greater social stratification.<sup>44</sup> The suggestion of many writers that a more principled analysis of law and its role in society be included in Third World legal education also has merit.<sup>45</sup>

If nothing else, the law/development literature shows that there is no neat, orderly relationship between the legal structure of a country and its rate of economic growth. The experience of the past two decades has shown us that the Third World cannot wave away its problems with a magic legal wand and that the importation of laws from the West is not the answer to the legal problems of LDC's, even if their laws are hopelessly antiquated. Experience does seem to have shown, though, that LDC's need a stable and fair legal order if they are to develop, and that

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41. Murphy, *supra* note 22, at 244; OPPLER, *LEGAL REFORM IN OCCUPIED JAPAN* 107 n.32 (1976).

42. See generally *LAW IN JAPAN* (A. von Mehren ed. 1963); Huang, *Foreign Enterprise and Chinese Trademark and Patent Laws—A Digest-Commentary on Some Important Cases*, 12 INT'L LAW. 397 (1978).

43. Burg, *supra* note 1, at 527-28.

44. Valdez, *Legal Development and Social Change in Latin America and the Caribbean*, 62 A.B.A. J. 484, 485 (1976).

45. See generally Hager, *supra* note 21; Murphy, *supra* note 22; Nyhart, *supra* note 6.

lawmakers must be on guard to ensure that their laws are consistent with the needs and backgrounds of their constituents. If the law does not stay within these bounds, it may run so far ahead of its people as to lose its meaning.