

JUDICIAL REFORM AND ECONOMIC GROWTH: WHAT A DECADE OF EXPERIENCE TEACHES

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When asked to identify the essential conditions for economic growth, the founder of modern economics named three: Peace, low taxes, and “a tolerable administration of justice.” These three, he explained, were all that were necessary to “carry a state to the highest degree of opulence.”

Adam Smith’s stress on the importance of decently functioning courts, commercial codes, and the other ingredients that make for “a tolerable administration of justice” might seem obvious to traders, merchants, and those whose activities produce the opulence he believed every nation could achieve. Yet for almost 250 years his followers in the academy ignored it. When analyzing why some economies grew while others did not, economists typically paid little attention to the impact of courts, property titles, and other legal institutions. Their models assumed that if a contract was made, it would be enforced -- without cost or delay. They took it for granted that if one held rights to land, goods, warehouse receipts, patents, or other property, tangible or intangible, these rights would be protected from taking, by both the state and third parties.

Economic growth and a tolerable administration of justice

Only in the past decade or so have academics, policymakers, and others concerned about spurring economic growth begun to take Smith’s counsel seriously. Stung by the failure of stabilization, liberalization, and privatization to deliver sustained growth in so many different contexts, they have begun re-examining their assumptions. And as they have, they have realized that the protection of property rights and the enforcement of contracts, the essence of “a tolerable administration of justice,” is the one element poor countries across the board lack.

In an influential work appearing in 1990, Douglass North asserted that the inability to enforce contracts was the principal reason why some countries remained poor. Four years before receiving the Nobel Prize for his work illuminating the prerequisites for economic growth, he contended that the absence of low-cost means of contract enforcement was “the most important source of both historical stagnation and contemporary underdevelopment in the Third World” (1990, 54). Elaborating on this thesis at mid-decade, Oliver Williamson (1995) explained that when the judiciary is unable to enforce contractual obligations, a disproportionately large number of transactions occur in the spot market, where there is less opportunity for contract breach. Alternatively, firms circumvent the judicial system altogether. Purchasing their suppliers or customers or turning arms-length transaction into intra-firm ones. But in either case, the results are higher transaction costs and hence a “low-performance economy.”

Accumulating evidence reveals how “a tolerable administration of justice” underpins growth. Firms in Argentina and Brazil operating in provinces with better performing courts enjoy greater access to credit (Christini and Moya 2001). In Mexico larger, more efficient firms are found in states with better court systems (Laevan and Woodruff 2003). Entrepreneurs surveyed in Brazil, Peru, and the Philippines report that they would be willing to increase investment if they had greater confidence in their nation’s courts (Castelar-Pinheiro 1998; Sereno, de Diosa, and Capuano 2001; Herrero and Henderson 2004). The World Bank's Investment Climate Assessments finds that businesses in South Asia with confidence in the courts are far more likely to extend trade credit to customers and suppliers than those with little or no confidence in the courts.

Some of the most powerful evidence of the relationship between the quality of a nation's legal system and growth and development comes from Russia and other post-socialist countries. The bonds of trust arising from established relationships provide assurances that an existing supplier or customer will meet its obligations. But when doing business with a stranger, a firm is at much greater risk that it will not receive the promised goods or not be paid what it is due. One substitute for the trust built up over repeated transactions is confidence that the courts will uphold bargains, and surveys of Russian entrepreneurs as well as those in Poland, Romania and Slovakia show trust in courts is an important consideration in the decision whether to do business with a stranger (Johnson, McMillan and Woodruff 2002a). Russian entrepreneurs surveyed in 1997 expressed far less confidence in their nation's courts than those in Poland, Romania, and Slovakia and accordingly were much less likely to switch from an established supplier to a new, lower cost one or to deal with a new, unknown customer.

Paying less for inputs and selling more outputs are two ways firms increase productivity and hence boost growth. A third is through reinvesting profits in expanding operations. But if a firm is likely to have its operations seized by government or have to keep paying off government employees or "private enforcement agents" to stay in operation, why reinvest? Why not take the money and run?

Surveys show this is precisely how entrepreneurs in Russia, Poland, Romania, and Slovakia think. Those who believe their property rights are less secure are less likely to reinvest in their businesses than those who do (Johnson, McMillan, and Woodruff 2002b), and again, because Russian entrepreneurs feel their rights are less secure than

those doing business in Poland, Romania, and Slovakia, they are less likely to invest in expanding their firms than entrepreneurs in these countries.

Armed with evidence of this kind, policymakers, judges, and entrepreneurs in many developing and post-socialist nations, often with help from the international community, have sought to establish “a tolerable administration of justice.” And because capable, impartial courts are central to achieving this goal, judicial reform has been at the center of this effort. During the 1990s virtually every developing or post-socialist country initiated a program to reform courts and related entities.

Venezuela has reorganized judges’ offices, centralizing and streamlining tasks that used to be performed by clerks working for each judge. It also introduced computers and other information technology into the courthouse. The impact of these reforms in Barquesimeto and Ciudad Bolivar, the two cities where they were piloted, are shown in the table below. In both, the median time to resolve contract and debt collection cases have fallen sharply.

Table 1 Reforms speed up business in Venezuelan courts

(days from initiation to termination)

City

Case type	Barquesimeto		Ciudad Bolivar	
	Before	After	Before	After
Contract	242	127	368	180
Debt collection	790	237	744	242

Source: Supreme Court of Venezuela.

In Tanzania a specialized branch of the High Court was created to hear commercial matters. Although filing fees are higher than the ordinary courts, to which litigants can also turn, its caseload continues to grow while the time it takes to resolve disputes remains under eight months (Tanzania High Court 2003). Lawyers who appear before it report cases are decided accurately while litigants are treated with respect.

But despite successes such as these, most of the early reviews of judicial reform projects have been disappointing. Evaluators claim they have been too ambitious, too naïve to the social and political environment, poorly designed, and lacking reliable indicators of impact (Blair and Hansen 1994; Lawyers Committee 1996; Carothers 2003; Hammergren 2003; Heller 2003). Like those who criticized the effort in the 1960s to help Latin American African states reform their legal systems, these critics may be forgetting how long it takes for change to manifest itself. Their criteria for “success” may also be too ambitious. But whatever the debate about these questions, there is no argument that much has been learned from the judicial reform work of the 1990s.

Lessons from judicial reform projects

1) Judicial reform is much harder than initially predicted. Reforming courts and related institutions has proved to be a far greater challenge than originally thought. Early reform projects enthusiastically predicted that significant results could be quickly achieved. A 1995 World Bank loan to Bolivia, where the courts were in tatters, promised dramatic changes within five years. A 1997 model court project in Argentina forecast the rapid development of new methods and procedures for managing courts and case flow. In neither instance have the results been anywhere close to these predictions. The Bolivian project produced only modest results, and six years after the Argentine project was approved it remains stalled thanks to infighting among the political parties (Dezalay and Garth 2002). Nor are these the only two projects where designers made ambitious predictions of swift, comprehensive reform (Guttmann 2002, 28; World Bank 2003a; Jensen 2003).

Demonstrated success with narrowly targeted interventions have also been elusive. Almost a decade and a half after the Bank backed the Bangladeshi effort to create separate debt collection courts, they remain largely ineffective. Nor have similar attempts to establish commercial courts in Rwanda, Cape Verde, Bangladesh, Pakistan, and Cote d'Ivoire produced results. In every case, donors and local policymakers underestimated the challenges involved.

2) Projects cannot be developed on the cheap. Most judicial reform projects in the 1990s were developed on the basis of limited information. Rather than sponsoring efforts to secure comprehensive data on the number of filings, processing times, outcomes, and other quantitative measures of system performance, policymakers opted

for short-term, inexpensive assessments. Typically a desk review of local procedures was complemented by interviews with judges, lawyers, and other close observers of the system. In some instances surveys of court-users were conducted, and, as the importance of a participatory process became evident, these sources were supplemented with information gathered in workshops with judges, non-judicial personnel, lawyers and litigants.

But information gleaned from such sources is no substitute for quantitative data on system performance. Because of cognitive biases and other quirks in how humans perceive the operation of large, complex systems, reliance on perception data produces a highly skewed picture of court operations (Kritzer 1999). When only this kind of information is available, project designers are reduced to crafting interventions on the basis of the conventional wisdom, but as recent work in Argentina and Mexico has shown, what “everyone knows” about how the courts are performing is often wrong (Hammergren 2002). Finally, without empirical data on court performance, no baseline data is available against which to measure changes in performance over the life of a project.

The investment in collecting and analyzing performance data is substantial, even in developed countries, and policymakers anxious for quick victories have until recently been reluctant to take the time and commit the resources required. As its importance for a successful intervention has grown, however, this has begun to change. The Asian Development Bank recently spent \$1 million and a year helping the Pakistan judiciary prepare a judicial reform project. Much of that effort involved culling through case files to compile data on case type, time to disposition, number of continuances, amount in

controversy, outcome, and other variables essential for evaluating performance. Starting in 1999 the World Bank began financing similar exercises and has now completed studies in the Dominican Republic, Mexico, Argentina, and the Philippines. As judicial reform in Russia has progressed, reformers have also come to appreciate the need for an intensive review of court operations and begun collecting detailed information to guide the reform process.

Such exercises have in every case produced information crucial to devising a reform program. In the Philippines, where the courts are overloaded with cases, an early view was that the solution lay in more judges and more courts. But the data show that almost one-half of the cases brought to the courts are flimsy criminal cases that cannot withstand judicial scrutiny. Requiring the public prosecutors do a better job of screening out cases that should not be brought could thus cut the courts' workload in half!

3) Altering incentives is crucial. At the start of the 1990s, judiciaries in virtually every developing and transition nation confronted a host of similar problems: decrepit buildings, inadequate equipment, poorly-trained and underpaid judges and support personnel, cumbersome procedures, and poor management of personnel and physical resources. Not surprisingly, early projects aimed directly at curing these ills. Funding was supplied to renovate courthouses or construct new ones; judges and court clerks were trained, and consultants in civil procedure and management sent to devise and help implement change.

But, in common with the experience with reforms to other public sector institutions during the 1990s (World Bank 2000), most of these interventions produced little change (Burki and Perry 1998; Carothers 1996; Blair and Hansen 1994; GAO

1993). As experience with judicial reform grew, it became clear that the roots of poorly performing courts lay much less in a lack of resources and skills and much more in the behavior of judges, clerks, lawyers, and litigants. Reforms to the courts in India offer a well-documented example. An enormous number of tribunals have been created to handle civil service, tax, land, and consumer cases. Reformers thought that by taking these cases out of the regular civil courts they would lessen the demands on these courts and hence speed the disposition of accident, contract, and other cases. But as several studies document, creating more courts has had little effect (Moog 1997). The reason is that lawyers, clerks, and many litigants have an interest in court delay, an interest that reasserts itself once a new court or tribunal is created. Until the incentives that give rise to this interest are changed, it will matter little how many new courts are established.

Changing behavior requires changing the incentives the actor faces. As the importance of changing incentives has become clear, judicial reformers have begun searching for ways to alter them. A common one has been greater transparency to hold up to scrutiny, by fellow judges and the public alike, the performance of judges. This has dovetailed with the increasing emphasis on quantitative performance indicators and the introduction of information technology which makes data on caseloads and disposition rates of individual judges readily available. A second step has been to overhaul disciplinary rules to deter judges and clerks from accepting bribes or engaging in other wrongful acts.

The experience of the 1990s has shown that judicial reform demands more than a change in the incentives of judges. In the Cote d'Ivoire the principal stumbling block to judicial reform have been the incentives of the *greffiers*, court clerks in charge of

registering and enforcing judgments. Under the current system, where they take percentage of registration and enforcement fees, they have absolutely no reason to want to reduce them to levels that would make the courts more accessible (Berg and others 2001, 424-25). India is only one of many countries where lawyers draw out cases for personal reasons (Botero and others 2003, 67-68). Reformers have recently begun to address these issues, and in fact a World Bank assessment of the judicial system in Slovakia devotes considerable attention to the incentives facing Slovak lawyers (World Bank 2003b).

4) Speedier case disposition alone is not reform. In many nations a principal objective of initial reforms was the reduction in the costs and time needed to bring civil cases to an end. Anecdotes, and fragmentary data from some court systems, suggested that cases involving even very small amounts could take years, if not decades, to resolve and that the costs often exceeded the amount in controversy. Early projects thus sponsored a variety of interventions to reduce costs and delay: case management systems, support for small claims courts, more judges and courts.

With the growing availability of data on court caseloads in developing and transition countries, reformers have begun to recognize that reform requires more than simply speeding the disposition of existing cases. The type of cases a nation's courts resolve represent the sum of a variety of policy choices about where to locate court houses, how much to charge for filing a case, and indeed whether to even hear certain disputes. Were the United States to treat claims arising from automobile accidents and medical malpractice as insurance matters rather than court cases, many states could sharply reduce spending on their courts.

The question in every case is: Given the limited resources available for courts, does their current caseload reflect the best use of their resources? In Costa Rica almost half the cases filed involve traffic tickets (Costa Rica 2004). In Chile, a comparison of what citizens consider their major needs and the courts' caseload shows a wide divergence (Enrique Vargas, Peña, and Correa 2001, 96).

What those seeking to enhance the performance of developing country courts are learning is a lesson developed country reformers earlier discovered. Surveying reforms to civil justice systems in Europe in the 1970s and 1980s, one close student observed: "It is difficult to avoid the conclusion that a great deal of effort has been directed to the reduction of costs and delay, but little, if any, to an understanding of what it is that should be done more cheaply and expeditiously" (Jolowicz 1983). Again, only with a better understanding of what courts are actually doing today can reformers decide what they should do better and faster and what they should not be doing at all.

5) Too little attention was paid to how alternative means of resolving disputes complement courts. Judicial reform projects under-estimated the role of institutions besides courts in resolving disputes. Arbitration, mediation, and other forms of alternative dispute resolution methods can channel disputes away from the courts, yet many reforms ignored the obstacles parties wishing to arbitrate or otherwise turn to an alternative to the courts faced. Laws in several Latin American countries provide that only lawyers may serve as arbiters, but one reason firms in developed countries turn to arbitration is that they can select an engineer or other expert with the relevant technical knowledge, to resolve the case.

Another common obstacle is uncertainty over how to enforce an award when the losing party declines to comply voluntarily. In Russia, it was only with the recent changes in the procedures governing the arbitrazh courts that the law made it clear that these courts, and not the ordinary civil courts, have the exclusive responsibility for enforcing arbitration awards.

At the same time, reformers largely ignored that many disputes could be avoided altogether if more information were available on the creditworthiness and reliability of potential contracting parties. Reputation is central to assuring contract performance in all societies. As the survey of Russian and other transition country firms discussed above showed, in deciding whether to contract with a new partner, businesses are guided by what they know about the potential partner's history of complying with contractual obligations. A firm is more likely to contract with those who have a good reputation. Indeed, in both industrial nations and developing and transition states, various entities have emerged to meet the demand for such information. These organizations collect information on the creditworthiness and reliability of individuals and firms and sell it to financial institutions, industrial companies, and others in the business community. Those who contemplate breaching their obligations know that if they do, all will soon know.

Yet laws in many countries restrict the free flow of reputation information by, for example, preventing state-run banks from disclosing records on loan defaults or barring courts from releasing information about commercial disputes. Too often judicial reformers have ignored how improving the flow of accurate data bearing on creditworthiness could complement the role of the courts in improving contract compliance.

Conclusion

The decade plus experience with judicial reform in developing and post-socialist states has taught us much. If we have learned that it is hard, we have also learned that progress can be made, as the examples from Venezuela and Tanzania show. Most reassuringly, evidence from entrepreneurs in Russia, Poland, Romania, and Slovakia, as well as from other countries, shows us perfection is not required to realize improvements in the business climate. The courts in Poland, Slovakia, and Romania surely are nowhere close. But as the confidence entrepreneurs in these countries have in their national court systems has grown, their output and productivity has increased as well. And with that so too has national wealth and well-being.

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