



THE RULE OF LAW AND  
ECONOMIC DEVELOPMENT

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# RULE OF LAW AND ECONOMIC DEVELOPMENT:

## A Comparative Analysis of Approaches to Economic Development across the BRIC Countries

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# PREFACE:

Reinvigorating the faculty's longstanding research interests in Russian legal development, this report is the outcome of a partnership over the past year between the Faculty of Law at McGill University and the Center for Legal and Economic Studies (CLES), based in Moscow. The report complements a larger broad-based study involving contributions by notable legal scholars including Roderick A. Macdonald (McGill University), Peter Solomon (University of Toronto), David Lametti (McGill University), René Provost (McGill University), and Fabien Gélinas (McGill University). The primary goal of this partnership for the faculty is to support the work of CLES by channelling Canadian and foreign expertise in a range of areas to advance transparency, accountability, and good governance in Russia. CLES is committed to strengthening the rule of law, with an emphasis on the modernization of Russian criminal law and law enforcement practice to spur and sustain much-needed economic development. By drawing on McGill's position as a centre of comparative and foreign law expertise, the faculty has sought to advance research on the interplay between legal and economic development in transition economies.

Following two decades of transition to a market economy, Russia has weak political and economic institutions, rampant corruption, and lack of transparency and democratic accountability at all levels of government. This weak rule of law continues to undermine Russia's ability to realize its economic potential. In particular, ideological hostilities against entrepreneurial activities remain a significant hindrance to the development of a modern and diversified economy. However, recognition of Russia's increasingly strategic profile in various international fora, including its recent entry into the World Trade Organization, offer tremendous potential and long-awaited opportunities for the country to establish itself as a global economic player. The Russian context, marked by external opportunities, and internal tensions and challenges, provides the impetus to examine more closely the various dimensions of rule of law and its relationship to economic development. Specifically, if the Russian state were to engage in tangible actions to foster the rule of law, how might such efforts sustain much-needed economic growth?

In order to accomplish this goal, it became apparent that our inquiry ought to incorporate other transition and emerging economies to devise a comparative lens to examine commonalities across each and enable us to highlight contextually specific issues. Through interdisciplinary research across Brazil, Russia, India, and China (the so-called BRIC countries), our objective is not to prescribe models of transplantation, but rather, to compare the systems and structures in which law operates, and evaluate the current climate of rule of law and its relationship to economic development within each country. Six main components of rule of law engage distinct lines of inquiry: an introductory overview of rule of law and economic development, key aspects of governance, the quality of institutions, the role of the judiciary, the prevalence and effects of corruption, and media and civil society organizations. This report hopes to address both the direct and indirect links between these components and economic development. There is also a particular focus on media and civil society since the last decade has revealed the extent to which these two elements have increasingly served as tools to counter traditional aspects of governance and address democratic accountability. As the literature points out, they have been more effective in some contexts than others.

Our methodology presents an interpretation of existing theoretical and empirical literature. While a comparative lens was often employed to draw out sharp contrasts

and overlap across the BRIC countries, points of critical importance were highlighted within each country across the six sections, thereby deviating from the confines of a traditional comparative study. Given the nature of the study and the particularities across each country, from historical, economic, cultural, and social factors and the variance in political regimes, ranging from Brazil's new democracy to China's one-party authoritarian state, this methodology exposed salient points of intersection. A core unifying theme is that each of these regimes has witnessed enormous strides in economic development in recent years. Our research aims to provide an in-depth analysis of the complex and nuanced relationship between rule of law and its impact on sustainable economic growth. In the Russian context, the need to foster rule of law remains a critical challenge in pursuit of much-needed sustainable growth. It is hoped that this research may reveal key components for reform to facilitate this goal.

A cautionary note must acknowledge the limitations of this report's scope. Given the complexity of the issues and the nature of the economies examined, it is not an exhaustive study. Existing literature points to these challenges. Anecdotal evidence and current events provide rich sources for discussion and analysis. For this reason, this report does not attempt to provide a full account of each line of inquiry. At best, it is a cross section of important issues we think are essential for fostering rule of law with the aim of promoting economic development. Despite the inherent overlap across components of rule of law, each section is an independent inquiry.

The six sections of the report are summarized as follows.

## SECTION 1: AN INTRODUCTORY OVERVIEW OF RULE OF LAW AND ECONOMIC DEVELOPMENT ACROSS THE BRICS

This section establishes relevant events, agencies, and literature that have propelled the rule of law and economic development inquiry onto the world stage. This introduces our focus on institutions and their impact on economic development. This section is premised on Douglass North's definition of institutions as a set of rules of the game designed to constrain behaviour. A brief overview of the political structures across the BRICs is followed by a current assessment of rule of law within each country and concludes with an economic overview of each, with particular focus on sustainable economic growth.

## SECTION 2: GOVERNANCE ACROSS THE BRICS

Tracing the emergence of the term "good governance" and establishing the political form of governance structures across the BRIC countries, this section then delves into selected substantive political issues. For example it examines the political function of state capitalism that marks, in varying degrees, the approaches taken in Brazil, Russia, and China. We examine various indices for evidence of each state's progression, through both a development and economic lens. Within the political sphere, notable examples offer insight into the current state of accountability and transparency and the effectiveness of governance processes across the BRICs.

### **SECTION 3: EXAMINING THE QUALITY OF INSTITUTIONS ACROSS THE BRICS**

A significant component of this section provides an overview of empirical literature that has attempted to measure institutions and highlights why evidence suggests the primacy of institutions over policy. This leads into a discussion on political economy where scholars have emphasized that sustainable economic growth ultimately requires political change and pointed to the importance of political institutions over economic institutions to influence a country's capacity for reform. The interplay of both formal and informal institutions reveals variants of systems and mechanisms. Cross-country studies on firm entry processes sheds light on the differences across the BRIC economies to help reveal potential strategies for reform.

### **SECTION 4: THE JUDICIARY ACROSS THE BRICS – INSTITUTIONAL VALUES AND JUDICIAL AUTHORITY AT THE INTERSECTION OF GOVERNANCE**

A foundational discussion on judicial authority and judicial independence feeds into case studies on Brazil, Russia, and China, which is then followed by an in-depth comprehensive examination into India's judiciary. The section emphasizes the necessary interplay between judicial independence and accountability, a key area of reform targeted by anti-corruption efforts, along with the potential for judicial institutions to act as a key check on the executive and legislative branches of government. A comprehensive look at India's judiciary, which has exemplified many of these ideals, critically examines the distinct challenges facing judicial reform. This includes current attempts to help improve the effectiveness and efficiency of service delivery, particularly with respect to high-value economic disputes. This discussion brings together various components of rule of law examined in this report including the need to improve the quality of judicial institutions, the judiciary's role in governance, judicial accountability with anti-corruption efforts, and the role of the media.

### **SECTION 5: CORRUPTION ACROSS THE BRICS**

Adopting a workable definition for corruption, this section examines different types of corruption including petty corruption, mid-level corruption, and informal patronage networks that influence business transactions, including the effect of corruption on foreign investors. While high levels of corruption plague each of the BRIC countries, the scale and nature of corruption varies across each. Of notable mention is the finding that the type and scale of corruption appears to be shifting. With the exception of India perhaps, corruption appears to be moving from petty transactional corruption to complex cases of political influence peddling, mutual exchange, and state capture. The interplay between corruption, tax evasion, and capital flight reveals that weak enforcement of existing domestic legislation is further exacerbated by inadequate international cooperation. While the BRIC states are increasingly cognizant of corruption's economic repercussions, varying degrees of lack of political will undermines anti-corruption efforts. For example, China, Russia, and India's political leadership have consistently undermined institutional accountability by weakening the independence and effectiveness of their anti-corruption institutions. A database of relevant international and domestic laws and agencies accompanies this section to provide a valuable resource to assess the current state of local and international sources of anti-corruption efforts.

### **SECTION 6: MEDIA AND CIVIL SOCIETY**

In recent years, media and civil society organizations have occupied an increasingly prominent role in the development process, as integral components to help advance sound political institutions and support economic reforms. In a critical appraisal of literature in this emerging area, along with selected case studies, this section examines how responsible media and effective civil society might help foster institutional accountability, curb corruption, and enhance legitimacy and popular support for development initiatives in emerging economies. Importantly, traditional media and new media are examined independently. Finally, we assess the implications of state control of media and civil society across the BRIC countries.

# SECTION 1:

## An Introductory Overview to Rule of Law and Economic Development across the BRICs

### INTRODUCTION

*Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government.*<sup>1</sup>

From a theoretical perspective, definitions of the rule of law range from minimalist to comprehensive, and exist along a wide continuum of conceptions that can be framed as institutional, procedural, or aspirational in nature.<sup>2</sup> There are, however, some general principles to which the rule of law can be held up to. In *The Morality of Law*, Lon Fuller's renowned text promulgates eight principles of legality that capture the basic essence of the rule of law: 1) laws must be of general application (i.e. specifying rules prohibiting or permitting behaviour of certain kinds), 2) laws must be widely promulgated or publicly accessible to ensure that citizens know what the law requires, 3) laws should be prospective in application, 4) laws must be clear and understandable, 5) laws must be non-contradictory, 6) laws must not make demands that are beyond the powers of the parties affected, 7) laws must be constant and not subject to frequent changes, 8) laws must reflect congruence between rules as announced and their actual administration and enforcement.<sup>3</sup> These eight criteria of generality, publicity, non-retroactivity, clarity, non-contradiction, constancy, and congruity specify necessary conditions for lawmaking, which is "the enterprise of subjecting human conduct to the governance of rules."<sup>4</sup> Joseph Raz borrows from Fuller's formal components to include principles of institutional design, namely the guaranteed independence of the judiciary, the principles of natural justice, judicial review, and access to justice.<sup>5</sup> Brian Tamanaha states that the rule of law exists, in its most basic terms, when government officials and citizens are generally bound by and

<sup>1</sup> Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Chicago: Encyclopædia Britannica, 1952), 403.

<sup>2</sup> Maggie Gorman Vélaz, "Literature Review on the Rule of Law," (Ottawa: International Development Research Centre, 2009). See also M. J. Trebilcock and Ronald J. Daniels, *Rule of Law Reform and Development: Charting the Fragile Path of Progress* (Cheltenham: Edward Elgar, 2008). Trebilcock and Daniels sort definitions into categories described as "thick" or "thin" rule of law.

<sup>3</sup> Lon L. Fuller, *The Morality of Law* (New Haven: Yale University Press, 1964), 39.

<sup>4</sup> *Ibid.*, 106; See also Rachel Kleinfeld, "Competing Definitions of the Rule of Law," in *Promoting the Rule of Law Abroad: in Search of Knowledge*, ed. Thomas Carothers (Washington, DC: Carnegie Endowment for International Peace, 2006), 31-74.

<sup>5</sup> Joseph Raz, "The Rule of Law and Its Virtue," in *The Authority of Law: Essays on Law and Morality*, ed. Joseph Raz (New York: Clarendon Press, 1979), 214-18. Raz retains components such as generality, publicity, clarity, and constancy, and adds principles of institutional design. Like Fuller, Raz frames the rule of law as a feature of legal systems which enables the law to actually guide the behaviour of individuals.

abide by the law.<sup>6</sup> Through this lens, the fundamental, instrumental virtue of a legal system is therefore manifest as the rule of law.

This minimalist or "thin" approach to rule of law lies in its abstraction from legal and institutional details – a variety of different socio-cultural arrangements are compatible and even when institutions vary widely, the end goals of the rule of law can be achieved.<sup>7</sup> More comprehensive or "thick" conceptions of the rule of law tend to link the concept to rights, democracy, equality, or justice.<sup>8</sup> Trebilcock and Daniels caution, however, about the risks of associating rule of law with concepts such as justice, or other highly subjective terms, and treating them as universal and self-evident.<sup>9</sup> Moreover, in the context of comparative scholarship, sorting out what is relevant or not is also necessary.<sup>10</sup>

The core of rule of law lies in the legitimacy, predictability, and uniformity which laws are created, applied, and enforced, rather than a normative assessment of those laws' substance. This inquiry is therefore centered on a minimalist, procedurally oriented rule of law, which draws on empirical measurement to characterize and define the rule of law. In the first iteration of the annual *Governance Matters* reports in 1999, Kaufmann et al. describe the rule of law indicator as summarizing in broad terms the citizen's and state's respect for the institutions that govern their interactions,

in 'rule of law' we include several indicators which measure the extent to which agents have confidence in and abide by the rules of society. These include perceptions of the incidence of both violent and non-violent crime, the effectiveness and predictability of the judiciary, and the enforcement of contracts. Together, these indicators measure the success of a society in developing an environment in which fair and predictable rules form the basis for economic and social interactions.<sup>11</sup>

In turn, for the purposes of clarity, we adopt Douglass North's definition of institutions as a set of rules, compliance, procedures, and norms that are "designed to constrain the behaviour of individuals in the interests of maximizing the wealth or utility of principals."<sup>12</sup> This takes an instrumental approach for institutions that is broadly defined to include both formal and informal institutions, including those that are endogenous.

A key debate surrounding the rule of law is whether or not it can be an end in itself or a tool with which to attain greater goals or objectives. Voluminous theoretical and empirical studies in recent years have attempted to isolate the precise nature of its causal relationship to development, most of which have produced uneven results.

<sup>6</sup> Brian Z. Tamanaha, "The Primacy of Society and the Failures of Law and Development," *Legal Studies Research Paper Series No 09-0172*, (St John's University, School of Law, 2009), 9.

<sup>7</sup> Kevin E. Davis and Michael J. Trebilcock, "The Relationship between Law and Development: Optimists versus Skeptics," *American Journal of Comparative Law* 56, no. 4 (2008), 913-4.

<sup>8</sup> Guillermo O'Donnell, "Why the Rule Of Law Matters," *Journal of Democracy* 15, no. 4 (2004), 32. O'Donnell describes the need for a democratic rule of law that ensures political rights, civil liberties, and guarantees of a democratic regime that upholds rights, equality, and accountability. See also Amartya Sen, *The Idea of Justice* (Cambridge, Mass.: Belknap Press of Harvard University Press, 2009), 77-86. Sen acknowledges the instrumental potential of institutions in the pursuit of justice but emphasizes that the primary focus should be on the actual impact of institutional arrangements on peoples' lives, rather than on the objective quality of the institutions themselves).

<sup>9</sup> Trebilcock and Daniels, *Rule of Law Reform and Development*, 19.

<sup>10</sup> Xin Ren, *Tradition Of The Law and Law Of The Tradition: Law, State, and Social Control In China* (Westport, Conn.: Greenwood Press, 1997), 7. Xin points out, for example, that while the individual's right to privacy is at the heart of Western civilization, it has literally no legal status in Chinese traditional law.

<sup>11</sup> Daniel Kaufmann et al., *Governance Matters II: Updated Indicators For 2000-01*, vol. 2772 (World Bank Publications, 2002), 6.

<sup>12</sup> Douglass Cecil North, *Structure and Change in Economic History* (New York: Norton, 1981), 201-2. See for comparison Edward L. Glaeser et al., "Do Institutions Cause Growth?" *Journal of Economic Growth* 9, no. 3 (2004). Glaeser et al. argue that property rights do not constrain actors, they result from other institutions or policy choices.

While some evidence exists on how the rule of law interacts with development, a large part of the debate is about how to go about it, rather than whether it has the potential to promote development.<sup>13</sup>

While it is widely assumed that the rule of law is essential for economic growth, Haggard and Tiede emphasize that the rule of law is clearly a multi-dimensional concept that encompasses a range of distinct components, from security of the person and property rights, to checks and balances on government and control on corruption.<sup>14</sup> Empirical work demonstrates the substantial efforts to devise adequate empirical measures of rule of law, from subjective indicators (i.e. evaluations of experts or citizens or those that make up aggregate indices) to more objective ones (i.e. proxies designed to capture features of the institutional and legal environment). The relative benefit of either type of indicator has been an ongoing point of controversy. On the one hand, there is a risk of bias with subjective measures,<sup>15</sup> while on the other hand, there is the risk that objective measures may have no bearing on how the institution actually works.<sup>16</sup> Haggard, MacIntyre, and Tiede describe the complexity of this task, stating:

Security of property rights and integrity of contract underpin, respectively, investment and trade, which in turn fuel economic growth and development. However, property rights and contracts rest on institutions, which themselves rest on coalitions of interests. Formal institutions are important, but, particularly in developing countries, informal institutional arrangements play a significant part as well.<sup>17</sup>

When framed in such terms, the overlap between formal and informal institutions comes into play alongside both technical and political considerations, which collectively manifest and interact under the rubric of rule of law. Moreover, and perhaps unsurprisingly, whereas rule of law measures are tightly correlated across advanced industrial states, in the developing world measures are much more heterogeneous.<sup>18</sup> An objective of this inquiry, however, will focus on the nature of emerging and/or transitional economies, both independently and in relation to each other.

A brief overview of the external and internal factors that led to the recent surge of interest in the relationship between the rule of law and economic development is necessary to better understand the confluence of developments that occurred over the last fifty years.

Economic development, described broadly, connotes the progressive transformation of a society and its economy. Modernization theorists of the 1950s and 1960s framed it as converting traditional society to a modern society. Traditional societies were characterized by subsistence agriculture and/or the bulk of a few primary commodities. Modern societies are where growth of per capita income is internalized in the social and economic system, through mechanisms that promote accumulation

of capital, technological improvement, and growth of a skilled labour force.<sup>19</sup> In the late 1960s, in the push to modernize poor countries, development economists were focused on closing the gap between East/West and North/South countries. Thereby three axes were promulgated: Political stability, described as reasonable impartiality of governmental administration; a legal institutional framework to lessen non-economic risk; and a social system that permits mobility of all kinds and depersonalizes economic and social relationships.<sup>20</sup> The latter half of the 20<sup>th</sup> century focused on modernization and self-sustaining growth for developing countries, placing trade and related financial measures at the forefront of fundamental restructuring for less developed countries. The rise of the Washington Consensus in the 1980s amplified these efforts under the International Monetary Fund.<sup>21</sup> The Washington Consensus espoused an economic orthodoxy establishing three key requirements for success: macrostability, liberalization (specifically lowering tariff barriers and market deregulation), and privatization.<sup>22</sup> Such comprehensive reform policies were a universal package to develop regimes suited for participation in the global market economy.

The fall of communism, particularly the Soviet Union, saw nations transition to market economies. This transition spurred legal reforms deemed necessary for domestic and international markets. Formerly government-held economic assets were sold into private hands, often at low prices, to insiders. This raised the spectre of unfair practices, corruption, and asset grabbing and prompted calls for better laws and institutions. Correspondingly, in the push for financial liberalization, the speculative nature of capital flows changed course with increasing deregulation. Inflows to emerging markets became short-term and highly volatile, precipitating what would become known as the 1997 Asian financial crisis. This was despite the fact that Asia had sound fundamentals such as budget surpluses, high savings rates, low inflation, a stable currency, liberalized trade, and a vast private sector. Thus, the blame was placed on weak institutional frameworks, namely lax financial regulation and enforcement, which equally renewed the call for economic-related legal reform.<sup>23</sup>

During this time, divergence in growth across countries increased significantly from 1980 to 1994. Growth in per capita GDP averaged 1.5 percent in advanced countries, 0.34 percent in less developed countries, and 0 percent in the poorest countries.<sup>24</sup> And yet, annual growth rates in per capita GDP across less developed economies from 1960 to 1990 ranged from negative 2.7 percent to positive 6.9 percent, while growth rates for developed economies showed convergence.<sup>25</sup> Such results, in the words of Pritchett, “imply that almost nothing that is true about the growth rates of advanced countries is true of developing countries, either individually or on average.”<sup>26</sup> This was further confirmed by the dramatic strides in economic development by countries, such as China and India, while many others were falling further behind. Aid money given to these countries to fund economic development programs often ended up in the overseas bank accounts of public officials or spent on purchasing arms for

<sup>13</sup> Davis and Trebilcock, “The Relationship Between Law and Development,” 917.

<sup>14</sup> Stephan Haggard and Lydia Tiede, “The Rule of Law and Economic Growth: Where are We?” *World Development* 39, no. 5 (2011).

<sup>15</sup> Glaeser et al., “Do Institutions Cause Growth?”

<sup>16</sup> Haggard and Tiede, “Rule of Law and Economic Growth” (2011), 676. See also Marcus J. Kurtz and Andrew Schrank, “Growth and Governance: A Defense,” *Journal of Politics* 69, no. 2 (2007). For an empirical critique of the World Bank’s governance indicators, see Arndt and Oman’s work where the authors call into question whether governance, and by extension the rule of law indicator, may be evaluated positively due to the observed outcome rather than institutional causes; Christiane Arndt and Charles Oman, *Uses and Abuses of Governance Indicators* (Paris: Development Centre of the Organization for Economic Co-operation and Development, 2006).

<sup>17</sup> Stephan Haggard et al., “The Rule of Law and Economic Development,” *Annual Review of Political Science* 11, no. 1 (2008), 205.

<sup>18</sup> Haggard and Tiede, “Rule of Law and Economic Growth” (2011), 677.

<sup>19</sup> Harry Gordon Johnson, *Economic Policies Toward Less Developed Countries* (Brookings Institution, 1967), 44-6.

<sup>20</sup> Stanley D. Metzger and John Carey, “Law and Policy Making for Trade Among ‘Have’ and ‘Have-not’ Nations; Background Paper and Proceedings” (paper presented at the 11th Hammarskjöld Forum, Dobbs Ferry, N.Y., Published for the Association of the Bar of the City of New York by Oceana Publications, 1968), 6. This was promulgated in the lead up to the second United Nations Conference on Trade and Development in New Delhi in 1968.

<sup>21</sup> John Williamson, *Latin American Adjustment: How Much Has Happened?* (Washington, DC: Institute for International Economics, 1990); “Unraveling the Washington Consensus: An Interview with Joseph Stiglitz,” in *Multinational Monitor* 21 no. 4, (April 2000) online: <<http://multinationalmonitor.org/mm2000/00april/interview.html>>. Largely formulated out of experience with Latin America, the Washington Consensus was formulated in Washington in 1989 among members of the IMF, the US Treasury Department, and the World Bank.

<sup>22</sup> “Unraveling the Washington Consensus: An Interview with Joseph Stiglitz.”

<sup>23</sup> Tamanaha, “Primacy of Society,” 15.

<sup>24</sup> Lant Pritchett, “Divergence, Big Time,” *The Journal of Economic Perspectives* 11, no. 3 (1997), 14.

<sup>25</sup> *Ibid.*

<sup>26</sup> *Ibid.*



the military.<sup>27</sup> Improving the legal system therefore offered the possibility to restrain corruption. In 1997, Pritchett emphasized that “while it is conceivable that there is an all-purpose universal theory and set of policies that would be good for promoting economic growth, it seems much more plausible that the appropriate growth policy will differ according to the situation.”<sup>28</sup> The rise of the theory of new institutional economics in the 1990s, led by Nobel Prize winning economic historian Douglass North, acknowledged that economic principles and their institutional embodiment must give due recognition to variance in form and context,

economies that adopt the formal rules of another economy will have very different performance characteristics than the first economy because of different informal norms and enforcement. The implication is that transferring the formal political and economic rules of successful Western economies to third-world and Eastern European economies is not a sufficient condition for good economic performance.<sup>29</sup>

Critics urged the fundamental misguidedness of the original Washington Consensus recipe, with its narrow economic strategies and excessive preoccupation on increasing the GDP, rather than on more inclusive concepts such as equitable growth or even acknowledgement of alternative approaches.<sup>30</sup> For example, China has been the most successful economic performer in recent decades and yet, as Stiglitz points out, while it pursued macrostability, it clearly did not follow other elements such as privatization or liberalization.<sup>31</sup> There was also growing recognition that countries facing different challenges, in particular post-socialist transition economies, never found adequate answers to their most pressing problems in the Washington Consensus.<sup>32</sup>

These were the conditions that allowed the rule of law to gain renewed prominence for security, political, and economic reasons.<sup>33</sup> Correspondingly, scholarship’s theoretical drivers have focused on the institutional underpinnings of long-term growth. Advanced in large part by new institutional economics, protection of property rights and security of contract were viewed as core components to sustained economic expansion.<sup>34</sup> Yet to political scientists, this consensus revealed vulnerabilities, as both property rights and contract enforcement are “clearly endogenous to some underlying political bargains and institutions.”<sup>35</sup>

In what Haggard terms “the rule of law complex,” we learn that the relationship between the rule of law and economic development is not about “getting the law right” but rather how discrete components may come out of complex causal chains that include complementary institutions and political bargains.<sup>36</sup> For this reason, our inquiry will examine several distinct elements that make up both the rule of law complex

<sup>27</sup> Paul Collier, *The Bottom Billion : Why the Poorest Countries are Failing and What Can Be Done About It* (Oxford; New York: Oxford University Press, 2007), 103.

<sup>28</sup> Pritchett, “Divergence, Big Time,” 15.

<sup>29</sup> Douglass C. North, “Economic Performance Through Time,” *The American Economic Review* 84, no. 3 (1994), 366.

<sup>30</sup> Joseph E. Stiglitz, *More Instruments and Broader Goals : Moving Toward the Post Washington Consensus* (Helsinki, Finland: UNU/WIDER, 1998); Grzegorz W. Kolodko, “Transition to a Market Economy and Sustained Growth. Implications for the Post-Washington Consensus,” *Communist and Post-Communist Studies* 32, no. 3 (1999); Dani Rodrik, *One Economics, Many Recipes : Globalization, Institutions, and Economic Growth* (Princeton: Princeton University Press, 2007).

<sup>31</sup> “Unraveling the Washington Consensus: An Interview with Joseph Stiglitz.”

<sup>32</sup> Kolodko, “Transition to a Market Economy,” 237-8. Kolodko emphasizes the need for corporate governance reform, the behaviour aspect to institution building, the necessity for equitable growth, issues of sequencing, and the need for cultural changes to facilitate efficiency and growth, not only as internal behavioural changes to these organizations but also changes in the interactions between them.

<sup>33</sup> Haggard et al., “Rule of Law and Economic Development” (2008), 206. See also Tamanaha, “Primacy of Society,” 14-5.

<sup>34</sup> Douglass C. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge University Press, 1990).

<sup>35</sup> Haggard et al., “Rule of Law and Economic Development (2008),” 206.

<sup>36</sup> *Ibid.*, 221.

and economic development. We will use empirical evidence, theoretical literature, and recent events across Brazil, Russia, India, and China, known under acronym, “BRICs.”<sup>37</sup> Specifically, we will examine the following five components: governance, institutional quality, the judiciary, the prevalence and effects of corruption, and media and civil society organizations. The objective of this inquiry is not to prescribe models of transplantation, but rather, to draw out relevant analogies, similarities, and differences amongst the BRICs, and to identify challenges that each country is facing in its relationship to the rule of law and economic development. It is our hope that this inquiry will enable a fuller understanding of this valuable relationship. We also hope that it will offer guidance on the means to achieve the full potential of sustained economic development.

Before turning to the five components that will frame our examination, we offer a brief overview of each country’s political structures, current state of rule of law, and economic system. We focus particularly on sustainable economic growth. We hope this will provide a preliminary overview across the BRICs that sets the stage for our comparative and interdisciplinary discussion.

## POLITICAL SYSTEMS AND LEGAL TRADITIONS ACROSS BRIC COUNTRIES

Brazil is a newly democratic federal republic with a presidential system. The president is both head of state and head of government. It has the classic tripartite branches of government formally established by the Constitution and its legal system follows the civil law tradition. The process of re-democratization began in 1985 after several decades of dictatorship and a period of military rule.

India is a federation with a parliamentary system. It obtained independence as a nation state in 1947. Its legal system is largely based on English common law, continuing the legacy of the British Raj. India’s legal system is notably pluralistic. For example, in family law each religion adheres to its own specific laws. India’s Constitution, which came into effect in 1950, is the lengthiest in the world. It prescribes, among others things, the federal and administrative structure, fundamental rights, and directive principles of state policy.

Russia’s Constitution sets out the country as a federation and semi-presidential republic wherein the President is head of state and the Prime Minister is head of government. The federal government is composed of three branches: the legislative, executive, and judicial. If Brazil and India are functioning democracies, Russia is a “managed” democracy. The process of democratization in Russia began in the early 1990s after the fall of the Soviet Union. In many ways, the transition from command economy to a market economy remains an ongoing process. The shift from Soviet law to civil law marked this transition, most notably with the introduction of a private civil law that created the private sector.

<sup>37</sup> Jim O’Neill, “Building Better Global Economic BRICs,” Goldman Sachs *Global Economics Paper* 66 (2001). Jim O’Neill, then Head of Global Economic Research at Goldman Sachs, coined the term BRICs in this 2001 paper. Two years later, Goldman Sachs made its first detailed projections of how the rise of the BRIC economies may become among the five most dominant economies by 2050 in a paper entitled, “Dreaming with BRICs: The Path to 2050” (October 2003) *Global Economics Paper* No 99. Political dialogue between the leaders of the BRIC countries began in 2006 when they decided to form a political bloc and hold a series of high-level meetings. In 2010, South Africa became the newest full member of the expanded organization, now known as BRICS. In addition to advocating for a more inclusive voice in global leadership, they are also committed to increasing trade and development loans amongst their respective countries. See Christopher Bodden, “Emerging Economies Summit Could Shuffle Global Power,” *Huffington Post* (April 13, 2011), online: <www.huffingtonpost.com>.

China is an authoritarian state that has been ruled by the Communist Party of China since 1949. The country's political structure has become more diffuse, however, and can no longer be characterized in rigid hierarchical terms. Since the 1980s, China shifted away from a Soviet-style centrally-planned economy to a more market-oriented mixed economy under one-party rule. Many political actors, not just senior leaders, make up the political process and influence policy makers. Today, its political system is partly decentralized and there are limited democratic processes internal to the Party.<sup>38</sup> China's legal system is one of the oldest in the world. It is a complex mix of traditional Chinese approaches and Western influences. In the early 20<sup>th</sup> century it adopted a legal code in the civil law tradition and in the latter half of the 20<sup>th</sup> century was influenced by socialist law.

## OVERVIEW OF RULE OF LAW ACROSS THE BRICS

Table 1.1 reproduces the results of the World Justice Project *Rule of Law Index 2011*, which offers a detailed and comprehensive picture of the extent to which countries adhere to the rule of law in practice.<sup>39</sup> To date over 66,000 people and 2,000 experts have been interviewed in 66 countries. Under each factor in the table below, the first column represents the country's overall score, where one is the highest and zero is the lowest. The second column represents the country's global ranking compared to the other 66 countries assessed. This assessment of the BRICs reveals the strengths and weakness of rule of law and is an introduction to the distinct components we will examine later.

**Table 1.1:** World Justice Project: *Rule of Law Index 2011*

COUNTRY	FACTOR 1: Limited Government Powers		FACTOR 2: Absence of Corruption		FACTOR 3: Order and Security		FACTOR 4: Fundamental Rights		FACTOR 5: Open Government		FACTOR 6: Effective Regulatory Enforcement		FACTOR 7: Access to civil justice		FACTOR 8: Effective Criminal Justice	
BRAZIL	0.61	26/66	0.67	24/66	0.62	51/66	0.67	25/66	0.51	30/66	0.57	26/66	0.59	24/66	0.48	44/66
RUSSIA	0.41	55/66	0.49	40/66	0.67	45/66	0.54	47/66	0.41	52/66	0.47	49/66	0.54	40/66	0.64	23/66
INDIA	0.63	24/66	0.42	51/66	0.38	65/66	0.63	36/66	0.55	25/66	0.45	56/66	0.50	48/66	0.51	35/66
CHINA	0.53	37/66	0.60	31/66	0.81	25/66	0.40	64/66	0.54	26/66	0.50	43/66	0.52	44/66	0.61	25/66

Source: Mark David Agrast et al., *World Justice Report: Rule of Law Index 2011* (Washington DC: The World Justice Project, 2011).

We see that under factor 1, that Russia has the weakest limit on government powers, scoring considerably lower than the other three countries, and notably, even worse than China. This suggests that Russia's separation of powers is weak and that government is ineffectively limited by the legislature, the judiciary, and other independent checks and balances. Under factor 2, absence of corruption, Indian government officials are the most corrupt and Russia is the second-worst. It is important to note that Brazil has a high score and ranking for both factors 1 and 2 suggesting that it has the healthiest constraints on government powers and the least corrupt public officials. Under factor 3, order and security, China has the highest rank amongst

<sup>38</sup> Michael F. Martin, "Understanding China's Political System" paper presented at the Committees of Congress (Washington, US, Library of Congress Congressional Research Service, 2010). For more on China's governance system see also this report's section on governance.

<sup>39</sup> Mark David Agrast et al., *World Justice Report: Rule of Law Index 2011* (Washington DC: The World Justice Project, 2011). The index uses eight factors, which are further disaggregated into 52 sub-factors.

the four countries. Russia is a distant second, clustered closely with Brazil and India who score the worst. This suggests that they are not able to effectively control crime, civil conflict, and violence. In terms of fundamental rights, under factor 4, the newly democratic regime of Brazil has the best score. It prevails over India, which follows at a distant second. India's score demonstrates that it has vulnerabilities that undermine its democratic principles. Russia in turn follows at a distant third and perhaps unsurprisingly, China trails last, ranking 64<sup>th</sup> out of 66. Regarding the degree of government openness, under factor 5, the top two countries are India and China, followed relatively closely by Brazil. Russia's poor score in this category reveals a fundamental weakness in legality, recalling Fuller's principles that laws must be clear and understandable, non-contradictory, constant, and not subject to frequent changes. For factor 6, Brazil holds the most effective regulatory enforcement. By contrast, India shows the least effective enforcement and is clustered closely by China and Russia. Brazil again holds the highest score in terms of access to justice, under factor 7, while the remaining three countries are closely clustered a significant distance away. In terms of effective criminal justice, under factor 8, for the first time, Russia prevails as the most effective, immediately followed by China in second place, India in third, and Brazil in fourth.

Russia experiences fundamental weaknesses in seven out of eight factors, including ineffective limits on government powers, corruption, a non-open government, and ineffective regulatory enforcement. Given that Russia's only high score was in effective criminal justice, this signals a disproportionate over-reliance on or over-investment in the criminal justice system. China demonstrates a stronger, more evenly distributed rule of law with better results in limits on government powers, absence of corruption, order and security, and open government. China's only extremely poor results are the absence of fundamental rights. By contrast, India reveals a wide fluctuation and discrepancy in rule of law measures. It experiences the best results in limits on government powers and open government and the worst results in terms of corruption, order and security, and effective regulatory enforcement. Of the four countries, Brazil prevails as the country with the strongest rule of law, achieving consistently strong results for six out of the eight factors. This suggests a more stable and predictable rule of law. Brazil's area of weakness appears to be the failure to control crime levels and an ineffective criminal justice system.

Importantly, the *Rule of Law Index 2011* reveals the wide variance of rule of law across regimes indicating that any simplistic attempt to correlate the types of regimes and their strength of rule of law is not possible.

## ECONOMIC OVERVIEW OF THE BRICS

Table 1.2 uses World Bank data to establish various components of economic growth at current day levels. For example, unsurprisingly China exceeds all four countries in GDP growth. India follows in second place and Russia comes in fourth. Importantly, GDP per capita is relatively high for both Brazil and Russia standing at seven times the GDP per capita of India and over two times higher than China. In turn, China's GDP per capita is three times higher than India's. Given its high level of GDP growth and lowest rank for GDP per capita, this suggests that India has the greatest wealth disparity of the four countries.

Regarding the private sector, the World Bank used three measurements: merchandise trade, trade in services, and the number of domestic companies listed on the domestic stock exchange. China has the highest trade in merchandise and Russia is a close second. India exceeds all countries in terms of trade in services. Perhaps most

**Table 1.2: Economic Overview**

	GDP growth (annual %) 2010	GDP per capita for 2010 (current US\$)	Private Sector: Merchandise trade (% of GDP); Trade in services (% of GDP); and Listed domestic companies on domestic stock exchange (figures for 2010)	Ease of doing business index (2011) (1=most business-friendly regulations to worst = 183)	Strength of legal rights index (2011) (0=weak to strong=10)	Foreign direct investment, net inflows for 2010 (BoP, current US\$ in millions)	Poverty headcount ratio at national poverty line (% of population)	Labour participation rate (% of total population ages 15 + for 2009)	Internet users per 100 people (2010)
<b>BRAZIL</b>	7.5	10,710	Merchandise trade: 18.8 Trade in services: 4.5 Listed companies: 373	126/183	3/10	48,437	21.4 (2009)	71	40.7
<b>RUSSIA</b>	4.0	10,440	Merchandise trade: 43.8 Trade in Services: 8.1 Listed companies: 345	120/183	3/10	42,868	11.1 (2006)	63	43.4
<b>INDIA</b>	8.8	1,475	Merchandise trade: 31.7 Trade in services: 13.9 Listed companies: 4,097	132/183	8/10	24,159	37.2 (2005)	58	7.8
<b>CHINA</b>	10.4	4,428	Merchandise trade: 50.2 Trade in services: 6.2 Listed companies: 2,063	91/183	6/10	185,080	2.8 (2004)	74	34.4

Source: World Development Indicators 2011 (Washington, DC: World Bank, 2011) online: <<http://data.worldbank.org>>.

tellingly, the number of domestic companies listed on domestic stock exchanges reveals a gross disparity: India has twice the number of listed domestic companies as China and approximately nine times the number of listed domestic companies as Russia and Brazil. This reveals a dramatic disparity for both Russia and Brazil which can have a large impact on the private sector.

Turning to the *Ease of Doing Business Index for 2011*, China ranks the highest at 91<sup>st</sup> out of 183 countries, while India is the worst at 132<sup>nd</sup>. This result seems to conflict with the finding that India has the highest number of listed domestic companies on its stock exchange and suggests that this poor ranking has not had a direct impact on the size of the private sector. Russia and Brazil rank at 120 and 126 respectively, which suggests that ease of doing business does impact growth in the private sector. In addition, given that Russia and Brazil have few listed domestic companies, their poor ranking suggests that there is a disproportionate impact on the few companies in operation. In fact, drawing on the strength of the legal rights indicator, the results appear to realign themselves accordingly as India prevails with the strongest legal rights, whereas the weakest legal rights are found in both Brazil and Russia, both at 3 out of 10.<sup>40</sup> These results, when viewed as a whole, suggest that the strength of legal rights for companies directly impacts the health and vibrancy of the private sector.

When it comes to foreign direct investment, China exceeds all four countries by a large margin. It is here we see the significance of the ease of doing business indicator, as the rankings correspond to foreign direct investment scores across each of the four countries. This suggests that a country's business-friendly regulations take on more significance than the strength of its legal rights, because they stimulate and attract investors.

The last three indicators measure poverty, labour participation, and number of Internet users. Internet usage is included as a proxy for both infrastructure and participatory democracy. India has the highest degree of poverty and lowest degree of

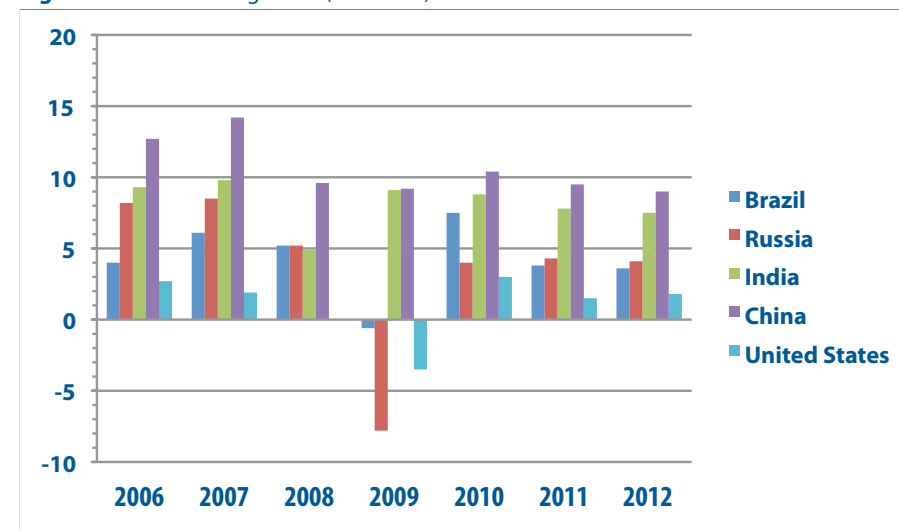
labour participation in contrast with the other four countries. China has the least poverty and highest degree of labour participation. In terms of Internet usage, exceptionally, Russia figures prominently, and has the highest score with over 43 percent of the population using the Internet. Brazil follows at a close second where over 40 percent of the population are Internet users. This figure is important for Russia, because the government otherwise controls the free press and impedes robust civil society. The state has, to a large extent, preserved freedom of expression on the Internet. These figures show that broad usage across the population has enabled a vibrant online community. In this way, the Internet has fostered participatory democracy when other more traditional avenues have been thwarted. Like Russia, China enjoys relatively high Internet usage, unlike Russia, however, there is heavy government control and censorship. The percentage of Internet users in India stands in stark contrast to the other countries at merely 7.8 percent. The overwhelming presence of the media and the robustness of civil society in India suggest two hypotheses. The media and civil society flourish within the middle and upper classes, excluding the majority of the poor. Or, alternatively, and probably more accurately, given the long historical presence of the free press and a vibrant civil society, it is possible that other communication tools, such as text messaging or other traditional forms fill the large gap left by limited Internet access. Add to this India's reliance on informal institutions and it becomes clear that any drawbacks associated with lack of Internet infrastructure are made up through other means of participatory democracy.

## SUSTAINABLE ECONOMIC GROWTH

The world economy experienced rapid growth in the decade before the global financial crisis, reaching growth levels that were even higher than those in the immediate aftermath of the Second World War.<sup>41</sup> The BRIC countries represent over 40 percent of the world's population, over 2.8 billion people, and despite geographic distance and varying interests, these countries have been the impressive drivers of global growth. Using World Bank and International Monetary Fund figures, figure 1.1 charts the BRICs' GDP growth from 2006 to 2012 compared to the United States. Here we see the remarkable historical achievement of China's growth rate, which, on average, has exceeded 10 percent. Of the four countries, India's growth rate was most dramatic in 2009, despite the sharp recession experienced in developed countries in 2008 and 2009. Out of the four countries, Russia was hit the worst in 2009 by the global financial crisis, but it recovered swiftly, as seen by its growth in 2010.

<sup>40</sup> Legal indicator results measure the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders thus facilitating lending.

<sup>41</sup> Dani Rodrik, "The Future of Economic Convergence," *NBER Working Paper* no. 17400 (2011), 6.

**Figure 1.1: BRICs GDP growth (annual %) from 2006 to 2012**

**Source:** *World Development Indicators 2011* (Washington, DC: World Bank, 2011) online: <<http://data.worldbank.org>>; *World Economic Outlook September 2011: Slowing Growth, Rising Risks*, *World Economic and Financial Surveys* (Washington DC: International Monetary Fund, 2011).

China and India lead in trade in manufacturing and services respectively. The source of gains in Russia and Brazil, however, are due to the rise in demand for commodities and natural resources. Varying manifestations of state capitalism figure prominently in Brazil, Russia, and China, where state-run companies operate in key sectors of their economies. India, on the other hand, does not have prominent state capitalism and instead has a wide breadth of actors in the private sector. It is important to emphasize, however, that the Asian growth superstars, such as China and India, embody instances “of mixing the conventional and the unconventional – of combining policy orthodoxy with unorthodoxy.”<sup>42</sup>

As Rodrik explains, China’s policies on property rights, subsidies, finance, and exchange rates, to name a few, have departed drastically from conventional orthodoxy. After all, he states,

it is not evident that a dictatorship that refuses to even recognize private ownership (until recently), intervenes right and left to create new industries, subsidizes loss-making state enterprises with abandon, ‘manipulates’ its currency, and is engaged in countless other policy sins would be responsible for history’s most rapid convergence experience.<sup>43</sup>

In describing India, he portrays a similarly unconventional mix: “Its half-hearted, messy liberalization is hardly the example that multilateral agencies ask other developing countries to emulate.”<sup>44</sup> Foreign economists advise India to speed up the pace of liberalization, open its financial system, rein in corruption, and set up privatization and structural reform. Yet India’s political system is hesitant, which Rodrik notes may not be due to lack of leadership, but due to genuine uncertainty and differing views over how to achieve a better functioning market economy without large social costs.<sup>45</sup>

<sup>42</sup> Ibid., 18. See also Rodrik, *One Economics, Many Recipes*, 39-42.

<sup>43</sup> Rodrik, “The Future of Economic Convergence,” 18.

<sup>44</sup> Ibid.

<sup>45</sup> Ibid., 18.

No emerging country faces a bigger challenge than China. It has come under increasing pressure from developed countries for its currency undervaluation. Developed countries like the US advocate that China increase domestic growth and rely less on exports. But if China adopts these policies, according to Rodrik, this could lead to slowed growth which would be debilitating. He states that:

If what matters for China’s growth is ultimately the structure of production, a shift in the composition of demand may do real harm to the economy’s growth. A reorientation towards services and domestic consumption would reduce the demand for its industrial products and blunt the forces of convergence.<sup>46</sup>

This leads to the critical debate over what determines convergence in economic growth, which is an open-ended question despite the accumulation of long lists of variables. There is no one set of policies that guarantee convergence, “they are the outcomes of many different things going on simultaneously, including external and exogenous circumstances as well as policies of unknown effectiveness and unclear direction of impact.”<sup>47</sup> Summers outlines three objectives which directly impact the rate of growth: a country’s ability to integrate with the global economy (and attract trade and investment), its capacity to maintain sustainable government finances and sound money, and its ability to put in place an institutional environment where contracts can be enforced and property rights can be established.<sup>48</sup> Having established this, how to achieve these “abilities” or “capacities” remains nebulous at best, especially when juxtaposed against the unconventional policy approaches in China and India.

“Genuine” growth requires changes in growth determinants such as investment, export diversification, and productivity. With the exception of some oil economies in the Middle East, most countries that have grown at 4.5 per capita per year over three decades have accomplished this sustained growth through diversification into manufactures.<sup>49</sup> China, of course, is the notable exception. Economies dependent upon commodity exports may experience growth, but specialization in a few highly profitable primary activities tends not to raise productivity in terms of employment.<sup>50</sup> India demonstrates that it is possible to generate growth in tradable services, but that this model can accomplish only limited structural change, since reliance on education and skills generates too few jobs for the unskilled workforce with which it will remain endowed for a considerable time.<sup>51</sup> If manufacturing and modern services are growth drivers, markets need to work reasonably well in order to attract entrepreneurs, firms, capital, and employment. Rodrik notes that weak markets and institutions impose an especially high “tax” since these sectors require a well-developed contractual environment and otherwise rely on extended division of labour.<sup>52</sup> Creating functioning market economies requires more than simply focusing on macroeconomic stability, liberalization, and openness – it is a process that involves deeper institutional transformation measured in decades not years. Laws and regulations can be rewritten relatively quickly, but it is a country’s institutions that establish the rules of the game, because they are “cognitive constructs that shape expecta-

<sup>46</sup> Ibid., 44.

<sup>47</sup> Ibid., 19.

<sup>48</sup> Lawrence H. Summers, “Globalization and American Interests,” in *Godkin Lectures* (Kennedy School of Government, Harvard University: John F Kennedy Jr. Forum, April 7 2003) cited in Rodrik, “The Future of Economic Convergence,” 19-20.

<sup>49</sup> Rodrik, “The Future of Economic Convergence,” 33.

<sup>50</sup> Margaret S. McMillan and Dani Rodrik, “Globalization, Structural Change and Productivity Growth,” *NBER Working Paper*, no. 17143 (2011).

<sup>51</sup> Barry Bosworth et al., “Sources of Growth in the Indian Economy,” *NBER Working Paper*, no. 12901 (2007).

<sup>52</sup> Dani Rodrik, “The Real Exchange Rate and Economic Growth,” *Brookings Papers on Economic Activity* (2008).

tions about how other people behave.”<sup>53</sup> Such expectations are difficult to modify and replace. Moreover, where the beneficiaries of the established order remain politically strong, they can easily undermine reforms that impinge upon their privilege. As Acemoglu and Robinson emphasize, sustainable economic growth ultimately requires political change.<sup>54</sup> Correspondingly, framing potential growth in terms of investment climate, Goldman Sachs suggests that investors “may need to look deeper under the surface of the macro landscape and discriminate more if they are to earn above-average returns from understanding this dynamic.”<sup>55</sup>

In terms of GDP levels, the BRIC economies are projected to make up four out of the five largest economies in the world by 2050, joined by the US in second place. These figures are reproduced under table 1.3 below. Goldman Sachs estimates that the Chinese economy is set to surpass the US as early as 2026 and the BRICs together to surpass the US in 2015 and the G7 in 2032.<sup>56</sup> Projections also estimate that while China will take the lead in the next several decades, India will overtake it in 2050.<sup>57</sup> Goldman Sachs suggests that we have likely seen the peak in potential growth for the BRICs as a group and that the next decade will also see the peak in underlying growth rates for each BRIC country.<sup>58</sup> Over the last few years, there has been a shift of emphasis away from the BRICs onto other emerging markets and their potential.<sup>59</sup> Goldman Sachs estimates that in 2050, emerging markets collectively will be shy of the BRICs but roughly equal to the developed markets, at 30 percent of the global economy.<sup>60</sup>

For his part, Rodrik maintains that even though the convergence gap for developing countries has closed somewhat over the last decade, it stands as wide today as in 1950. That is, the potential growth rate for developing countries is as high as it has ever been since the end of the Second World War.<sup>61</sup> Thus, he states that rapid convergence is possible in principle, but unlikely in practice. He emphasizes that high growth will likely remain episodic and that sustained convergence is likely to remain restricted to a relatively small number of countries.<sup>62</sup> Goldman Sachs admits that their estimates are merely projections which are limited by the challenge of identifying factors that sustain growth.<sup>63</sup>

<sup>53</sup> Rodrik, “The Future of Economic Convergence,” 34. See also North, *Institutional Change (1990)*; Katharina Pistor, “The Standardization of Law and Its Effect on Developing Economies,” *The American Journal of Comparative Law* 50, no. 1 (2002).

<sup>54</sup> Daron Acemoglu and James A. Robinson, *Why Nations Fail: the Origins of Power, Prosperity and Poverty* (New York: Crown Business, 2012).

<sup>55</sup> Dominic Wilson et al., “The BRICs 10 Years On: Halfway Through The Great Transformation,” *Global Economics Paper*, no. 208 (Goldman Sachs Global Economics, Commodities and Strategy Research, 2011).

<sup>56</sup> *Ibid.*, 8.

<sup>57</sup> Willem Buiter and Ebrahim Renbari, “Global Growth Generators: Moving Beyond Emerging Markets and BRICs,” *Citigroup Global Markets* 21 (2011).

<sup>58</sup> Wilson et al., “The BRICs 10 Years On,” 8.

<sup>59</sup> *Ibid.*, 6; Buiter and Renbari, “Global Growth Generators: Moving Beyond Emerging Markets and BRICs.”

<sup>60</sup> Wilson et al., “The BRICs 10 Years On,” 9.

<sup>61</sup> Rodrik, “The Future of Economic Convergence,” 3.

<sup>62</sup> *Ibid.*

<sup>63</sup> Wilson et al., “The BRICs 10 Years On,” 16.

**Table 1.3:** BRICs move up the GDP rankings

	1980	2000	2010	2050*
1	United States	United States	United States	<b>CHINA</b>
2	Japan	Japan	<b>CHINA</b>	United States
3	Germany	Germany	Japan	<b>INDIA</b>
4	France	United Kingdom	Germany	<b>BRAZIL</b>
5	United Kingdom	France	France	<b>RUSSIA</b>
6	Italy	<b>CHINA</b>	United Kingdom	Japan
7	Canada	Italy	<b>BRAZIL</b>	Mexico
8	Mexico	Canada	Italy	Indonesia
9	Spain	Mexico	Canada	United Kingdom
10	Argentina	<b>BRAZIL</b>	<b>INDIA</b>	France
11	<b>CHINA</b>	Spain	<b>RUSSIA</b>	Germany
12	<b>INDIA</b>	Korea	Spain	Nigeria
13	Netherlands	<b>INDIA</b>	Australia	Turkey
14	Australia	Australia	Mexico	Egypt
15	Saudi Arabia	Netherlands	Korea	Canada
16	<b>BRAZIL</b>	Argentina	Netherlands	Italy
17	Sweden	Turkey	Turkey	Pakistan
18	Belgium	<b>RUSSIA</b>	Indonesia	Iran
19	Switzerland	Switzerland	Switzerland	Philippines
20	Indonesia	Sweden	Poland	Spain

**Source:** Dominic Wilson et al., “The BRICs 10 Years On: Halfway Through The Great Transformation,” *Global Economics Paper*, no. 208 (Goldman Sachs Global Economics, Commodities and Strategy Research, 2011)

While there are divergent projections for the BRICs, sustaining their recent growth experience will become imperative for each regime in the years to come. This suggests a return to national focus where governments evaluate what mix of conventional and unconventional policies best promote sustainability. No one solution or set of policies will achieve sustained economic growth. Yet, the various components of rule of law that will be the focus of this study will provide an opportunity to examine how the rule of law may impact the challenge of sustainable growth.

## CONCLUSION

The rule of law and its relationship to economic growth continues to occupy a significant presence in theoretical and empirical research. This undertaking is all the more complex given that the concept of rule of law is multi-dimensional and defined along a spectrum of conceptions. For the purposes of this report, we will focus on a minimalist and procedurally oriented concept of rule of law, one that accounts for North's definition of institutions. Our aim in this introduction was to provide a preliminary foundation to our in-depth analysis across five main components of rule of law: governance, institutional quality, the judiciary, corruption, and media and civil society organizations. Given the particularities across each country, from historical, economic, political, cultural, and social differences, we will use a comparative and interdisciplinary approach that raises salient intersecting points, key challenges, and best practices.

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# SECTION 2:

## Governance across the BRICs

### INTRODUCTION

Governance is central to understanding the rule of law in a country. It encompasses the entire way the state is run and ensures that all relevant stakeholders are adequately and equitably included.

The governance section divides into two parts. The first provides an overview of the discourses of the term “governance” used by policy makers and multilateral agencies. The second part provides a comparative review of governance structures in each of the BRIC economies using empirical data to illustrate salient issues. The purpose is to analyze the governance challenges faced by each of the economies on the road to rule of law and economic development.

### THE STATE OF GOVERNANCE TODAY

#### UNDERSTANDING THE TERM “GOVERNANCE”

Academics and policy makers are the two main groups responsible for developing a theory of governance. Academics generally focus on the different modes of interpenetration of state and civil society relations.<sup>1</sup> This approach assesses the various interactions amongst state stakeholders. It defines governance as an allocation process of state resources through complex structures and practices.<sup>2</sup> Consequently, and more importantly, this conception does not prejudge the locus of actual decision making. Some conceptions of “governance” are often limited to government – that is, if there is a problem with governance, then both the problem and solution lie within government. For academics this myopic government centred focus fails to consider the full diversity of stakeholders. Rather, governance is a fluid and collaborative process comprised of citizens, the government, bureaucracy, the business sector, and the media.

Policy makers, on the other hand, tend towards a technical conception of governance which prioritizes the state and its relationship to the market. The state plays the predominant role in formulating policy which produces stability and prosperity. This thinner conception focuses on how the state can optimally regulate to ensure accountability, due process of law, and other related safeguards.<sup>3</sup>

The appendix to this section lists the definitions of governance employed by the main international organizations engaged in the governance debate. While academic definitions underscore the importance of all relevant stakeholders this should not overshadow the state’s role in the overall process. All things considered, the path to good

<sup>1</sup> Martin Doornbos, “Good Governance: The Rise and Decline of a Policy Metaphor?” *Journal of Development Studies* 37, no. 6 (2001), 96.

<sup>2</sup> Thomas G. Weiss, “Governance, Good Governance and Global Governance: Conceptual and Actual Challenges,” *Third World Quarterly* 21, no. 5 (2000); Tony Bovaird and Elke Löffler, “Evaluating the Quality of Public Governance: Indicators, Models and Methodologies,” *International Review of Administrative Sciences* 69, no. 3 (2003).

<sup>3</sup> Doornbos, “The Rise and Decline of a Policy Metaphor?”

governance depends on political will within the state which must create a conducive environment for all stakeholders and engage them in the dynamic relationship of governance.

Leftwich proposes an approach that straddles the academic and policy conceptions.<sup>4</sup> He divides governance into three aspects: systemic, political, and administrative. The systemic aspect refers to governance as a *regime* – that is, a *system* that incorporates and manages relationships within a society as well as its political and economic rules. The political aspect presupposes that the regime enjoys legitimacy and authority. In current discourse, such legitimacy and authority are derived from a democratic mandate in a pluralistic society. However, as Leftwich remarks, democracy is not necessarily a precursor to good governance. The administrative aspect is much narrower in perspective and means “an efficient, independent, accountable and open public service.”<sup>5</sup>

Leftwich tends towards an instrumental perspective of good governance. Much like the rule of law, good governance can have a “thick” and “thin” definition. The thick definition demands the inclusion of particular ideals and ideologies, such as democracy, whereas the thin definition limits itself to the state system’s functionality. If the aim of good governance is rule of law, economic development, stability, and prosperity, the means to achieve it are as varied as the number of states. This is particularly pertinent given the current liberal underpinnings of good governance discourse amongst today’s donor community.

#### EVOLUTION OF THE TERM “GOVERNANCE”

Governance is imbued with ideology. Given the multiple ways to achieve governance, it is thus necessary to investigate the origins of those ideologies.

Before the 1980s, only a small category of specialists who studied organizational management employed the term “governance.” It had not yet entered the lexicon of experts on state and international relations. In the late 1980s, around the end of the Cold War, multilateral donor agencies began to use the term. The international financial institutions – the World Bank and the International Monetary Fund – noticed that mismanaged and corrupt governments undermined loan and aid programs. Following experiences with aid programs in Africa, Asia, and Latin America, the President of the World Bank at the time, Barber Conable, commented: “If we are to achieve development, we must aim for growth that cannot be easily reversed through the political process of imperfect governance.”<sup>6</sup> Yet, the World Bank is in fact precluded from engaging in political assessments under its Articles of Agreement.<sup>7</sup> Not to be deterred, the international financial institutions discussed how to render constituent elements of good governance “a-political.”<sup>8</sup> Following suit, individual donor countries, unsure what constituted good governance, used the same definition as the international financial institutions. From a position of obscurity “good governance” rapidly became a critical condition for any aid package.

Many actors, encouraged by the western developed countries, interpreted the USSR’s disintegration as the triumph of liberalism and free-market capitalism over socialism

<sup>4</sup> Adrian Leftwich, “Governance, the State and the Politics of Development,” *Development and Change* 25, no. 2 (1994), 371.

<sup>5</sup> Ibid.

<sup>6</sup> Barber Conable, “Opening Remarks,” in *Proceedings of the World Bank Annual Conference on Development Economics*, ed. Summers and Shah (Washington, DC: World Bank, 1992), 6.

<sup>7</sup> IBRD Articles of Agreement, Article IV, Section 10.

<sup>8</sup> Doornbos, “The Rise and Decline of a Policy Metaphor?”



and planned economies.<sup>9</sup> The World Bank pushed for neo-liberal policies, and the primacy of the individual spurred the development of human rights discourse and economic development. Leftwich presents the argument succinctly:

Neo-liberal political theory asserts that democratic politics and a slim, efficient and accountable public bureaucracy are not simply desirable but also *necessary* for a thriving free market economy, and vice versa, for the two are inextricably implicated with each other. Neo-liberals thus regard an obese state apparatus with a large stake in economic life as being both inefficient from an administrative point of view and also incompatible with an independent and vibrant civil society which is held to be the basis of effective democracy. Hence neo-liberal developmentalists often argue that poor development records and adjustment failures have been a direct consequence of authoritarian rule and deficient governance, all arising from excessive concentration of both economic and political power in the hands of the state, which is incompatible with accountable and responsive good governance in a free economy.<sup>10</sup>

The result is that good governance discourse is closely associated with a liberal democratic model found in Western Europe and North America. This is a far too narrow conception of governance. While some components of good governance are accepted without much debate the entire framework need not be the one prescribed by the international financial institutions. Indeed, the World Bank's "technicist" approach naively deemphasizes the role of history, culture, and politics in rule of law and economic development.<sup>11</sup> With this in mind, we now address how good governance could work without adherence to any particular ideological prescriptions.

### THE FUNCTIONING OF "GOVERNANCE"

Governance should be conceived as a regime in which various stakeholders realize their ambitions through an interactive process, facilitated by a complex of rules and institutions. This framework is most effective when the state plays a central role and state actors encourage good governance through their political will. That said, the extent of the state will vary in each jurisdiction.

Understanding governance requires an understanding of each actor in society. Part of this process requires a determination of who has a say and how they should decide in any given instance. A simple illustration of how this could work is drawn from the Institute on Governance's policy paper (see figure 2.1).<sup>12</sup>

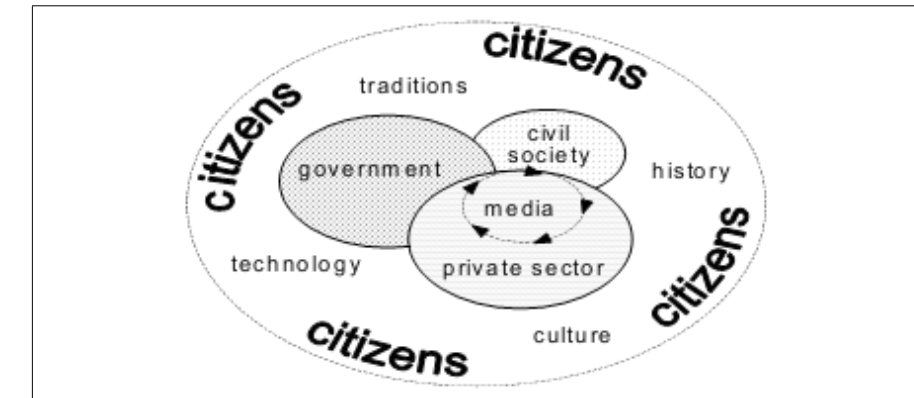
<sup>9</sup> Little attention had been paid to the Chinese growth strategy at this point.

<sup>10</sup> Leftwich, "Governance, the State and the Politics of Development," 369. See also Milton Friedman and Rose D. Friedman, *Free to Choose: a Personal Statement* (New York: Harcourt Brace Jovanovich, 1980), 21.

<sup>11</sup> Leftwich, "Governance, the State and the Politics of Development."

<sup>12</sup> J. Graham et al., "Principles for Good Governance in the 21st Century," (2003) *Institute on Governance: Policy Brief* no. 15.

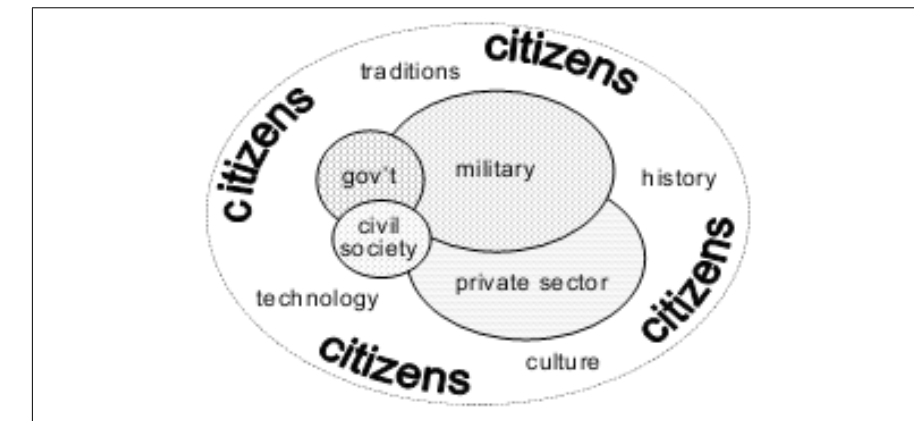
**Figure 2.1:** Schematic Illustrating the Interplay between Stakeholders in the Governance Process



Source: J. Graham et al., "Principles for Good Governance in the 21st Century" (2003) *Institute on Governance, Policy Brief* no. 15, 3.

Figure 2.1 shows four sectors of society: government, private sector, civil society (such as NGOs and other similar bodies), and media. The sectors overlap to demonstrate their permeability. Their relative sizes resemble those of western developed countries. This schematic could be completely different, as demonstrated in figure 2.2. There the military has a larger presence and plays a significant role in all sectors of society including the private sector. This resembles military states such as Myanmar.

**Figure 2.2:** Schematic Illustrating the Interplay between Stakeholders in the Governance Process



Source: J. Graham et al., "Principles for Good Governance in the 21st Century" (2003) *Institute on Governance, Policy Brief* no. 15.

The aim of good governance should be to attain rule of law and economic development or state stability, prosperity, and human development. In light of this, the spheres' relative sizes need not cause concern, so long as they efficiently and productively realize these aims. It is for each individual state to configure itself, given its history and particularities. Indeed, much empirical evidence indicates that, all other things being equal, the type of political regime does not necessarily have an impact

on a society's wealth.<sup>13</sup> Finally, having reached the appropriate configuration, it is equally important that all stakeholders trust and approve of one another.

The Institute on Governance presents five guiding principles that may be adopted for optimal configuration (see table 2.1). They are in accordance with UN Development Plan (UNDP) principles.<sup>14</sup>

**Table 2.1: Five Principles of Good Governance**

The Five Good Governance Principles	The UNDP Principles and related UNDP text on which they are based
<b>1. LEGITIMACY AND VOICE</b>	<b>Participation</b> – all men and women should have a voice in decision-making, either directly or through legitimate intermediate institutions that represent their intention. Such broad participation is built on freedom of association and speech, as well as capacities to participate constructively. <b>Consensus orientation</b> – good governance mediates differing interests to reach a broad consensus on what is in the best interest of the group and, where possible, on policies and procedures.
<b>2. DIRECTION</b>	<b>Strategic vision</b> – leaders and the public have a broad and long-term perspective on good governance and human development, along with a sense of what is needed for such development. There is also an understanding of the historical, cultural, and social complexities in which that perspective is grounded.
<b>3. PERFORMANCE</b>	<b>Responsiveness</b> – institutions and processes try to serve all stakeholders. <b>Effectiveness and efficiency</b> – processes and institutions produce results that meet needs while making the best use of resources.
<b>4. ACCOUNTABILITY</b>	<b>Accountability</b> – decision-makers in government, the private sector and civil society organizations are accountable to the public, as well as to institutional stakeholders. This accountability differs depending on the organizations and whether the decision is internal or external. <b>Transparency</b> – transparency is built on the free flow of information. Processes, institutions, and information are directly accessible to those concerned with them, and enough information is provided to understand and monitor them.
<b>5. FAIRNESS</b>	<b>Equity</b> – all men and women have opportunities to improve or maintain their well-being. <b>Rule of Law</b> – legal frameworks should be fair and enforced impartially, particularly the laws on human rights.

**Source:** J. Graham et al., "Principles for Good Governance in the 21st Century" (2003) *Institute on Governance: Policy Brief* no. 15, 3.

The international community has almost universally adopted these principles as nearly all countries are signatories to the *International Convention on Civil and Political Rights* or the *International Convention on Economic, Social, and Cultural Rights*. In addition, the norms within such instruments have attained the status of customary international law.

## ASSESSING GOVERNANCE ACROSS THE BRICS

This is loosely structured around the three governance elements – systemic, political, and administrative – provided by Leftwich. Examples and statistics highlight some of the particular governance challenges faced in each state.

<sup>13</sup> Stephan Haggard et al., "The Rule of Law and Economic Development," *Annual Review of Political Science* 11, no. 1 (2008); J. Isham et al., "Governance and Returns on Investment: an Empirical Investigation," *World Bank Policy Research Working Paper*, no. 1550 (1995); Adam Przeworski et al., *Democracy and Development: Political Institutions and Well-being in the World, 1950-1990* (Cambridge, UK: Cambridge University Press, 2000); Adam Przeworski, "Democracy and Economic Development," in *Science and the Public Interest*, ed. Edward D. Mansfield and Sisson Richard (Columbus: Ohio State University Press, 2004).

<sup>14</sup> The UNDP's goals are economic development through improving human development. The UNDP's *Human Development Index*, in this regard, is a critical measuring tool for the success of a good governance framework.

## REGIME OR POLITICAL FORM

The first stage of Leftwich's approach is governance as a regime – that is, a system of political and socio-economic relations. This aspect has infinite scope. We limit our understanding to political governance or form and this may include whether the state is democratic or not. We have chosen to use democracy as a ground for comparison because, while it is a simplistic distinction to make amongst the BRICs, it still produces a rich discussion of their political form.

Democracy encompasses various political forms, such as constitutional liberalism, social democracy, or grassroots democracy.<sup>15</sup> Huntington distinguishes democracy's form and substance:

Elections, open, free and fair, are the essence of democracy, the inescapable sine qua non. Governments produced by elections may be inefficient, corrupt, shortsighted, irresponsible, dominated by special interests, and incapable of adopting policies demanded by the public good. These qualities make such governments undesirable but they do not make them undemocratic. Democracy is one public virtue, not the only one, and the relation of democracy to other public virtues and vices can only be understood if democracy is clearly distinguished from the other characteristics of political systems.<sup>16</sup>

Huntington focuses on the procedures that render governments democratic. The nature of politics is a question of political function – the substance or colouring of that political form. Importantly, one must distinguish between form and function. Here we address form, considering the question of political structures from an instrumental or minimalist perspective.<sup>17</sup> We will also look at the structures normatively and assess how appropriate they are for economic development. Next we will consider political function.

### Normative Political Forms and the Link to Economic Development

Democracies require free, fair, and open elections and any limitations on these aspects will make a state less democratic. There is therefore a sliding scale of democracy based on whether these characteristics are more or less limited. While some studies use various definitions of democracy we analyze the procedures of democracy.<sup>18</sup> Regimes are non-democratic where citizens cannot participate in a procedure to select their leaders. There are, however, hybrid regimes,<sup>19</sup> competitive authoritarian

<sup>15</sup> Michael Kaufman and Haroldo Dilla Alfonso, *Community Power and Grassroots Democracy: the Transformation of Social Life* (Ottawa: International Development Research Centre, 1997).

<sup>16</sup> Samuel P. Huntington, *The Third Wave: Democratization in the Late Twentieth Century* (Norman: University of Oklahoma Press, 1991), 9-10. This is a particularly thin conception of democracy. It can, however, also be conceived in a much thicker form. This would include political function such as constitutional liberalism, entailing the provision of particular civil and political rights for the individual. The distinction between the two, however, is of function and form, and we argue that in assessing the governance structure, the two should be distinguished.

<sup>17</sup> Joseph Alois Schumpeter, *Capitalism, Socialism, and Democracy*, 2nd ed. (New York: Harper, 1947), 269; Adam Przeworski et al., "What Makes Democracies Endure?" *Journal of Democracy* 7 (1996). These authors equally make this distinction and thus adopt a minimalist approach. In these cases it is to the definition of democracy, which thus has the same effect of separating the political framework versus the political function.

<sup>18</sup> Richard Rose and William Mishler, "Comparing Regime Support in Non-democratic and Democratic Countries," *Democratization* 9, no. 2 (2002). These authors are an example of scholars who use a specific definition of democracy. To qualify as an electoral democracy, a state must have satisfied the following criteria:

- 1) A competitive, multiparty political system;
- 2) Universal adult suffrage for all citizens (with exceptions for restrictions that states may legitimately place on citizens as sanctions for criminal offenses);
- 3) Regularly contested elections conducted in conditions of ballot secrecy, reasonable ballot security, absence of massive voter fraud, and that yield results that are representative of the public will; and
- 4) Significant public access of major political parties to the electorate through the media and through generally open political campaigning.

<sup>19</sup> Larry Diamond, "Thinking About Hybrid Regimes," *Journal of Democracy* 13, no. 2 (2002).

regimes,<sup>20</sup> and pseudodemocratic regimes.<sup>21</sup> Pseudodemocracies have formal democratic political institutions, such as multiparty electoral competition, but this often masks, sometimes to legitimate, an authoritarian reality. Notwithstanding this, states may configure their democracy in different configurations such as parliamentary democracy, presidential democracy, a federal republic, and so on.

We shall discuss only those systems pertaining to the BRIC economies. We shall consider the power relationships through case studies of fiscal policy. Fiscal policy is a good indicator of a system's efficiency and locus of power within the state.

### Brazil

Brazil achieved independence in 1822 and has since gone through several regime changes; it has had a constitutional style parliamentary system and it has had military rule. Today it is a presidential style democracy organized in a federal republic. Irrespective of the political system, the state always played a significant role in steering economic development. Vargas, an authoritarian leader who led the country between 1930 and 1945, established the institutional foundations for the Brazilian developmental state. He more or less laid the foundations for the country's administrative, legal, and economic structures. In subsequent years of military government, the state continued to play a central role in economic development.<sup>22</sup> The country's periodic instability, however, reflects the mercurial nature of Brazilian politics. Between 1985 and 1994, for example, Brazil underwent six different stabilization programs.<sup>23</sup>

Brazil's federal structure has three parts: the federal government, states, and municipalities. Brazil's 5,560 municipalities are constitutional parts of the federation; they are not subdivisions or dependents of the states. In 1988, following years of centralization under the military, Brazil embraced a decentralized democratic system. It adopted a new Constitution which devolved significant power to the municipalities.<sup>24</sup> This decentralization of power manifested itself politically and financially.<sup>25</sup> Politically, each municipality holds elections for mayors and municipal councils for four-year terms and each municipality is entitled to issue its own constitution known as *Organic Law (Lei Orgânica)*.<sup>26</sup> Financially, the Constitution paved the way for enhanced centre-to-state revenue distribution. Prior to 1988, the federal government held 44.6 percent of public revenue. After 1988, this gradually decreased to 36.5 percent and represented only 5.7 percent of GDP.<sup>27</sup> Correspondingly, the states' share increased from 37.2 percent to 40.7 percent, or around 6.3 percent of the GDP and the municipalities' share increased from 18.2 percent to 22.8 percent, or 3.5 percent of the GDP. In 2001, local governments administered around 12.5 percent of the country's total public revenue which included its own revenue and constitutional transfers. When federal grants are added, local governments have become account-

able for 15.5 percent of total public revenue.<sup>28</sup> The Constitution aims to provide regional and local governments significant autonomy in the allocation of funds, but it also stipulates that certain proportions be spent on centrally identified priority areas such as primary education and health-care programs.<sup>29</sup> This is consistent with Brazil's history as a welfare state and ambition to address the acute problem of inter- and intra-regional inequality.

Like most federations, Brazil faces a serious challenge in managing regional debt. The current "Fiscal Responsibility Laws,"<sup>30</sup> passed in 2000, were promulgated as a result of a major fiscal scandal in 1996.<sup>31</sup> The 1988 Constitution makes clear stipulations for local and regional governments wishing to borrow either from internal or external markets. In order to borrow, the respective government must attain its legislature's approval and then submit its request to the Central Bank for assessment. The Central Bank produces a technical report recommending approval or rejection, which it sends to the Senate. The Senate often approved the states' request even when the Central Bank rejected the request. The 1996 scandal arose out of an improperly used provision which allowed regional governments to issue bonds to pay for debts contracted before 1988.<sup>32</sup> As Souza explains,

the bonds could only be issued when the courts recognised the debt as pertinent. After the courts' decisions, subnational governments had to ask for the Central Bank and the Senate's authorization to issue the bonds. Because of the high rates of inflation until 1994, politicians had over-estimated the amount to be paid and apparently used the resources for other purposes. All the cases which went for Senate approval were passed despite negative recommendations issued by the Central Bank. Five states and seven municipalities, six in São Paulo, including its capital, were involved in these scandals. As a result of this, the Senate set up a Parliamentary Inquiry Commission to investigate these cases, given that there were suspicions of two types. Firstly, subnational governments were using resources for purposes other than the payment of judicial awards, in particular to pay their bills with the building industry, a powerful lobby in Brazil. Secondly, the bonds were issued in the market by private financial institutions, with high profits.<sup>33</sup>

The Parliamentary Inquiry did not hold any implicated officials accountable, but it was the impetus for the "Fiscal Responsibility Law." The law limits states from accumulating debt and spending on payroll and prohibits the federal government from bailing out indebted subnational governments. Public sector financial managers may now be liable to criminal and administrative charges if they fail to adhere to stan-

<sup>20</sup> Steven Levitsky and Lucan A. Way, "The Rise of Competitive Authoritarianism," *Journal of Democracy* 13, no. 2 (2002).

<sup>21</sup> Juan J. Linz, *Totalitarian and Authoritarian Regimes* (Boulder, CO: Lynne Rienner Publishers, 2000), 60.

<sup>22</sup> Ibid.; Werner Baer, *The Brazilian Economy: Growth and Development* (Westport, Connecticut: Praeger, 1995).

<sup>23</sup> L. Burlamaqui et al., *The Rise and Halt of Economic Development in Brazil: 1945-2004* (United Nations University World Institute for Development Economics Research, 2006), 13.

<sup>24</sup> José R. Afonso and Luiz De Mello, "Brazil: an Evolving Federation" paper presented at the IMF/EAD Seminar on Decentralization, (Washington DC, November 20-21 2000).

<sup>25</sup> Teresa Ter-Minassian, *Fiscal Federalism in Theory and Practice* (Washington, DC: International Monetary Fund, 1997), 438. Ter-Minassian states that "the democratization process, culminating in the enactment of the 1988 Constitution, was accompanied by a resurgence of decentralization trends. These tendencies have been especially marked on the revenue side, resulting in a relatively high degree of control over revenue sources by the state and local governments, compared with other large federations around the world."

<sup>26</sup> Celina Souza, *Brazil's System of Local Government, Local Finance and Intergovernmental Relations*, EngKaR Research Project (Washington DC: World Bank, 2002).

<sup>27</sup> Ibid., 11.

<sup>28</sup> Ibid., 12.

<sup>29</sup> Ibid., 13. Souza reports that the "1996 Constitutional Amendment no. 14 created a fund earmarking existing resources from federal, state and local governments to be spent on primary education. The municipalities are obliged to earmark fifteen percent of what they receive from ICMS [a value-added tax] and FPM [Municipal Participation Fund] transfers. This obligation expires in 2007. In 2002, Constitutional Amendment 29 followed the same path, this time earmarking federal, state and local resources for health care programmes. The municipalities have to allocate fifteen percent of their own revenue and of constitutional transfers to health care programmes. The percentage earmarked by each level of government is to be reviewed every five years."

<sup>30</sup> Brazil, "Fiscal Responsibility Law," Law 101/2000 of May 4, 2000. For a good oversight of the fiscal oversight legislation, see *Brazil: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF Country Report No. 01/217 (Washington, DC: International Monetary Fund, 2001); Aaron Schneider, "Governance Reform and Institutional Change in Brazil: Federalism and Tax," *Commonwealth and Comparative Politics* 45, no. 4 (2007). In addition see our comprehensive database of anti-corruption legislation at the end of this report.

<sup>31</sup> Souza, *Brazil's System of Local Government*, 16; M.H. Tavares de Almeida, "Decentralization and Centralization in a Federal System: The Case of Democratic Brazil," *Revista de Sociologia e Política* 1 (2006).

<sup>32</sup> Souza, *Brazil's System of Local Government*, 17.

<sup>33</sup> Ibid., 16-7.

dards.<sup>34</sup> The “Fiscal Responsibility Law” transformed fiscal policy and governance in Brazil. Previous incarnations of the bill failed to become law, but this law succeeded because the necessary political actors, including states, saw its value and backed it. The success of the “Fiscal Responsibility Law” reflects the role of political economy in determining governance structures and their reforms.<sup>35</sup>

## India

India has twenty-eight states, six Union Territories and a National Capital Territory.<sup>36</sup> The Delhi National Capital Territory and Union Territory of Pondicherry have their own elected legislatures, whereas central government appointees govern the remaining Union Territories. A Chief Minister is the executive head of each state. In addition, the President appoints a governor to each state who is an agent of the Prime Minister.<sup>37</sup> India is federal because the Constitution assigns particular powers to each state.

India holds elections across all three levels – federal (national), state, and local. It introduced local elections in 1993, which effectively increased the number and diversity of elected officials. India’s ability to conduct elections on such a scale makes it a democratic success story. Yet its democratic structure is perennially challenged by its large and heterogeneous population, the caste system, and the regional disparities in social and economic development. Its recent emergence as an economic power has enhanced interregional disparities and widened the income gap between rural and urban areas. These challenges make India’s governance complex. Two examples, which consider federal-state relations, demonstrate India’s complex governance challenges.

The first example considers intergovernmental finance transfers provided under the Constitution. The Finance Commission and the Planning Commission are the two main bodies that facilitate financial transfers. The Finance Commission distributes tax revenues and makes grants.<sup>38</sup> It is appointed by the President of India every five years. The Planning Commission is a central government body which makes grants and loans to implement five year development plans.<sup>39</sup> Rao et al., examining data between 1965 and 1995, show that these bodies have only had a moderate impact on interstate inequalities.<sup>40</sup> Their report also showed that private investment is disproportionately greater in higher-income states than lower-income states. The two state financing bodies have been unable to counteract this trend to address growing inequality. Moreover, India’s political economy exacerbates this problem. While the bodies both abide by formulae to allocate funds, both can also make discretionary grants. Unfortunately, these discretionary grants are subject to political influence.<sup>41</sup> Rao and Singh cite cases where states represented by members on the commissions

<sup>34</sup> Ibid., 14.

<sup>35</sup> Schneider, “Governance, Federalism, and Tax,” 21.

<sup>36</sup> M. Govinda Rao and Nirvikar Singh, “The Political Economy of India’s Fiscal Federal System and its Reform,” *Publius: The Journal of Federalism* 37, no. 1 (2007).

<sup>37</sup> Nirvikar Singh, “The Dynamics of Reform of India’s Federal System,” *SSRN Electronic Journal* (2007), online: <<http://ssrn.com/abstract=1282263>>.

<sup>38</sup> India, *Report of the Twelfth Finance Commission (2005-10)*, Finance Commission (November 2004), 9. The Report states that “Article 280 of the Constitution describes the duties of the finance commission, the core of which relates to sharing of central taxes under article 270 and determination of grants for the states as provided for under article 275. The Commission’s approach is guided by the mandate of the constitutional provisions and the terms of reference (TOR) contained in the Presidential order constituting the commission.”

<sup>39</sup> Rao and Singh, “Political Economy of India.”

<sup>40</sup> M. Govinda Rao et al., “Convergence of Incomes across Indian States: A Divergent View,” *Economic and Political Weekly* 34, no. 13 (1999).

<sup>41</sup> Rao and Singh, “Political Economy of India,” 29.

do relatively better.<sup>42</sup> This skews subnational financing which does little to address India’s regional inequalities.

The second example considers the management of state debt and over-expenditure. Between 2004 and 2005, the states raised on average 39 percent of the combined government revenues, but incurred on average 66 percent of expenditures.<sup>43</sup> Transfers from the centre (including grants, loans, and tax-sharing) made up most of the difference, with the states also borrowing moderately from other sources. States must seek central government approval for domestic borrowing whenever they are in debt to the centre and are prohibited from seeking foreign sources of finance. One benefit of being indebted to the central government is that states receive some leeway in the repayment of debt. For example, the State Electricity Boards delayed paying bills to the central government’s National Thermal Power Corporation.<sup>44</sup>

The commissions have difficulty imposing fiscal discipline on state governments. The initial strategy during the tenure of the Eleventh Finance Commission (which met between 2000 and 2005) was to conclude “memorandums of understanding” with state governments that would make central-state transfers dependent upon fiscal discipline. The states’ incentives for fiscal reform, however, were too weak.<sup>45</sup> Under the Twelfth Finance Commission (which met between 2005 and 2010), the central and many state governments passed fiscal discipline legislation. As part of these laws, the central government offers debt relief when the states successfully implement the legislation.<sup>46</sup> One of the benefits is that the legislation created public benchmarks for evaluating state fiscal performance.

India’s size impedes successful management. The federal government’s policy must adapt to subnational governments’ demands so that it can deliver economic growth to the whole country as well as each regional unit. Political dynamics beyond formal laws significantly affect fiscal policy outcomes. Considering India’s complex structures and population it is a relatively successful democratic state.<sup>47</sup> Several obstacles, however, continue to impede greater success including elected officials with criminal records, caste politics, and widespread corruption.<sup>48</sup>

## Russia

Post-Soviet Russia faces its own structural governance challenges as a relatively new democratic state. These are largely the result of the country’s ongoing transition from a centrally-planned to market economy. Russia underwent rushed privatization, known as “shock therapy,” in the 1990s without an adequate legal or financial framework.<sup>49</sup> Furthermore, complicated federal-regional relationships have also challenged its governance.

During transition, President Boris Yeltsin wished to grant greater autonomy to regional leaders. In 1991, the Russian Federation consisted of twenty-one republics, forty-nine *oblasts*, and six *krais*; the two special status cities of Moscow and St.

<sup>42</sup> Ibid., 41 in note 3.

<sup>43</sup> Singh, “The Dynamics of Reform of India’s Federal System,” 7.

<sup>44</sup> Ibid., 9.

<sup>45</sup> Ibid., 12.

<sup>46</sup> Ibid.

<sup>47</sup> Amartya Sen, “Democracy as a Universal Value,” *Journal of Democracy* 10, no. 3 (1999).

<sup>48</sup> “India Politics: New State MPs ‘face criminal charges,’” *BBC News* (March 12 2012), online: <[www.bbc.co.uk](http://www.bbc.co.uk)>; Jeffrey Witsoe, “Corruption as Power: Caste and the Political Imagination of the Postcolonial State,” *American Ethnologist* 38, no. 1 (2011).

<sup>49</sup> Michael D. Intrilligator et al., “What Russia Can Learn From China in its Transition to Market Economy,” in *Clumsy Solutions for a Complex World: Governance, Politics and Plural Perceptions*, ed. Marco Verweij and M. Thompson (Basingstoke: Palgrave Macmillan, 2006).

Petersburg, both of which had *oblast* status; ten autonomous *okrugs*; and one autonomous *oblast*.<sup>50</sup> Yeltsin intended to break down the Soviet state's framework, but this had negative repercussions for relations between the federal government and various republics. Stoner-Weiss explains that:

[While] the center favored a national federal system – a type of 'federalism from above' – where the central government would clearly take the lead in determining the distribution of power between itself and the federation's constituent units, ... regional leaders advocated (and continue to advocate) for a more contractually based federal system, where regions would sign individual or collective agreements with the central state that would govern their membership in the federation.<sup>51</sup>

This disconnect in political governance encouraged provinces not to comply with federal policy.

The privatization process in Russia's regions created pockets of beneficiaries – both public and private – with interests that they sought to protect from the federal government. Subsequently, working in conjunction with regional governments, these beneficiaries found novel ways of resisting the Kremlin's reach.<sup>52</sup> First, operating from various regions, these beneficiaries successfully persuaded regional governments to pass legislation that contradicted the federal Constitution in ways that affected the economy in their regions, thereby undermining the state's regulatory capacities. Second, regional governments restructured regional judiciaries to ensure that they controlled the outcome of cases that threatened to jeopardise local interests.<sup>53</sup> Third, regional governments used economic protectionism and imposed illegal tariffs and taxes on goods entering their regions. This strategy privileged local goods and services above others, which led to market distortions.<sup>54</sup> Finally, regional governments, under the influence of local economic interests, declared their ownership of natural resources in order to prevent dispersion of wealth.<sup>55</sup>

In its initial years, the Russian Federation suffered through power struggles between the federal and regional governments. When Vladimir Putin became President, however, he attempted to consolidate power back in the centre.<sup>56</sup> Waller refers to this as Putin's establishment of "power vertical."<sup>57</sup> It is difficult to gauge whether these reforms impacted intergovernmental conflicts, yet, to a certain extent, they restored the Kremlin's control. Putin's first measure was to establish seven federal districts within the federal executive that covered approximately twelve sub-units of the Russian Federation. This restructuring aimed to establish direct administrative control over the regions. Effectively, it subordinated elected governors and regional presidents to the President's appointees. His second measure was to take away the elected governors' automatic right to sit on the Federation Council in order to minimize the governors' influence at the federal level. Under this new measure, two appointed representatives – one nominated by the regional parliament and the other nominated by the regional government or President – represent the regions in

<sup>50</sup> Kathryn Stoner-Weiss, "Resistance to the Central State on the Periphery," in *The State After Communism: Governance in the New Russia*, ed. Timothy J. Colton and Stephen Holmes (Lanham: Rowman & Littlefield Pub., 2006), 88.

<sup>51</sup> *Ibid.*, 89.

<sup>52</sup> *Ibid.*, 104.

<sup>53</sup> *Ibid.*

<sup>54</sup> *Ibid.*

<sup>55</sup> *Ibid.*

<sup>56</sup> *Ibid.*, 107 et seq; Michael McFaul and Kathryn Stoner-Weiss, "The Myth of the Authoritarian Model – How Putin's Crackdown Holds Russia Back," *Foreign Affairs* 87 (2008).

<sup>57</sup> Michael Waller, *Russian Politics Today: the Return of a Tradition* (New York: New York: Palgrave, 2005).

the upper chamber. Finally, Putin introduced measures that would remove regional governors or legislatures if it was legally proven that they were deliberately passing legislation that subverted or undermined federal law or the Constitution. The new reforms also demanded that regions reverse any existing legislation that contradicted the Constitution.

The measures primarily sought to centralize a fragmented federation. Indeed, Blanchard and Shleifer argue that political decentralization contributed to Russia's poor economic performance. China has achieved greater economic output despite having a federal structure, because of centralization.<sup>58</sup> Russia is far more centralized today, but it has yet to achieve optimal efficiency. China maintains a politically centralized and vertical governance structure, but it accords significant responsibility to local officials which promotes economic growth and development.<sup>59</sup>

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## China

Unlike the other BRIC nations, China has a centrally planned economy and a non-democratic political structure led by the Communist Party. Subsequently, China's challenges managing centre-periphery relations are far different than Brazil's, India's, and Russia's.

China is a federation with twenty-two provinces, five autonomous regions, four state-controlled municipalities (Beijing, Tianjin, Shanghai, and Chongqing), and two self-governing administrative regions (Hong Kong and Macau). The state is composed of two vertically integrated and interlocking institutions. One is the Chinese Communist Party, headed by the Politburo and its Standing Committee. The other state institution is the state government apparatus, headed by the Premier and State Council, which is a *de facto* cabinet. The Chinese President, Hu Jintao, is the general secretary of the Communist Party and chair of the Politburo.<sup>60</sup> Equally important are the National People's Congress and the People's Liberation Army. The National People's Congress is a unicameral legislative house. According to China's Constitution it is the highest organ of state power.<sup>61</sup> In reality, however, it is subordinate to the State Council and the Chinese Communist Party Standing Committee.<sup>62</sup> These institutions preside collectively over the People's Republic of China.

The Communist Party and the state government apparatus are expansive and hierarchical networks that reach into many aspects of society. The diffusion of political power between the Party and government, and to a lesser degree the People's Liberation Army and National People's Congress, makes it difficult to determine the sources of authority that set and implement specific policies. In terms of provincial, municipal, and local governments, each successive tier of government reports to the preceding tier above it, and, in practice, each tier exercises varying degrees of autonomy. Here, the relationship between the local Party leader and the local top government official is critical to the effectiveness of local government. In general the ministries rely on local authorities to implement national laws and regulations and are frequently faced with having to prioritize between the policies of the Party, the

<sup>58</sup> Olivier Blanchard and Andrei Shleifer, "Federalism With and Without Political Centralization: China versus Russia," *NBER Working Paper*, no. 7616 (2000).

<sup>59</sup> Pranab Bardhan, "Decentralization of Governance and Development," *The Journal of Economic Perspectives* 16, no. 4 (2002). Bardhan discusses the link between decentralization and development.

<sup>60</sup> Michael F. Martin, "Understanding China's Political System" paper presented at the Committees of Congress (Washington, DC, US Library of Congress Congressional Research Service, 2010).

<sup>61</sup> China, People's Republic of China Constitution, art 57.

<sup>62</sup> Martin, "Understanding China's Political System."

central government, or multiple ministries. The maintenance of local party discipline has long been understood as a major challenge for the Chinese government.<sup>63</sup>

Although China is highly politically centralized it is administratively decentralized. As Martin explains:

Party policy is communicated down the layers of the Party organization by means of directives and Party committee meetings. At these meetings, Party members review and discuss the directives. In many cases, the directives do not give specific guidance on how to implement the new policies, thereby allowing the committee to develop a plan of action compatible with local conditions. However, this also provides lower-level Party organizations with the power to passively or actively resist or reinterpret Party policy.<sup>64</sup>

Decentralization has also fostered meritocracy at all levels of government.<sup>65</sup> Professional mobility depends on an official's performance and ability to implement policy and foster good relationships within the Party.<sup>66</sup>

The National People's Congress is particularly important in determining the country's political leadership. The Communist Party meets at the Party Congress every five years. The Congress determines the size and membership of the Party's next Politburo. The next meeting is scheduled for Fall of 2012, and Xi Jinping and Li Keqiang are expected to replace President Hu and Premier Wen.<sup>67</sup>

One-party rule allows China's political leaders to enact economic policy decisively and purposefully. Indeed, the state's strength enabled it to implement a long-term growth strategy that has resulted in remarkable infrastructure development, technological innovation, and a sophisticated financial market.<sup>68</sup> Unlike Russia, China has developed despite a relatively decentralized federal structure. China's economic success stems from its ability to maintain political unity across the regions.<sup>69</sup>

### Assessing Political Form as a Path to Economic Development

There is no obvious link between political structure and economic growth. All too frequently, discussions pit liberal democracies against autocracies to assess which is the better vehicle for economic growth. For example, one might conclude that autocracies are more adept at fostering economic growth after comparing India and China. Yet, this basic dichotomy fails to capture important nuances. Empirical studies have shown that one political framework is not necessarily better than the other.<sup>70</sup> Przeworski et al. considered 18 different studies that contrast the capabilities of these two states in facilitating economic growth through different regions and

time periods.<sup>71</sup> They produced inconclusive results: in eight studies democracy was more favourable, eight found authoritarianism more favourable, and five found no difference at all. An even more puzzling finding revealed that before 1988, eight out of eleven studies found that authoritarian regimes grew more quickly whereas zero out of nine post 1987 found that authoritarian regimes grew more quickly. Multiple complex factors and variables other than political form determine economic growth and development.

Below we set out some of the advantages and disadvantages of the BRIC's political frameworks and their relation to economic development and the governance process. We do not presume to assess every configuration of each system, rather we present some comparisons of strengths and weaknesses.

First, democracies are better at avoiding catastrophes characteristic of authoritarian states, such as China's Great Leap Forward and Cultural Revolution.<sup>72</sup> Moreover, democracies more effectively nurture social diversity, protect minorities, and maintain social cohesion.<sup>73</sup> Indeed, Sen has shown that famines have never occurred in any independent democratic country with a relatively free press.<sup>74</sup> Government policy goes unchallenged when a population does not have civil or political rights to pressure government – be it through voting or protesting – and where there is no media to expose government inefficiencies.<sup>75</sup> Sen adds, “when things go fine and everything is routinely good, this instrumental role of democracy may not be particularly missed. It is when things get fouled up, for one reason or another, that the political incentives provided by democratic governance acquire great practical value.”<sup>76</sup>

Second, democracies experience more pressure to spread the benefits of development throughout the population when levels of inequality rise too high.<sup>77</sup> For example, democracies permit civil society groups to mobilize against capitalist excesses and to bring attention to environmental and labour issues. Bardhan opines that through civic engagement, development is more likely to be sustainable.<sup>78</sup> Another argument suggests that authoritarian governments are also able to make development sustainable. Hankla and Kuthy argue that when authoritarian governments enjoy power for long periods and have institutionalized authoritarian tendencies they have a greater incentive to adopt policies, such as trade openness, that may strengthen long-term economic performance.<sup>79</sup> Their incentive is to appease the citizens to prevent revolutions and instability. With longer tenure, leaders are also less inclined to misappro-

<sup>63</sup> Ibid.

<sup>64</sup> Ibid., 6.

<sup>65</sup> Maria Edin, “Remaking the Communist Party-State: The Cadre Responsibility System at the Local Level in China,” in *Bringing the Party Back In: How China is Governed*, ed. Kjeld Erik Brødsgaard and Yongnian Zheng (Singapore: Eastern Universities Press, 2004).

<sup>66</sup> This decentralized political incentive system is discussed in further detail below.

<sup>67</sup> Michael Elliott, “Xin Jinping: The 100 Most Influential People in the World,” *Time* (April 18 2012), online: <www.time.com>.

<sup>68</sup> Pranab K. Bardhan, *Awakening Giants, Feet of Clay: Assessing the Economic Rise of China and India* (Princeton, N.J.: Princeton University Press, 2010).

<sup>69</sup> Blanchard and Shleifer, “Federalism With and Without Political Centralization.”

<sup>70</sup> Przeworski et al., *Democracy and Development: Political Institutions and Well-being in the World, 1950-1990*; Przeworski, “Democracy and Economic Development”; Stephan Haggard and Lydia Tiede, “The Rule of Law and Economic Growth: Where are We?” *World Development* 39, no. 5 (2011), 675. Haggard and Tiede discuss possible institutional checks on government. In their review of literature covering the nexus between economic growth and democracy, they state that empirical findings are “divided at best.”

<sup>71</sup> Adam Przeworski and Fernando Limongi, “Political Regimes and Economic Growth,” *The Journal of Economic Perspectives* 7, no. 3 (1993), 60.

<sup>72</sup> Bardhan, *Awakening Giants*, 141-6.

<sup>73</sup> Todd Landman, “Democracy and Human Security: Essential Linkages,” *Democracy, Conflict and Human Security* (2006).

<sup>74</sup> Jean Drèze and Amartya Sen, “Hunger and Public Action,” Clarendon Press (1987) online: <http://site.ebrary.com/id/10283761>; Amartya Sen, “Development: Which Way Now?” *The Economic Journal* 93, no. 372 (1983); Amartya Sen, *Resources, Values, and Development* (Oxford: B. Blackwell, 1984); Amartya Sen, “Rationality and Social Choice,” *The American Economic Review* 85 (2002). Sen's work is discussed in this report's section on media and civil society.

<sup>75</sup> Barry R. Weingast, “The Political Foundations of Democracy and the Rule of Law,” *The American Political Science Review* 91, no. 2 (1997). Weingast makes a similar point, arguing that citizens can rise up and attempt to depose the sovereign. Subsequently, state officials are forced to make legal, political, and institutional concessions in order to guard against this threat.

<sup>76</sup> Sen, “Democracy as a Universal Value,” 7-8.

<sup>77</sup> Bardhan, *Awakening Giants*, 141.

<sup>78</sup> Ibid., 143.

<sup>79</sup> Charles R. Hankla and Daniel Kuthy, “Economic Liberalism in Illiberal Regimes: Authoritarian Variation and the Political Economy of Trade,” (Annual Conference of the International Studies Association, Montreal, 2011).

appropriate state funds.<sup>80</sup> Hankla and Kuthy also argue that the institutionalized autocracies will tend to incorporate dissenting voices into the governing process, increasing the size of their “selectorate.”<sup>81</sup>

As the number of people that a leader must satisfy in order to stay in power grows, it becomes increasingly difficult for her to pay off all relevant political actors through protectionist policies. Instead, an autocratic leader must look increasingly toward public goods such as free trade, whose effects fall on society widely.<sup>82</sup>

On the basis of these arguments it is arguable that authoritarian systems may also achieve sustainable development.

Third, democracies are better at developing information technology.<sup>83</sup> The global economy is increasingly driven by the Internet, blogging, and open-source applications which facilitate sharing ideas. Censorship tends to hamper such innovation. It follows that strict Internet regulation may jeopardise Chinese innovation and development.<sup>84</sup>

Finally, while democracies do not necessarily stimulate better economic growth, Rodrik has shown that democracies produce much less economic volatility than autocracies.<sup>85</sup> Rodrik finds that a 0.5 increase in the democracy score (roughly the difference between Malaysia and the US) is associated with a reduction of 1.7 percentage points in the standard deviation of annual per capita GDP growth rates.<sup>86</sup> This is largely because democracies induce greater cooperation and compromise in the political sphere, which in turn produces greater stability.

Democracies also have many governance weaknesses. First, they suffer from competitive populism which encourages politicians to pander to the electorate. This impedes a state’s pursuit of long-term economic strategies as politicians focus on short-term goals. India exemplifies this problem as regular elections force politicians to pander to citizens to secure political power – although they do not always follow through on their promises.

Second, democracies tend to favour the majority of the electorate at the expense of vulnerable minorities.<sup>87</sup> This is particularly true in countries with large heterogeneous populations, where significant ethnic, racial, or religious differences can lead to political conflict. In addition, some modes of democratic governance have

a tendency to disproportionately concentrate power. For example, without adequate checks and balances, presidential systems are more prone to concentrate power than parliamentary systems. Deficient vertical and horizontal accountability mechanisms may usurp power from other state actors and thus undermine their roles within the governance process. Horizontal accountability is the capacity of a network of relatively autonomous powers (other institutions) to question and punish improper ways of discharging responsibilities.<sup>88</sup> Vertical accountability is the means through which citizens, mass media, and civil society seek to enforce standards of good performance on officials. Moreover, concentration of power could easily lead to arbitrary use of power contrary to the rule of law, thus becoming rule *by* law – that is, a state official may act in a manner that is unconstrained by the law.<sup>89</sup>

Third, electoral politics may lead to “clientelism” if there is a weak civic culture. Politicians may promise benefits to select groups in exchange for political campaign financing at the expense of the general public.<sup>90</sup> Morse et al., report how this takes shape in Brazil and Russia.<sup>91</sup> In Brazil, where voting is compulsory, clientelism manifests itself as vote buying. A recent national survey found that over 13 percent of respondents admitted to voting for a candidate in exchange for a benefit.<sup>92</sup> Between 2000 and 2008, Brazil prosecuted and convicted at least 660 politicians for distributing benefits during electoral campaigns.<sup>93</sup> In the case of Russia, voting is optional so party machines buy voter turnout.<sup>94</sup> The United Russia Party, affiliated with President Putin, allegedly used government funds to reward voters with food, alcohol, haircuts, concert tickets, legal and medical services, and subsidized utility bills.<sup>95</sup>

Sen has identified several characteristics that recur as “helpful policies” that facilitate economic growth. These include openness to competition, use of international markets, public provision of incentives for investment and exports, high literacy and good education, successful land reforms, and other social opportunities that widen participation in the economic expansion process.<sup>96</sup> Such characteristics are not necessarily common to or inherent within one particular political structure. Moreover, a political framework’s success is not dependent on the kind of framework itself. Rather, it succeeds when the government can adequately insulate itself from special interests.<sup>97</sup> This is similar to the problem faced by state regulators who must avoid capture by the very people they are meant to regulate. Sun, in discussing the

<sup>80</sup> Ibid. The clear example that contradicts this, however, is the recent Arab Spring revolution. In Egypt and Tunisia, following long years of rule under Hosni Mubarak and Zine El Abidine Ben Ali, respectively, citizens revolted against their rule and ultimately deposed them. The results of these recent events suggest that the reality is more complex than the assertions made by Hankla and Kuthy. See also Mancur Olson, “Dictatorship, Democracy, and Development,” *The American Political Science Review* 87, no. 3 (1993); Martin C. McGuire and Mancur Olson, Jr., “The Economics of Autocracy and Majority Rule: The Invisible Hand and the Use of Force,” *Journal of Economic Literature* 34, no. 1 (1996). In these pieces Olson reflects on the economic dilemmas facing the “predatory autocrat.”

<sup>81</sup> In a democracy, the selectorate is the same as the electorate and includes all voters, but in an autocracy, the selectorate exist in various configurations, for example, the military, the business elite, the party central committee, or some other group.

<sup>82</sup> Hankla and Kuthy, “Economic Liberalism in Illiberal Regimes,” 2.

<sup>83</sup> Bardhan, *Awakening Giants*, 144.

<sup>84</sup> For more on the impact of new media on rule of law and economic development see the section on media and civil society of this report.

<sup>85</sup> Dani Rodrik, “Participatory Politics, Social Cooperation, and Economic Stability,” *The American Economic Review* 90, no. 2 (2000).

<sup>86</sup> Ibid., 140. The index of democracy is an average of the Freedom House indices on civil liberties and political rights, averaged for the 1970s and rescaled to 0-1. Growth and its volatility are measured over the period 1975-1998 (with shorter time spans for some countries with fewer data points). The following controls are used in both regressions: log per capita GDP in 1975, log population, a measure of terms-of-trade volatility, and dummies for Latin America, East Asia, Sub-Saharan Africa, and oil exporters. The sample covers 96 countries.

<sup>87</sup> James T. Schleiter, *The Making of Tocqueville’s Democracy in America*, 2nd ed. (Indianapolis: Liberty Fund, 2000), Chapter 14.

<sup>88</sup> “Accountability in Governance,” online: <sitesources.worldbank.org>.

<sup>89</sup> William Partlett, “Mr. Putin’s ‘Rule-by-Law State,’” *Brookings Institute* (June 19 2012), online: <www.brookings.edu>.

<sup>90</sup> Examples of this exist in countries that have developed complex financial markets and strong financial lobbying groups, and have also undergone a degree of “financialization.” Financialization is the increasing proportion of a country’s GDP that is created by the financial sector, and thus the increasing importance accorded to that sector. The result of this socio-economic phenomenon is that governments are more susceptible to powerful financial lobbying groups. In the UK, HSBC has continually threatened to relocate its headquarters from London. Banks in Europe have complained about higher transaction costs associated with regulatory reforms. Treasury records show that Timothy Geithner and Assistant Treasury Secretary Mary Miller met with 37 senior executives of major financial institutions, including Citigroup, Morgan Stanley, Deutsche Bank, and Barclays – and no representatives of public-interest or consumer groups. For more see Simon Duke, “Go Easy on Banks or We Could Leave UK, Threatens HSBC,” *Daily Mail Online* (March 7 2011), online: <www.dailymail.co.uk>; Jeremy Grant, “Regulation: Industry Pleads its Case Against Rules Forged in Heat of Crisis,” *Financial Times* (March 28 2011), online: <www.ft.com>; Lynn Stout, “The Legal Origin of the 2008 Credit Crisis,” *SSRN Electronic Journal* (2011), online: <http://ssrn.com/abstract=1770082>.

<sup>91</sup> Jordan Gans-Morse et al., “Varieties of Clientelism: Machine Politics During Elections,” *SSRN Electronic Journal* (2010), online: <http://ssrn.com/abstract=1664112>.

<sup>92</sup> Ibid., 24.

<sup>93</sup> Ibid.

<sup>94</sup> Ibid., 26. Turnout buying differs from vote buying. In the former, attempts are made to induce constituents to participate in the election, whereas in vote buying, attempts are made to induce to the constituents to vote in a particular manner.

<sup>95</sup> Ibid., 29; Anatoly Medetsky, “Getting Out the Vote With Ads, Food, SMS,” *The Moscow Times* (March 5 2004), online: <www.themoscowtimes.com>; Natalya Krainova, “Campaign Violations Rife in Krasnoyarsk,” *The Moscow Times* (April 17 2007), online: <www.themoscowtimes.com>.

<sup>96</sup> Sen, “Democracy as a Universal Value,” 10.

<sup>97</sup> Bardhan, *Awakening Giants*; Pranab Bardhan, “Symposium on the State and Economic Development,” *The Journal of Economic Perspectives* 4, no. 3 (1990).

pernicious effects of corruption on societal growth and development, elaborates on this point:

The position of a state in relation to its society can be thought of as varying along a continuum from decentralized and constrained by social groups ('soft') to centralized and relatively insulated from society ('hard'). Because hard states have the capacity to resist private demands, they are able to exert control over the direction of the society and economy.<sup>98</sup>

Neither democratic nor authoritarian structures necessarily achieve this ideal balance.

## POLITICAL FUNCTION

This section analyzes some of the substantive political issues in each of the BRIC states. Political function includes many configurations that range from liberal democracy to totalitarianism at the extreme ends of the spectrum and restrained autocracy and illiberal democracy in the middle.<sup>99</sup> These configurations accord varying degrees of political, social, and economic rights to citizens.

Political function can be divided into two parts – the political and the economic.<sup>100</sup> The political function of the state does not always align with its economic function, just as political ideology does not necessarily align with economic ideology. For example, individual freedom is the political foundation of a liberal state which does not tolerate infringement of individual rights. The economic corollary of individual freedom is a preference for free markets and minimal state regulation.<sup>101</sup> Such an economic approach enables individuals to interact and transact with other economic actors without unnecessary obstacles. Yet politically liberal states do not necessarily choose liberal economic policies. China exemplifies a state where there is a sharp contrast between political and economic ideologies. The state severely restricts individual political rights, yet, since the 1970s economic reforms, China has opened its economy to competition between economic actors.<sup>102</sup> It embarked on a path to become a socialist market economy which combines the state sector with a market economy.<sup>103</sup> This has been called socialism with Chinese characteristics. As Premier Wen-Jia Bao once explained in an interview:

The complete formulation of our economic policy is to give full play to the basic role of market forces in allocating resources under the macroeconomic guidance and regulation of the government.

<sup>98</sup> Yan Sun, *Corruption and Market in Contemporary China* (Ithaca, NY: Cornell University Press, 2004), 16.

<sup>99</sup> Steven Fish, "Why Autocracy Thrives in Russia," in *Russian Political Succession Panel*, ed. Hoover Institution (ForaTV, March 7th 2008); F. Zakaria, "The Rise of Illiberal Democracy," *Foreign Affairs* 76 (1997), 23. Zakaria describes a spectrum of illiberal democracy, "ranging from modest offenders like Argentina to near-tyrannies like Kazakhstan and Belarus, with countries like Romania and Bangladesh in between." See also Guillermo A. O'Donnell, "Delegative Democracy," *Journal of Democracy* 5, no. 1 (1994), 52-104; Larry Jay Diamond, *Developing Democracy: Toward Consolidation* (Baltimore: Johns Hopkins University Press, 1999).

<sup>100</sup> These two aspects are often considered together under the umbrella of "political economy." Political economy is a rationalization of the relationship amongst actors and institutions, the political environment, and the economic system.

<sup>101</sup> Leftwich, "Governance, the State and the Politics of Development," 369.

<sup>102</sup> See the discussion below on the restriction of civic rights such as freedom of expression, and the censorship of the Internet.

<sup>103</sup> "Socialist Market Economy - How China Got Here," University of California Los Angeles (2009) online: <[http://www.aasc.ucla.edu/uschina/econ\\_chineseconomy.shtml](http://www.aasc.ucla.edu/uschina/econ_chineseconomy.shtml)>.

We have one important piece of experience of the past 30 years: that is to ensure that both the visible hand and the invisible hand are given full play in regulating the market forces.<sup>104</sup>

The following discussion shall be divided into two parts. The first part will explore models and strategies pursued for economic growth and measure the success of these efforts against governance indicators. The second part will discuss BRIC economies' political landscape, focusing on relevant oversight mechanisms.

## Economic Approaches to Growth and Development

Each BRIC country's economic strategy resulted from its unique political history. India pursued the principles of the Washington Consensus following the 1991 monetary crisis. This reversed its previous strategy, known as mixed economy, in which the state had a large and active presence in the economy. Brazil owes its economic success to the state's heavy influence and participation. Since the end of authoritarianism in 1945, successive Brazilian governments, whether democratic or not, instituted plans to develop various economic sectors. The government and state banks financed these plans and to this day they continue to play an active role. China provides an alternative to these two states. Its dual track approach created an economically liberal framework coupled with heavy state influence which still coordinates economic actors. Russia's economic history is marked by the schism-like transition from a centrally planned to market economy. In addition, it lacked the regulatory framework and oversight to effectively facilitate transition.

State capitalism is a prominent feature in Brazil, Russia, and China. In the new millennium the state has re-emerged as a major economic player which emulates the behaviour of a private entrepreneur. Bremmer documents the history of state capitalism over four waves.<sup>105</sup> The 1973 oil crisis marked the first wave of state capitalism.<sup>106</sup> In that crisis, members of the Organization of the Petroleum Exporting Countries (OPEC) cut oil production in response to the US' support for Israel in the Yom Kippur War. The resulting increased oil prices allowed OPEC members to gain political and economic power over oil-consuming states. They turned their state-produced resources into effective geopolitical tools. The second wave began in the late 1980s with the Washington Consensus.<sup>107</sup> Centrally planned or state-dominated economies, such as Brazil, India, China, and Mexico, embraced economic liberalization to break the cycle of stagnation and instability. Their economic adjustments followed Washington Consensus principles to varying degrees.<sup>108</sup> The rise of sovereign wealth funds in 2005 marked the third wave. The fourth, and current, wave involves emerging and wealthier states attempts to revive their economies in the face of high unemployment and sluggish economic growth, following the 2008 financial crisis.<sup>109</sup>

There are various kinds of state capitalism, ranging from the interventionist kind found in China to the more liberal kind found in Brazil. In addition, state capitalism may be more effective at different stages of development. The state may be more or less effective at earlier stages of transition than in later stages or vice versa.

<sup>104</sup> "Transcript of Interview with Chinese Premier Wen Jiabao," *CNN World* (September 29 2008), online: <[articles.cnn.com](http://articles.cnn.com)>.

<sup>105</sup> Ian Bremmer, "State Capitalism Comes of Age – The End of the Free Market," *Foreign Affairs* 88 (2009).

<sup>106</sup> *Ibid.*, 45.

<sup>107</sup> *Ibid.*, 46. See also John Williams, "A Short History of the Washington Consensus," in *The Washington Consensus Reconsidered: Towards a New Global Governance*, ed. Narcis Serra and Joseph E. Stiglitz (Oxford: Oxford University Press, 2008).

<sup>108</sup> Dani Rodrik, "Goodbye Washington Consensus, Hello Washington Confusion? A Review of the World Bank's 'Economic Growth in the 1990s: Learning from a Decade of Reform,'" *Journal of Economic Literature* 44, no. 4 (2006).

<sup>109</sup> Bremmer, "State Capitalism Comes of Age," 48-9.



There are many reasons why a state would adopt state capitalism in pursuit of economic development. First, state-owned industries act as national industry champions that can boost national pride. State capitalism enables local industry to become more competitive with foreign actors which in turn encourages it to establish global standards of practice. Second, when a state enterprise expands internationally, it has more opportunities to discover new technologies and secure resources for use at home. Finally, the state's involvement encourages the company to take a longer-term outlook, rather than only worry about the short-term requirements of shareholder profits and dividends.

On the other hand, state capitalism presents other challenges. First, how can the state effectively regulate a sector in which it is an active player? This is known as the principal/agent problem. This problem creates another systemic regulatory problem where there is no discernible distinction between interference and intervention. Second, given the potential cost to the public, the state must be careful to invest wisely, a process which depends on context. It may successfully implement infrastructure projects but be less successful with consumer services. Or it may not be wise for a state to invest in every sector that lacks a comparative trade advantage and/or technical expertise. Third, encouraging large national champions may stifle the development of small and medium enterprises. Fourth, states should be cautious not to combine incompatible growth strategies since, as *The Economist* eloquently puts it, “mating two dinosaurs seldom produces a gazelle.”<sup>110</sup> Fifth, large state corporations' unregulated expansion may distort international trade and international relations. Finally, corruption and state cronyism have the potential to flourish if adequate checks and balances are not put in place. The People's Bank of China estimates that between the mid-1990s and 2008 some 16,000 to 18,000 Chinese officials and executives at state-owned companies stole US\$123 billion.<sup>111</sup> *The Economist* points out that politicians who operate under state capitalism tend to have more power than their counterparts who operate in liberal democracies.<sup>112</sup>

Below are some of the features of state capitalism in the BRIC economies. First, states have invested large amounts in their state enterprises – so called “national champions” – resulting in increased activity and size. The consequence is a few large state-owned companies. In China and Russia these companies take up a large portion of the stock markets. In China, where the state no longer invests in smaller township and village enterprises, the largest state-owned enterprises' assets increased from US\$360 billion in 2002 to US\$2.9 trillion in 2010.<sup>113</sup> In addition, China's investment in the state-owned China Mobile has enabled it to capture a domestic market of 518 million subscribers, making it the largest mobile carrier in the world.<sup>114</sup>

Second, the way that the state exerts power over companies has changed. Company presidents used to report directly to government ministries, but today the state exerts power through minority share ownership. There are still a few enterprises where the state retains majority ownership. This is particularly true for enterprises engaging in the natural resource sector such as Russia's Gazprom and China's National Petroleum Corporation.

<sup>110</sup> “Mixed Bag: State Owned Enterprises Are Good At Infrastructure Projects, Not so Good at Innovation,” *The Economist* (January 21 2012), online: <www.economist.com>.

<sup>111</sup> “The Long View: And the Winner Is,” *The Economist* (January 21 2012), online: <www.economist.com>.

<sup>112</sup> “A Choice of Models, Theme and Variations: State Capitalism is Not All the Same,” *The Economist* (January 21 2012), online: <www.economist.com>.

<sup>113</sup> “State Capitalism's Global Reach: New Masters of the Universe,” *The Economist* (January 21 2012), online: <www.economist.com>.

<sup>114</sup> Tania Branigan, “State Owned China Mobile is World's Biggest Mobile Phone Operator,” *The Guardian* (January 11 2010), online: <www.guardian.co.uk>.

Third, the state provides companies with significant financial resources and opportunities. China's state-owned commercial banks finance equity investment in a range of companies, as does Brazil's National Development Bank through its investment subsidiary (BDESPar).<sup>115</sup>

BRIC economies have pursued state capitalism in varying manners and degrees. It has played a particularly important role in shaping the Chinese economy. China is the world's largest state-capitalist and controlling shareholder through the State-Owned Assets Supervision and Administration Commission and the Communist Party's Organization Department.<sup>116</sup> Through these institutions, the state wields great influence over executive appointments. It regularly shuffles these executives. For example, in 2004 it shuffled executives at the three largest telecoms companies and in 2011 did the same with the chiefs of the three largest oil companies – each of these companies is a *Fortune 500* company.<sup>117</sup> The state has also expanded these companies globally, bringing them up to international business standards. Indeed, companies such as PetroChina have gone public and are now listed on the New York Stock Exchange.

Brazilian state capitalism emerged out of a conscious desire to foster macroeconomic stability, develop its welfare state, and manage a gradual privatization process.<sup>118</sup> In 2009, its major investment vehicle, the BNDESPar, had holdings worth US\$53 billion or just over 4 percent of the stock market. Brazil's approach is to maintain minority share holdings in key enterprises, which Lazarini and Musacchio describe as the “Leviathan as a minority shareholder.”<sup>119</sup> One advantage of this system is that the state is represented during the decision-making process and can make things happen, but its small voting share means that it cannot *overwhelm* the decision making process. A second advantage is that having a state development bank as shareholder alleviates capital constraints on state-sponsored enterprises. There are, however, shortcomings. State involvement, in whatever its form, may politicize business management. For example, the state may influence decisions that require the company to make redundancies or outsource jobs. This problem is acute for Brazil as its history of state capitalism is ideologically tied to the creation of a welfare state.

Under Russian state capitalism, government officials often directly manage state corporations. For example, former Deputy Prime Minister Igor Sechin is the Chairman of Rosneft, one of Russia's largest state-owned oil and gas companies.<sup>120</sup> As part of President Medvedev's agenda to improve transparency and accountability he tried to change these corporate governance structures by removing state officials from management positions.<sup>121</sup> Putin has not repealed these initiatives, but he is keen to maintain the state's prominent role in key sectors.<sup>122</sup> For Putin, state capitalism is a way to ensure Russia's economic prosperity and global competitiveness. Russia, like

<sup>115</sup> Baer, *The Brazilian Economy*; Burlamaqui et al., *Rise and Halt*; Robert Cull and Lixin Colin Xu, “Bureaucrats, State Banks, and the Efficiency of Credit Allocation: The Experience of Chinese State-Owned Enterprises,” *Journal of Comparative Economics* 28, no. 1 (2000).

<sup>116</sup> “The Long View: And the Winner Is,” *The Economist*.

<sup>117</sup> Erica Downs and Michal Meidan, “Business and Politics in China: The Oil Executive Reshuffle of 2011,” *World Security Institute, China Security*, no. 19 (2011).

<sup>118</sup> Burlamaqui et al., *Rise and Halt*; Baer, *The Brazilian Economy*, chapter 10.

<sup>119</sup> Sergio Lazarini and Aldo Musacchio, “Leviathan as a Minority Shareholder: A Study of Equity Purchases by the Brazilian National Development Bank (BNDES), 1995-2003,” *SSRN Electronic Journal* (2010), online: <http://ssrn.com/abstract=1713429>.

<sup>120</sup> “Igor Sechin Appointed President of Rosneft,” *Rosneft* (May 23 2012), online: <www.rosneft.com>.

<sup>121</sup> “Russia Orders Ministers Removed From Company Boards,” *Hurriyet Daily News* (April 4 2011), online: <www.hurriyetdailynews.com>.

<sup>122</sup> Catherine Belton, “Putin Stands by State Capitalism,” *Financial Times* (January 30 2012), online: <www.ft.com>; Douglas Busvine, “Putin Puts State Capitalism First for Russia,” *Reuters* (January 30 2012), online: <www.reuters.com>.

many other resource rich countries, is increasingly nationalizing its resources.<sup>123</sup> Oil and gas companies privatized in the 1990s, such as Gazprom, Yukos Oil, and Sibneft, have since been re-nationalized.<sup>124</sup> The danger with President Putin's plan, however, is that it may have repercussions beyond politics. Aggressive state capitalism may impede potential and existing foreign investment in Russia. Moreover, it may negatively affect diplomatic relations with states who perceive Russia as anti-competitive or hostile to foreign investment.

In the early 1990s India turned away from state capitalism. Prior to the 1990s the Indian economy was based on import substitution and the state had a large and active presence in the economy. This period was marked by slow growth – a phase dubbed “Hindu Growth.” In 1991 a balance of payment crisis created an economic downturn. As a result, Finance Minister, Manmohan Singh, accepted an International Monetary Fund bailout accompanied by a structural adjustment package. The package demanded broad deregulation, privatization, and simplification of the licensing system, as well as tax reforms and inflation control – dictums of the Washington Consensus.<sup>125</sup> Under the package, India had to deposit 20 tonnes of gold with the Union Bank of Switzerland and 47 tonnes with the Bank of England as collateral.<sup>126</sup> These reforms caused significant growth and converted India to a market based economy.

While the liberalization process may have assisted India's growth, Rodrik and Subramanian argue that growth actually resulted from an attitudinal shift in the 1980s from welfare to pro-business policies.<sup>127</sup> Here, Rodrik and Subramanian distinguish between “pro-business” and “pro-market.” Whereas a pro-market strategy removes market obstacles through economic liberalization, a pro-business strategy raises profitability for local incumbents and producers as well as established industries and commercial enterprises. Rodrik and Subramanian found that there was a decisive break from India's previously sluggish growth rates in the 1980s. Between 1950 and 1980 growth averaged 1.7 percent per capita and between 1980 and 2000 it averaged 3.8 percent per capita.<sup>128</sup> In addition, Rodrik and Subramanian found that after decades of no growth, beginning in the 1980s there was a sharp upward trend in real GDP per capita, real GDP per worker, and total factor productivity. Notably, there was not such a dramatic increase in numbers after the 1991 liberalizations.<sup>129</sup> Rather, economic growth continued but at a decelerated rate.<sup>130</sup>

Interestingly, India's new pro-business attitude was not solely motivated by economic reasons but also by wider political economy considerations. As Rodrik and Subramanian explain:

The attitudinal change was grounded primarily in political calculation, and not in a desire to enhance the efficiency of the economic regime. As Kohli notes, Indira's main objective was to counter the perceived threat posed by the Janata party, which had trounced Congress in the Hindi heartland in the 1977 elections. Her political rhetoric consequently became less secular and populist and more communal and private-sector oriented. In Kohli's words, ‘in India's political culture ... the two packages of secularism and socialism and Hindu chauvinism and pro-business have tended to offer two alternative legitimacy formulae for mobilizing political support.’ After 1980, Indira dropped the first package in favor of the second. From our perspective, what is particularly important is that Indira now actively sought to woo the business and industrial establishment.<sup>131</sup>

By contrast, Russia does not share this pro-business attitude.<sup>132</sup> Scepticism hangs over the business sector and its interaction with regulators. Cognizant of this sentiment and its role in impeding economic growth, organizations such as the Center for Legal and Economic Studies are pursuing proposals on the de-criminalization of business and economic activity in Russia.<sup>133</sup>

#### Assessing the Success of the Various Economic Approaches

In this section we consider each country's success by looking at governance indicators. We select the following indicators:

- UN *Human Development Index* (HDI)
- GDP per capita
- *Global Competitiveness Report 2011-12: Institutions*
- *Global Competitiveness Report 2011-12: Infrastructure*
- *Global Competitiveness Report 2011-2012: Macroeconomic Stability*

Each BRIC economy, except Russia, has improved on the UN HDI and in GDP per capita between 1980 and 2009 (see figures 2.3 and 2.4). The improvements, however, are uneven. China and India had almost the same HDI scores in 1980, but since then China's rates have consistently outpaced India. Since 1980, China's GDP per capita has increased by 1,083.21 percent while India's has increased by 234.31 percent. On an annual basis, this translates into a 36.11 percent increase for China and a 7.81 percent increase for India.<sup>134</sup> Russia's HDI growth appears to be slowing and its GDP per capita actually dropped from \$14,766 to \$13,611 between 2009 and 2008.<sup>135</sup> Notwithstanding this drop, it still retains the highest GDP per capita due largely to revenues generated from high commodity prices.

<sup>123</sup> Carlos Valdez, “Bolivia Nationalizes Electrical Grid,” *Bloomberg Businessweek* (May 1 2012), online: <www.businessweek.com>; Raphael Minder, “Spain Stings Argentina Over Oil Company Nationalization,” *The New York Times* (April 20 2012), online: <www.nytimes.com>; “Resource Nationalism in Africa: Wish You Were Mine,” *The Economist* (February 11 2012), online: <www.economist.com>.

<sup>124</sup> Marshall I. Goldman, *Petrostate: Putin, Power, and the New Russia* (Oxford: Oxford University Press, 2008). There is, however, uncertainty as to the next wave of privatization in Russia. Within President Putin's new cabinet, there appears to be a divide as to the most appropriate avenue to be pursued. For more information, see “Russia's New Cabinet: Putin's Gang,” *The Economist* (May 23 2012), online: <www.economist.com>.

<sup>125</sup> Bernard Weinraub, “Economic Crisis Forcing Once Self-Reliant India to Seek Aid,” *The New York Times* (June 29 1991), online: <www.nytimes.com>.

<sup>126</sup> Michel Chossudovsky, “India under IMF Rule,” *Economic and Political Weekly* 28, no. 10 (1993).

<sup>127</sup> Dani Rodrik and Arvind Subramanian, “From ‘Hindu growth’ to Productivity Surge: the Mystery of the Indian Growth Transition,” *NBER Working Paper*, no. 10376 (2004).

<sup>128</sup> *Ibid.*, 106. India's sustained growth over the last decade has recently begun to slow down and the Rupee has been devalued.

<sup>129</sup> This argument is similarly supported by J. Bradford DeLong, “India Since Independence: An Analytic Growth Narrative,” ed. Dani Rodrik, *In Search of Prosperity: Analytic Narratives on Economic Growth* (Princeton: Princeton University Press, 2001); J. Williamson and R. Zaghera, “From Slow Growth to Slow Reform,” *Institute for International Economics* (2002).

<sup>130</sup> Rodrik and Subramanian, “Hindu Growth,” 4.

<sup>131</sup> *Ibid.*, 15. See also Atul Kohli, “Politics of Economic Liberalization in India,” *World Development* 17, no. 3 (1989).

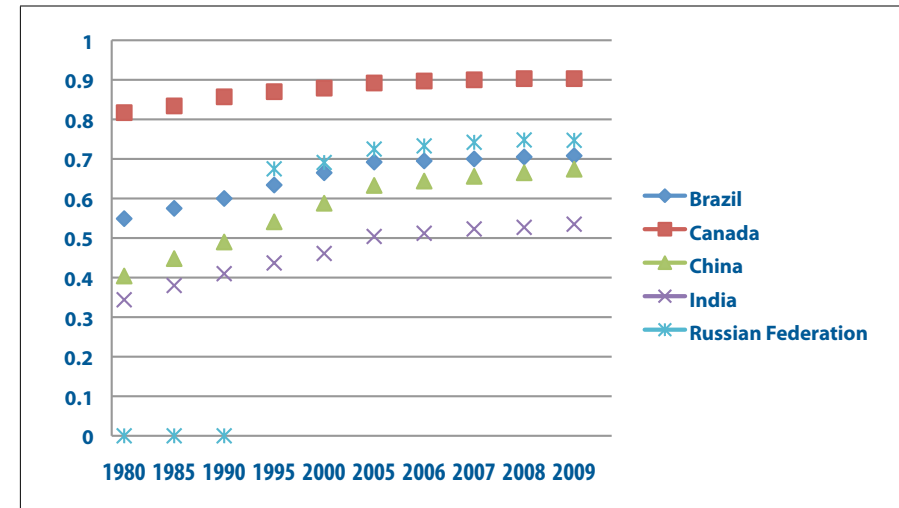
<sup>132</sup> Mehnaz S. Safavian et al., “Corruption and Microenterprises in Russia,” *World Development* 29, no. 7 (2001).

<sup>133</sup> For more information, see the website of the Center for Legal and Economic Studies, online: LECS-CENTER <http://www.lecs-center.org>.

<sup>134</sup> Figures calculated on the basis of data from 1980 to 2010, available from “GDP per capita (2005 PPPS)” *International Human Development Indicators* (United Nations, 2011) online: <http://hdrstats.undp.org/en/indicators/20206.html>.

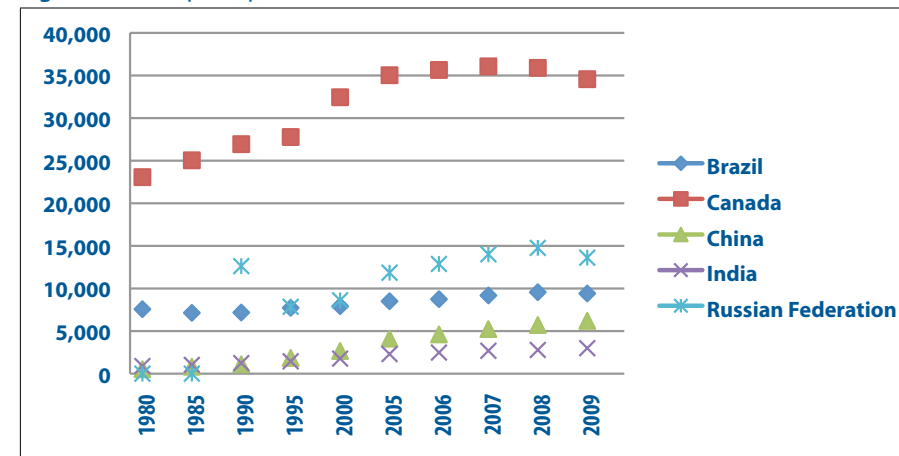
<sup>135</sup> *Ibid.* These figures are expressed in international dollars. An international dollar has the same purchasing power over GDP that the US dollar has in the United States.

**Figure 2.3: UN Human Development Index 1980-2009**



Source: "Human Development Index (HDI) from 1980 to 2010" *International Human Development Indicators* (United Nations, 2011) online <<http://hdrstats.undp.org/en/indicators/default.html>>.

**Figure 2.4: GDP per capita in PPP terms 1980-2009**



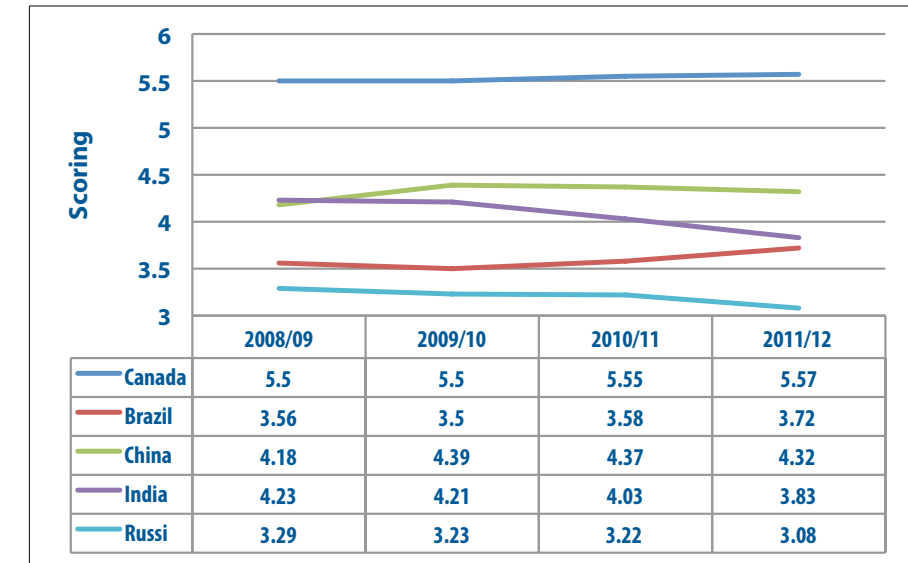
Source: "GDP per capita (2005 PPP\$)" *International Human Development Indicators* (United Nations, 2011) online: <<http://hdrstats.undp.org/en/indicators/20206.html>>.

Notably, China's HDI score has improved significantly compared to the other BRICs, while their progress appears to have stalled. Thus, from relative underdevelopment, China has surpassed India and is now comparable to Russia and Brazil. Russia and Brazil grew tepidly on the HDI index in the last ten years, recording 8.1 percent and 6.47 percent growth respectively.

According to the World Economic Forum's *Global Competitiveness Report Institutions Ranking*, between 2008 and 2011, Russia and India experienced a slight deterioration in their rankings out of 140 countries (see figures 2.5 and 2.6).<sup>136</sup> Russia's rank declined from 110th to 128th. Brazil, on the other hand, witnessed a marked improvement in its rating as it jumped from rank 93 to 77. Institutions are a fundamental component of governance frameworks, which is a subject elaborated on in the institutions section of this report.

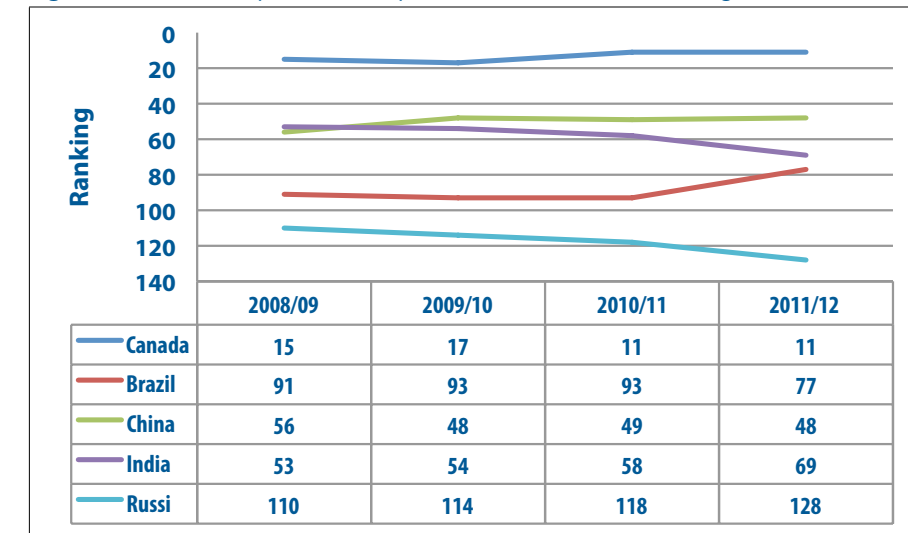
<sup>136</sup> *The Global Competitiveness Report Index 2012-2013 data platform*. World Economic Forum (website). (Geneva, Switzerland: World Economic Forum, 2012) online: <<http://www.weforum.org/issues/competitiveness-0/gci2012-data-platform/>>.

**Figure 2.5: Global Competitiveness Report 2011-12, Institutions Score**



Source: *The Global Competitiveness Report Index 2012-2013 data platform*. World Economic Forum (website). (Geneva, Switzerland: World Economic Forum, 2012) online: <<http://www.weforum.org/issues/competitiveness-0/gci2012-data-platform/>>.

**Figure 2.6: Global Competitiveness Report 2011-12, Institutions Ranking**



Source: *The Global Competitiveness Report Index 2012-2013 data platform*. World Economic Forum (website). (Geneva, Switzerland: World Economic Forum, 2012) online: <<http://www.weforum.org/issues/competitiveness-0/gci2012-data-platform/>>.

The BRICs, except for India, performed well in infrastructure development (see figures 2.7 and 2.8). One of India's major constraints is a critical shortage of power. Infrastructure growth in Russia, China, and Brazil is a result of strategic investment by state corporations. By 2008, China increased the total length of its expressways to over 60,000 km, ranking only second in the world.<sup>137</sup> It built 6,400 km of high speed rail and built the world's largest hydroelectric project, the Three Gorges Dam.<sup>138</sup> India, however, has moved much more slowly. Consider, for example, the Dharavi Redevelopment Project in Mumbai which started in 1997. According to Bardhan,

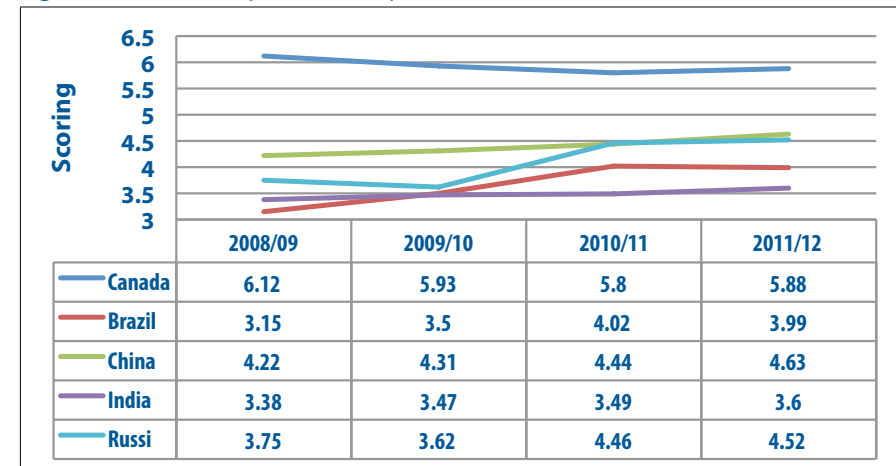
<sup>137</sup> *Development of China's Transportation Infrastructure and International Connectivity*, ed. Zhang Yunling, ERIA Research Project Report 2009 No. 7-5 (ERIA, 2010).

<sup>138</sup> "Mixed Bag: State Owned Enterprises" *The Economist*.

it has taken more than ten years to negotiate with the different contending parties involved on a proposal, not for relocation, but for on-site ‘rehabilitation’ of most of Dharavi’s residents and many commercial activities, and to convince the state government to allocate the political and financial resources required for the project.<sup>139</sup>

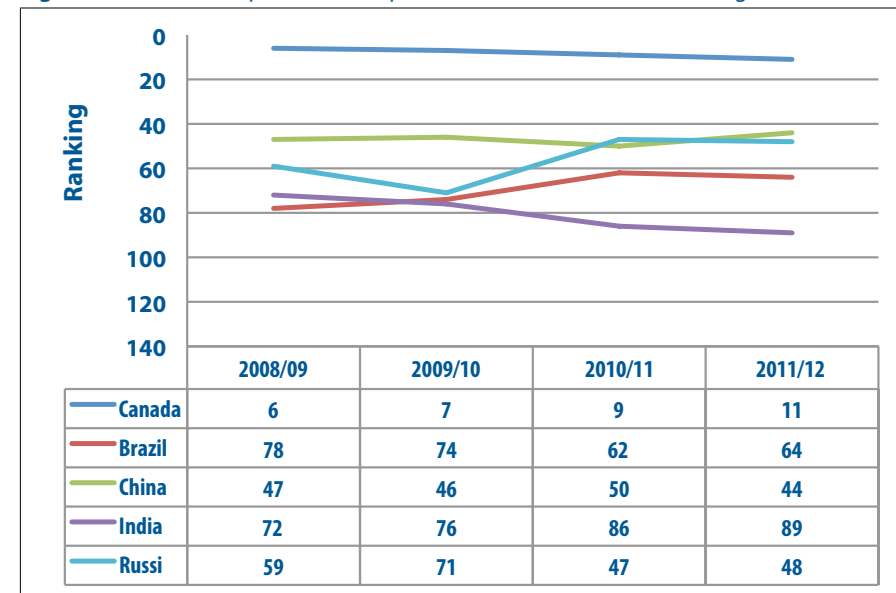
Bardhan suggests that this may also be due to the difficulties found within India’s institutional-political environment.

Figure 2.7: Global Competitiveness Report 2011-12, Infrastructure Score



Source: The Global Competitiveness Report Index 2012-2013 data platform. World Economic Forum (website). (Geneva, Switzerland: World Economic Forum, 2012) online: <<http://www.weforum.org/issues/competitiveness-0/gci2012-data-platform/>>.

Figure 2.8: Global Competitiveness Report 2011-12, Infrastructure Ranking

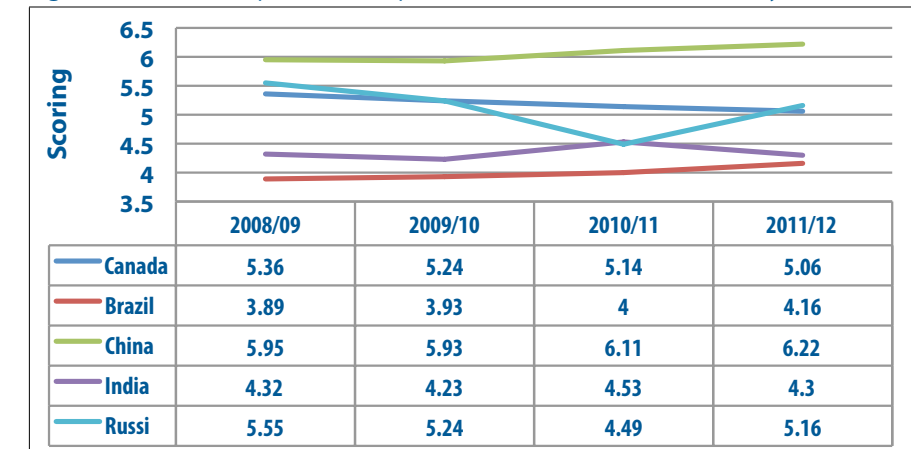


Source: The Global Competitiveness Report Index 2012-2013 data platform. World Economic Forum (website). (Geneva, Switzerland: World Economic Forum, 2012) online: <<http://www.weforum.org/issues/competitiveness-0/gci2012-data-platform/>>.

139 Bardhan, *Awakening Giants*, 61.

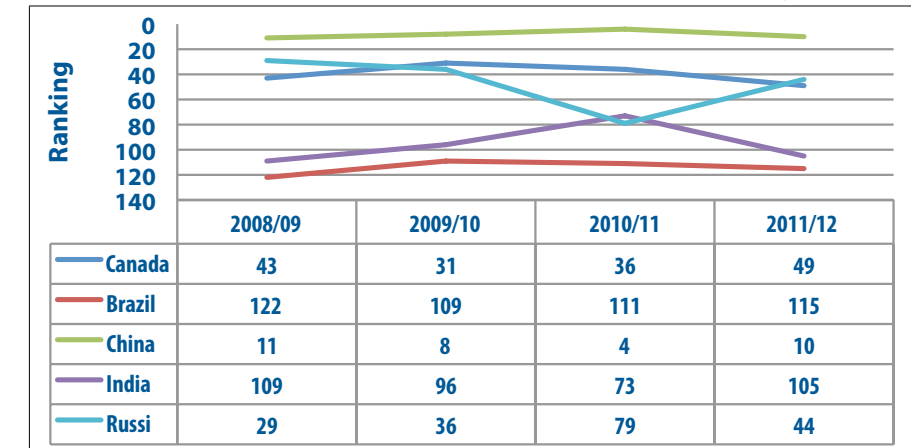
The macroeconomic stability statistics offer a more varied picture (see figures 2.9 and 2.10). China’s score has increased over the last three years and the 2008 financial crisis has had little impact on its economy. Doubt remains over its currency exchange rate which many claim to be undervalued thus giving its export market an unfair advantage. Inflation has recently dropped to manageable levels, this should enable the government to ease monetary policy and step up plans to facilitate growth.<sup>140</sup> Issues such as inflation, however, remain a problem for Russia, India, and Brazil, who have struggled with inflation over various periods in their histories.<sup>141</sup>

Figure 2.9: Global Competitiveness Report 2011-12, Macroeconomic Stability Score



Source: The Global Competitiveness Report Index 2012-2013 data platform. World Economic Forum (website). (Geneva, Switzerland: World Economic Forum, 2012) online: <<http://www.weforum.org/issues/competitiveness-0/gci2012-data-platform/>>.

Figure 2.10: Global Competitiveness Report 2011-12, Macroeconomic Stability Ranking



Source: The Global Competitiveness Report Index 2012-2013 data platform. World Economic Forum (website). (Geneva, Switzerland: World Economic Forum, 2012) online: <<http://www.weforum.org/issues/competitiveness-0/gci2012-data-platform/>>.

140 David Pierson, “China’s Inflation Rate Drops to 20-Month Low,” *Los Angeles Times* (March 10 2012), online: <[articles.latimes.com](http://articles.latimes.com)>.

141 Martin Gilman, “On Inflation, Russia Not Out of the Woods Yet,” *The Moscow Times* (September 14 2011), online: <[www.themoscowtimes.com](http://www.themoscowtimes.com)>.

**The Political Element: “Separation of Powers” and “Checks and Balances”**

This section assesses the *de facto* and *de jure* state of accountability and transparency mechanisms. These mechanisms fall under the principles of separation of power and purpose. There must be a separation of purpose from power so that different branches of government are motivated by different goals; as US founding father James Madison put it, each branch of government should have “a will of its own.”<sup>142</sup> These are critical principles to any good governance process that seeks to ensure rule of law.<sup>143</sup>

**Table 2.2:** Enforcement of Regulatory Mechanisms

COUNTRY	RANK
BRAZIL	26 <sup>th</sup> /66
CHINA	43 <sup>rd</sup> /66
INDIA	56 <sup>th</sup> /66
RUSSIA	49 <sup>th</sup> /66

Source: Mark Agrast et al. *World Justice Report: Rule of Law Index 2011*. (Washington DC: The World Justice Project, 2011).

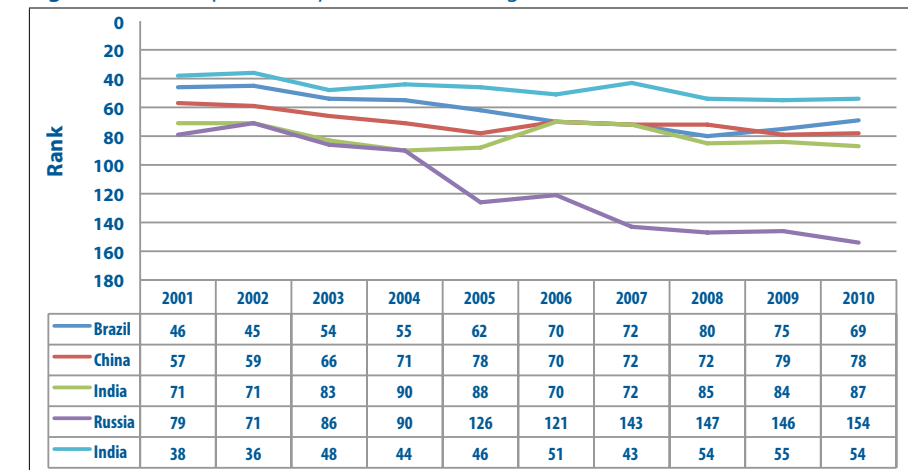
According to Transparency International’s *Corruption Perception Index*, in the last ten years, each of the BRIC member states dropped in the overall *Corruption Perception Index* rankings (see figure 2.11), which is to say that the international perception of corruption in these countries worsened.<sup>144</sup> The World Justice Project’s *Rule of Law Index* for 2011 shows that Russia, India, and China have relatively poor regulatory enforcement mechanisms, coming in with rankings of 49, 56, and 43, respectively, out of 66 countries. Brazil has fared slightly better with a ranking of 26 (see table 2.2). The nature of a state’s political economy is often the cause for this disconnect between idealized normative practice and reality. Below we highlight examples of each state’s attempts to tackle arbitrary uses of power.

<sup>142</sup> Stephan Haggard and Mathew D. McCubbins, *Presidents, Parliaments, and Policy* (Cambridge: Cambridge University Press, 2001), 2.

<sup>143</sup> Ibid.

<sup>144</sup> For an in-depth discussion of the value of corruption perception indices and what they measure, see this report’s section on corruption.

**Figure 2.11:** Corruption Perception Index, Ranking



Source: Transparency International, *Corruption Perception Index*. (Berlin: Transparency International, 2010) online: <www.transparency.org>.

**Brazil**

Brazil’s *Corruption Perception Index* rank fell from 46th in 2001 to 69th in 2010. Its judiciary is lauded as the most independent in Latin America, but it still faces significant challenges. Brazil has been plagued with corruption scandals in the last few decades and to date six ministers in President Dilma Roussef’s cabinet have resigned over corruption allegations.<sup>145</sup> Brazil, however, faces deeper accountability problems, specifically in law enforcement.<sup>146</sup> Police militias are responsible for many extrajudicial murders and a culture of brutality.<sup>147</sup> They are powerful, controlling roughly 45 percent of Rio de Janeiro, including the drug trade in the favelas.<sup>148</sup> Controlling these rogue state officials has proved to be challenging as even judges have been killed in the process.<sup>149</sup> Brazil also faces a significant problem with illegal campaign financing (see box 2.1).

<sup>145</sup> Tom Philips, “Brazil is the Latest Country to Get Angry About Corruption,” *The Guardian* (October 27 2011), online: <www.guardian.co.uk>.

<sup>146</sup> A militia group is an armed force that is distinguished by its lack of official recognition by or sanction from the state. They may be constituted by various members consisting of police, soldiers, or civilians.

<sup>147</sup> Simon Romero and Taylor Barnes, “In Brazil, Officers of the Law, Outside the Law,” *The New York Times* (January 9 2012), online: <www.nytimes.com>.

<sup>148</sup> Ibid.

<sup>149</sup> Ibid.

**Box 2.1: Budgetgate**

In 1992, Brazil impeached President Fernando Collor over the “Budgetgate Scandal.” Following this scandal, 18 members of Congress were fired and a further 11 were investigated. The scandal stemmed from campaign racketeering by Collor’s treasurer, Paulo Cesar Farias. Farias solicited, coerced, and threatened businessmen to contribute to Collor’s campaign. He threatened to blacklist businessmen that did not contribute by refusing to give them government contracts. The media exposed the tactics which resulted in a major investigation against Collor. Investigators later discovered that US\$204 million were missing from the federal budget which resulted in another investigation of 43 members of Congress.

Following Budgetgate, Congress passed legislation modifying the bidding process for public contracts, strengthened campaign finance legislation, and created a new Secretariat of Internal Control. The scandal demonstrated that Brazil’s judiciary and legislature are equipped to challenge corruption and maladministration. Nevertheless, Brazil still has grave accountability problems in the stages leading up to trial as law enforcement is riddled with corruption.

**Source:** David Fleisher, “Political Corruption in Brazil,” *Crime, Law and Social Change* 25, no. 4 (1996); Carlos Santiso, “Economic Reform and Judicial Governance in Brazil: Balancing Independence With Accountability,” *Democratization* 10, no. 4 (2003).

With the aim of strengthening its accountability mechanisms, Brazil has established several independent regulatory agencies that regulate the market.<sup>150</sup> Previously, regulatory power was concentrated within the Presidency. Under this system, there was an absence of institutionalized horizontal accountability mechanisms overseeing the President or the Legislature. New regulatory bodies, inspired by those in Europe and the US, were thus introduced by constitutional amendments in 1990 and 2001. Agencies include the National Telecommunications Agency, National Electric Power Agency, National Oil Agency, and National Health Surveillance Agency, among others. They were to serve as new mechanisms of public participation and vertical accountability. Their structure was intended to further democratize Brazilian state bureaucracy as well as the legal and political systems.

The regulatory agencies operate mostly in the fields of water, electricity, mines, and energy. They share three main characteristics:

- Decisions by deliberative councils;
- Autonomy of the regulatory body in the decision-making processes (i.e. normative, adjudicative, and executive powers); and
- Mechanisms of vertical accountability through direct public participation in the decision-making processes (by means of public hearings and public consultations).<sup>151</sup>

The agencies mark a new decision-making dynamic within the Brazilian state and provide additional means of oversight. Yet these agencies are far from perfect. Prado reports that agencies remain open to corruption and political influences despite being constitutionally independent.<sup>152</sup> This may be due to structural weaknesses caused

<sup>150</sup> Paulo T.L. Mattos, “The Regulatory Reform in Brazil: New Regulatory Decision-Making and Accountability Mechanisms,” *Institute for International Law and Justice* (2007); Mariano Mota Prado, “The Challenges and Risks of Creating Independent Regulatory Agencies: A Cautionary Tale from Brazil,” *Vanderbilt Journal Transnational Law* 41 (2008).

<sup>151</sup> Mattos, “Regulatory Reform in Brazil,” 4.

<sup>152</sup> Prado, “Challenges and Risks of Creating Independent Regulatory Agencies.”

by the wholesale transplantation of foreign models, the President’s influence in selecting agency chairmen, or the President’s influence over individual agency members.<sup>153</sup> Prado cautions against transplanting one-size-fits-all models from other countries and emphasizes the uniqueness of a country’s legal, political, and institutional environment.

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### India

Political accountability challenges exist at every level of India’s political structure. As Bardhan explains,

local democracy or self-government is still inadequately developed: regular elections at the district level and below are not followed up with effective accountability of governance to the local people in most areas (for funding and personnel, local governments are still hopelessly dependent on authorities above, apart from the problems of capture by the local power elite), and the delivery of essential social services and local public goods continues to be dismal.<sup>154</sup>

India has relatively strong formal structures, specifically the judiciary, that hold politicians accountable.<sup>155</sup> The 2G spectrum scandal in 2008 demonstrates the relative efficiency of India’s formal accountability mechanisms. The Central Bureau of Investigation was involved in the investigation even though the Supreme Court criticized it for being “tardy.”<sup>156</sup> The Central Bureau of Investigation called a special court to try the accused and the Supreme Court has since quashed the 122 faulty licences describing their allocation as “unconstitutional and arbitrary.”<sup>157</sup> The corporations involved recently filed an appeal against the Supreme Court’s decision, but the court rejected the appeal.<sup>158</sup> The government has also, after several refusals, agreed to establish a Joint Parliamentary Committee to investigate the scandal. This investigation has yet to be concluded. Although the judiciary and Central Bureau of Investigation are relatively strong formal institutions they face serious weaknesses.<sup>159</sup> Luckily, India’s strong civil anti-corruption movement is putting pressure on the government to improve its institutions and enact stronger legislation to hold officials accountable. This has contributed to a dynamic whereby civil society is making up for the horizontal accountability weaknesses in the formal state institutions.<sup>160</sup>

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### China

As a single-party authoritarian state China faces unique accountability challenges. The checks and balances characteristic of a liberal democracy do not exist. Yet, one-party rule means that the Communist Party is solely to blame for any abuse of power by its members.

The National People’s Congress has taken on a greater role in the legislative process and has achieved relative independence. Martin perceives it as a mere “rub-

<sup>153</sup> *Ibid.*, 496 et seq.

<sup>154</sup> Bardhan, *Awakening Giants*, 18.

<sup>155</sup> *Global Corruption Report 2007: Corruption in Judicial Systems*, ed. Diana Rodriguez, et al. (Cambridge: Transparency International, Cambridge University Press, 2007).

<sup>156</sup> “Supreme Court pulls up CBI for tardy spectrum probe,” *The Statesman* (October 29 2010), online: <www.thestatesman.co.in>.

<sup>157</sup> “Five Crore Fine for Unitech, Swan and Tata Teleservices,” *NDTV* (February 2 2012) online: <www.ndtv.com>.

<sup>158</sup> “2G Scam: SC Dismisses Review Petitions of Telecom Companies,” *The Times of India* (April 4 2012), online: <articles.timesofindia.indiatimes.com>.

<sup>159</sup> These weaknesses are discussed at length in this report’s sections on the judiciary and corruption.

<sup>160</sup> For further discussion on this movement see the media and civil society section of this report.

ber-stamping” body, but Chien-Min presents compelling evidence that the National People’s Congress is becoming assertive and autonomous.<sup>161</sup> The 1982 Constitution created six permanent committees in the National People’s Congress, including one on legal matters. Added to these were the Committee on Internal and Judicial Affairs in 1988 and the Committee on Environmental Protection in 1993. The committees have developed their own rules and sub-committees. Of particular interest to us is the Law Committee.

The Law Committee reviews all bills before they are considered by the National People’s Congress. As Chien-Min explains,

it is the Law Committee that has the ultimate power of deciding whether to incorporate those opinions [of other interested committees] and bring them to the attention of the Praesidium of the [National People’s Congress] or the [National People’s Congress Standing Committee] plenary meeting. Without this procedure of *tongyi shenyi* (to examine indiscriminately), a bill is not allowed to progress to the second reading. The role of the Law Committee is especially significant for the [National People’s Congress] owing to its large size and short meeting time (only a couple of weeks per annum).<sup>162</sup>

The National People’s Congress and other People’s Congresses also exercise supervisory oversight in the implementation of various laws. The practice, known as *pingyi*, has won acclaim from various high-ranking members of the National People’s Congress for its use in inspecting the work of government departments (*gongzuo pingyi*) or particular officials (*shuzhi pingyi*) at various levels. Inspecting officials from the various People’s Congresses often visit particular departments and conduct follow-up reviews to ensure that standards are met. *Gongzuo pingyi* has been particularly useful in tackling corruption within law enforcement agencies at the local level (*zhengfa xitong*). This has translated into oversight of police work, the Procurator’s office, and the court system.<sup>163</sup> It should be noted, however, that while these are concrete steps towards improving oversight within this unique party-state system, Chien-Min admits that this is an initiative that has been implemented mainly at the local level and has had mixed results. But as with most reform in China, it is at the local level that reforms are first tested before making their way up the system.

## Russia

Russia faces tremendous accountability problems with its fledgling democratic institutions. President Putin has demonstrated over his multiple terms that he prizes stability above all else.<sup>164</sup> This raises issues about the extent to which other actors can adequately offset the President’s power. Energy security especially raises concerns. Russia has tied its economic success to its natural resources which has made it vulnerable to a “resource curse.”<sup>165</sup> It derives approximately half of its federal budget from energy.<sup>166</sup> Yet, those profits are not distributed equally across the country as poorer sectors of the population have less access.<sup>167</sup> Such overreliance on resources

<sup>161</sup> Martin, “Understanding China’s Political System”; Chao Chien-Min, “The National People’s Congress Oversight: Power and the Role of the CCP,” in *Bringing the Party Back In: How China is Governed*, ed. Kjeld Erik Brødsgaard and Yongnian Zheng (Singapore: Eastern Universities Press, 2004).

<sup>162</sup> Chien-Min, “The National People’s Congress Oversight: Power and the Role of the CCP,” 123.

<sup>163</sup> *Ibid.*, 129.

<sup>164</sup> “Vladimir Putin: ‘A Vote for Stability,’” *Aljazeera* (March 5 2012), online: <www.aljazeera.com>; Beom-Shik Shin, “The Return of Old Putin and the New Future of Russia,” *International Relations and Security Network* (May 14 2012), online: <www.isn.ethz.ch>.

<sup>165</sup> Daniel Treisman, “Is Russia Cursed by Oil?” *Journal of International Affairs* 63, no. 2 (2010).

<sup>166</sup> “Russia GDP: Trading Economics,” *Trading Economics* (2012) online: <www.tradingeconomics.com>.

<sup>167</sup> *Development As Accountability: Accountability Innovators in Action*, (AccountAbility, 2007), 30.

is associated with weak democracies, high levels of corruption, and income inequality. Egorov et al. have found a correlation between resource rich countries and weak media.<sup>168</sup> Given the Kremlin’s close relationship to oil corporations, oversight may be irregular and inadequate.<sup>169</sup>

A group of NGOs have founded an initiative named the “Sustainable Development of Model Communities on a Municipal Level in Russia,” which develops energy-efficiency projects by strengthening cooperation among organizations, sectors, and regions.<sup>170</sup> To date, the group was able to develop mechanisms of joint financing for communities amongst local governments, NGOs, businesses, and the public on the basis of resource consolidation and transparent decision making. The group was also able to develop integrated approaches to local decision making in the distribution of local resources.<sup>171</sup>

## EFFICIENT, INDEPENDENT, ACCOUNTABLE, AND OPEN PUBLIC SERVICE

For the final stage of Leftwich’s analysis – the administrative aspect – we assess the extent to which citizens can participate in governance. We start with *Voice and Legitimacy* which assesses the extent to which stakeholders are able to participate in governance. The *Voice and Accountability* dimension of the *World Governance Indicators* assesses open, independent, and efficient public service from the perspective of citizens (see figure 2.10). China had the worst score in the last decade, followed by Russia. India and Brazil are roughly equal as the best performers in the group. We also consider policies that increase citizens’ ability to participate.

Brazil’s relatively good performance could be attributed to its formation of “participatory publics.” According to Wampler and Avritter, “participatory publics are comprised of organized citizens who seek to overcome social and political exclusion through public deliberation, the promotion of accountability, and the implementation of their policy preferences.”<sup>172</sup> Participatory publics were constitutionalized in 1988. They have since become fora for collaboration between local politicians and citizens. Participatory budgeting is one of the most successful forms of participatory publics. Through this process, citizens directly debate decisions on allocation of public resources in their neighbourhoods. The municipality of Porto Alegre initiated this practice in 1989 and by 2001 it had spread to at least 103 municipalities.<sup>173</sup> Such initiatives challenge pervasive clientelism in Brazil. In 2010, it was this type of citizen’s petition, signed by 1.5 million people, that precipitated *Ficha Limpa*, or “Clean Records Bill.”<sup>174</sup> In February 2012 Brazil’s Supreme Court ruled that the bill was constitutional.<sup>175</sup> It requires public officials to have clean criminal records to be eligible for public office.

<sup>168</sup> Georgy Egorov et al., “Why Resource-poor Dictators Allow Freer Media: A Theory and Evidence from Panel Data,” *The American Political Science Review* 103, no. 4 (2009).

<sup>169</sup> Luke Harding, “WikiLeaks Cables Condemn Russia as ‘Mafia State,’” *The Guardian* (December 1 2010), online: <www.guardian.co.uk>.

<sup>170</sup> *Development As Accountability: Accountability Innovators in Action*.

<sup>171</sup> *Ibid.*, 35.

<sup>172</sup> Brian Wampler and Leonardo Avritter, “Participatory Publics: Civil Society and New Institutions in Democratic Brazil,” *Comparative Politics* 36, no. 3 (2004), 295.

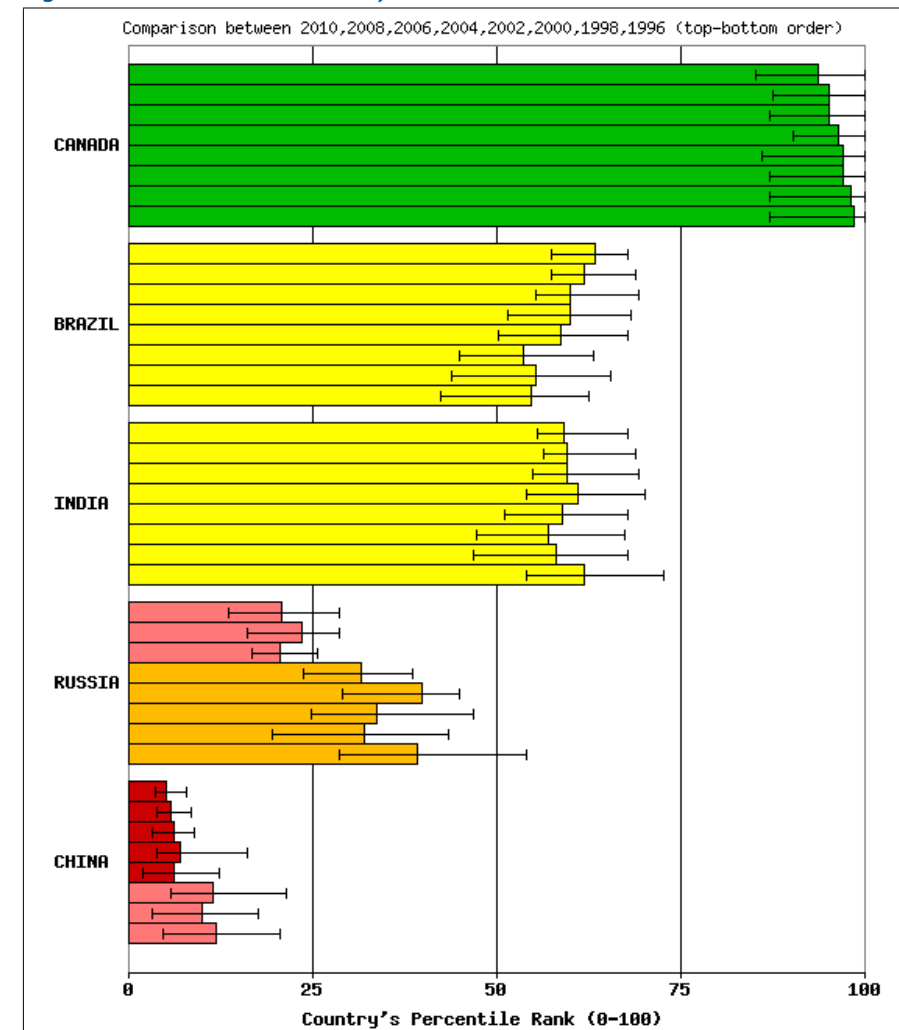
<sup>173</sup> *Ibid.*, 291-92.

<sup>174</sup> Brazil, “Clean Records Bill” or *Ficha Limpa*, Law 9,840/99 of December 29, 1999; “Cleaning Up: A Campaign Against Corruption,” *The Economist* (July 8 2010), online: <www.economist.com>. For more see database of legislation at the end of this report.

<sup>175</sup> Sarah de Sainte Croix, “Brazil Anti-Corruption Act Upheld: Daily,” *The Rio Times* (February 17 2012), online: <riotimesonline.com>.

India has a similarly good score in this category. For all the criticisms that may be leveled against it, India's is the largest functioning democracy in the world. Individuals may cast ballots at all state levels, which is no easy task for a population of 700 million. Moreover, politicians are receptive to citizens' concerns in order to win votes.

**Figure 2.12: Voice and Accountability (2010)**



Source: D. Kaufmann et al., *The World Governance Indicators: Methodology and Analytical Issues* (2010) online: <[http://info.worldbank.org/governance/wgi/sc\\_country.asp](http://info.worldbank.org/governance/wgi/sc_country.asp)>.

**Note:** The governance indicators presented here aggregate the views of the quality of governance provided by a large number of enterprise, citizen, and expert survey respondents in industrial and developing countries. These data are gathered from a number of survey institutes, think tanks, non-governmental organizations, and international organizations.

Nevertheless, Goetz and Jenkins show how the majority of individuals are excluded from the governance process.<sup>176</sup> Only special interest groups, lobby groups, and elites have access to politicians, which has disillusioned the majority of citizens. Moreover, institutions lack horizontal accountability and are not transparent, efficient, or effective. Subsequently, in partnership with various NGOs, citizens have taken it upon themselves to engage with local officials to improve public service delivery. One such

example is of the group Rationing Kruti Samiti, which is sponsored by various NGOs in Mumbai (see box 2.2).<sup>177</sup>

**Box 2.2: Rationing Kruti Samiti (RKS)**

Since 1993 RKS has pressured public officials to improve Mumbai's Public Distribution System, which is India's program for administering food subsidies. It assumed a role of vertical accountability. Officially, the State Vigilance Committee monitors the Public Distribution System. In the face of corruption, inefficiency, and "leakage," however, RKS created its own monitors. It established its own vigilance committees composed of Public Distribution System clients to track supplies from distribution outlets and sales to clients. The strategy was to develop a constructive relationship with public-sector officials to improve the Public Distribution System's efficiency. Over time, RKS gained semi-official recognition. At regular meetings with public officials it brought up cases of mal-administration which led to some administrative reforms. As Goetz and Jenkins explain:

*The regular meetings, which systematically reviewed progress on various aspects of reform, were also used to push – successfully, as it turned out – for simplification of procedures at the shop level, the introduction of new products in the system and the implementation of new measures to ensure product quality at the consumer level.*

*The latter measure, requiring provision of a sealed transparent sample of each bulk commodity attached (and unremovable) from each new delivery, was seen as a key way of enabling consumers to monitor the system more effectively. This sample would indicate the quality of commodities delivered. The purpose was to counter the practice of adulteration, in which, for instance, kerosene is diluted, or rice mixed with sand, to disguise the theft of some portion of the original consignment. Physical evidence about the quality of the sample was important because it enabled illiterate consumers to identify differences between the quality of the original consignment from the government warehouses and the commodity that actually made it to the [Public Distribution System] sale counter. Official auditors could be alerted to these cases, and could then perform a more detailed probe of the shop's operations.*

The RKS has been tremendously successful and is still active with the Public Distribution System. Their success was also largely due to outside factors which created a favourable environment. For example, a reform-oriented Regional Controller of Rationing was receptive to their initiatives.

Source: Anne Marie Goetz and Rob Jenkins "Hybrid Forms of Accountability: Citizen Engagement in Institutions of Public-Sector Oversight in India." *Public Management Review* 3, no. 3 (2001), 372

<sup>176</sup> Anne Marie Goetz and Rob Jenkins, "Hybrid Forms Of Accountability: Citizen Engagement in Institutions of Public-sector Oversight in India," *Public Management Review* 3, no. 3 (2001).

<sup>177</sup> Ibid., 365.



After assessing these kinds of initiatives, Goetz and Jenkins identify five conditions that improve citizen-initiated versions of horizontal accountability, which are equally applicable to Brazil:

- Legal standing for non-governmental observers within institutions of public-sector oversight;
- A continuous presence for these observers throughout the process of the agency's work;
- Well-defined procedures for the conduct of encounters between citizens and public-sector actors in meetings;
- Structured access to the flow of official documentary information; and
- The right of observers to issue dissenting reports directly to legislative bodies.<sup>178</sup>

China has the lowest *Voice and Accountability* ranking of the group. While China's authoritarian system excels at implementing long-term investment strategies it is unsuccessful at including dissent. The government places huge importance on public order and cohesion and to this end suppresses civil disobedience and limits freedom of expression. A good example is the extensive Internet censorship – the so-called “Great Firewall of China.”<sup>179</sup> In addition, since President Hu Jintao's leadership, officials arrested many journalists in a crackdown on the media.<sup>180</sup> Notably, however, in response to a land expropriations scandal in Guangdong province, the government permitted Wukan citizens to elect officials themselves.<sup>181</sup> While this is a step forward for grassroots democracy, it does not necessarily signal wider democratization in China.

The Chinese governance system has evolved somewhat from the nomenklatura system that emulated the Soviets.<sup>182</sup> Within the old system, the Party retained significant control over senior personnel appointments, dismissals, and transfers at all levels across the country. In the new system the Party eased the strict control exercised by senior officials and gave mid-level managers more leeway over their personnel. The Party reformed the local cadre responsibility system (*gangwei zerenzhi*) and introduced performance contracts (*gangwei mubiao zerenshu*).<sup>183</sup> Moreover, the Party converted strict targets to guidelines for development projects, tax collection, family planning, and agriculture. Party officials are now evaluated on their performance by their direct superiors rather than senior officials from the central administration.<sup>184</sup> If they do well, they are promoted or given greater responsibility; if they do not, then they are demoted or transferred elsewhere. The evaluation methods include assessments or citizen complaint letters. Edin elaborates on the role of the citizenry in this process:

Citizens submitting complaint letters to higher levels fulfil a similar function in the monitoring of local leaders. O'Brien and Li have highlighted how complaint letters affect the evaluation score of local leaders, who may be downgraded if too many complaints are filed or if complaints are not dealt with properly. In one county in Zhejiang,

two situations are considered to pose serious problems for the cadres: one is where complaints are filed or if complaints are not treated appropriately at the county level such that the complainant appeals to the next higher level (*yueji shangfang*) and the other is, in direct translation, ‘to assemble a mob in order to submit a letter of complaint’ (*juhong shangfang*). Information from citizens plays a major role in uncovering cadre misbehaviour as it is an alternative channel of information, and intervention from the public also puts pressure on the Party to act. One study reports that 80% of the tipoffs about cadre misconduct and financial irregularities came from letters of complaint sent by the public.<sup>185</sup>

Edin cautions that one should not be quick to classify this as a democratization process.<sup>186</sup> Although citizens are able to influence decisions, the Party still retains veto power. This is akin to “client-rating,” whereby citizens voice their views. If this were actual democratization, citizens would be accorded specific rights such as freedom of speech and association which would not be compromised for the sake of stability and prosperity.<sup>187</sup>

Russia has a weak *Voice and Legitimacy* rating which is only worsening. President Putin, a former KGB official, has repressed political dissent to maintain stability.<sup>188</sup> Moreover, many journalists and lawyers in Russia have often been arrested and/or assaulted.<sup>189</sup> During Medvedev's presidency, he tried to reform many aspects of administration and imbue government with a respect for the rule of law – topics which we elaborate at length in the institutions, judiciary, and corruption sections of this report. With Putin's re-election it remains to be determined whether he will continue with these reforms or will shut down citizen participation. Recent demonstrations against President Putin's re-election, however, demonstrate that the Russian public is showing strong signs of public participation, protest, and dissent. Russia is thus at a critical governance juncture; the Russian government may choose to include Russian citizens' voices as a valuable stakeholder in the governance process or they may shut them out.

<sup>178</sup> Ibid., 369.

<sup>179</sup> *Race to the Bottom: Corporate Complicity in Chinese Internet Censorship*, 8(C) vols., vol. 18 (Human Rights Watch, August 2006).

<sup>180</sup> Ibid.

<sup>181</sup> For a short overview of land expropriation in China see Liao Junping, *Land Expropriation in China – A Simple Introduction* (2009).

<sup>182</sup> John P. Burns, “China's Nomenklatura System,” *Problems of Communism* 36, no. 5 (1987).

<sup>183</sup> Maria Edin, “State Capacity and Local Agent Control in China: CCP Cadre Management from a Township Perspective,” *The China Quarterly*, no. 173 (2003); Kevin J. O'Brien and Lianjiang Li, “Selective Policy Implementation in Rural China,” *Comparative Politics* 31, no. 2 (1999).

<sup>184</sup> Edin, *Bringing the Party Back In*.

<sup>185</sup> Ibid., 181. See also Kevin J. O'Brien and Lianjiang Li, “The Politics of Lodging Complaints in Rural China,” *The China Quarterly*, no. 143 (1995).

<sup>186</sup> Edin, *Bringing the Party Back In*.

<sup>187</sup> Ibid., 182.

<sup>188</sup> Brian D. Taylor, *State Building in Putin's Russia: Policing and Coercion After Communism* (Cambridge: Cambridge University Press, 2011), 99.

<sup>189</sup> For more on this topic see our section on media and civil society.

## CONCLUSION

Governance is a complex concept that attempts to make sense of a state's mechanisms and processes. As a concept, it considers both the holistic function of the state and its internal particularities. It should be conceived as a regime in which the aspirations of various stakeholders are realized through a process of interaction, facilitated by a complex of rules and institutions. Within this, the role of the state is most certainly critical as it is only through the state's political will that such a framework can be productive. That said, the power of the state must be counter-balanced by various other actors within the governance process, such as media and civil society.

Governance is pivotal to the attainment of rule of law and economic development. As has been shown, the particular political form or function that a state may adopt does not necessarily create negative consequences. Notwithstanding this, states should attempt to adhere to the UN Development Program's five principles that ensure good governance, so that various stakeholders play an adequate role and their needs are sufficiently met.

## APPENDIX 2.1: DEFINITIONS OF THE TERM “GOOD GOVERNANCE” AS EMPLOYED BY VARIOUS INTERNATIONAL ORGANIZATIONS

**World Bank:** Governance is the manner in which power is exercised in the management of a country's economic and social resources. The World Bank has identified three distinct aspects of governance: 1) the form of political regime; 2) the process by which authority is exercised in the management of a country's economic and social resources for development; and 3) the capacity of governments to design, formulate, and implement policies and discharge functions.<sup>190</sup>

**UNDP:** “UNDP defines governance as the exercise of political, economic and administrative authority in the management of a country's affairs at all levels. Governance comprises the complex mechanisms, processes and institutions through which citizens and groups articulate their interests, mediate their differences and exercise their legal rights and obligations. Good governance has many attributes. It is participatory, transparent and accountable. It is effective in making the best use of resources and is equitable. And it promotes the rule of law.”<sup>191</sup>

**OECD:** The concept of governance denotes the use of political authority and exercise of control in a society in relation to the management of its resources for social and economic development. This broad definition encompasses the role of public authorities in establishing the environment in which economic operators function and in determining the distribution of benefits as well as the nature of the relationship between the ruler and the ruled.<sup>192</sup>

**Commission on Global Governance:** Governance is the sum of the many ways individuals and institutions, public and private, manage their common affairs. It is a continuing process through which conflicting or diverse interests may be accommodated and co-operative action may be taken. It includes formal institutions and regimes empowered to enforce compliance, as well as informal arrangements that people and institutions either have agreed to or perceive to be in their interest.<sup>193</sup>

**Institute of Governance, Ottawa:** Governance is a process whereby societies or organizations make their important decisions, determine whom they involve in the process and how they render account.<sup>194</sup>

<sup>190</sup> World Bank, *Governance: the World Bank's Experience* (Washington, DC: World Bank, 1994), xiv.

<sup>191</sup> UNDP, *Governance for Sustainable Human Development*, (New York: UNDP, 1997), 2.

<sup>192</sup> Organization for Economic Co-operation and Development, *Development Assistance, Participatory Development and Good Governance* (Washington, DC: OECD Publications and Information Centre, 1995), 14.

<sup>193</sup> Commission on Global Governance, *Our Global Neighbourhood: the Report of the Commission on Global Governance* (New York: Oxford University Press, 1995), 2.

<sup>194</sup> Graham et al., “Principles for Good Governance.”

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# SECTION 3:

## Examining the Quality of Institutions across the BRICs

### INTRODUCTION

The surge of interest in the relationship between rule of law and economic development is the result of a confluence of factors including Africa's disappointing development growth, the fall of the Soviet Union coinciding with democracy promotion, and efforts to advance the rule of law for political, economic, and security reasons. Following disappointments in state-led growth development strategies, the focus shifted towards a limited role for the state and the revival of free-market economics. The Washington Consensus espoused a universal package of policy reforms through liberalization, privatization, and stabilization. These principles produced meager growth, however, even amongst the most ambitious reformers in Latin America, which was further tested by the East Asian crisis in 1997.<sup>1</sup>

These disappointing outcomes shifted focus towards the primacy of institutions over policy as the key determinant for long-term economic development. This increased the importance of the problem of economic growth, rehabilitated the role of institutional variables, and shifted attention to the classical issues of economic freedom, market principles, and the limits of government. As described by North:

Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights). ... [They] provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation, or decline.<sup>2</sup>

Up to that point, much of the literature on institutions and transaction costs acknowledged that institutions were efficient solutions to the complex problems confronting entrepreneurs, but took it as a given that formal economic constraints or property rights are specified and enforced by *political* institutions.<sup>3</sup> North revived the need to account for the evolution of both political and economic institutions “that create an economic environment that induces increasing productivity.”<sup>4</sup> Institutions became the central focus for explaining the varied performance of economies over time, especially in light of the overwhelming failure of economies to “produce a set

of economic rules of the game (with enforcement) that induce sustained economic growth.”<sup>5</sup>

The core theoretical mechanisms that link law to economic development are property rights and contract enforcement.<sup>6</sup> These mechanisms were the groundwork of New Institutional Economics. These mechanisms were further developed in New Economic History, of which North was the most influential proponent.<sup>7</sup> There is a direct lineage between this early work and New Growth Theory which focuses on the role of institutions.<sup>8</sup> According to New Institutional Economics, there are several channels that link contract and property rights with economic growth, but incentives play a central role. As Haggard et al. summarize,

the more well-developed and secure are property rights, the greater the incentives individuals have to invest. Secure property rights and the capacity to contract over time and space also permit trade and a corresponding increase in the efficiency of resource allocation, including through the development of the financial system ... Investments can be expropriated, and contracts can be broken. Individuals can protect their own property or reach self-enforcing bargains to address these risks, but the costs of monitoring and enforcement and the effects of uncertainty can easily outweigh the gains from investment and trade. Credible third-party enforcement of property rights and contract increases private returns, extends time horizons, and deters opportunistic behavior.<sup>9</sup>

In essence, the predictability of the rule of law through its consistent application and enforcement allows actors “to foresee accurately the legal consequences of their actions and not be subject to sudden surprises.”<sup>10</sup>

In this section, we will explore the inherent difficulty in establishing causality between rule of law and economic development, especially with regard to institutional variables. This introduces a discussion of the importance of informal institutions. The entire discussion is informed by Haggard and Tiede's thesis that institutions cannot be unbundled from one another. Next we discuss the emergence of the primacy of institutions over policy, which was a direct result of the poor outcomes generated by the Washington Consensus. Following that we discuss the role of political economy, particularly the role of economic and political incentives for reform. Lastly, we

<sup>5</sup> North, “Institutions,” 98.

<sup>6</sup> Ronald H. Coase, “The Problem of Social Cost,” *Journal of Law and Economics* 3 (1960); A. Alchian, “Some Economics of Property Rights,” *Il Politico* 30 (1965); Armen A. Alchian and Harold Demsetz, “The Property Rights Paradigm,” *The Journal of Economic History* 33, no. 1 (1973); Harold Demsetz, “Toward a Theory of Property Rights,” *The American Economic Review* 57, no. 2 (1967); Williamson, *The Economic Institutions Of Capitalism*; Oliver E. Williamson, “The Vertical Integration of Production: Market Failure Considerations,” *The American Economic Review* 61, no. 2 (1971).

<sup>7</sup> Douglass C. North and Robert Paul Thomas, *The Rise of the Western World; A New Economic History* (Cambridge: University Press, 1973); Douglass C. North, *Structure and Change in Economic History* (New York: Norton, 1981); Douglass C. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge University Press, 1990); Kenneth W. Dam, *The Law-Growth Nexus: The Rule of Law and Economic Development* (Washington, DC: Brookings Institution Press, 2007).

<sup>8</sup> Daron Acemoglu et al., “The Colonial Origins of Comparative Development: An Empirical Investigation,” *American Economic Review* 91, no. 5 (2001); Daron Acemoglu and Simon Johnson, “Unbundling Institutions,” *NBER Working Paper*, no. 9934 (2003); William Easterly and Ross Levine, “Tropics, Germs, and Crops: How Endowments Influence Economic Development,” *Journal of Monetary Economics* 50, no. 1 (2003); Dani Rodrik et al., “Institutions Rule: the Primacy of Institutions over Geography and Integration in Economic Development,” *NBER Working Paper*, no. 9305 (2002).

<sup>9</sup> Stephan Haggard et al., “The Rule of Law and Economic Development,” *Annual Review of Political Science* 11, no. 1 (2008).

<sup>10</sup> John A. Ferejohn and Pasquale Pasquino, “Rule of Democracy and Rule of Law,” in *Democracy and the Rule of Law*, ed. Adam Przeworski and José María Maravall (Cambridge, UK: Cambridge University Press, 2003), 242. See also Simeon Djankov et al., “The Regulation of Entry,” *The Quarterly Journal of Economics* 117, no. 1 (2002); Rafael La Porta et al., “Law and Finance,” *Journal of Political Economics* 106 (1996).

<sup>1</sup> Sharun Mukand and Dani Rodrik, “In Search Of The Holy Grail: Policy Convergence, Experimentation, and Economic Performance,” *NBER Working Paper*, no. 9134 (2002), 1-3. Despite embarking on an orthodox reform agenda across Latin America, by the late 1990s, only Chile had been a genuine success. Argentina collapsed, Uruguay and Bolivia had meager growth rates and Mexico, Brazil, and others had yet to attain the growth rates that they experienced between 1950 and 80. On the other hand, countries that had been successful in East Asia such as South Korea and Taiwan employed orthodox policies that emphasized fiscal conservatism, exports, and human resources and unorthodox policies that protected their domestic markets and made extensive use of industrial policies.

<sup>2</sup> Douglass C. North, “Institutions,” *Journal of Economic Perspectives* 5, no. 1 (1991), 97.

<sup>3</sup> Oliver E. Williamson, *Markets and Hierarchies, Analysis and Antitrust Implications: A Study In The Economics Of Internal Organization* (New York: Free Press, 1975); Oliver E. Williamson, *The Economic Institutions Of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, 1985).

<sup>4</sup> North, “Institutions,” 98.

discuss the interaction between formal and informal institutions in each of the BRIC countries and how these impact economic growth.

## MEASURING INSTITUTIONS: ENDOGENEITY, CAUSALITY, AND COMPLEMENTARITIES

Prompted by the wide differences in economic growth between developed and developing countries, many scholars have studied the link between rule of law and economic development through the lens of institutions.<sup>11</sup> New growth theory literature has attempted to disaggregate institutional variables – especially strength of property rights protection and contract enforcement – to determine what effect, if any, they have on economic growth.<sup>12</sup> North, de Soto, and others, established that security of property rights and contract enforcement provided incentives to investors which in turn fuel economic growth. Indeed the majority of studies have shown that there is a strong link between secure property rights and contract enforcement and economic growth. The more salient questions, however, are: Do these institutions cause economic growth or does economic growth create these strong institutions? Furthermore, is it the institutions themselves that cause economic growth, or is it other factors, which cannot be disaggregated from the institutions – such as underlying political conditions – which cause economic growth?

To illustrate this problem Haggard et al. refer to Acemoglu et al.'s famous study from 2001.<sup>13</sup> Acemoglu et al. hypothesized that settler mortality in the colonies in the 18th and 19th centuries provided an exogenous variable – that is, a variable that affects an economic model without actually being affected by the model – that had an impact on the security of property rights. They measured security of property rights through “risk of expropriation.” Furthermore, they hypothesized, that low settler mortality produced institutions that were more persistent over time with low expropriation risk. Their findings suggest a strong causal influence between settler mortality and weak property rights protection. Thus, they concluded that settler mortality was indeed an exogenous variable. Notably, however, they did not exclude the possibility that economic growth could also be a cause of secure property rights:

Government expropriation is not the only institutional feature that matters. Our view is that there is a ‘cluster of institutions’ including constraints on government expropriation, independent judiciary, property rights enforcement, and institutions providing equal access to education and civil liberties, that are important to encourage investment and growth. Expropriation risk is related to all these institutional features.<sup>14</sup>

Thus, Haggard et al. note that Acemoglu et al. did not resolve the problem of whether economic growth causes secure property rights or vice versa. Furthermore, Acemoglu et al. acknowledged the fact that security of property rights was an institution which functioned in conjunction with many other variables which could not be disaggregated. Thus Haggard et al. conclude that Acemoglu et al.'s study does not demonstrate “the primacy of the property rights story” as they are incapable of distinguishing between competing institutional hypotheses. This outcome creates an

<sup>11</sup> Haggard et al., “Rule of Law and Economic Development” (2008), 206.

<sup>12</sup> North and Thomas, *The Rise of the Western World*; Acemoglu et al., “Colonial Origins,” 205; Rodrik et al., “Institutions Rule.”

<sup>13</sup> Haggard et al., “Rule of Law and Economic Development” (2008); Stephan Haggard and Lydia Tiede, “The Rule of Law and Economic Growth: Where are We?” *World Development* 39, no. 5 (2011); Acemoglu et al., “Colonial Origins.”

<sup>14</sup> Acemoglu et al., “Colonial Origins,” 1370-71 in note 3.

ongoing challenge for understanding the relationship between rule of law and economic development as institutions are “endogenous” variables – that is, they cannot be dissociated from the other measures in the model.

Haggard and Tiede replicated the model used by Acemoglu et al. in 2001 to test other measures that may also be endogenous to long-term growth such as: security of the person; institutional checks on government power; and checks on corruption.<sup>15</sup> They found that settler mortality is indeed a good instrument for the protection of property rights, but it is also a good instrument for all the institutional variables used in their cluster analysis.<sup>16</sup> Consequently, the issue of “unbundling institutions” has not been solved and an even wider range of rule of law measures may be producing the divergence in long-term growth.<sup>17</sup>

In the same study, Haggard and Tiede created a cluster analysis which measured distinct causal mechanisms that are generally associated with rule of law.<sup>18</sup> They found looser than expected correlations across developing and transition countries.<sup>19</sup> Discrete components of the rule of law “hang together” in very different ways than in advanced industrial states where components are tightly correlated.<sup>20</sup> The cluster analysis results led the authors to surmise that *de jure* institutions may not be the source slow economic development and that reform initiatives that target these institutions might not be an adequate solution.<sup>21</sup>

Overall, Haggard and Tiede found that aggregate indices perform better than the discrete components of rule of law highlighted in theoretical literature.<sup>22</sup> In addition, indices and subjective measures may be capturing informal institutions or important differences between *de jure* and *de facto* rule of law.<sup>23</sup> To try to disaggregate any component of the rule of law or institutions would be misleading. Thus, in order to properly understand the relationship between rule of law, institutions, and economic development we must look at formal and informal institutions and political economy. In this discussion, rather than relying on broad cross-national studies we look at country specific studies, which provide more reliable indicators.

## THE PRIMACY OF INSTITUTIONS OVER POLICY

Through a different lens, one that asserts the primacy of institutions over policy, Rodrik et al. examined the respective contributions of institutions, geography, and international trade (trade openness) to explain the difference in per capita GDP between rich and poor countries.<sup>24</sup> Controlling for institutions, geography has at best a weak direct effect on incomes, although it has a strong indirect effect through insti-

<sup>15</sup> Haggard and Tiede, “Rule of Law and Economic Development” (2011), 678.

<sup>16</sup> *Ibid.*, 678-9.

<sup>17</sup> This finding further questions Acemoglu et al.'s claim to have identified a distinct instrument capable of differentiating between the significance of property rights versus contracting. Acemoglu and Johnson, “Unbundling Institutions.”

<sup>18</sup> Haggard and Tiede, “Rule of Law and Economic Development” (2011).

<sup>19</sup> *Ibid.*, 678.

<sup>20</sup> *Ibid.*, 677. The sample of 74 developing and transition countries generated 3 clusters with 49, 19, and 4 countries in each cluster respectively. China was not included in the sample.

<sup>21</sup> *Ibid.*

<sup>22</sup> *Ibid.*, 678.

<sup>23</sup> *Ibid.* See also Christopher Woodruff, “Measuring Institutions,” in *International Handbook on the Economics of Corruption*, ed. Susan-Rose Ackerman (Cheltenham: Edward Elgar, 2006).

<sup>24</sup> Rodrik et al., “Institutions Rule.”



tutions by influencing their quality.<sup>25</sup> Similarly, once institutions are controlled for, trade is almost always insignificant, although it too has a positive effect on institutional quality.<sup>26</sup> Their results demonstrate that the quality of institutions overrides everything else. For example, the difference between the quality of institutions measured in Bolivia and South Korea is equivalent to one standard deviation or a 6.4-fold difference.<sup>27</sup> Therefore, if Bolivia were to somehow acquire South Korea's quality of institutions, its GDP per capita would increase by 6.4 times, which is, not coincidentally, the rough income difference between the two countries. Despite these rather striking findings, their conclusions are nonetheless sobering:

It is helpful to know that geography is not destiny, or that focusing on increasing the economy's links with world markets is unlikely to yield convergence [across countries]. But the operational guidance that our central result on the primacy of institutional quality yields is extremely meager ... Obviously, the presence of clear property rights for investors is a key, if not the key, element in the institutional environment that shapes economic performance. Our findings indicate that when investors believe their property rights are protected, the economy ends up richer. But nothing is implied about the actual form that property right should take. We cannot even necessarily deduce that enacting a private property-rights regime would produce superior results compared to alternative forms of property right.<sup>28</sup>

The authors proceed to contrast the experiences of China and Russia to illustrate how form doesn't follow function:

Despite the absence of formal private property rights, Chinese entrepreneurs have felt sufficiently secure to make large investments, making that country the world's fastest growing economy over the last two decades. In Russia, by contrast, investors have felt insecure, and private investment has remained low. Our institutional quality indicators bear this out, with Russia scoring considerably lower than China despite a formal legal regime that is much more in line with European norms than China's. Credibly signaling that property rights will be protected is apparently more important than enacting them into law as a formal private property rights regime.<sup>29</sup>

Rodrik et al. conclude that their findings do not lead to a particular set of policy conclusions, rather they stress that the optimal institutional arrangements are dependent on a country's specific context and are influenced by historical, geographical, politico-economic, and other initial conditions.<sup>30</sup> This conclusion, they argue, accounts for why developed regions – such as the US, Western Europe, and Japan – have such a wide array of institutional differences between them.

If we look to the BRIC economies, China and India stand out as models of successful growth over the last few decades, whereas growth has been less salutary for

Brazil and Russia although they benefit from high commodity prices. Increased growth rates in China and India fit awkwardly into the paradigm espoused by the Washington Consensus and even New Institutional Economics, largely because policy and institutional reform in both countries departed from conventional wisdom. China's remarkable growth is undoubtedly partially due to liberalizing its markets and introducing hard budget constraints and element of competition in the state sector. Its reforms have been marked by two-track pricing, limited deregulation, financial restraint, an unorthodox legal regime, and the absence of clear private property rights.<sup>31</sup> To a lesser degree, India's reforms were also a departure from orthodoxy, as they were in large measure gradual. For example, even after the trade reform of the early 1990s, India remained one of the world's most protected economies.<sup>32</sup> In the case of Brazil, during the late 1980s and early 1990s, reforms were piecemeal until President Fernando Henrique Cardoso (who was in power between 1995 and 2002) proposed and implemented a comprehensive reform agenda.<sup>33</sup> Although Brazil remained susceptible to external shocks, hyperinflation was eliminated and inflation was brought under control. While this constituted a demonstrable improvement, post-stabilization growth has been weak.<sup>34</sup>

The Chinese state has been far too involved in production, regulation, and planning to discount a state-led approach, an approach that runs contrary to the limited role of the state espoused in New Institutional Economics literature.<sup>35</sup> China has embarked on its highly unorthodox version of market-oriented reforms within a predominantly socialist legal setting.<sup>36</sup> Similarly, Russian growth has occurred during periods when liberalization was reversed and the state reclaimed assets and planning.<sup>37</sup> In Russia's case, this growth represents a return to pre-1998 collapse rates and has occurred during a phenomenal boom in petroleum and natural gas prices, thus, it makes it difficult to accurately assess the state's role in generating growth.<sup>38</sup>

The primacy of institutions and its relationship to growth followed on the heels of the Washington Consensus, picking up where it left off. The primacy of institutions theory embodied similar principles for transition including stabilization, liberalization, and privatization, following political democratization. For example, a 1998 World Bank study entitled *Beyond the Washington Consensus: Institutions Matter* illustrates this progression.<sup>39</sup> A good market economy requires not only “getting prices right” but also “getting property rights right” and “getting institutions right.”<sup>40</sup> In this way, Washington Consensus policies were grafted onto a “menu” of best practice institutions found in developed economies.<sup>41</sup> Qian illustrates this objective in the following way:

<sup>25</sup> Jared M. Diamond, *Guns, Germs, and Steel: the Fates of Human Societies* (New York: Norton, 2005); John L. Gallup et al., “Geography and Economic Development,” *NBER Working Paper*, no. w6849 (1998); Jeffrey D. Sachs, “Tropical Underdevelopment,” *NBER Working Paper*, no. w8119 (2001).

<sup>26</sup> Jeffrey A. Frankel and David Romer, “Does Trade Cause Growth?” *The American Economic Review* 89, no. 3 (1999); Jeffrey D. Sachs et al., “Economic Reform and the Process of Global Integration,” *Brookings Papers on Economic Activity* 1995, no. 1 (1995). Sachs emphasizes the role of international trade as a driver of productivity change and fostering economic convergence across countries.

<sup>27</sup> Rodrik et al., “Institutions Rule,” 4.

<sup>28</sup> Ibid., 21-2.

<sup>29</sup> Rodrik et al., “Institutions Rule,” 22.

<sup>30</sup> Ibid.

<sup>31</sup> Mukand and Rodrik, “In Search Of The Holy Grail,” 2.

<sup>32</sup> Ibid.

<sup>33</sup> Anthony Spanakos, “Reforming Brazil: A Preliminary Assessment,” in *Reforming Brazil*, ed. Mauricio A. Font, Anthony Peter Spanakos, and Cristina Bordin (Lanham, Md.: Lexington Books, 2004); Anthony Spanakos and Fernando Ferrari-Filho, “Why Economic Performance Has Differed Between Brazil and China? A Comparative Analysis of Brazilian and Chinese Macroeconomic Policy,” *XV Revista Venezolana de Análisis de Coyuntura* 111 (2009).

<sup>34</sup> Spanakos and Ferrari-Filho, “Why Economic Performance Has Differed Between Brazil and China?”

<sup>35</sup> Spanakos and Ferrari-Filho, “Why Economic Performance Has Differed Between Brazil and China?”; Ziya Öniş and Fikret Şenses, “Rethinking the Emerging Post-Washington Consensus,” *Development and Change* 36, no. 2 (2005).

<sup>36</sup> Yingyi Qian, “How Reform Worked in China,” *SSRN Electronic Journal* (2002), online: <http://ssrn.com/abstract=317460>. Qian discusses China's experimentalism and adoption of “transitional institutions” that differ from those in the West.

<sup>37</sup> Spanakos and Ferrari-Filho, “Why Economic Performance Has Differed Between Brazil and China?”; See also Peter Ferdinand, “Russia and China: Converging Responses to Globalization,” *International Affairs* 83, no. 4 (2007).

<sup>38</sup> Spanakos and Ferrari-Filho, “Why Economic Performance Has Differed Between Brazil and China?”

<sup>39</sup> Shahid Javed Burki and Guillermo Perry, *Beyond the Washington Consensus: Institutions Matter* (Washington, DC: World Bank, 1998).

<sup>40</sup> See Ronald H. Coase, “The Institutional Structure of Production,” *American Economic Review* 82 (2008); Oliver E. Williamson, “Institutions and Economic Organization: the Governance Perspective” paper presented at the World Bank Annual Conference on Development Economics (The World Bank, 1994).

<sup>41</sup> Qian, “How Reform Worked in China,” 7-8. See Dani Rodrik and Arvind Subramanian, “The Primacy of Institutions (and What this Does and Does Not Mean),” *Finance & Development* 40, no. 2 (2003), 32. They discuss the functions of institutions as market-creating, market-regulating, market-stabilizing, and market-legitimizing.

To [institutional economists], a set of institutions are critical for sustained growth, including secure private property rights protected by the rule of law; impartial enforcement of contracts through an independent judiciary; appropriate government regulations to foster market competitions; effective corporate governance; transparent financial systems, etc ... Economists then use these institutions as a benchmark to judge transition and developing economies, and often find huge institutional gaps. These findings then serve three purposes. First, they generate a diagnosis of the deficiency of institutions in developing and transition economies. Second, they are used to explain why these economies perform poorly, confirming the central hypothesis that institutions matter. Third, they lead to recommendations for institution building: if the economy has weak property rights, clarify them; a weak financial system? strengthen it; a bad law? change it; a corrupt legal system? clean it up.<sup>42</sup>

Qian argues that institutional economists have missed an important institutional dimension by failing to investigate how reform worked, or did not work, in many developing and transition economies:

Compare China with Russia for the last decade [1992 to 2002]. Neither of them had the rule of law, secure private property rights, effective governance, or strong financial system. But the two exhibited a huge performance difference, which obviously cannot be attributed to the presences or absence of the best practice institutions. ... [This] naive perspective often confuses the goal (i.e., where to finish up) with the process (i.e., how to get there) and thus tends to ignore the intriguing issues of transition paths connecting the starting point and the goal. It is as if one neglects the ‘transition equations’ (or ‘equations of motion’) and the ‘initial conditions’ in dynamic programming. Although building best practice institutions is a desirable goal, getting institutions right is a process involving incessant changes interacting with initial conditions. The difference in China and Russia is not at all that China has established best practice institutions and that Russia did not. The difference lies in the institutions in transition.<sup>43</sup>

In Qian’s view, there is an important difference between conventional institutions and institutions in transition, in that the rules of the game in transitional institutions are dynamic. Transitional institutions find the means to make special arrangements to compensate for backwardness or deficiencies and are in search of feasible paths – that is, imperfect paths – to fit the economic and political realities of transition.<sup>44</sup>

In China, two key successful institutional reforms include the “dual-track” approach to market liberalization and the innovative ownership form of firms, called the township and village enterprises (TVEs).<sup>45</sup> Dual-track reform improved efficiency and protected existing rents. It thus had both an economic and political rationale. It utilized existing institutions that had been designed for central planning. For example, economic agents were able to participate in the market at free market prices, provided they fulfilled their obligations for fixed quantities of goods at fixed planned prices under the pre-existing plan. As Qian notes, the first implication of

the dual-track approach is political – reform could be implemented without creating losers. Agents could benefit from market participation while implicit transfers under the plan track could compensate potential losers by protecting the status quo.<sup>46</sup> The economic implications were that the market track undid any inefficiency of the plan track. Between 1978 and 1988, state procurement of domestically produced grains remained essentially fixed while production increased by almost one-third.<sup>47</sup> Industrial market liberalization in coal and steel also followed this success, growing the economy on the basis of market-track expansion.

The second example of a successful institutional reform is TVEs. They are an innovative ownership form that improves efficiency amidst an adverse climate of insecure private property rights. At the same time, the equity stake at the local government level served both local and national state interests because it granted a higher share of revenue than standard privatization. TVEs benefitted from local available labour and cheaper credit from the local rural credit co-operatives (and other informal local sources) flush from farmers’ savings from the dual-track approach. Indeed, local officials often acted as informal guarantors or sponsors of credit to TVEs.<sup>48</sup> They also prevailed under relatively hard budget constraints and TVEs were not bailed out as local resources couldn’t permit it.<sup>49</sup> This resulted in increased competition amongst TVEs from different localities and eventually, as they grew larger, they began to compete with state-owned enterprises when their products overlapped.<sup>50</sup> In 1978, TVEs comprised only 6 percent of the GDP, whereas by 1996, they climbed to 26 percent.<sup>51</sup>

The most critical feature of TVEs is the community government ownership. Strong anti-private property ideology, inherited from the central-planning era, led to political crackdowns on private enterprises such as the “anti-spiritual pollution campaign” of 1983, the “anti-bourgeois liberalization campaign” of 1987, and a campaign after the Tiananmen Square protests of 1989.<sup>52</sup> TVEs offered more security because of the protection given by community governments and by extension the national government. Rural community governments do not vote or elect the national government, but they support it by providing local public goods and maintaining order. TVEs, therefore, contained both political and economic dimensions as they supported the national government while also fostering local business development. In turn, since they were deemed more useful to the national government than private owners, TVEs had more secure property rights than private enterprises.<sup>53</sup> Since local government owned the TVEs, this created higher incentives for it to provide local public goods and gave it control rights that ensured access to the future revenue of the firm. As a result, the national government was able to leave a bigger budget to local government and thus prey less on TVEs than on private enterprises. Local governments were then less concerned about revenue confiscation which reduced TVE revenue hiding. As Qian illustrates, TVE ownership substituted the problematic fiscal system because it allowed revenue extraction in the absence of an effective taxation system. In the process, TVE ownership also allowed a large proportion of revenue to remain in rural areas, rather than be redistributed by the national government to urban areas.<sup>54</sup>

<sup>42</sup> Qian, “How Reform Worked in China,” 7-8.

<sup>43</sup> Ibid., 8.

<sup>44</sup> Ibid., 10. For a study of Russian transition see also Andrei Shleifer and Daniel Treisman, *Without a Map: Political Tactics and Economic Reform in Russia* (Cambridge: MIT Press, 1999).

<sup>45</sup> Qian, “How Reform Worked in China,” 13. See also Lawrence J. Lau et al., “Reform without Losers: An Interpretation of China’s Dual-Track Approach to Transition,” *Journal of Political Economy* 108, no. 1 (2000).

<sup>46</sup> Qian, “How Reform Worked in China,” 16.

<sup>47</sup> Lau et al., “Reform without Losers,” 136.

<sup>48</sup> Pranab K. Bardhan, *Awakening Giants, Feet of Clay: Assessing the Economic Rise of China and India* (Princeton, N.J.: Princeton University Press, 2010), 20.

<sup>49</sup> Ibid.

<sup>50</sup> Ibid., 21.

<sup>51</sup> Ibid., 20.

<sup>52</sup> Qian, “How Reform Worked in China,” 20.

<sup>53</sup> Jiahua Che and Yingyi Qian, “Insecure Property Rights and Government Ownership of Firms,” *The Quarterly Journal of Economics* 113, no. 2 (1998); Dani Rodrik, “Institutions for High-Quality Growth: What They Are and How to Acquire Them,” *NBER Working Paper No. 7540* 35, no. 3 (2000).

<sup>54</sup> Qian, “How Reform Worked in China,” 24-5.

Transitional institutions thus depend on incentives, particularly government incentives, and also need to be efficiency enhancing and compatible with the interests of ruling political groups. By the early 1990s, the plan track (of the dual-track program) began to be gradually phased out and by the late 1990s it merged into a single-track market. At the same time, through the 1990s, TVEs were privatized. This process accelerated and gained legitimacy after 1998 when the Chinese Constitutional Amendment included the private sector as “an important component” of the economy.<sup>55</sup> Local government had incentives for privatization. They were able to keep the privatization revenue and levy fees on local private firms sharing only a fixed amount with the higher-level government.<sup>56</sup> Contrasting China with India, Bardhan summarizes their respective approaches in the following way,

thus decentralization of resources, rents, and responsibility, combined with centralized personnel control where local performance is rewarded by promotion, serves as a major engine of growth in China. The Indian governance system is quite a contrast in this respect: resources at the disposal of local governments are scanty, and officials are not rewarded for local economic performance. In fact, in general Indian officials serve in local areas for brief periods, often ‘on deputation’ (with no institutional memory and no stake in local performance), and are averse to taking on high-risk, high-return projects because they do not share in the high return but do share in the blame if the project fails; so instead they bide time in their temporary posting, taking care not to rock the boat. A reputation for administrative efficiency does play some role in promotion, but seniority trumps most other factors in career paths.<sup>57</sup>

Zhuravskaya examines the fiscal relationship in Russia between city governments and the regions (which are one level below the federal government).<sup>58</sup> She compares data from 1992 to 1997 to find that increases in a city’s own revenue was almost entirely offset by decreases in shared revenues from the region to the city. Thus, she finds that revenue sharing between regional and local governments provides local governments with no incentives to increase the tax base or provide public goods.<sup>59</sup> Qian notes that, as compared to China, this results in nearly no fiscal incentives for local governments to support local private firms, in post-reform Russia.<sup>60</sup> Further evidence by Jin et al. suggest that if the central government takes away locally generated revenue, there is no incentive for local governments to support productive local businesses as it cannot benefit from such efforts.<sup>61</sup> If local governments’ expenditures are linked to the revenue they generate, the incentive for support offers direct benefits.

Popov frames post-Soviet Russia’s fragile growth as two “lost decades.”<sup>62</sup> While this weak performance was caused by many circumstances, he argues that the primary cause was the state’s weakening institutional capacity during transition. From 1989 to 1998, Russia experienced a transformational recession where GDP fell to 55 percent of the 1989 level.<sup>63</sup> It has recovered at a rate of approximately 7 percent a year and by 2011/12 will have surpassed this 1989 level. In 2009, Russia’s GDP fell consid-

erably, registered at negative 7.8 percent, due to the collapse in oil prices and outflow of capital caused by the world recession.<sup>64</sup> This was considerably worse than the US which fell to negative 3.5 percent and dramatically divergent from most emerging markets which did not experience a recession (China’s GDP was 9.2 percent, India’s was 9.1 percent, and Brazil’s was negative 0.6 percent).<sup>65</sup>

In the 1990s, Russian society became increasingly criminalized, a fact supported by Haggard and Tiede’s cluster analysis discussed above.<sup>66</sup> Its crime levels were surpassed only by South Africa and Columbia; Brazil’s crime rate, although located in the same cluster, was half the rate of Russia’s.<sup>67</sup> Moreover, the rate of “unnatural deaths” (accidents, murders, suicides) had skyrocketed to 245 per 100,000 inhabitants by the beginning of the 21st century, which meant that if such rates persisted, one out of six Russians born in 2002 would have an “unnatural death.”<sup>68</sup>

Criminal law offers a key perspective on why entrepreneurialism in Russia remains precarious and underdeveloped. Entrepreneurialism is often credited with granting national economies flexibility, diversity, and the strength to weather economic downturns. In Russia it can provide a flexible buffer to ease dependence on commodities and the impact of their inevitable boom and bust cycles. Both Brazil and Russia suffer from undergrowth, as is evident from the dramatically low number of domestic companies listed on their stock exchanges. As of 2010, Brazil had only 373 such companies and Russia had 345, whereas India had 4,097 and China had 2,063.<sup>69</sup> In 2008, the portion of Russia’s GDP generated by small and medium enterprises was estimated at 13 to 17 percent.<sup>70</sup> By contrast, China’s officially released data in 2005 showed that small and medium enterprises accounted for 55 percent of its GDP. In the US the proportion is 50 to 60 percent and in the EU it is 70 percent. The gross underdevelopment of small and medium enterprises in Russia is attributed to unduly complex bureaucratic hurdles that give rise to corruption and insecure property rights.

Radchenko and Fedotov from the Center for Legal and Economic Studies, based in Moscow, juxtaposed official statistics of existing Russian firms with criminal proceedings. They found that 14.91 percent of companies were prosecuted, that is one in six firms, between 2000 and 2010.<sup>71</sup> They also charted new firm entry versus exit in 2011 and found that 6 percent of companies closed which was the same percentage of new firms registered.<sup>72</sup>

The risk of expropriation, through overly aggressive recourse to criminal law, has become a primary threat to entrepreneurial growth in Russia. It is not the only barrier, however, as bribery figures reveal. In a comprehensive survey conducted by Information Science for Democracy (INDEM), bribery figures reveal that small and medium enterprises face the gravest challenges. In 2005, the market volume for all-Russian business corruption was US\$316 billion, which represents 2.66 times the

<sup>55</sup> Qian, “How Reform Worked in China,” 40.

<sup>56</sup> Ibid., 41.

<sup>57</sup> Bardhan, *Awakening Giants*, 38-9.

<sup>58</sup> Ekaterina V. Zhuravskaya, “Incentives to Provide Local Public Goods: Fiscal Federalism, Russian Style,” *Journal of Public Economics* 76, no. 3 (2000).

<sup>59</sup> Ibid., 357-58.

<sup>60</sup> Qian, “How Reform Worked in China,” 30.

<sup>61</sup> Hehui Jin et al., “Regional Decentralization and Fiscal Incentives: Federalism, Chinese Style,” *Journal of Public Economics* 89, no. 9-10 (2005).

<sup>62</sup> Vladimir Popov, “The Long Road to Normalcy,” *UNU-WIDER Working Paper*, no. 2010/13 (2010), 2.

<sup>63</sup> Ibid., 1.

<sup>64</sup> Vladimir Popov, “The Long Road to Normalcy,” 2.

<sup>65</sup> World Bank, *World Development Indicators 2011*, (Washington, D.C.: World Bank, 2011) online: <<http://data.worldbank.org>>. See the introduction section of this report, figure 1.1: *BRICs GDP growth (annual %) from 2006 to 2012*.

<sup>66</sup> Haggard and Tiede, “Rule of Law and Economic Development” (2011).

<sup>67</sup> Popov, “The Long Road to Normalcy,” 5.

<sup>68</sup> Ibid.

<sup>69</sup> *World Development Indicators 2011*. See also the introduction section of this report, table 1.2: *Economic Overview*.

<sup>70</sup> Max Bolotinsky and Hongda Jiang, “SMEs in Russia and China: A Comparison,” *Alinga Consulting Group, Business and Support Consulting* (April 8 2008), online: <[www.acg.ru](http://www.acg.ru)>.

<sup>71</sup> V.A. Veretikhin et al., “Состояние уголовной политики государства в отношении бизнеса,” [“State Criminal Policy Against Business”] (2012), online: <<http://www.lecs-center.org/ru/component/content/article/34/162-criminalization-report>>.

<sup>72</sup> Andrei Fedotov, “Уголовное преследование предпринимателей — не виртуально,” [“The Prosecution of Businessmen — not ‘Virtual’”] *Forbes* (April 10 2012), online: <[www.forbes.ru](http://www.forbes.ru)>.

federal budget revenues, a significant increase since 2001.<sup>73</sup> Therefore, these figures tell us that bribe-taking government officials are 2.5 times more effective than the tax-collection services.<sup>74</sup> These results reveal the persistence of perverse incentives and weak economic institutions.

Qian highlights the behavioural component of institutions and the need to foster the right incentives, specifically for government, that are compatible with the interests of ruling groups.<sup>75</sup> A crucial determinant of growth is government's behaviour, especially local government, which often has direct regulatory authority over new and/or small enterprises. Institutional development goes beyond mere compatibility with initial conditions. China's "transitional institutions" aligned government interests to create incentives through hybrid models and control rights.<sup>76</sup> This privatization process was also marked by gradualism. While high levels of corruption can be found across the BRICs, in Russia, evidence suggests that perverse capture of weak economic institutions signals a greater problem – political power is guarded closely and greatly undermines economic potential.<sup>77</sup> The following section will examine the relationship between political and economic institutions to investigate this intersection more closely.

## POLITICAL ECONOMY: INSTITUTIONS AND CREDIBLE COMMITMENT BY SOVEREIGNS

Scholars often focus on political institutions, rather than specifically economic institutions, as the type of institutions that affect economic processes.<sup>78</sup> There are a number of differences between them, however. For example, political institutions, such as elections, are more likely to specify procedures, whereas economic institutions may be more flexible as can be seen in the procedures associated with contracting. Punishments for non-compliance, however, are more likely to be specified in economic institutions, such as contracting, than in political institutions.<sup>79</sup> According to Acemoglu et al., economic institutions determine the incentives of and the constraints on economic actors whereas political institutions determine the constraints on and the incentives of key actors in the political sphere.<sup>80</sup> Both political and economic institutions are endogenous – that is, they are shaped by the society in which they operate. Implicit in the notion that political power determines economic institutions, is that political interests compete and conflict over distribution of resources and indirectly over economic institutions.<sup>81</sup> Thus, institutions are structured so that political institutions influence the equilibrium of economic institutions, which in turn determine economic outcomes.<sup>82</sup>

North asserted that one of the fundamental institutional obstacles to economic development is a lack of institutional constraints on a powerful, discretionary state.<sup>83</sup>

<sup>73</sup> "Diagnostics of Russia Corruption 2005 – Preliminary Results," (2005), online: <www.indem.ru/en/Publicat/2005diag\_engV.htm>.

<sup>74</sup> Ibid.

<sup>75</sup> Qian, "How Reform Worked in China."

<sup>76</sup> Ibid.

<sup>77</sup> For more on this subject see regulatory capture in corruption section of this report.

<sup>78</sup> Edward L. Glaeser et al., "Do Institutions Cause Growth?" *Journal of Economic Growth* 9, no. 3 (2004).

<sup>79</sup> Stefan Voigt, "How (not) to Measure Institutions," *Institute of Law & Economics* (2009).

<sup>80</sup> Daron Acemoglu et al., "Institutions as the Fundamental Cause of Long-Run Growth," *NBER Working Paper 10481* (2004).

<sup>81</sup> Ibid., 3.

<sup>82</sup> Ibid., 5.

<sup>83</sup> Douglass C. North, "A Neoclassical Theory of the State," in *Structure and Change in Economic History*, ed. Douglass C. North (New York: Norton, 1981), 20. North argues that agents who control the state should be modelled as self-interested: the set of property rights that they would choose for society would be those that maximized their payoff and not the set that maximized social welfare.

Where the state is not constrained, the sovereign faces a fundamental commitment problem.<sup>84</sup> Thus the distinction between institutions and macroeconomic policies and their relationship to the structure of the regime requires attention. Balcerowicz explains that reform that changes a country's institutional framework also changes all the institutions that influence an individual's behaviour in a given country. Macroeconomic policies, on the other hand, do not operate through institutions but through their impact on the economic variables, such as interest rates or aggregate demand.<sup>85</sup> The state may make top-down changes to both institutions and macroeconomic policies, but the institutional framework does not depend solely on top-down reforms. Institutional change may be due to bottom-up change such as self-regulation. Here, Balcerowicz notes that the proportion of top-down versus bottom-up change depends on the basic features of the institution's system, such as centralization of decisions regarding interpersonal relations or conversely, freedom of interpersonal interactions. In turn, macroeconomic policies depend on the existing institutional framework. While the inherited institutional framework is key, both depend on non-institutional factors, such as the personalities of the top decision makers – the weaker the institutional constraints, the larger the potential impact of their personality. Weaker constraints matter more in the case of absolute monarchs than constitutional monarchs, yet all governments have the power to renege on their commitments and can have powerful incentives to do so – this is known as the credible commitment problem.<sup>86</sup>

Weingast, building on Olson's work, identifies the core dynamics of this tension to illustrate that even the absolute ruler cannot overcome the basic weakness of absolutism.<sup>87</sup> Sovereigns can choose to either respect citizens' rights or transgress them, but the ruler nonetheless faces two constraints: economic and political. For economic growth to occur, the sovereign or government must not merely establish the relevant set of rights, but must make a credible commitment to them.<sup>88</sup> In Russia, for example, a disenfranchised electorate has recently taken to the streets to protest the recent parliamentary and presidential elections. The breadth of Putin's "personality variable" and the highly concentrated power calls into question whether the state will remain above the law and continue to act as what Fish calls restrained-autocracy.<sup>89</sup> As Weingast contends, sovereigns do face political restraints on transgressing private rights. Notwithstanding coordination challenges, citizens can ultimately depose the sovereign, thereby compelling the ruler to make institutional, legal, and policy concessions to guard against this threat.<sup>90</sup>

<sup>84</sup> P. Keefer, *A Review of the Political Economy of Governance: From Property Rights to Voice* (World Bank, Development Research Group, Investment Climate, 2004). Keefer argues that the ability to make credible commitments is crucial to economic development, stressing that the role of checks and balances in achieving credible commitments is more likely to be present and effective in democracies than under authoritarian rulers.

<sup>85</sup> Leszek Balcerowicz, "Institutions and Convergence (preliminary version)," *CASE Network Studies and Analyses* (2007), 11.

<sup>86</sup> Haggard et al., "Rule of Law and Economic Development" (2008), 213.

<sup>87</sup> Mancur Olson, "Dictatorship, Democracy, and Development," *The American Political Science Review* 87, no. 3 (1993); Martin C. McGuire and Mancur Olson, Jr., "The Economics of Autocracy and Majority Rule: The Invisible Hand and the Use of Force," *Journal of Economic Literature* 34, no. 1 (1996); Douglass C. North and Barry R. Weingast, "Constitutions and Commitment: The Evolution of Institutional Governing Public Choice in Seventeenth-Century England," *The Journal of Economic History* 49, no. 4 (1989); B.R. Weingast, "The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development," *Journal of Law Economics & Organization* 11 (1995); Barry R. Weingast, "The Political Foundations of Democracy and the Rule of Law," *The American Political Science Review* 91, no. 2 (1997); Kenneth A. Schultz and Barry R. Weingast, "The Democratic Advantage: Institutional Foundations of Financial Power in International Competition," *International Organization* 57, no. 1 (2003).

<sup>88</sup> Haggard et al., "Rule of Law and Economic Development" (2008).

<sup>89</sup> Steven Fish, "Why Autocracy Thrives in Russia," in *Russian Political Succession Panel*, ed. Hoover Institution (ForaTV, March 7th 2008).

<sup>90</sup> North and Weingast, "Constitutions and Commitment"; Barry R. Weingast, "Constitutions as Governance Structures: The Political Foundations of Secure Markets," *Journal of Institutional and Theoretical Economics* 149, no. 1 (1993); Haggard et al., "Rule of Law and Economic Development" (2008).

Political economy is fundamentally embedded in the process of institutional reform through the decision-making process. This gives rise to the relative importance of structural and institutional constraints versus political agency, choice, and rationality. As Weyland notes, constraint-oriented arguments account fairly well in regular politics, but they are not entirely convincing in times of crisis, when the existing parameters for politics are up for grabs.<sup>91</sup> On the one hand, leaders may take advantage of severe challenges to evade, override, or even reshape the constraints they are facing. On the other hand, they may create a new institutional framework that sets lasting parameters for normal politics in the future. In this way, crises are critical junctures, which leave legacies in institutional structures and policy patterns and give rise to what Krasner called a “punctuated equilibrium” model.<sup>92</sup>

Krasner’s model responds to North and others who argue that institutional change may be delayed by organized interests who may resist cooperation and favour the status quo.<sup>93</sup> The term “punctuated equilibrium” contrasts the term gradualism, and is borrowed from the field of evolution. Darwin’s evolutionary model suggests that species adapt to changing circumstances through gradual change. Punctuated equilibrium “suggests that long periods of stasis [are] followed by relatively short periods of change.”<sup>94</sup> This latter view argues that species can tolerate and even persist despite environmental variation and thus it is only when a dramatic change occurs that “some characteristics [are] disadvantaged relative to others, leading to the emergence of a new species.”<sup>95</sup> In Krasner’s view punctuated equilibrium describes the impact that dramatic shifts have had on political structures including destruction, transformation, and adaptation. The collapse of the Soviet Union provides a pertinent example of this type of crisis. Following Stalin’s death in 1953, the Soviet Union went through a period of political and economic stagnation, which lasted over thirty years. It became clear under Brezhnev’s leadership in the 1970s that the Soviet planned economy was not able to provide its citizens with even basic necessities. Gorbachev’s *perestroika* was an attempt to address this economic stagnation while maintaining the political status quo. *Perestroika* was an attempt to create a socialist market economy by liberalizing the economic and political monopolies through the agency of a reformed Communist Party. The element of *glasnost*’ or “openness” was introduced with the aim of humanizing the society and creating more transparent and inclusive political and economic institutions. However, the half-hearted attempt to reform a stagnant centrally-planned economy resulted in a “non-planned, non-market” economy which ultimately led to the destruction of the Soviet Union.<sup>96</sup>

Experience has demonstrated that in order for markets to function properly, they need to be embedded in economic, social, and political institutions. Unfettered pursuit of private self-interest and initiative, constrained only by market competition, are not sufficient to create acceptable societal outcomes. In Brazil and Russia in particular, “shock therapy” removed the myriad of allocative distortions and poor incentives for production, but the fact that this was done in a very short time, in the absence of required legal and financial infrastructure, subsequently produced weak institutions.

<sup>91</sup> Kurt Gerhard Weyland, *The Politics of Market Reform In Fragile Democracies: Argentina, Brazil, Peru, and Venezuela* (Princeton: Princeton University Press, 2002).

<sup>92</sup> Stephen D. Krasner, “Approaches to the State: Alternative Conceptions and Historical Dynamics,” *Comparative Politics* 16, no. 2 (1984), 240-3. See also Ruth Berins Collier and David Collier, *Shaping the Political Arena: Critical Junctures, the Labor Movement, and Regime Dynamics in Latin America* (Princeton, N.J.: Princeton University Press, 1991).

<sup>93</sup> North, *Institutional Change* (1990).

<sup>94</sup> Stephen D. Krasner, *Power, the State, and Sovereignty: Essays on International Relations* (New York: Routledge, 2009), 4.

<sup>95</sup> *Ibid.*

<sup>96</sup> Anders Åslund and Richard Layard, *Changing the Economic System in Russia* (New York: St. Martin’s Press, 1993).

As we have seen, even in an economy that has been stabilized, liberalized, and privatized, there is no guarantee that growth will ensue. North cautions us not to forget path dependency. He contests the implicit assumption that underlay neo-classical reasoning – that instrumental rationality characterizes the way choices are made. Were this the case, North asserts, institutions would not matter and the policy maker could impose efficient rules upon an economy and alter its direction instantly.<sup>97</sup> In 1997, North was compelled to state,

The Eastern European demise of communism in 1989 reflected a collapse of the perceived legitimacy of the existing belief system and consequent weakening of the supporting organizations. The result was the destruction of most of the formal institutional framework, but the survival of many of the informal constraints. Policy makers were confronted not only with restructuring an entire society, but also with the blunt instrument that is inherent in the policy changes that can only alter the formal rules but cannot alter the accompanying norms and even have had only limited success in inducing enforcement of policies.

A major complicating issue was our lack of understanding about political economy. ... [Political markets] entail not simply a set of formal rules, but complementary norms that will undergird such rules and equally enforcement mechanism (such as the rule of law). None of these existed in Russia ... and the consequences have been high costs of transaction without secure property rights and with enforcement undertaken by Mafia-like groups ... Indeed, an historic dilemma of fundamental importance has been the difficulties of economies shifting from a political economy based on personal exchange to one based on impersonal exchange. ... The difficulty comes from the belief system that has evolved as a result of the cumulative past experiences of that society not equipping its members to confront and solve the new problems. Path dependence, again, is a major factor in constraining our ability to alter performance for the better in the short run.<sup>98</sup>

Acemoglu and Robinson largely pick up on these observations to argue that world inequality can be viewed through the lens of political and economic institutional differences, which are themselves the result of past changes.<sup>99</sup> The authors discount historical determinism: geography is not destiny and the cultural hypothesis widely advocated as the basis for such inequality is an *outcome* of institutions, not an independent cause.<sup>100</sup> Rather, the modern level of prosperity rests on political foundations, because investment and innovation require credible political commitment to provide reassurance. Power must be centralized and institutions of power must be inclusive to create sustainable development. Acemoglu and Robinson describe inclusive political institutions as institutions that vest power broadly and tend to uproot economic institutions that expropriate resources, erect entry barriers, and suppress functioning markets.<sup>101</sup> Extractive institutions, on the other hand, enable elites to serve their own interests. In many failed states there has been a long history of extractive institutions. For example the Soviet Union’s institutions were themselves largely a continuation of tsarist institutions, which were predicated on absolutist law

<sup>97</sup> Douglass C. North, “The Contribution of the New Institutional Economics to an Understanding of the Transition Problem,” in *Wider Annual Lectures* (UNU World Institute for Development Economics Research, 1997).

<sup>98</sup> *Ibid.*, 16-17.

<sup>99</sup> Daron Acemoglu and James A. Robinson, *Why Nations Fail: the Origins of Power, Prosperity and Poverty* (New York: Crown Business, 2012).

<sup>100</sup> *Ibid.*, 57.

<sup>101</sup> *Ibid.*, 81.

and oligarchy.<sup>102</sup> States with extractive institutions are likely to grow over the next years, but only if they have attained some degree of political centralization.<sup>103</sup> What can break the vicious cycle? It is a set of factors (i.e. historical moments) combined with a broad coalition of constituencies (which may include other complementary institutions) who push for reform.<sup>104</sup>

### Box 3.1: Sino-Forest Corporation and Property Rights in China

Canadian-owned Sino-Forest Corporation is the largest foreign company operating in China's domestic forestry industry. It cultivates and harvests trees in a sustainable manner. There are three principal areas of business: ownership and management of forest plantation trees, the sale of standing timber and logs, and the complementary manufacturing of downstream engineered-wood products. Over the last year, Sino-Forest has been plagued with scandals due in large measure to its convoluted structure involving a complex web of intermediaries and subsidiaries in China. In March 2012, after Ernst & Young LLP (itself facing multiple Sino-related lawsuits) refused to sign off on its 2011 financials. The company was forced into insolvency and had to file for creditor protection. The Ontario Securities Exchange has filed a cease-trade order, but the scandal transcends this imbroglio; Chinese customers, suppliers, and the government itself have turned against the company. Today it faces multiple lawsuits.

In June 2011, short-seller Carson Block, of Muddy Waters LLC, blew the whistle on their opaque business operations, accusing the company of overstating its forestry assets, operating a "Ponzi scheme," and being a "near total fraud." The company set up an independent committee to defend it against the allegations. The committee, however, was unable to get to the bottom of Sino's third-party relationships or whether Sino had inappropriate personnel connections with its Chinese intermediaries and its suppliers. The committee's report adds another layer of intrigue by describing "backers:"

*Backers are individuals with considerable influence in political, social or business circles, or all three. ... Such backers or their identified main business entities do not generally appear in [China's State Administration for Industry and Commerce] filings by the Suppliers or Als [authorized intermediaries] as shareholders thereof, and in most instance, in any other capacity. ... [Stressing] the importance of "Guanxi" in Chinese business, [the report] is not specific as to particular benefits and why these particular relationships are important. [There exists] little information to validate the political or business connections of such backers, or the nature of the relationship between the backers and the Suppliers or Als. There is no documentary evidence of the nature of their support for their respective Suppliers or Als nor the consideration (if any) received by the backers for their support of the Suppliers or Als.<sup>1</sup>*

These backers refused to speak with the independent committee's investigators. Such secrecy prompted one Canadian journalist to question, "whether the

real role of these backers is to help exploit Chinese resources for the benefit of the Western shareholders or to help fleece Western shareholders for the benefit of Chinese suppliers and bureaucrats."

While the independent committee did confirm that Sino-Forest's cash holdings had been reported accurately, it was only able to follow a few of its selected timber title claims to the actual trees. The problem is twofold. Foreigners may be subject to criminal sanctions in China for possessing maps and other geographical information deemed to be classified as state secrets, which is an especially difficult problem given the remote areas where alleged title to trees is located. Two independent forestry experts were engaged to conduct asset valuation of only two out of ten forest compartments, which proved correct, but they were unable to retain the maps used. Moreover, the company was unable to obtain registered title to purchased plantations in the jurisdictions where standing timber is held without land use/lease rights. It could only obtain forestry bureau confirmations, which are not officially recognized documents, and thus could be open for challenge.<sup>ii</sup> Such difficulties are further reinforced by the fact that Sino-Forest was unable to review any documentation of Als or suppliers to independently verify movements of cash in connection with set-off arrangements used to settle purchase prices paid, or sale proceeds received by, or on behalf of Sino-Forest.<sup>iii</sup>

<sup>i</sup> *Final Report – Sino-Forest*, 9.

<sup>ii</sup> *Ibid*, Schedule 1 S-5, S-6.

<sup>iii</sup> *Ibid*, Schedule 1 S-6, S-7.

**Source:** Colby Cosh, "Sino-Forest: a Prolonged Moan from the Investigators," *Macleans* (February 2 2012). online: <[www2.macleans.ca](http://www2.macleans.ca)>; *Final Report of the Independent Committee of the Board of Directors of Sino-Forest Corporation*, (Sino-Forest Corporation, 2012), 5-6.

Acemoglu and Robinson describe the critical juncture of Mao's death in 1976, which had a powerful influence on the power shift that followed.<sup>105</sup> The devastation and human suffering caused by the Great Leap Forward and the Cultural Revolution generated widespread demand for change, which Deng Xiaoping and his allies were able to secure. Once Deng and the reformers were in control of the state, they launched further reforms that moved economic institutions away from extractive models to more inclusive models – that is, away from the rigidly communist ones towards institutions that provided incentives to increase productivity and trade.

The authors argue, however, that extractive political institutions have retained their grip in China, since property rights are not entirely secure and an inhospitable climate for and suspicion of private entrepreneurs persist. This is evidenced by expropriation of and jail terms for entrepreneurs who try to compete with state-owned enterprises, but lack the support of the local party cadre or, even more important, of Beijing.<sup>106</sup> For example, Guofang, a local Chinese entrepreneur sought to compete with the inefficient state-owned steel factories, to provide a low-cost alternative. In 2003, he commenced construction on his plant with the support of local Party officials in Changzhou.<sup>107</sup> Within the year, however, on orders from the Communist Party in Beijing, Guofang was arrested on vague charges and spent the next five years in jail.<sup>108</sup> The connection between business and the Party is highly lucrative for both,

<sup>102</sup> *Ibid.*, 402.

<sup>103</sup> *Ibid.*, 435.

<sup>104</sup> *Ibid.*, 427.

<sup>105</sup> *Ibid.*, 420-7.

<sup>106</sup> *Ibid.*, 437-9.

<sup>107</sup> *Ibid.*, 437-8.

<sup>108</sup> *Ibid.*

businesses supported by the party receive contracts on favourable terms, can evict ordinary people to expropriate their land, and violate laws and regulations with impunity. Those who stand in the path of this business plan will be trampled and can even be jailed or murdered.<sup>109</sup>

Recalling Rodrik et al.'s findings regarding the primacy of institutions over geography and trade openness, Russia ranks considerably lower than China. This is despite their very different institutional mechanisms. Russia has a high degree of formal law whereas China has other mechanisms that proxy for it.<sup>110</sup> Rodrik states that “credibly signaling that property rights will be protected is apparently more important than enacting them into law as a formal private property rights regime.”<sup>111</sup> China's success in this area has garnered much attention, if only because its success is greater than other transition countries. China remains an example of the government's credible commitment in a specific context, where transitional institutions have helped to create incentives to configure the rules of the game. Recent events surrounding a Canadian company, Sino-Forest, have shed light on the boundaries of Chinese property rights protection (see box 3.1). This example is limited to the opacity of private property rights within the domestic forest industry in a region that is beyond the scope of most foreign direct investment in China. Nevertheless, such opacity may have negative impacts on China's reputation.

As Acemoglu and Robinson note, while Chinese economic institutions are more inclusive today than three decades ago, the Communist Party remains all-powerful. It controls the entire state bureaucracy, the armed forces, the media, and large parts of the economy. There is little political freedom and almost no popular participation in the political process. The authors concede that China's authoritarian economic reform approach has become appealing for developing nations, especially when juxtaposed against the failures of the Washington Consensus.<sup>112</sup> Part of the regime's appeal derives from its greater attractiveness – it gives rulers who preside over extractive institutions free reign to maintain and even strengthen their hold on power and legitimize their extraction.<sup>113</sup>

Economic growth under authoritarian, extractive political institutions is likely to continue for some time in China. The authors argue, however, that China will ultimately fail to achieve sustainable growth. This is because sustainable economic growth is only supported by truly inclusive institutions and the creative destruction necessary for innovation. Moreover, growth under an authoritarian regime will not lead to more inclusive political institutions. Under their theory, China and Russia are likely to reach the limits of their growth before they are compelled to transform their political institutions to be more inclusive – that is, before elites would support inclusive reforms.<sup>114</sup>

All the more pressing for Russia is that its growth is largely attributed to the increased value of natural resources, which further masks the weakness of its economic institutions. This suggests that if and when such commodity prices follow their inevitable boom and bust cycle, both economic and political institutions will come under intensified pressure. Thus, Russia must work towards greater inclusivity as soon as possible as the success of economic institutional reforms remains inextricably linked to political institutional reforms.

<sup>109</sup> Ibid., 439.

<sup>110</sup> Rodrik et al., “Institutions Rule.”

<sup>111</sup> Ibid., 22.

<sup>112</sup> Acemoglu and Robinson, *Why Nations Fail*, 441.

<sup>113</sup> Ibid.

<sup>114</sup> Ibid., 446.

Compared to China and Russia, Brazil and India's greatest success is the pluralism and inclusivity of their political institutions.<sup>115</sup> Political inclusivity may, in the long run, prove to be a determining factor that creates more robust and sustainable economic growth in Brazil and India.

## MEASURING THE IMPACT OF FORMAL AND INFORMAL INSTITUTIONS

Institutions to protect property rights and enforce contract can be formal – legislation, policing, and the judiciary – or informal – social networks, communication channels, and norms. Many variants of formal and informal systems exist in most countries. Scholars cannot agree, however, what the relative merits or flaws are of each. Rubin recommends, for example, that private adjudication supported by formal enforcement can be a key approach for governance building in transition economies.<sup>116</sup> The *arbitrazh* courts in Russia are an example of this, where arbitration has become a primary mechanism for business-to-business dispute resolution. Another example is Tsai's 2002 study of “back-alley banking” in Asia, that documents a range of informal mechanisms for enforcing loan contracts, from trust-based relationship lending to more institutionalized mechanisms such as credit co-operatives.<sup>117</sup> In 2004, Dixit compared relation-based and rule-based systems and argued that economies of scale are what distinguish the constraints of informal institutions.<sup>118</sup> This gives rise to the theory that formal institutions only become more effective than informal institutions once a threshold of scale has been surpassed. As Haggard et al. point out, this means that as the number of participants in a system increases, it becomes increasingly difficult to maintain information flows or to warn of transgressions and punishment mechanisms to sanction offenders.<sup>119</sup>

Turning towards India, we begin with a brief overview of economies of scale to examine the peculiarities that support economic growth. Thereafter, we examine the relative roles of formal and informal institutions across the BRICs and will evaluate barriers to firm entry.

India's unique development strategy simultaneously favoured and disfavoured domestic entrepreneurship against a backdrop of arcane rules and procedures. Licensing, regulation, and sectoral protectionism created distinct contrasts with other countries at similar levels of development. For example, the average firm size in manufacturing in India is about US\$300,000 per firm as compared to about US\$4 million in similar countries, thus firms are over ten times smaller in India for the same type of industry.<sup>120</sup> The industrial sector is dominated by extremely small enterprises and 87 percent of manufacturing employment comes from microenterprises of fewer than ten employees.<sup>121</sup> Indian manufacturing is also significantly more diversified in terms of output and employment than countries of comparable income and size.<sup>122</sup> Between 2000 and 2001, small firms (6 to 9 workers) made up 42 percent of all manufacturing employment and large firms (over 500 workers) made up 23 percent.

<sup>115</sup> Ibid., 447. Acemoglu et al. discuss Brazil's pluralism.

<sup>116</sup> P.H. Rubin, “Growing a Legal System in the Post-Communist Economies,” *Cornell International Law Journal* 27 (1994).

<sup>117</sup> Kellee S. Tsai, *Back-Alley Banking: Private Entrepreneurs in China* (Ithaca: Cornell University Press, 2002).

<sup>118</sup> Avinash K. Dixit, *Lawlessness and Economics: Alternative Modes of Governance* (Princeton, N.J.: Princeton University Press, 2004). See also John Shue Li, “Relation-based versus Rule-based Governance: an Explanation of the East Asian Miracle and Asian Crisis,” *Review of International Economics* 11, no. 4 (2003).

<sup>119</sup> Haggard et al., “Rule of Law and Economic Development” (2008), 220.

<sup>120</sup> K. Kochhar et al., “India's Patterns of Development: What Happened, What Follows,” *NBER Working Paper*, no. 12023 (2006), 10.

<sup>121</sup> Bardhan, *Awakening Giants*, 34-5.

<sup>122</sup> Kochhar et al., “India's Pattern of Development,” 11.

Unique distortions created unique sources of comparative advantage that allowed India to follow a different path. Bardhan highlights two salient characteristics, which are important for our purposes. First, Indian firm structure is characterized by a “missing middle,” particularly compared to China and other developing countries. Second, trade and deregulatory reforms and the slowly declining small-scale reservation, have witnessed a decline, not a rise, in the employment share of large firms.<sup>123</sup> Bardhan comments on such peculiarities in the following way:

Many factors may be responsible for the missing middle and the decline in the employment share of large firms. Labor laws, at least in some states, discourage hiring in large firms. But in most states this has not prevented large-scale retrenchment and layoffs, closures, and amalgamations. Infrastructural deficit, say in electricity, discourages the setting up of firms (or use of equipment that is prone to damage from erratic electricity supply and the associated voltage fluctuations) particularly in the middle of the size distribution, firms that cannot afford their own generators and, even if they can, find that the cost of generating power on a small scale is too high to be economically feasible. Highly inadequate access to credit has the same effect on small and medium firms. The peculiarities of the Indian industrial structure have something to do with the much lower contribution to growth in India compared to China from resource reallocation from low-productivity agriculture to the higher-productivity industrial sector.<sup>124</sup>

It is important to note that most of the economy in India is not in the formal corporate sector: 45 percent of non-farm output and about 85 percent of non-farm employment is outside the public and private organized sector.<sup>125</sup> In Bardhan’s view, the reduction in controls and regulations and the increased leeway given to market forces may have unleashed entrepreneurial energies in both the formal and informal sectors and created links between the two sectors (in the form of subcontracting).<sup>126</sup> Importantly, Bardhan challenges the widely spread belief that India’s growth is the result of the software and information technology sector. Indeed the service sector is where the most significant growth in India has occurred (as compared to China’s manufacturing-centred growth). By breaking down its components, however, Bardhan reveals that a large part of the service sector’s growth was in the traditional or “unorganized sector,” which in the past decade formed about 60 percent of service-sector output.<sup>127</sup> This is a higher rate than in the manufacturing sector. Such services are provided by tiny enterprises, often below the policy radar, unlikely to have been directly affected substantially by the regulatory or foreign trade policy reforms. In this way, Bardhan demonstrates that the link between economic reform and growth in the leading service sector is yet to be firmly established.

Entrepreneurship and the process of new firm entry is an important element in economic development to generate innovation and to increase competition and diversification.<sup>128</sup> Hernando De Soto, among other scholars, has emphasized the critical

<sup>123</sup> Bardhan, *Awakening Giants*, 36.

<sup>124</sup> *Ibid.*, 36-7.

<sup>125</sup> *Ibid.*, 26.

<sup>126</sup> *Ibid.*

<sup>127</sup> *Ibid.*, 27-9.

<sup>128</sup> Stephen J. Nickell, “Competition and Corporate Performance,” *Journal of Political Economy* 104, no. 4 (1996);

Wesley M. Cohen and Steven Klepper, “The Tradeoff Between Firm Size and Diversity in the Pursuit of Technological Progress,” *Small Business Economics* 4, no. 1 (1992).

role of institutions, in the process of new firm entry in developing countries.<sup>129</sup> Estrin and Prevezer draw on the findings of a series of cross-country studies to analyze the impact of both informal and formal institutions and their interaction with entry processes across the BRIC economies.<sup>130</sup> They assessed formal and informal processes across four types of institutions: property rights and contracting; regulation, including labour regulation; access to finance and credit; and infrastructure. The objective was to evaluate whether the interaction between formal and informal institutions could, in principle, make matters better or worse for entrants. Did informal mechanisms compensate for formal institutional deficiencies? Did the informal interaction lack positive compensation or undermine relatively decent formal institutions?

Table 3.1 presents an overview of entry and exit rates – both gross and net entry – and therefore the survival conditions across the BRIC countries. They identify divergence across Indian states. Thus, “high entry states,” with entry rates of three to four percent per year include from the 1980s, Rajasthan, Tamil Nadu, Uttar Pradesh, and Andhra Pradesh and in the 1990s, Rajasthan, Tamil Nadu, Kerala, Haryana, and Gujarat.<sup>131</sup> Importantly, Russia is the only country with both low entry and low exit rates. Figures 3.1 to 3.4 concentrate on the four most significant dimensions that affect the creation of new firms: property rights/contract (figure 3.1), labour regulation enforcement (figure 3.2), infrastructure (figure 3.3), and finance/access to credit (figure 3.4).

**Table 3.1: Entry and Exit Rates**

	Gross Entry	Gross Exit	Net Entry
<b>CHINA</b>	High	Low	High (6%)
<b>BRAZIL</b>	High (14%)	High (10%)	Medium (4%)
<b>INDIA</b>	Medium in high entry states 3-4%	Low	Medium in high entry states 3-4%
<b>RUSSIA</b>	Low	Low	Low

**Source:** Saul Estrin and Martha Prevezer, “A Survey on Institutions and New Firm Entry: How and Why do Entry Rates Differ in Emerging Markets?” *Economic Systems* 34, no. 3 (2010), 294.

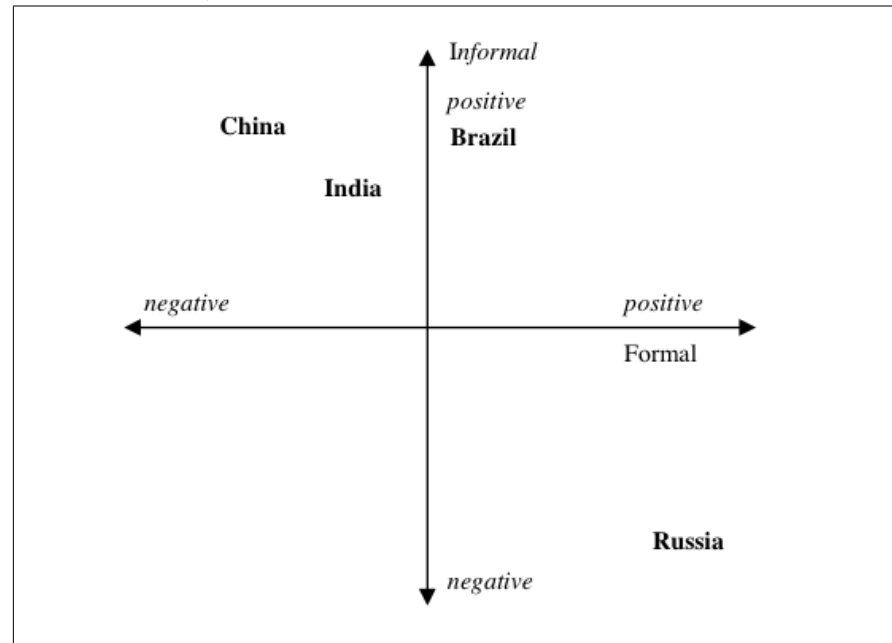
<sup>129</sup> Hernando De Soto, *The Other Path: the Invisible Revolution in the Third World* (New York: Harper & Row, 1990). See also P. A. Geroski, “What Do We Know About Entry?” *International Journal of Industrial Organization* 13, no. 4 (1995); James R. Tybout, “Manufacturing Firms in Developing Countries: How Well Do They Do, and Why?” *Journal of Economic Literature* 38, no. 1 (2000); Djankov et al., “The Regulation of Entry”; Bee Yan Aw et al., “Productivity, Output, and Failure: A Comparison of Taiwanese and Korean Manufacturers,” *The Economic Journal* 113, no. 491 (2003); Leora Klapper et al., “Entry Regulation as a Barrier to Entrepreneurship,” *Journal of Financial Economics* 82, no. 3 (2006); E. Bartelsman et al., “Microeconomic Evidence of Creative Destruction in Industrial and Developing Countries,” *IZA Discussion Paper No. 1374* 3464 (2004).

<sup>130</sup> Saul Estrin and Martha Prevezer, “A Survey on Institutions and New Firm Entry: How and Why do Entry Rates Differ in Emerging Markets?” *Economic Systems* 34, no. 3 (2010). See also Ruta Aidis and Yuko Adachi, “Russia: Firm Entry and Survival Barriers,” *Economic Systems* 31, no. 4 (2007); Sumon Kumar Bhaumik et al., “Entry, Reforms, Complementarity and Performance: A Tale Of Two Indian Manufacturing Sectors,” *Economic Systems* 31, no. 4 (2007); Nauro F. Campos and Mariana Iooty, “Institutional Barriers to Firm Entry and Exit: Case-Study Evidence from the Brazilian Textiles and Electronics Industries,” *Economic Systems* 31, no. 4 (2007); Ruta Aidis and Saul Estrin, “Institutions, Networks and Entrepreneurship Development in Russia: an Exploration,” (2006); Randolph Luca Bruno et al., “Institutional Determinants of New Firm Entry in Russia: a Cross Regional Analysis,” *IZA Discussion Paper No. 3724* (2008); Lihui Tian, “Does Government Intervention Help the Chinese Automobile Industry? A Comparison with the Chinese Computer Industry,” *Economic Systems* 31, no. 4 (2007).

<sup>131</sup> Estrin and Prevezer, “A Survey on Institutions and New Firm Entry,” 300.



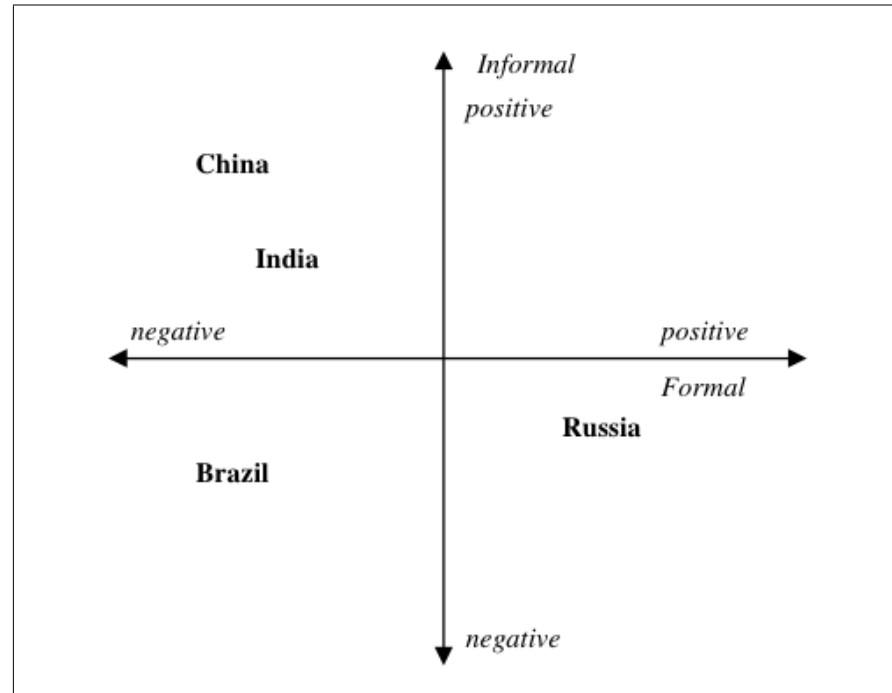
**Figure 3.1: Property Rights and Contract**



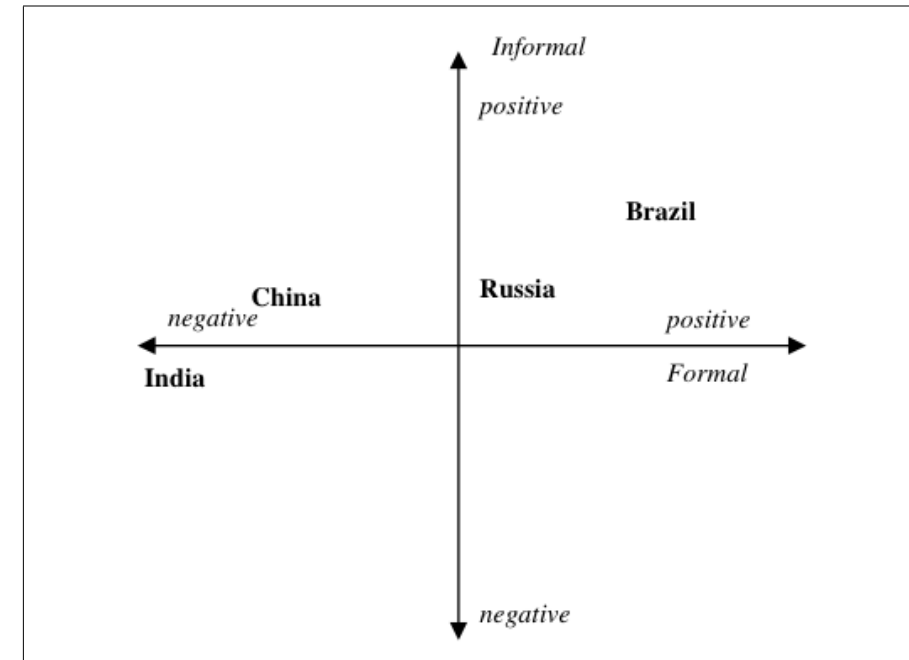
**Source:** Saul Estrin and Martha Prevezer, "A Survey on Institutions and New Firm Entry: How and Why do Entry Rates Differ in Emerging Markets?" *Economic Systems* 34, no. 3 (2010), 294.

**Note:** Figures 3.2-3.5 originate from the same source.

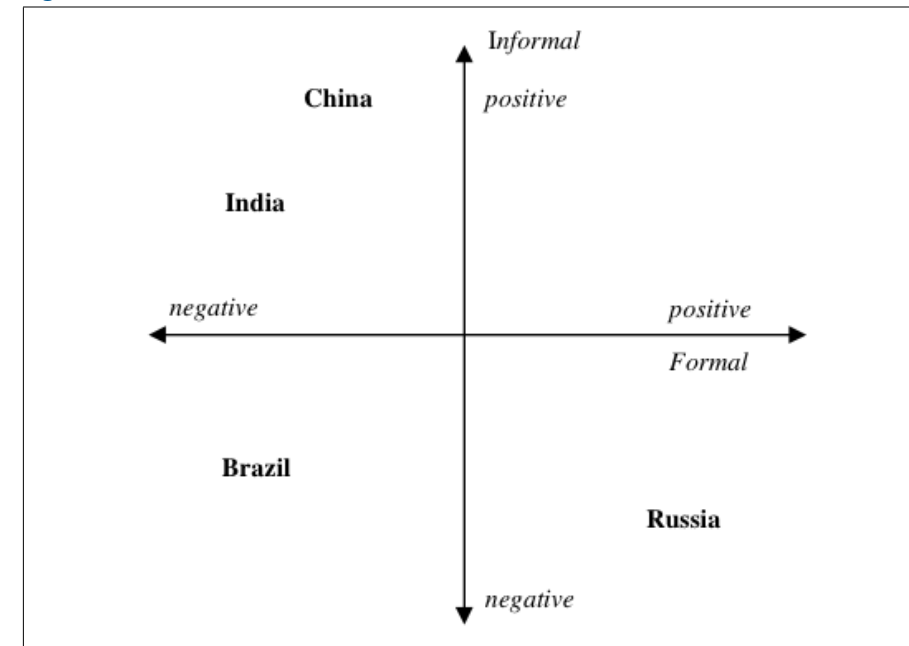
**Figure 3.2: Labour Regulation Enforcement**



**Figure 3.3: Infrastructure**



**Figure 3.4: Finance and Access to Credit**



The four quadrants in figures 3.1 to 3.4 reveal that, with the exception of infrastructure, China and India have similar scores. The results indicate that, broadly speaking, in both countries deficiencies in formal institutions are compensated by positive informal mechanisms. For example, microfinance, access to illegal credit, support for enterprises from state-owned banks, and lack of enforcement of labour regulations (in most areas in China and in some states in India) are examples where formal obstacles are overcome through informal means.

Returning to table 3.1, the authors note that the measure they used for entry rates in India is different from other countries. For India, their definition of entry was based

on the establishment of new plants, rather than new firm registration – since a new plant could equally be associated with the expansion of an existing firm as the establishment of a new firm, their measure was incapable of distinguishing the difference between the two categories. India underwent major shifts in policy changes in the 1980s and the 1990s and different states underwent differing periods of growth. For this reason, in terms of similarity with China, the above assessment of figures 3.1 to 3.4, only applies in some states. In other states, the lack of formal structures in the entry process is further aggravated by informal corruption, lawlessness, and bribery.<sup>132</sup> Figure 3.3 reveals that India suffers from protracted deficiencies in infrastructure. This supports Bardhan's reasoning that access to a reliable power supply remains the principal constraint to growth and explains the significant lack of mid-sized firms. This is equally bound up with complementary problems of bureaucracy, regulation, and excessive corruption.

Rodrik and Subramanian contrast India's periods of reform.<sup>133</sup> In the early 1980s, they say, reforms were geared towards expanding incumbent firms, while 1990s reforms were oriented towards encouraging new entrants. The results of such policies are seen at the state level where there are contrasting levels of growth – the hinterlands were marked by stagnation, low-skilled workers, and more severe inequality.<sup>134</sup> For example, the gap between India's rich and poor regions, such as Maharashtra and Uttar Pradesh, is greater than the difference in average income between India and China.<sup>135</sup> The two states that feature higher entrants and expansion (with rates of three to four percent), thereby having capitalized on both types of policy reform in the 1980s and 1990s are Rajasthan and Tamil Nadu.<sup>136</sup> Since exit procedures are poorly developed in India, net entry rates are artificially boosted by low exit rates – due to the effects of unemployment, India emphasizes restructuring firms rather than closure.<sup>137</sup> With harder budget constraints at state level, judges are becoming more prone to declaring closures, however, although this still varies by state. In general, entrepreneurship is high in India (it is 17.5 percent compared to 10.5 percent in the US and higher than in Brazil and in China).<sup>138</sup> In Brazil, 85 percent of firms rate access to external finance as a severe obstacle, but in India only 25 percent of Indian firms report access issues, which is roughly on par with China. India, as in China, relies heavily on informal credit for small and medium enterprises.<sup>139</sup>

Estrin and Prevezer emphasize that in China, state power compensates for weak property rights and contract enforcement. As for labour regulation, there is a discrepancy between what is written in law and regulatory enforcement in practice. Thus, in an intensely competitive labour market, the government turns a blind eye in favour of employers if practice runs contrary to the law.<sup>140</sup> In the authors' view, such conditions may help foster a positive firm entry environment. On the other side, the costs of exit are high since China has no formal bankruptcy code. Priority is ranked in favour of employees, then government, and then creditors, thus losses are principally borne by the banks and central government.<sup>141</sup> The state is wary of closing firms and the consequences of unemployment. While courts have the final say to determine bankruptcy, the Communist Party and government influence these deci-

sions and corruption in this area is said to be high.<sup>142</sup> The risk of bankruptcy is therefore transferred from the entrepreneur to the state, which prolongs inefficiency. For example, the state tends to support the inefficiency of incumbents in key protected sectors such as the automobile industry.<sup>143</sup> In terms of access to finance, state-owned banks have the discretion to decide who receives loans and often favour important firms at the expense of small and medium enterprises.<sup>144</sup> This leads to heavy reliance on informal sources of finance, such as unofficial and illegal credit institutions, based largely on personal connections and reputation.

Results for Brazil are diverse. In the area of property rights/contract and infrastructure, both formal and informal mechanisms lessen constraints on entry, demonstrating levels close to a more developed country.<sup>145</sup> Brazil suffers serious weaknesses in terms of labour regulations, described as onerous and highly regulated, and lack of access to finance, especially for smaller firms. These barriers are not adequately compensated by informal mechanisms.<sup>146</sup> In Brazil, it appears that the public sector squeezes out the private sector as the main borrower. Indeed, only large firms have access to long-term finance through international capital markets.<sup>147</sup> Brazil has high gross entry and exit levels and net entry levels settle to four percent per year, although levels vary widely across industries. Nevertheless, overregulation and insufficient access to credit drive firms into the informal sector.<sup>148</sup> This underscores the link between formalism, regulation, and the size of the unofficial economy, which in Brazil has expanded to 42 percent of its GDP.<sup>149</sup> For this reason, a higher proportion of firms cited access to external finance as the biggest obstacle to growth. This presents a remarkable contrast to China and India, where informal sectors are about 17 percent and 26 percent respectively, and fall in line with OECD levels.<sup>150</sup>

Like Brazil, Russia has an enormous informal sector that measures 49 percent of the official GDP.<sup>151</sup> The cause of these large informal sectors, however, is different. The strongest deterrent to new entry in Russia is weak property rights and contract enforcement, which represent a disjuncture between law as written and poor enforcement in practice. Russia's placement in the quadrant in figure 3.1, at the lowest bottom right corner, reveals a significant weakness in *de facto* property rights and contract enforcement. Corruption is linked to deficiencies in law enforcement whereby legislation can be interpreted in multiple ways and applied selectively by the authorities. Poor enforcement is compounded by high levels of corruption, bribery, and capture of state processes by incumbents.<sup>152</sup>

Radaev found that over 80 percent of Russian entrepreneurs had suffered from broken contracts.<sup>153</sup> Moreover, industrial concentration has increased – 23 Russian business groups control 35 percent of industrial output.<sup>154</sup> Aidis and Adachi reveal that

<sup>132</sup> Ibid., 293.

<sup>133</sup> Dani Rodrik and Arvind Subramanian, "From 'Hindu growth' to Productivity Surge: the Mystery of the Indian Growth Transition," *NBER Working Paper*, no. 10376 (2004).

<sup>134</sup> Kochhar et al., "India's Pattern of Development."

<sup>135</sup> Estrin and Prevezer, "A Survey on Institutions and New Firm Entry," 301.

<sup>136</sup> Bhaumik et al., "Entry, Reforms, Complementarity and Performance."

<sup>137</sup> Estrin and Prevezer, "A Survey on Institutions and New Firm Entry," 300.

<sup>138</sup> Ibid., 301.

<sup>139</sup> Ibid., 303.

<sup>140</sup> Ibid., 298. See also Tian, "Does Government Intervention Help?"

<sup>141</sup> Estrin and Prevezer, "A Survey on Institutions and New Firm Entry," 299.

<sup>142</sup> Ibid.

<sup>143</sup> Ibid. See also Tian, "Does Government Intervention Help?"

<sup>144</sup> Estrin and Prevezer, "A Survey on Institutions and New Firm Entry," 300.

<sup>145</sup> Ibid., 295.

<sup>146</sup> Ibid.

<sup>147</sup> Ibid.

<sup>148</sup> Ibid., 295.

<sup>149</sup> Ibid., 296.

<sup>150</sup> Ibid., 295.

<sup>151</sup> Ibid., 304.

<sup>152</sup> Ibid., 295. See also the corruption section of this report.

<sup>153</sup> V. Radaev, "Entrepreneurship Strategies and the Structure of Transaction Costs in Russian Business," in *The New Entrepreneurs of Europe and Asia: Patterns of Business Development in Russia, Eastern Europe, and China*, ed. Victoria E. Bonnell and Thomas B. Gold (Armonk, N.Y.: M.E. Sharpe, 2002).

<sup>154</sup> Estrin and Prevezer, "A Survey on Institutions and New Firm Entry," 304.

in certain regions the governor's influence has greatly protected incumbents.<sup>155</sup> For example, Yegor Stroyev has governed the region of Oryol for 16 years, his family and friends run the local economy, and opposition has been crushed.<sup>156</sup> Similarly, governor Rutskoi and his family have dominated local business and the administration of Kursk.<sup>157</sup>

Arbitrary regulatory enforcement through tax and inspection agencies further underscores Russia's serious deficiencies. Bureaucrats enjoy independent powers to inspect businesses at any time, with no limits to the frequency or duration of inspections.<sup>158</sup> OPORA's 2005 research on factors affecting the development of small enterprises in Russia found that, on average, a small enterprise was inspected seven times a year, representing not only excessive administrative regulation but also a major source of corruption.<sup>159</sup> Bardhan argues that India's infrastructure deficit has impacted firm sizes and has led to what he terms the "missing middle." Given the evidence which points to a harsh climate of regulatory administration in Russia, it is useful to compare the most current data available regarding access to electricity and its impact on businesses. The results place Russia in a distinct category. Russia's distribution utilities have demonstrated a wholesale failure to provide electricity, due to significant delays and exorbitant costs (see table 3.2 below). In India's case the weakness appears to be the cost, which is especially prohibitive in poorer regions. India still fares better than China, however, in terms of time delay and cost factor. Brazil's cost is similar to Canada's, although in Brazil service is twice as fast. While Russia does not face an extraordinary increase in the number of procedures, the time delay for service is a crippling 10.5 months and the costs are astronomically prohibitive. Costs in Russia are six times more than China. China is ranked as the second most costly and over 273 times more costly than the US. If these figures are indeed accurate, following on Bardhan's findings, Russian businesses could be facing a wholesale "missing small and medium enterprise sector." Through this lens, data on corruption becomes all the more acute.

As for access to financial capital, Russian entrepreneurs, like those in India and China, rely on informal networks. The Russian equivalent of *guanxi* is known as *blat*, which existed under the Soviet regime as the means to access scarce resources.<sup>160</sup> Such informal networks have not evolved to adequately make up for formal institutions' weakness, as they have in India and China.<sup>161</sup> Rather, as Hsu describes, *blat* has devolved into a sophisticated form of corruption accessible only to the elite.<sup>162</sup> It permits powerful groups to retain their stronghold and favours incumbents over newcomers, which results in disproportionate gains to elite groups.<sup>163</sup> Puffer and McCarthy argue that the commitment and trust needed in such informal networks

<sup>155</sup> Aidis and Adachi, "Russia: Firm Entry and Survival Barriers." Aidis and Adachi argue that internationally comparative data do not provide any clues to the specific Russian business landscape and how it impacts the low level of new firm entry – in terms of purely formal constraints, Russia otherwise fares comparatively well. Their deeper analysis uncovers the informal impediments associated with the lack of rule of law, inconsistent enforcement of regulations, regional autonomy, and pervasive corruption. These informal constraints directly impact new firm creation, firm survival, and firm exit.

<sup>156</sup> Estrin and Prevezer, "A Survey on Institutions and New Firm Entry," 304. See also Aidis and Adachi, "Russia: Firm Entry and Survival Barriers."

<sup>157</sup> Olga Kryshstanovskaya and Stephen White, "The Rise of the Russian Business Elite," *Communist and Post-Communist Studies* 38, no. 3 (2005), 304.

<sup>158</sup> Estrin and Prevezer, "A Survey on Institutions and New Firm Entry," 304-5.

<sup>159</sup> OPORA, "Conditions and Factors Affecting the Development of Small Entrepreneurship in the Regions of the Russian Federation," *OPORA Report* (2005).

<sup>160</sup> Aidis and Estrin, "Institutions, Networks and Entrepreneurship."

<sup>161</sup> Estrin and Prevezer, "A Survey on Institutions and New Firm Entry," 305; Carolyn L. Hsu, "Capitalism Without Contracts versus Capitalists Without Capitalism: Comparing the Influence of Chinese Guanxi and Russian Blat on Marketization," *Communist and Post-Communist Studies* 38, no. 3 (2005).

<sup>162</sup> Hsu, "Capitalism without Contracts."

<sup>163</sup> Aidis and Estrin, "Institutions, Networks and Entrepreneurship." See also the corruption section of this report.

have eroded, because of weak ties, little knowledge and information, and relatively few participants.<sup>164</sup>

**Table 3.2: Getting Electricity Data**

Economy	Procedures (number)	Time (days)	Cost (% of income per capita)
BRAZIL	6	59	150.5
RUSSIA	9	302	4,671.7
INDIA	7	67	400.6
CHINA	6	132	755.2
CANADA	8	168	152.3
UNITED STATES	4	68	16.9

Source: *Doing Business 2011: Making a Difference for Entrepreneurs* (Washington DC: World Bank, 2010), 90-1.

## CONCLUSION

Estrin and Prevezer's comparative case study on the importance of institutions on firm entry reveals the similarities and sharp distinctions across the four institutional components and the diverse relationships that exist between formal and informal mechanisms. New firms are an important aspect of the development process, influencing the pace and character of economic growth. Recalling Haggard and Tiede's 2010 findings, Estrin and Prevezer's results support the view that different institutions have significant impacts in different contexts and that informal and formal institutions do not always function as complementarities. Informal institutions can undermine formal institutions, as is the case in Russia, and to a lesser extent in Brazil. Or else, informal institutions substitute the deficiencies of formal ones as is the case in India and China. This suggests that studies relying only on formal measures must be interpreted cautiously. By extension, Dixit presents a methodological approach for reform that acknowledges the need to identify the multiple causes that operate simultaneously in order to tackle them in practice.<sup>165</sup>

The interaction between corruption and the informal sector in emerging markets helps to distinguish differences across institutions and systems. For example, in China, high levels of corruption act to some extent to buffer inefficiencies in formal structures. By contrast, in Russia, corruption acts instead to debilitate those structures. Estrin and Prevezer caution potential policy makers that, in China, eradicating corruption could be damaging and they should instead focus on strengthening the underlying institutional weaknesses that corruption substitutes. For Russia however, the authors are clear that formal structures must be strengthened at the expense of the informal ones. This suggests a far more active intervention to bring informal structures in line with the formal ones. This is because the large size of the informal sector is related to failures to enforce existing regulations. By contrast, once formal institutions are improved, Brazil will likely experience a more natural shrinking of the informal sector. As for India, it is clear that one of the biggest impediments to sustained growth, at least in terms of expansion and new entrants, is infrastructure

<sup>164</sup> Sheila M. Puffer et al., "Navigating the Hostile Maze: A Framework for Russian Entrepreneurship," *The Academy of Management Executive* 15, no. 4 (2001).

<sup>165</sup> Avinash K. Dixit, "Evaluating Recipes for Development Success," *The World Bank Research Observer* 22, no. 2 (2007).

deficiencies. Given the peculiarities of industrial size in India – fostering the middle gap may well create a future source of sustainable growth.

Throughout this discussion a constant thread has emphasized the need to focus on *de facto* rule of law to identify how the rules play out in practice. Specifically, empirical literature reveals that the particular way clusters of institutions “hang” together in the context of developing and transition economies may be the most important determinant of economic growth and suggests a turn to micro-level work to draw out these particularities.<sup>166</sup>

Another central theme has focused on the ways in which political and economic institutions create an economic environment that encourages growth. In this vein, a state’s credible commitment is framed through a specific context and the *de facto* quality of institutions trumps formal legal rules and policy making. China and India are examples of successful growth in the face of unorthodox market reforms. China’s transitional institutions, such as dual-track pricing and township and village enterprises, created incentives for both private and public actors alike and India is marked by a gradualist approach towards liberalization. Fragile growth in the first two decades of post-Soviet Russia, however, created a significantly weak institutional capacity, that persists today. For example, the gross underdevelopment of small and medium enterprises in Russia can be attributed to unduly complex bureaucratic and procedural hurdles that give rise to corruption, which is exacerbated by insecure property rights. Correspondingly, the Russian state continues to be defined by extremely concentrated power. Brazil has suffered from piecemeal reform dating from the late 1980s and it has only been within the last decade that comprehensive reforms have begun to be implemented.

The unique growth and institutional quality within each BRIC country reveals the crucial role of political economy: political institutions influence the equilibrium of economic institutions, which in turn determine economic outcomes. Along these lines, the greatest strength for both Brazil and India, as opposed to China and Russia, can be found in the degree of pluralism and inclusivity that persists within their political institutions, which may prove to be a determining factor for robust and sustainable economic growth.

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<sup>166</sup> Haggard et al., “Rule of Law and Economic Development” (2008).

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# SECTION 4:

## The Judiciary across the BRICs – Institutional Values and Judicial Authority at the Intersection of Governance

### INTRODUCTION

The rule of law in its most basic conception exists when government officials and citizens are generally bound by and abide by the law.<sup>1</sup> We have argued elsewhere that political and economic institutions are important components that make up the rule of law complex and in turn, influence economic growth. Here we argue that the judiciary, in particular, occupies a pivotal position in legal systems and society in general. An independent, effective, and non-corrupt judiciary plays a central role in the promotion of the rule of law in society.<sup>2</sup> The judiciary also ensures that members of the executive and legislative branches of government lawfully exercise their public powers.<sup>3</sup>

Tamanaha observes that legal institutions require social and political stability, ample human and economic resources, and favourable cultural attitudes toward law. The results of reform efforts also depend on the incentives at play – who stands to gain or lose money, status, and power.<sup>4</sup> In the absence of these and surrounding conditions, it will be hard for legal reforms to take. A 2002 study of failed judicial reform efforts across Latin America concluded, “in sum, good judging can only be expected when all elements of the justice system are reformed, when civil society actively supports reform, and when the political culture places a high value on a reformed judiciary.”<sup>5</sup>

A common thread throughout this section is the institutional values of independence, accountability, and legitimacy espoused by Trebilcock and Daniels.<sup>6</sup> Of particular relevance is the tenacious paradox that Tamanaha speaks of in the context of reform, “the populace must identify with and respect the law and judges if the legal system is to function properly, but the legal system must function properly if the populace is to identify with and respect the law and judges.”<sup>7</sup> A brief discussion will distinguish key aspects of the judiciary, followed by an overview of empirical literature on the judiciary and its relationship to economic development. Case studies will demonstrate current challenges facing the judiciary in Brazil, Russia, and China, followed by a comprehensive analysis of the judiciary in India. A brief overview of

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<sup>1</sup> Brian Z. Tamanaha, *On The Rule Of Law: History, Politics, Theory* (Cambridge: Cambridge University Press, 2004).

<sup>2</sup> Ronald J. Daniels and Micheal J. Trebilcock, “The Political Economy of Rule of Law Reform in Developing Countries,” *Michigan Journal of International Law* 26 (2004), 110.

<sup>3</sup> Brian Z. Tamanaha, “The Primacy of Society and the Failures of Law and Development,” *Legal Studies Research Paper Series*, no. 09-0172 (St John’s University, School of Law, 2009).

<sup>4</sup> *Ibid.*

<sup>5</sup> Michael Dodson, “Assessing Judicial Reform in Latin America,” *Latin American Research Review* 37, no. 2 (2002), 202.

<sup>6</sup> Micheal J. Trebilcock and Ronald J. Daniels, *Rule of Law Reform and Development: Charting the Fragile Path of Progress* (Cheltenham: Edward Elgar, 2008), 59.

<sup>7</sup> Tamanaha, “Primacy of Society,” 13.



India's judicial structure will demonstrate the complex role of governance that the judiciary has played, from upholding constitutional principles to judicial activism. We will examine India's challenge of legislating to achieve greater judicial accountability in an environment where judges retain wide authority and strong independence. Then we will look at how substantial backlogs, a shortage of judges, weak infrastructure, and other challenges facing the judiciary are linked to litigation rates, economic growth, and human development. We will examine specific reform efforts, such as specialized commercial courts dedicated to high-value commercial disputes, the state of Maharashtra's effort to expand the powers of lower courts, and alternative dispute resolution. This comprehensive analysis of India's judiciary will demonstrate the judiciary's role in governance and the reform efforts aimed at sustaining economic growth.

The overarching aim of this section is to delve deeply into the role of judicial institutions. We will look at how the judiciary holds political institutions accountable and also provides redress for citizens. We will examine the extent to which the judiciary plays a role in the complex relationship between rule of law and economic development.

## JUDICIAL POWER AND JUDICIAL INDEPENDENCE

Weingast contends that the strength of the state can be its greatest weakness. If it is strong enough to secure private property rights, it is equally strong enough to attenuate or expropriate them.<sup>8</sup> Rational politicians have an interest in an independent judiciary because it can potentially make their promises more credible. But as Feld and Voigt point out, if politicians' shorter-term preferences deviate from judicial dicta, they might be inclined to encroach on judicial independence.<sup>9</sup>

It is helpful at the outset to distinguish between judicial power and judicial independence. Judicial power allows judges to make authoritative and binding decisions. Judicial independence is a mechanism that upholds institutional values, including judicial accountability. Both of these features contribute towards the judiciary's legitimacy and together they help to decipher the goal of judicial reform within a particular system or regime. For example, judicial independence may exist within a legal system irrespective of its legal foundations, whereas strong independence coupled with narrow jurisdiction limits the reach of a judge's power.

Solomon describes three dimensions to judicial power: jurisdiction, discretion, and authority to ensure compliance.<sup>10</sup> Judges are powerful to the extent that they have legal jurisdiction to hear disputes of public importance. Judges must also have the discretion, however, to make significant choices within those areas of jurisdiction. In other words, judicial discretion may be limited by judicial or administrative superiors.<sup>11</sup> For example, in the USSR and post-Soviet Russia, policy directives issued by the supreme courts specified how judges in lower courts were to apply particular laws.<sup>12</sup> The power of authoritativeness means the judge's ability to enforce public

compliance with judicial decisions.<sup>13</sup> In this way, judicial authority is connected to the legitimacy and support of the courts as institutions.

Solomon defines independence as "the mechanisms that insulate members of the judiciary from pressures, external or internal to it, that might affect the impartiality of their decisions."<sup>14</sup> These mechanisms, or basic protections, include security of tenure, good salaries, well-funded courts, and control over key aspects of the administration of courts.<sup>15</sup> Other mechanisms include limiting pressures linked with judicial bureaucracy, judges' evaluations and career advancement, and the leverage of court chairs.<sup>16</sup>

While judicial power and independence are distinct enquiries, they often overlap and influence each other.<sup>17</sup> If judges are not insulated from influence their scope of power is constrained. Formally, jurisdiction is conferred upon courts by legislatures but still requires cases to be brought to the courts. Discretion begins with the law but in practice equally depends on the extent to which judges are insulated from improper influence. The authority of judicial decisions relies on state and citizens' compliance, which includes the perception that courts are fair and impartial.

McNollgast argues that judicial independence is not a constant feature of a given legal system and is prone to fluctuations that mirror the political composition of the branches of government.<sup>18</sup> For example, judicial independence is greater under a decentralized government than under a more centralized government. This is because a centralized government enables the executive and legislature to coordinate to undermine judicial decisions or increase the number of courts with loyal agents.<sup>19</sup> As Tiede notes, judicial independence may also vary depending on the particular issue being discussed.<sup>20</sup> In the case of property rights enforcement, the legislature may curtail judicial discretion, while in other areas, it will allow more discretion. In this way, judicial independence fluctuates with political alignment, but also with the importance of different political issues.<sup>21</sup>

Whether or not judicial independence has an effect on economic policy and performance remains controversial. La Porta conducted a study that employed objective measures of judicial independence such as judicial tenure and the law-making power of judicial decisions. He found that independence has positive effects on the security of property rights and other regulatory outcomes.<sup>22</sup> Glaeser and Shleifer, however, do not find that judicial independence is associated with long-term growth.<sup>23</sup> What can account for such divergent outcomes?

Woodruff provides a possible response to such divergence.<sup>24</sup> He makes an important distinction between *de jure* and *de facto* institutions. Objective measures such as those used in La Porta's study fail to account for whether the judiciary may be compromised for example, by political interference or rampant corruption. Objective

<sup>8</sup> Barry R. Weingast, "Constitutions as Governance Structures: The Political Foundations of Secure Markets," *Journal of Institutional and Theoretical Economics* 149, no. 1 (1993).

<sup>9</sup> Lars P. Feld and Stefan Voigt, "Economic Growth and Judicial Independence: Cross-Country Evidence Using a New Set of Indicators," *European Journal of Political Economy* 19, no. 3 (2003).

<sup>10</sup> Peter H. Solomon Jr, "Judicial Power in Russia: Through the Prism of Administrative Justice," *Law and Society Review* 38, no. 3 (2004), 551-52.

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

<sup>13</sup> Tom R. Tyler and Gregory Mitchell, "Legitimacy and the Empowerment of Discretionary Legal Authority: The United States Supreme Court and Abortion Rights," *Duke Law Journal* 43, no. 4 (1994), 717.

<sup>14</sup> Solomon Jr, "Judicial Power in Russia," 552.

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.

<sup>17</sup> Ibid.

<sup>18</sup> McNollgast, "Conditions for Judicial Independence," *Journal Contemporary Legal Issues* 15 (2006).

<sup>19</sup> Stephan Haggard et al., "The Rule of Law and Economic Development," *Annual Review of Political Science* 11, no. 1 (2008), 217.

<sup>20</sup> Lydia B. Tiede, "Judicial Independence: Often Cited, Rarely Understood Positive Political Theory and the Law," *Journal of Contemporary Legal Issues* 15 (2006).

<sup>21</sup> Ibid.

<sup>22</sup> Rafael La Porta et al., "Judicial Checks and Balances," *Journal of Political Economics* 112 (2003).

<sup>23</sup> E.L. Glaeser and A. Shleifer, "Legal Origins," *Quarterly Journal of Economics* 117 (2001).

<sup>24</sup> Christopher Woodruff, "Measuring Institutions," in *International Handbook on the Economics of Corruption*, ed. Susan-Rose Ackerman (Cheltenham: Edward Elgar, 2006).

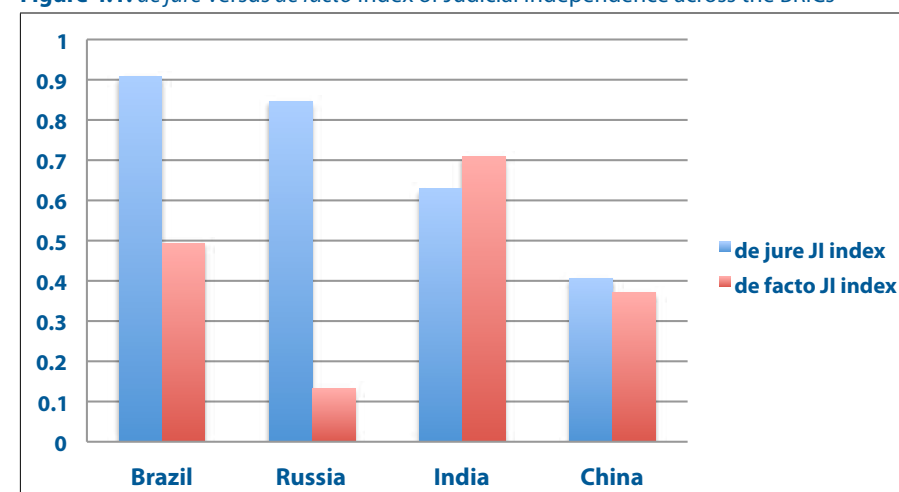
measures, that only measure *de jure* factors, are unable to properly assess how the legal system actually works in practice.

Building on this distinction, Feld and Voigt construct a database that accommodates multiple components for both *de jure* and *de facto* judicial independence, focusing on the independence of the highest court across 57 countries.<sup>25</sup> The *de jure* index is based on the legal foundations in legal documents, drawing on 23 characteristics grouped into 12 variables. The index for each country can take on a value between 0 and 1, where greater values indicate a higher degree of judicial independence. The *de facto* index measures how judicial independence is factually implemented using 8 variables where countries are again ranked between 0 and 1.

Between 1980 and 1998, they find that *de jure* judicial independence does not have an impact on economic growth. *De facto* judicial independence, however, positively influences real GDP growth per capita.<sup>26</sup> In this sense, institutions do matter, but require “real” not formal measurements for assessment.<sup>27</sup> Here, we see that judicial independence is important for economic growth, but it cannot simply be obtained by changes in law. As Feld and Voigt’s study emphasizes, it must be backed up by “actually living judicial independence.”<sup>28</sup>

Figure 4.1 reproduces Feld and Voigt’s findings to compare *de jure* and *de facto* judicial independence across the BRIC countries.

**Figure 4.1:** *de jure* versus *de facto* Index of Judicial Independence across the BRICs



Source: Lars P. Feld and Stefan Voigt, “Economic Growth and Judicial Independence: Cross-Country Evidence Using a New Set of Indicators,” *European Journal of Political Economy* 19, no. 3 (2003), 523-26.

Through this lens, Russia ranks by far the overall weakest in terms of *de facto* judicial independence. And yet, it ranks second highest in terms of formal independence for judges. This creates two problems. First, Russia has not achieved meaningful and real independence within the judiciary, despite efforts targeting formal written law. Second, such lack of meaningful independence is the weakest across all four countries. It ranks even lower than China – an authoritarian state. Such results reveal the extent of judicial dependence on concentrated power in Russia as well as the degree to which powerful vested interests are capable of exerting substantial influence on the judiciary.

<sup>25</sup> Feld and Voigt, “Economic Growth and Judicial Independence.”

<sup>26</sup> Ibid.

<sup>27</sup> Haggard et al., “Rule of Law and Economic Development” (2008).

<sup>28</sup> Feld and Voigt, “Economic Growth and Judicial Independence,” 514.

Brazil evidences a similar yet far less drastic disjunction between formal and “real” judicial independence. Reforms in Brazil were implemented to grant judges substantial institutional independence. For example, they were given protections against removal, guaranteed salaries, and control over staffing, discipline, and their budget.<sup>29</sup> Nonetheless, Dodson has observed that “sweeping increases in the autonomy of the judiciary led to rampant nepotism and other opportunities for corruption.”<sup>30</sup> The judiciary came to be seen as a “privileged enclave” widely scorned by the public.<sup>31</sup> We will discuss below how Brazil faced challenges through sequential reforms and how negative effects of excessive judicial independence were further amplified by judges’ resistance to accountability measures.

In China, courts are institutionally embedded within the government structure and they resemble an administrative agency rather than an independent branch of government. Judicial decisions are subject to internal review by political authorities, which is made worse by *guanxi* networks.<sup>32</sup> These are networks among elites which, among other overlapping factors, subject courts to improper external influence. China’s challenge is not the sharp discrepancy between *de jure* and *de facto* independence, as is the case for Russia and Brazil. Its challenge is that it has the lowest score for both factors of all the BRIC countries.

By contrast, India is a leader in judicial independence. Its *de facto* independence ranks highest across all four countries and even higher than its rank for formal independence. While the other countries have each re-written their formal laws to encourage independence, these efforts have not translated into the depth of real independence enjoyed by judges in India’s highest courts. Nevertheless, the Indian judiciary is facing calls for greater accountability. In addition, service delivery and corresponding issues of access to justice remain an ongoing challenge.

Feld and Voigt conclude that judicial independence must be shaped by additional informal procedures, accompanied and enforced by informal social sanctions.<sup>33</sup> They note that removals before the end of their term, income security, and deviation from formal term lengths are more important factors for economic growth than *de jure* independence.<sup>34</sup> The only *de jure* factor that has any significant impact is a constitutional specification of court procedures.<sup>35</sup> Based on these results, the key to strengthening judicial independence ought to target procedural reform and strengthen effective informal norms.

A review of the literature reveals that executive interference and rampant corruption are clear indications of whether judicial independence has been compromised, rather than formal measures such as judges term lengths or budgets. Haggard et al.

<sup>29</sup> Tamanaha, “Primacy of Society,” 27.

<sup>30</sup> Dodson, “Assessing Judicial Reform in Latin America,” 215.

<sup>31</sup> Ibid.

<sup>32</sup> For our purposes, we use the term *guanxi* by way of its private/public interference, understood as relations-based rather than rule-based governance. Fan et al. set out the complexity of the term within the Chinese context. Of particular relevance is how the authors describe “rent-seeking *guanxi*”:

The term *guanxi* consists of two Chinese words, *guan* and *xi*. *Guan* means, ‘a door and its extended meaning is to close up.’ *Xi* means to ‘tie up and extend into relationships.’ *Guanxi* therefore means ‘past the gate and get connected’ ... Favour-seeking *guanxi* is ‘culturally rooted, signifying social contracts and interpersonal exchanges of resources in a collectivistic society’... Rent-seeking *guanxi* on the other hand: ‘reflects on institutional norms signifying social collusion based on power exchanges in a hybrid Chinese socialist market economy.’

Ying Han Fan et al., “Guanxi and its Influence on the Judgments of Chinese Auditors,” *Asia Pacific Business Review* 18, no. 1 (2011), 84-5. See also Y. Lee Don and Philip L. Dawes, “Guanxi, Trust, and Long-Term Orientation in Chinese Business Markets,” *Journal of International Marketing* 13, no. 2 (2005); Yadong Luo, “Guanxi and Performance of Foreign-Invested Enterprises in China: An Empirical Inquiry,” *MIR: Management International Review* 37, no. 1 (1997); Chenting Su et al., “Is Guanxi Orientation Bad, Ethically Speaking? A Study of Chinese Enterprises,” *Journal of Business Ethics* 44, no. 4 (2003). See also *guanxi* discussion in the corruption section of this report.

<sup>33</sup> Feld and Voigt, “Economic Growth and Judicial Independence,” 516.

<sup>34</sup> Ibid.

<sup>35</sup> Ibid.

point out a key difference between higher and lower courts.<sup>36</sup> An analysis of high or supreme courts addresses the larger constitutional issue of checks and balances on government. The degree of independence of high courts thus points to constraints on the executive and legislature which play an oversight role and hold political institutions accountable. Lower courts, however, more often deal with routine property and contract claims. Thus, lower courts' independence is essential to assess the strength of core economic institutions. This will be examined particularly in the case study on India's judiciary below.

## CASE STUDIES OF THE JUDICIARY

### BRAZIL

Between independence in 1822 to the end of military dictatorship in 1985, Brazil's judges have experienced periods of formal independence and recurrent interference from the executive and legislative branches which has impacted their *de facto* independence. For this reason, reformers in the 1987/1988 Constitutional Assembly sought to ensure a high degree of judicial independence to insulate the judiciary from external political influence and allow it to serve effectively as an instrument of horizontal accountability for executive and legislative abuses of power.<sup>37</sup> Constitutional reforms granted financial and administrative autonomy to the judiciary and expanded its powers of constitutional review. These reforms have been relatively successful as measured by autonomous rulings on politically sensitive issues and by its functional insulation from external influence.<sup>38</sup> Moreover, reformers also strengthened the guarantee of tenure until retirement and made judges' salaries "irreducible."<sup>39</sup> Higher courts were tasked to hear administrative disciplinary cases against lower court members, where the maximum penalty was forced retirement with full benefits in proportion to time worked.<sup>40</sup> In short, the Constitution gave judges wider scope for constitutional review and near total control over their own financial, administrative, and disciplinary affairs.<sup>41</sup>

Soon after the 1988 Constitution was enacted, institutional reform brought unprecedented strength and political power to Brazilian judges and courts – power that was largely left unchecked by the lack of mechanisms to ensure accountability.<sup>42</sup> While mechanisms for accountability had been proposed, judges feared a return to external interference. In addition, there was little popular support for implementing accountability mechanisms, due perhaps to the judges' strong anti-authoritarian public image.<sup>43</sup> By the 1990s, the lack of effective oversight and accountability mechanisms to oversee the use of public resources, clear criteria for career advancement, and various administrative and disciplinary affairs led to "financial recklessness, corruption, nepotism, and favouritism within the Brazilian judiciary."<sup>44</sup> Excessive mismanagement of funds included the construction of luxurious headquarters for the Superior

Tribunal of Justice amounting to over US\$170 million.<sup>45</sup> Prillaman describes how judges obtained excessive individual benefits:

Judges, empowered to set up their own wages, pension, staffing requirements, and budgets, have treated themselves – particularly their upper ranks – exceptionally well, with some of the world's most generous benefits. A Supreme Court justice earns US\$10,800 monthly – more than the President himself – while an average judge of first instance earns more than thirty times the national minimum salary. Judges do even better in retirement; Brazil's National Accounting Office has calculated that a typical judge of first instance earned US\$2,393 monthly in 1994 when serving on bench, but US\$3,559 when he retired – the only country in the world in which a judge earns more in retirement than when serving on the bench.<sup>46</sup>

Several cases of judicial corruption surfaced in the late 1990s, such as the much-publicized construction of the São Paulo Regional Higher Labour Court. The President of this court, Judge Nicolau dos Santos Neto, was sentenced for diverting more than US\$90 million, intended for the construction of the Court's headquarters, to private bank accounts, including his own.<sup>47</sup> The Senate created a congressional commission of inquiry to investigate this case and eight others in 1999. It reported evidence of nepotism, financial irregularities, and corruption in higher and lower courts in several states.<sup>48</sup> In 2004, following seven intense years of political pressure, the first meaningful reforms to ensure greater accountability were finally approved in the form of Constitutional Amendment 45.<sup>49</sup>

In the 1990s, political institutions also went through high-profile corruption scandals. This included the 1992 impeachment of Fernando Collor de Mello, Brazil's first democratically elected president since the end of the military dictatorship, on corruption charges. This was followed, in 1993, by a corruption scandal involving 29 members of Congress.<sup>50</sup> During this period, both the executive and legislature were significantly weakened and impaired in their ability to achieve substantial judicial reform.

The judiciary successfully blocked any reforms for several years, despite widespread support for external oversight from civil society organizations and trade unions. As Prado explains the resistance was threefold: the strong belief in the value of judicial independence came to define the practices and attitudes of the judiciary since early reforms in 1988, self-interested judges were not willing to restrain the power they had been granted, and excessive independence combined with a lack of accountability opened up space for corruption and other corrosive practices and those benefiting did not want to surrender such practices.<sup>51</sup>

President Luiz Inácio Lula da Silva, elected in 2002, prioritized judicial reform. By 2004, a constitutional amendment created an external judicial council tasked with disciplinary action and budgetary and administrative oversight. The Association of

<sup>36</sup> Haggard et al., "Rule of Law and Economic Development" (2008).

<sup>37</sup> Mariana Mota Prado, "The Paradox Of Rule Of Law Reforms: How Early Reforms Can Create Obstacles To Future Ones," *University of Toronto Law Journal* 60, no. 2 (2010), 558.

<sup>38</sup> William C. Prillaman, *The Judiciary and Democratic Decay in Latin America: Declining Confidence in the Rule of Law* (Westport, CT: Praeger Publishers, 2000), 83.

<sup>39</sup> Prado, "The Paradox Of Rule Of Law Reforms," 559.

<sup>40</sup> *Ibid.*, 559-60.

<sup>41</sup> Prillaman, *The Judiciary and Democratic Decay*, 81.

<sup>42</sup> *Ibid.*, 85-6.

<sup>43</sup> Prado, "The Paradox Of Rule Of Law Reforms," 560; Anthony W. Pereira, "Explaining Judicial Reform Outcomes in New Democracies: The Importance of Authoritarian Legalism in Argentina, Brazil, and Chile," *Human Rights Review* 4, no. 3 (2003), 7.

<sup>44</sup> Prado, "The Paradox Of Rule Of Law Reforms," 561.

<sup>45</sup> *Ibid.*

<sup>46</sup> Prillaman, *The Judiciary and Democratic Decay*, 86.

<sup>47</sup> Matthew M. Taylor and Vinicius C. Buraneli, "Ending Up in Pizza: Accountability as a Problem of Institutional Arrangement in Brazil," *Latin American Politics and Society* 49, no. 1 (2007), 71-72.

<sup>48</sup> Brazil, Senate "CPI Do Judiciário Investigou Nove Casos", Government of Brazil (website) online: <<http://www12.senado.gov.br/noticias/materias/1999/12/17/cpi-do-judiciario-investigou-nove-casos-187578364>> referred to in *Ibid.*, 62.

<sup>49</sup> Prado, "The Paradox Of Rule Of Law Reforms," 562.

<sup>50</sup> *Ibid.*, 563.

<sup>51</sup> *Ibid.*, 564.

Brazilian Magistrates challenged the amendment, but the Supreme Court affirmed its constitutionality.

#### Box 4.1: Canada's Judicial Compensation and Benefits Commission

In 1997 the Supreme Court of Canada handed down a key decision on the remuneration of judges, which established new constitutional requirements for determining judicial compensation through objective and independent procedures. The judgment established distinct facets of judicial independence: security of tenure, financial security, and administrative independence. A significant tension in Canada's system is that there is no constitutional division between the judiciary and legislative branches, as in the US, and the appointment of judges by politicians was supposed to give judges a measure of accountability to the public. The Judicial Compensation and Benefits Commission attempts to resolve this tension.

The Judicial Compensation and Benefits Commission is intended to be a tool to establish financial security for judges. In considering judicial compensation the commission is entitled to consider Canada's economic conditions, such as cost of living, role of financial security to ensure independence, and the need to attract outstanding candidates to the post. The commission then makes a recommendation regarding remuneration, which the government may or may not implement. In refusing to implement the recommendation, however, the government must demonstrate that it has a legitimate reason for departing from the commission's recommendations, a reasonable factual foundation, and that it has respected the commission's process. This imposes on the government a significant requirement to show just cause for departing from the commission's recommendations. The process' significant drawback, however, is that the main grounds for reviewing the government's decision lies with judges themselves, who may not be fully unbiased.

Source: Karen Eltis and Fabien Gélinas, "Judicial Independence and the Politics of Depoliticization" (March 21 2009) online: <<http://ssrn.com/abstract=1366242>>.

Judicial independence and accountability are mutually reinforcing objectives that are twin pillars for reform. For example, the Canadian Judicial Council's 2006 report finds that there is a compelling constitutional rationale for changing the executive model of court administration in Canada to a model which features a greater degree of judicial autonomy. Such change, the report concludes, would not only enhance judicial independence and the accountability of the judiciary in court administration, but would equally improve service delivery.<sup>52</sup> Here we see how the role of judicial autonomy is informed by the nuanced interplay between independence and accountability.

While the Brazilian experience is context-specific, sequential reform demonstrates the consequences of favouring one goal over another and the significant risk it carries. If judicial accountability is favoured over independence, external forces may attempt to influence judges' decision making, encouraging them to rule in favour of what is politically acceptable or even personally advantageous.<sup>53</sup> If the predominant goal is greater independence, the risk comes from judges who may use their position

to pursue personal, professional, or political agendas at the expense of rule of law.<sup>54</sup> While one area is being strengthened, the other areas remained flawed and may serve to undermine reform efforts, consequences that run contrary to the presumption that one positive reform will inevitably lead to another.<sup>55</sup> Prado acknowledges that full-fledged reforms carry a reduced risk because they avoid these undesired consequences, however, in her view, the influence of path dependency, especially in the case of transitional countries, may pose obstacles, such as switching costs to a new institutional regime, and thus piecemeal reforms may be the only option available.<sup>56</sup>

Prado illustrates how the critical juncture of the 1988 constitutional reforms reveals the elements of path dependency facing Brazil's transition to democracy. First, the Brazilian judiciary was one of the most independent in Latin America during the military dictatorship and therefore did not have much to lose in maintaining the status quo.<sup>57</sup> Thus, in a process where one group was demanding reforms and another was resisting them, the balance of bargaining power weighed in the judiciary's favour.<sup>58</sup> Second, Congress delegated most of the 1988 judicial reforms to a group of experienced legal actors, including members of the judiciary, who faced little political opposition. The judiciary was able to negotiate directly with other interest groups as politicians with voting power were not interested in judicial reforms and likely deferred to the decisions of this group.<sup>59</sup> Third, a political compromise assured that the judiciary absorbed magistrates into the higher courts, who had been politically connected to the military regime.<sup>60</sup>

Socio-cultural-historical factors also affected the 1988 bargain. First, Prillaman highlights the lack of public interest in judicial reforms.<sup>61</sup> Citizens did not take issue with being deprived of control over, or even access to, information about the judiciary. This was further reinforced by the Brazilian legal establishment's public image as an anti-authoritarian body.<sup>62</sup> Second, the hierarchy of values placed more emphasis on independence than accountability. This attitude framed accountability as undue political interference.<sup>63</sup> Third, legitimacy also affected the 1988 bargain, as Pereira observes:

In Brazil, unlike in Argentina and Chile, reformers could not tap a sense among political elites that the judiciary had failed to protect democracy from the military and was somehow tainted by an authoritarian past. While a perception that the judiciary as inefficient was widespread, reformers had difficulty linking democratization with judicial reform.<sup>64</sup>

As Prado explains, the difficulty in persuading political elites of the need for judicial reform arose from the fact that amongst their ranks was a president with strong ties to the military regime with little concern for judicial reforms and a civil political class that was, "more interested in obtaining the benefits associated with government service than with building an accountable government."<sup>65</sup> This was further reinforced by

<sup>54</sup> Ibid. See also John A. Ferejohn and Larry D. Kramer, "Independent Judges, Dependent Judiciary: Institutionalizing Judicial Restraint," *New York University Law Review* 77 (2002).

<sup>55</sup> Prillaman, *The Judiciary and Democratic Decay*, 77-78.

<sup>56</sup> Prado, "The Paradox Of Rule Of Law Reforms," 569. See also Pereira, "Explaining Judicial Reform Outcomes."

<sup>57</sup> Prado, "The Paradox Of Rule Of Law Reforms," 571.

<sup>58</sup> Ibid., 570.

<sup>59</sup> Ibid., 571.

<sup>60</sup> Ibid. See also Prillaman, *The Judiciary and Democratic Decay*, 77-78.

<sup>61</sup> Prillaman, *The Judiciary and Democratic Decay*, 95.

<sup>62</sup> Prado, "The Paradox Of Rule Of Law Reforms," 572; Pereira, "Explaining Judicial Reform Outcomes," 7.

<sup>63</sup> Prado, "The Paradox Of Rule Of Law Reforms," 572.

<sup>64</sup> Pereira, "Explaining Judicial Reform Outcomes," 9.

<sup>65</sup> Prado, "The Paradox Of Rule Of Law Reforms," 572-73.

<sup>52</sup> Karim Benyekhlef et al., *Alternative Models of Court Administration* (Ottawa: Canadian Judicial Council, Subcommittee on Alternative Models of Court Administration, 2005).

<sup>53</sup> Allan G. Tarr, "Creating and Debating Judicial Independence and Judicial Accountability," in *Convention of the American Political Science Association*, 30 August - 4 September (2006).

the lack of reformer leadership that could effectively identify and represent citizens' opinions.<sup>66</sup>

The Brazilian case suggests that reformers had a window of opportunity, but that they had few options but to favour independence over accountability. This example is particularly relevant in the context of transition and builds upon the discussion in the institution section of this report regarding the legacies of institutional structures and policy patterns.<sup>67</sup> Socio-cultural-historical factors and the political economy of legal reforms created a path-dependency which affected reformers' choice of strategies at the critical juncture of 1988. This had consequences that lasted more than 20 years.

## RUSSIA

Recalling Feld and Voigt's *Index of Judicial Independence*, Russia had the greatest contrast between *de jure* and *de facto* independence. There, written law stands in stark contrast to the impact those laws have achieved in practice.

In the former Soviet Union, the judiciary was notoriously subservient to the Communist Party. Courts were considered,

little more than an extension of executive power. In theory, judges were independent and subject only to law; in practice, they conformed to the expectations, and occasionally the explicit commands, of the Communist Party, the Procuracy, the Ministry of Justice, and even local soviets.<sup>68</sup>

The Soviet legal system has been described as “telephone justice,” where judges sometimes made decisions with input from party authorities.<sup>69</sup> Judicial training was often inadequate and the legal community looked down on judges.<sup>70</sup>

Early reforms focused on challenges inherited from the Soviet regime, namely overcoming the legacy of dependent judges and weak courts. These reforms included lifetime security of tenure (following a three year probation period); establishing the Judicial Qualifications Committee, a committee of peers which could only remove a judge for cause; immunity against administrative liability (such as traffic violations); and immunity from criminal prosecutions (although this could be waived at the Judicial Qualifications Committee's discretion).<sup>71</sup> Court budgets were also granted constitutional protection and judges' salaries were shielded from unilateral executive or legislative action.<sup>72</sup> At this time, the administration of the courts had been removed from the Ministry of Justice and placed under the control of chief judges.<sup>73</sup>

<sup>66</sup> Ibid., 573.

<sup>67</sup> Douglass C. North, “The Contribution of the New Institutional Economics to an Understanding of the Transition Problem,” in *Wider Annual Lectures* (UNU World Institute for Development Economics Research, 1997), 16. See also the institutions section of this report.

<sup>68</sup> Eugene Huskey, “Russian Judicial Reform after Communism,” in *Reforming Justice in Russia 1864-1996, Culture and the Limits of Legal Order*, ed. Peter H. Solomon Jr (Armonk, NY: M E Sharpe, 1997), 326.

<sup>69</sup> Trebilcock and Daniels, *Rule of Law Reform and Development*, 78.

<sup>70</sup> Peter H. Solomon Jr and Todd S. Foglesong, *Courts and Transition in Russia: the Challenge of Judicial Reform* (Boulder, Colo.: Westview Press, 2000), 8 & 93; Peter H. Solomon Jr, “Legality in Soviet Political Culture: A Perspective on Gorbachev's Reforms,” in *Stalinism: Its Nature and Aftermath: Essays in Honour of Moshe Lewin*. ed. Nick Lampert and Gabor Rittersporn (London, 1991).

<sup>71</sup> Peter H. Solomon Jr, “Putin's Judicial Reform: Making Judges Accountable as well as Independent,” *East European Constitutional Review* 11 (2002), 118.

<sup>72</sup> Trebilcock and Daniels, *Rule of Law Reform and Development*, 78.

<sup>73</sup> Solomon Jr, “Putin's Judicial Reform,” 118.

Through the 1990s, Solomon notes the positive effects of such reforms – nearly 80 percent of cases against public officials were won by private claimants.<sup>74</sup> He frames such improvements in the following way:

One should not forget that the challenge faced by Russia (and other post-Soviet states) was qualitatively different. Russia was subjecting public officials to court scrutiny on a broad scale for the first time in its history, a history in which no *rechtsstaat* had ever existed and which for a long period denied the validity of the concept. Viewed in this context, the achievements of the first decade of post-Soviet Russian administrative justice are substantial.<sup>75</sup>

Solomon nonetheless concedes that the public continued to perceive the courts as inefficient and corrupt despite such improvements.<sup>76</sup> A primary factor was inadequate financing by the federal government, which compromised judges' independence:

[This] led to the ‘sponsorship’ of courts by regional and local governments and private firms and by compensation packages for individual judges that included bonuses and perks (such as apartments) arranged by the chairmen of courts and their friends in local government. As a result, local politicians and their wealthy friends could still exercise improper influence over judges, and the chairs of courts had too much leverage over their subordinates.<sup>77</sup>

Foglesong describes the financial situation in much more dire terms, “in 1996 and 1997 the money allocated to the courts barely covered judges' wages; virtually nothing was left to pay for operating costs (paper, stamps, telephone service, heating and electricity), not to speak of repairs and improvements.”<sup>78</sup> Reaching desperate levels, courts became substantially dependent on local government authorities and private sources for subvention, credits, and in-kind assistance, so that in 1997, 22 percent of judges surveyed admitted that “the support had some influence on the handling of their cases.”<sup>79</sup> In similar terms, the Supreme Judicial Qualifications Committee was forced to “rely on favours from ‘sponsors,’ private donations, and government subventions, all obtained through negotiations.”<sup>80</sup> Foglesong argues that national/regional dynamics were a critical factor for interagency conflict, “national and sub-national governing bodies repeatedly have subverted efforts to make Russian courts financially autonomous.”<sup>81</sup>

Facing allegations of endemic corruption, then President, Vladimir Putin implemented a second wave of reforms in 2000 aimed at improving public perception and accountability measures. These reforms included broadening the membership of the Judicial Qualifications Committee to lawyers and legal scholars; implementing mandatory retirement; introducing fixed terms for court chairs with their rights and responsibilities set out in law; and decreased protection for judges from administrative and criminal offenses.<sup>82</sup> This coincided with a dramatic increase in spending on

<sup>74</sup> Ibid., 119.

<sup>75</sup> Solomon Jr, “Judicial Power in Russia,” 575.

<sup>76</sup> Solomon Jr, “Putin's Judicial Reform,” 119.

<sup>77</sup> Ibid., 118-9.

<sup>78</sup> Todd S. Foglesong, “The Dynamics of Judicial (In)dependence in Russia,” in *Judicial Independence in the Age of Democracy: Critical Perspectives From Around the World*, ed. Peter H. Russell and David M. O'Brien (Charlottesville: University Press of Virginia, 2001), 69.

<sup>79</sup> Ibid., 71.

<sup>80</sup> Ibid., 73.

<sup>81</sup> Ibid., 70.

<sup>82</sup> Solomon Jr, “Putin's Judicial Reform,” 120.

the courts (totaling 43,962,200,000 rubles over five years or approximately US\$1.4 billion) including adding new judges and raising judicial salaries.<sup>83</sup>

Have these reforms succeeded in achieving an independent and accountable judiciary in Russia? In an interview with Open Democracy, legal scholar Alena Ledeneva, suggests that the judicial system is,

clearly exposed to the broader set of informal practices, unwritten rules and loyalty bonds that dominate Russia's model of governance. These influences are what Russians collectively refer to as 'the system,' *sistema*. ... While it would be a caricature to suggest that every court case in Russia is decided according to directives from above, it is certainly possible to imagine a way *sistema* can produce 'correct' judgments for the government.<sup>84</sup>

Elaborating on the kinds of pressures facing judges, she states:

Oral commands from above certainly play their part. This is the most literal manifestation of *telefonnoye pravo*, or 'telephone justice,' a term you sometimes find in the media today. On the other hand ... informal pressure does not have to be directly communicated. It can be the kind of pressure that reins you back from stepping outside the system. The dependence judges have on court chairmen, their managers. The self-censorship. The need to play by unwritten rules in order to function or prosper within the judicial system.

These are the kind of pressure I focus on in my research. Unfortunately, they are also the most difficult ones to get at, since people themselves have trouble identifying it. Insiders don't want to 'flag' it. It is only really thanks to the whistleblowers who speak out that we have some knowledge of it. Judge Olga Kudeshkina is one good example, though she isn't alone: Pashin, Morshchakova, and most recently Yaroslavtsev and Kononov have all provided important information for the record.<sup>85</sup>

Kudeshkina's European Court of Human Rights ruling is an example of the Strasbourg courts' rebuke of Russia's judicial system and the pressures facing judges. In 2006, Russian citizens allegedly lodged 12,000 complaints before the European Court of Human Rights, which is said to comprise almost one-fifth of all applications filed by the Council of Europe's 47 member states.<sup>86</sup> It would appear that the European Court of Human Rights has emerged as a powerful external check on domestic disputes involving Russian authorities. Current draft legislation, however, is underway in Russia to bar Russian citizens from appealing to the European Court of Human Rights before having exhausted all available legal recourses at home. Such reform would allow Russia's courts to deal with issues within its own judicial system and ease Strasbourg's caseload. Critics, however, have challenged the underlying motives for these reforms, claiming that Russian courts don't want their judgments challenged and that the European Court of Human Rights' frequent rebukes of the Russian government are causing extreme displeasure in the Kremlin.<sup>87</sup>

<sup>83</sup> Ibid., 121.

<sup>84</sup> Alena V. Ledeneva and Oliver Carroll, "Is Russia's Judicial System Reformable?" online: <<http://www.opendemocracy.net/>>.

<sup>85</sup> Ibid.

<sup>86</sup> Claire Bigg, "Russia: Judicial Reform Under Way, But For the Right Reasons?" *Radio Free Europe Radio Liberty* (October 24 2007), online: <[www.rferl.org/](http://www.rferl.org/)>.

<sup>87</sup> Ibid.

#### Box 4.2: Examples of Pressure to Produce "Correct" Judgments for the Russian Government

**2004 The Three Whales case:** Judge Olga Kudeshkina presided over the case of Pavel Zaitsev, an investigator at the Ministry of Internal Affairs, facing criminal charges of abuse of office following his investigation into alleged furniture smuggling at the Grand and Three Whales shopping centres outside Moscow. At trial, the state prosecutor, Dmitry Shokhin's performance was called into question. He tried to delay and disrupt proceedings and eventually called for Judge Kudeshkina's resignation. Olga Yegorova, chairwoman of the Moscow City Court, then pressured Kudeshkina to falsify case materials and eliminate records of Shokhin's strange behaviour. When Kudeshkina refused, her case was transferred to another judge. Judge Kudeshkina went public and was subsequently dismissed from the bench. She brought her case before the European Court of Human Rights. In 2009 the European Court of Human Rights established that the chairwoman of the Moscow City Court had interfered in a fair and just hearing of a criminal case and declared that the premature removal from the bench violated Kudeshkina's right to free expression. Following the ruling, Judge Kudeshkina applied to the Moscow City Court for re-examination of the decision to remove her but the application was rejected.

**2008 Boyev v Solovyov libel case:** Valery Boyev, the head of the Kremlin's rewards department, brought a libel case against Vladimir Solovyov, a well-known broadcaster. Solovyov had made statements alleging that the Kremlin controlled arbitration courts. However, a dramatic intervention by Yelena Valyavina, the first deputy chair of the Supreme Arbitration Court, supported Solovyov's claims. Valyavina said Boyev had pressured her to return certain judgements. This evidence proved decisive and Boyev withdrew his claim. Valyavina's statement was unprecedented – at no point in recent times has a senior woman judge made such a statement. As Ledeneva states, "one can certainly imagine that prior to making [the statement] she consulted with the head of the Supreme Arbitration Court, Anton Invanov, and that Ivanaov in turn consulted with his friend and co-author, Dmitry Medvedev. The Valyavina statement is as clear a signal as you can get that the President does not want bureaucrats interfering in the work of the courts."

**Sources:** Olga Kudeshkina, "Tackling Russia's Legal Nihilism," online: <<http://www.opendemocracy.net/>>; Alena V. Ledeneva and Oliver Carroll, "Is Russia's Judicial System Reformable?" online: <<http://www.opendemocracy.net/>>.

In 2009, the Centre for Political Technologies published a report based on a qualitative study that examined the judicial system.<sup>88</sup> Contrary to popular belief, it found that while corruption was generally a problem, it reflected similar corruption levels across Russian society. Most significant, however, is the extent to which courts are dependent on and protect the interests of public officials. A significant factor that reinforced judicial impartiality is judges' fear of and dependence on court chairmen. Court chairmen are not hired on the basis of their legal qualifications and they are highly susceptible to political bias.<sup>89</sup> According to Kudeshkina, court chairmen have considerable power. They can decide how to treat a plea, which cases are assigned to judges, and whether to transfer cases to more loyal judges. They also hand out bonuses and determine judges' career advancement. They can also initiate disciplinary proceedings against judges which include sanctions such as removal from the bench.<sup>90</sup> The report recommended that chairmen should be judges, as in they are in

<sup>88</sup> "Судебная Система России: Состояние Проблемы," [The Judicial System in Russia: Current State and Problems] *Center for Political Technologies* (Moscow: Institute of Contemporary Development, 2009).

<sup>89</sup> Ibid., 12.

<sup>90</sup> Olga Kudeshkina, "Tackling Russia's Legal Nihilism," online: <<http://www.opendemocracy.net/>>.

the Constitutional Court, that they should be selected by the judicial community on a fairly short-term basis, and that there should be computerized case distribution.<sup>91</sup>

Ledeneva's conclusions mirror Feld and Voigt's. She emphasizes the crucial significance of *de facto* judicial independence. She frames this as the requirement of express support from the highest source of political authority. She states:

Being a legalist is not necessarily in Medvedev's favour here. He believes that it is possible to change the system by changing the law, whereas what actually needs to be changed is culture, institutional culture. Specifically, you need to combine mechanisms that increase risk for non-normative behaviour, but also create protection for those who want to go professional [meaning acting as an independent official], like Olga Kudeshkina. That has proven, so far, to be very difficult to achieve ... [moreover] any change in the formal rules introduces yet another constraint to be dealt with informally. If Medvedev really wants to make changes, ultimately he will be forced to work through *sistema*. He will, for example, have to use oral commands and make sure they are followed. One way of interpreting the Valyavina affair, indeed, is that it sent a new signal: one which instructs officials and businessmen not to interfere with the courts.<sup>92</sup>

Upon finalizing this section, Vladimir Putin was sworn in as Russia's President and his approach to Medvedev's modernization process remains an open question.

## CHINA

This discussion of the Chinese judiciary will look at formal and informal institutions, specifically at the interplay between courts, politicians, and bureaucrats – a feature characteristic of China's court structure. Our analysis of judicial independence ultimately engages the topics of judicial accountability and corruption. The focus of our enquiry is the judiciary's impact, either directly or indirectly, on sustainable economic growth. As such, our discussion is correspondingly narrow in scope.

### Formal Institutions

Institutionally, China's courts are embedded within the government structure. They resemble an administrative agency rather than an independent branch of government. They answer to the corresponding people's congress and are overseen by the Procuracy.<sup>93</sup> The National People's Congress Standing Committee, rather than the Supreme People's Court, has the authority to interpret national law.<sup>94</sup> Similarly, courts do not possess the power to interpret administrative regulations. Instead this power rests with the issuing agency.<sup>95</sup> The Supreme People's Court, however, may issue judicial interpretations on questions of specific applications of law, which are tantamount to supplemental legislation.<sup>96</sup> At lower levels, Chinese courts report to and are supervised by the local people's congresses (local legislative organs).<sup>97</sup>

<sup>91</sup> "Судебная Система России: Состояние Проблемы," 12.

<sup>92</sup> Ledeneva and Carroll, "Is Russia's Judicial System Reformable?"

<sup>93</sup> Jamie P. Horsley, "The Rule of Law in China: Incremental Progress," in *China Today, China Tomorrow: Domestic Politics, Economy and Society*, ed. Joseph Fewsmith (Lanham: Rowman & Littlefield Publishers Inc., 2010), 57.

<sup>94</sup> *Ibid.*

<sup>95</sup> US, Congressional-Executive Commission on China, Virtual Academy "Chinese Courts and Judicial Reform" (June 3 2004) online: CECC <<http://www.cecc.gov/pages/virtualAcad/rol/judreform.php>>.

<sup>96</sup> Horsley, "The Rule of Law in China."

<sup>97</sup> CECC, "Chinese Courts and Judicial Reform."

In addition to institutional constraints on their authority and independence, the courts have been plagued by incompetence, lack of professionalism, and corruption – factors which undermine the public's trust.<sup>98</sup> Judges are appointed in accordance with Party guidance and remunerated by the people's congress at the corresponding government level. This system only exacerbates the problem of local protectionism and undue political influence.<sup>99</sup> Prior to 1995, judges were frequently retired military men and were not required to have any legal training. Over time, however, requirements for becoming a judge have steadily tightened. Now new judges must hold university degrees, pass a national unified judicial exam, and participate in ongoing legal education programs.<sup>100</sup> The challenges facing China's judiciary are substantial – as of 2003, only 40 percent of China's 220,000 judges held four year university degrees and only 2 percent held graduate degrees.<sup>101</sup> The quality of judicial personnel outside the major cities is still uneven and low salaries are said to contribute to widespread judicial corruption.<sup>102</sup> Judges have no security of tenure and are poorly paid, earning approximately one-tenth of what lawyers earn. Indeed, multiple scandals have come to light in recent years involving financial inducements made by lawyers to judges.<sup>103</sup>

Courts that handle large volumes of cases in developed areas such as Shanghai, Beijing, or Guangdong, have had more access to resources through reliance on litigation fees.<sup>104</sup> In response, the government has begun to implement a system where all litigation fees are sent to the provincial and central level and then redistributed through the finance bureau and high-level courts. This system includes increased central funding for poorer areas.<sup>105</sup> Lack of sufficient funding, however, is still a pressing issue in many poor areas.

### Informal Institutions

North highlighted the important role of informal constraints, that go beyond formal rules, which provide incentive structures that "produce a set of economic rules of the game (with enforcement) that induce sustained economic growth."<sup>106</sup> Informal constraints include sanctions, customs, traditions, and codes of conduct. Informal institutional arrangements are particularly important in developing countries. Similarly, Rubin recommends that private adjudication supported by formal enforcement is key for building governance in transition economies.<sup>107</sup>

The Chinese experience shows that economic development encourages legal development, in the sense that the focus of legal reform is on creating substantive and procedurally efficient contract and property rules rather than creating a first-class judiciary.<sup>108</sup> The rationale is that informal substitutes to a formal legal system are less expensive and play a significant role in enforcing and protecting property and

<sup>98</sup> Horsley, "The Rule of Law in China," 66.

<sup>99</sup> *Ibid.*, 57.

<sup>100</sup> *Ibid.*, 66.

<sup>101</sup> CECC, "Chinese Courts and Judicial Reform."

<sup>102</sup> *Ibid.*

<sup>103</sup> "Courthouse Corruption Criticized at NPC," *China Through a Lens: China.org.cn* (March 9 2005), online: <[www.china.org.cn](http://www.china.org.cn)>.

<sup>104</sup> Randall Peerenboom, "Judicial Independence in China: Common Myths and Unfounded Assumptions," in *Judicial Independence in China: Lessons for Global Rule of Law Promotion*, ed. Randall Peerenboom (Cambridge: Cambridge University Press, 2009), 74-75.

<sup>105</sup> *Ibid.*, 75. See also Jingwen Zhu, *Zhongguo Falü Fazhan Baogao (1979-2004)* [China Legal Development Report (1979-2004)] (Beijing: People's University, 2007). Zhu discusses how China has experimented with different ways of funding the courts. For example, funding was borne by the central government until 1980 and then funded locally thereafter. Litigation fees were handled in different ways, with local courts or finance departments retaining different rations and remitting the rest to the centre.

<sup>106</sup> Douglass C. North, "Institutions," *Journal of Economic Perspectives* 5, no. 1 (1991), 98.

<sup>107</sup> P. H. Rubin, "Growing a Legal System in the Post-Communist Economies," *Cornell International Law Journal* 27 (1994).

<sup>108</sup> Tarr, "Creating and Debating Judicial Independence and Judicial Accountability," 9.

contract rights.<sup>109</sup> Clarke et al. contend that “the various shortcomings of China’s legal institutions insofar as they protect contract rights [vis-à-vis property rights] may not matter very much, provided that the political structure in a sufficient number of places provides a reasonable degree of certainty to investors, both public and private.”<sup>110</sup>

In an effort to advance such alternative dispute mechanisms, China passed the “People’s Mediation Law.” It became effective in January 2011 and stresses the need to resolve civil disputes through mediation to maintain social harmony and stability.<sup>111</sup> It encourages parties to reach voluntary resolution through people’s mediation committees, where services are free and legally binding.<sup>112</sup> While mediation may be an effective tool in some cases, scholars are concerned that it will curtail Chinese citizens’ access to courts, that adequate resolution of disputes will depend on coercion, and that decisions will not be effectively enforced.<sup>113</sup> The government and the Party reportedly set mandatory mediation quotas, offering financial rewards and career incentives to judges with high rates of mediation and punishing judges who issue decisions that result in citizens petitioning higher courts.<sup>114</sup> Recent survey data suggests that the enforcement of mediated agreements remains weak and that pressure by courts to settle is eroding voluntary enforcement rates.<sup>115</sup>

Scholars such as Minzner have emphasized that emphasis on mediation coincided with the Party vigorously reasserting its primacy in the face of formal legal reform. In 2006, Party authorities launched a “socialist rule of law theory” campaign stressing loyalty to the Communist Party and the need to avoid Western rule-of-law theories.<sup>116</sup> In 2007, Xiao Yang, then President of the Supreme People’s Court, stated:

The power of the courts to adjudicate independently doesn’t mean at all independence from the Party. It is the opposite, the embodiment of a high degree of responsibility vis-à-vis Party undertakings.<sup>117</sup>

From the 1970s onwards, Chinese Communist Party policy, one of the more powerful informal institutions in China, attempted to establish the authority of law.<sup>118</sup> In October 2007, at the 17th Party Congress, President Hu Jintao pledged to “build a fair, efficient and authoritative socialist judiciary system to ensure that courts and procuratorates exercise their respective powers independently and impartially in accordance with the law.”<sup>119</sup> As Shen notes, however, “in both theory and reality ... it is impossible to have a comprehensive and institutionalized legal system with a high degree of authority when law is neither ‘autonomous’ nor ‘supreme,’ but used only as

an instrument of Party rule.”<sup>120</sup> Such instrumentality can be described as “the willingness of states or individuals to use legality as an instrument to achieve their policy objectives but to depart from it when compliance with the law no longer serves the attainment of such ends.”<sup>121</sup>

### The Interplay of Political and Legal Criteria

In principle, Chinese courts are supposed to exercise their adjudicatory power independently through free and open trials. In practice, government officials apply pressure on courts and the Party may intervene through court-based adjudication committees that supervise judges’ work.<sup>122</sup> Cohen describes how decisions in non-routine cases are made by the court’s adjudication committee, rather than the customary panel of three judges.<sup>123</sup> The court’s adjudication committee is composed of administrative leaders and some senior judges. It decides sensitive and complex cases behind closed doors after only listening to a report from the judge in charge of the trial.<sup>124</sup> Sometimes, outside agencies, such as higher courts and the Party apparatus, influence rulings behind the scenes.<sup>125</sup> For example, a Supreme Court training manual suggests some general guidelines for determining whether to accept a case:

The merits of the case by Courts must be measured against two criteria: (1) legal criteria: whether it falls within the scope of laws and regulations ... (2) political criteria: for questions that involve national defense, foreign relations, state interest and other matters that go beyond the scope of the power of the judiciary and are not suitable to be adjudicated by the courts, cases should not be accepted. This is dictated by the place of the courts ... in the political system.<sup>126</sup>

For this reason, courts have a large degree of discretion in accepting cases and frequently apply political and legal criteria in determining whether to accept them. Judges are often instructed by the Party or government authorities not to take up certain cases or categories of cases. For instance, a regulation issued by the Supreme Court in 2002 provides that the “Peoples’ Courts should not accept civil lawsuits from plaintiffs if they concern disputes that have arisen during the course of State-Owned Enterprises reforms carried out by responsible government departments.”<sup>127</sup> These examples show the supremacy of the Party and the interplay between law and politics. They also raise issues of access to justice for Chinese citizens, especially when cases are politically sensitive.

### Corporate Malfeasance and Selective Access to Justice

Howson did a comprehensive analysis of how Shanghai’s judiciary handled company law cases from 1992 to 2008.<sup>128</sup> He found that Shanghai judges are generally independent and competent when hearing company law cases that do not implicate national, social, or economic policy. In addition, he found more than 200 opinions where private litigants successfully sued government departments and state-owned enter-

<sup>109</sup> Donald Clarke et al., “Law, Institutions, and Property Rights in China,” *China’s Economy: Retrospect and Prospect* a special Report of the Asia Program of the Woodrow Wilson International Center for Scholars (Washington: Woodrow Wilson Center, 2005), 44.

<sup>110</sup> *Ibid.*, 45.

<sup>111</sup> China, “People’s Mediation Law” [Zhonghua renmin gongheguo renmin tiaojie fa], issued August 28, 2010, effective January 1, 2011, art 1.

<sup>112</sup> *Ibid.*, arts. 1, 4, 7-12, and 33.

<sup>113</sup> Carl F. Minzner, “China’s Turn Against Law,” *American Journal of Comparative Law* 59, no. 4 (2011); Stanley Lubman, “Civil Litigation Being Quietly ‘Harmonized,’” *The Wall Street Journal* (March 31 2011), online: <blogs.wsj.com>; Willy Lam, “Beijing Tightens Control Over Courts,” *Asia Times* (June 25 2011), online: <www.atimes.com>.

<sup>114</sup> Minzner, “China’s Turn Against Law,” 955-59.

<sup>115</sup> *Ibid.*, 962-63.

<sup>116</sup> “Luo Gan Qiushi fa wenzhang: Jiaqiang shehuizhuyi fazhi linian jiaoyu” [Luo Gan Publishes Article In ‘Seeking Truth’: Strengthen Socialist-Rule-of-Law Education], *Xinhua*, June 15, 2006, cited in *ibid.*, 948.

<sup>117</sup> “A correct concept of judicial authority is the proper meaning of rule of law,” China Court Daily, (February 21 2008) [“正确 的司法权威观是法治的应有之意,” 中国法院网, 2007-10-18], cited in *Walking on Thin Ice: Control, Intimidation and Harassment of Lawyers in China*, (New York: Human Rights Watch, 2008), 17.

<sup>118</sup> Kai Wang, “Whatever-ism with Chinese Characteristics: China’s Nascent Recognition of Private Property Rights and Its Political Ramifications,” *East Asia Law Review* 6 (2011), 85.

<sup>119</sup> Hu Jintao, “Hold High the Great Banner of Socialism with Chinese Characteristics and Strive for New Victories in Building a Moderately Prosperous Society in all,” in *Seventeenth National Congress of the Communist Party of China* (2007).

<sup>120</sup> Yuanyan Shen, “Conceptions and Receptions of Legality,” in *The Limits of the Rule of Law in China*, ed. Karen Turner-Gottschang et al. (Seattle: University of Washington Press, 2000), 30.

<sup>121</sup> William P. Alford, “Double-Edged Swords Cut Both Ways: Law and Legitimacy in the People’s Republic of China,” *Daedalus* 122, no. 2 (1993), 65 in note 8.

<sup>122</sup> Horsley, “The Rule of Law in China.”

<sup>123</sup> Jerome Alan Cohen, “China’s Legal Reform At the Crossroads,” *Far Eastern Economic Review* 169, no. 2 (2006).

<sup>124</sup> *Ibid.*

<sup>125</sup> *Ibid.*

<sup>126</sup> Huang Lirong, “Guan yu minshi libiaozhun defali sikao” [Legal Theory Considerations on the Standards of Case Filing in Civil Litigation], in *Guide on Case-Filing*, ed. Case-filing Office of the Supreme People’s court (Beijing: People’s Court Publishing House, 2004), cited in *Walking on Thin Ice: Control, Intimidation and Harassment of Lawyers in China*, 21 in note 50.

<sup>127</sup> *Ibid.*, 21 in note 51.

<sup>128</sup> Nicholas C. Howson, “Judicial Independence and the Company Law in the Shanghai Courts,” in *Judicial Independence in China: Lessons for Global Rule of Law Promotion*, ed. Randall Peerenboom (Cambridge: Cambridge University Press, 2009).



prises, demonstrating a certain degree of judicial independence. Nevertheless, courts more often than not refuse cases involving large state-run companies, publicly listed companies, or companies with significant state-owned assets. This is despite the fact that the 2006 Company Law gave courts the authority to act in commercial disputes where significant material interests are at stake. The fear was that encouraging litigation against such companies would open the floodgates to litigious shareholders and thus threaten social stability.<sup>129</sup> Howson notes the complete absence of foreign-invested enterprise forms from Shanghai courts, as foreign investors and their Chinese partners often choose exclusive arbitration.<sup>130</sup> He believes avoiding politically sensitive cases is a “tragedy” for China’s corporate governance reform, precisely because it was the dire state of corporate governance which propelled the 2006 Company Law amendments and the statute’s new justiciability.<sup>131</sup> He wonders whether the Chinese judiciary can sustain this defensive posture for much longer in the name of stability and social harmony. Certainly, there is a potential for a negative impact on long-term economic growth if courts refrain from accepting highly contentious cases.

Peerenboom paraphrases a media report, widely discussed on the Internet, which claims that,

Guangxi courts would not accept thirteen types of cases including securities litigation, land taking claims and compensation for resettlement, disputes arising out of illegal ponzi schemes and other chain sale scams, cases involving laid-off workers and retraining as a result of economic transition or as a result of bankruptcy, large scale government cancellation or rural responsibility system contracts, and remaining problems regarding how to divide collectively owned assets. Many of the cases fall into the [Economic and Social Rights] category. Many also involve large multi-party suits.<sup>132</sup>

For example, in 2012, a Wenzhou court refused to hear a lawsuit from nearly 150 creditors who wanted compensation for a large-scale lending scam by Liren, a Chinese company that previously operated in the education, real estate, and mining industries.<sup>133</sup> An estimated 7,000 private creditors lost approximately US\$714 million in the scheme.<sup>134</sup> According to the creditors’ lawyer, the court refused to take the case because the lawsuit “does not fall within the scope of administrative litigation.”<sup>135</sup> This scandal coincides with concerns about the risks of private financing in a local economy where banks are typically unwilling to lend to smaller companies. Allegedly, during the recent credit crunch, about 100 managers or heads of private companies in Wenzhou were reported to have disappeared, committed suicide, or declared bankruptcy, invalidating debts worth about 10 billion yuan or approximately US\$1.6 billion.<sup>136</sup> Importantly, when China began its economic reforms in 1978, Wenzhou was the first city to set up individual and private enterprises. It is thus a leader in market economy based reforms.

### Rule of Law and the Judiciary

Thousands of individuals continue to push into the court system as skyrocketing numbers of group lawsuits are brought to courts across the country. These suits per-

<sup>129</sup> Ibid., 147.

<sup>130</sup> Ibid., 144 in note 32.

<sup>131</sup> Ibid., 148.

<sup>132</sup> Randall Peerenboom, “Economic and Social Rights: The Role of Courts in China,” *San Diego International Law Review* (2010), 324.

<sup>133</sup> “Chinese Court Rejects Lending Scam Compensation Suit,” *People’s Daily Online* (March 2 2012), online: <english.peopledaily.com.cn>.

<sup>134</sup> Ibid.

<sup>135</sup> Ibid.

<sup>136</sup> Ibid.

tain to labour disputes, official malfeasance, environmental torts, food contamination, and securities violations.<sup>137</sup> According to the Supreme People’s Court, local courts heard approximately 12.2 million cases.<sup>138</sup> Peerenboom underscores that judicial independence is not an issue in many cases, nor is the source, likelihood, or impact of interference the same across cases.<sup>139</sup> He calls for a nuanced context-specific look at judicial independence and more complete descriptions of the actual issues judges face in their daily lives.<sup>140</sup> He recalls that there is no single path toward the rule of law and that rule of law principles are consistent with a wide variety of institutional arrangements. He also sees judicial development in China as a pragmatic political compromise in which the “court accepts some limits on its powers and refrains from challenging other organs in exchange for cooperation on certain issues that enhance the power and authority of the judiciary.”<sup>141</sup>

In this respect, there are relevant points to be made on China’s transition towards a socialist market economy. Scholars have noted that a certain degree of corruption in China may be the inevitable consequence of liberalization. According to Sun, the state’s gradual retreat subsequently increased the opportunities for corruption.<sup>142</sup> Sun emphasizes that disincentives, or oversight mechanisms, are important in shaping cadre conduct and that the lack of effective deterrence signals a weakness in administration:

The Chinese state appears to suffer most in the administrative dimension of its capacity. State capacity remains relatively potent in the other two dimensions, institutional and political. In the institutional dimension, the Chinese system has enjoyed regime continuity, along with its capacity to make political and economic rules. In the political dimension, the autonomy of national elites from societal pressures and concern with regime legitimacy/survival, in fact, motivate national elites to devote political capital and state resources to building state capacity in the anticorruption arena. However, in the administrative dimension, the state’s ability to enforce compliance and organizational coherence from its bureaucratic ranks has been cast in doubt by ... pervasive abuse.<sup>143</sup>

In Sun’s view, while incentives and opportunities for corruption have multiplied, the disincentives against it have weakened over the course of economic liberalization and administrative decentralization. Specifically, the “first-in-command” is now the head of a local government, state agency, or public firm rather than a higher-ranked Party secretary.<sup>144</sup> Thus, after decades of a rigidly hierarchical command economy, lower rank administrators now enjoy unprecedented power, which is virtually unchecked by either the judiciary or other administrative mechanisms.<sup>145</sup> The judiciary, which is itself supervised and controlled by administrators, has difficulty enforcing *ex post* measures against corporate malfeasance. Furthermore, the state’s administra-

<sup>137</sup> Howson, “Judicial Independence in China,” 148. For example, the Shanghai No. 1 Intermediate Court has seen doubling of cases in just twenty-four months; a basic level court in the Guangdong Province with only thirteen judges had to process 7,540 cases (mostly labour contract cases and disputes with laid-off workers); and a group lawsuit was accepted over a tainted milk scandal.

<sup>138</sup> “Highlights of Work Report on China’s Supreme People’s Court,” *XinHua.net English News* (March 11 2012), online: <news.xinhuanet.com>.

<sup>139</sup> Peerenboom, “Judicial Independence in China,” 4.

<sup>140</sup> Ibid.

<sup>141</sup> Ibid., 21.

<sup>142</sup> Yan Sun, *Corruption and Market in Contemporary China*, (Ithaca, N. Y.: Cornell University Press, 2004). In Chapters 2 to 4 Sun discusses the incentives and opportunities for corruption across reform periods and localities in China.

<sup>143</sup> Ibid., 158.

<sup>144</sup> Ibid., 160. For more detail, see also the governance section of this report.

<sup>145</sup> Ibid.

tive capacity is weakened because it cannot exact compliance or deter deviant behaviour *ex ante*.

The Chinese leadership recognizes that it continues to face formidable challenges in achieving compliance with and enforcement of law. China's 2008 white paper on establishing the rule of law concludes:

The development of democracy and the rule of law still falls short of the needs of economic and social development; the legal framework shows certain characteristics of the current stage and calls for further improvement; in some regions and departments, laws are not observed, or strictly enforced, violators are not brought to justice; local protectionism, departmental protectionism and difficulties in law enforcement occur from time to time; some government functionaries take bribes and bend the law, abuse their power when executing the law, abuse their authority to override the law, and substitute their words for the law, thus bringing damage to the socialist rule of law; and the task still remains onerous to strengthen education in the rule of law, and enhance the awareness of law and the concept of the rule of law among the public.<sup>146</sup>

As Horsley observes, what the white paper does not acknowledge is that the largest obstacle is the Party's own ambivalence about how far to permit the country to move towards a robust framework of rule of law,

despite continued lip service to the importance of rule of law and the principle that party members must also be subject to the Constitution and the law, the party remains unwilling to give judges the authority to decide cases independently ... particularly when cases involve the party-state. Moreover, the party maintains its own parallel, secretive system of 'justice,' under which the Party Central Discipline Inspection Commission investigates corruption and other forms of wrongdoing by party members, subjects them to the extralegal *shuanggui* ... or 'double treatment' system, and only at its discretion turns those cases over to the judicial system for disposition.<sup>147</sup>

Official sources have disclosed that from January to November 2010, the government investigated "119,000 graft cases, which led to 113,000 people being sanctioned, of whom 4,332 were prosecuted."<sup>148</sup> In terms of the judiciary in particular, a report published by the Supreme People's Court in February 2011 exposed 187 people within the judicial system for improper conduct that ranged from private use of public property to charging inflated fees.<sup>149</sup> The media has been actively reporting incidents of corruption, such as judges extorting money from litigants, engaging in

collusion, and accepting bribes.<sup>150</sup> In 2009, the "Five Prohibitions Policy" prohibits judges from corrupt behaviour including accepting gifts, interceding on behalf of another party, divulging work secrets, and engaging in favouritism.<sup>151</sup> In 2010, the Supreme People's Court emphasized the role of state supervision when it announced it would investigate local-level courts' ability to handle matters diligently and in the absence of corruption.<sup>152</sup>

Foreign and Chinese scholars alike have limited opportunity to systematically observe and research courts, but as Cohen suggests, what is known about courts is disturbing.<sup>153</sup> Some Chinese courts still woefully lack professional competence, particularly in rural areas and at the local level. Massive corruption, political interference, and local protectionism skew court judgments. In addition *guanxi*, a network of personal connections, is pervasive and continues to undermine judicial impartiality.<sup>154</sup> As mentioned above, the court structure is such that major and complex cases are decided internally by adjudicating committees, composed of senior administrators or judges, who collectively discuss and decide cases. These committees are also composed of senior Party members, including the local head of Public Security, who sometimes sit on the Party's political-legal committee.<sup>155</sup> Depending on the nature of the case, recourse to the adjudicative committee can be subsequent to consultation with the party's political-legal committee.

Reform or abolition of the court's adjudication committees has been debated for years and the controversy stems from the fact that adjudication committees often include senior judges and non-judges who do not sit on the panel or actually hear the cases.<sup>156</sup> For this reason, adjudicative panels would appear to violate the constitutional and international right to an open trial.<sup>157</sup> Panel judges are bound by the adjudicating committees' decisions, which scholars have criticized as opening the door to judicial corruption. Henderson notes that while this practice is probably exceptional, there is no empirical way to know how prevalent this situation actually is.<sup>158</sup>

Li's 2011 study provides an in-depth examination of how the judiciary's structure gives rise to and sustains corruption.<sup>159</sup> She examines 388 judges<sup>160</sup> sanctioned under the Party's extra-legal anti-corruption disciplinary regulations or the *Criminal Code* between 2000 and 2008.<sup>161</sup> Of these judges, 56 served in high courts, 155 in prefecture-level intermediate courts, 174 in county-level courts, and 94 in rural counties.<sup>162</sup>

<sup>146</sup> "White Paper Published on China's Rule of Law: China's Efforts and Achievements in Promoting the Rule of Law," (China: State Council Information, 2008).

<sup>147</sup> Horsley, "The Rule of Law in China," 66. For more information on these corruption investigations against officials conducted by the Party Disciplinary and Inspection Commission, which is exempted from judicial examination, see Flora Sapio, "Shuanggui and Extralegal Detention in China," *China Information* 22, no. 1 (2008). See also Ling Li, "Legality, Discretion and Informal Practices in China's Courts: A Socio-Legal Investigation Of Private Transactions In The Course Of Litigation" (PhD Thesis, Van Vollenhoven Institute, Faculty of Law, Leiden University, 2010). See also the corruption section of this report.

<sup>148</sup> "Corrupt Chinese Judges to Face Harsh Punishments: SPC Vice President," *Xinhua.net English News* (December 29 2010), online: <news.xinhuanet.com>.

<sup>149</sup> "Making Fundamental Improvements, Guaranteeing a Fair and Just Judiciary" [Zhuazhu genben qianghua cuoshi, baozhang gongzheng lianjie sifa], *People's Court Daily*, reprinted in *Legal Daily* (February 28 2011) cited in "Congressional-Executive Commission on China: Annual Report 2011," Congressional-Executive Commission on China One Hundred Twelfth Congress, First Session, (Washington: US Government Printing Office, 2011), 185.

<sup>150</sup> Mimi Lau, "Bribing Judges Is Almost a Sure Thing," *South China Morning Post* (May 21 2011); Chen Xianfeng & Wang Kailei, "Following the Trail of a Corrupt Court in Guangdong Province, Nine Judges Conspired With Others for Profit" [Guangdong zhanjiang fayuan fubai wo'an zhuizong: jiuming faguan yuren hemou huoli], *Communist Party of China News* (May 2 2011); Shao Ming, "Foshan Intermediate People's Court Responds to Judges Accepting Bribes, 'Sentences to Three, Postpones for Four'" [Foshan zhongyuan huiying faguan shouhui "pansan huansi"], *Southern Metropolis Daily* (June 17 2011) all cited in *ibid*.

<sup>151</sup> Supreme People's Court, Provisions Regarding the "Five Prohibitions" [Guanyu wuge yanjinde guiding], issued January 8, 2009, cited in *ibid*.

<sup>152</sup> "Strengthen Internal Supervision of the Courts, SPC Promotes Judicial Inspection Tour" [Jiaqiang fayuan neibu jiandu, zuigao fayuan quanmian tuixing sifa xuncha zhidu], *People's Court Daily*, reprinted in *Xinhua*, (October 21 2010) (other goals include implementing Party ideology, shaping ideas regarding a clean government, and resolving conflicts), cited in *ibid*.

<sup>153</sup> Cohen, "China's Legal Reform At the Crossroads."

<sup>154</sup> *Ibid*.

<sup>155</sup> Keith Henderson, "The Rule of Law And Judicial Corruption In China: Half-Way Over The Great Wall," in *Transparency International Global Corruption Report 2007: Corruption in the Judiciary* (Cambridge: Cambridge University Press, 2007).

<sup>156</sup> *Ibid*.

<sup>157</sup> *Ibid*.

<sup>158</sup> *Ibid*.

<sup>159</sup> Ling Li, "The 'Production' of Corruption in China's Courts – The Politics of Judicial Decision-Making and its Consequences in a One-Party State," *Journal of Law and Social Inquiry* (2011).

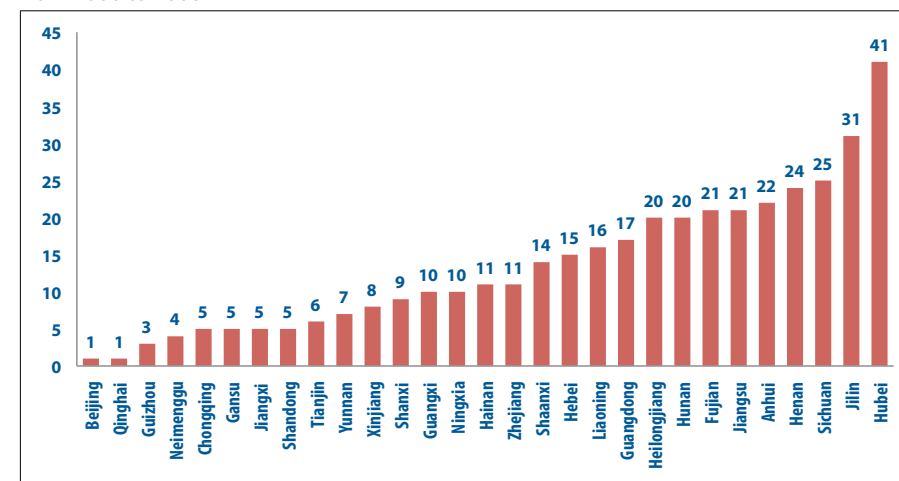
<sup>160</sup> *Ibid*, 7. This number includes four court accountants and one court bailiff and due to their marginality, Li conflates them into the category of "judges."

<sup>161</sup> *Ibid*, 8. Only eighteen cases were sourced between the years of 1991 and 1999 due to either the lack of accessibility of reports, lower levels of corruption, or decreased efforts against corruption.

<sup>162</sup> *Ibid*.

The study examines the type of corrupt conduct within the court structure. The findings suggest that corruption is not an aggregation of isolated acts but rather institutionalized activity, resulting from the routine operation of a judicial decision-making process, which provides participants at every level with numerous opportunities for manipulation and exploitation.<sup>163</sup> In Li's view, it is this institutionalization that has sustained corruption, allowing it to be continuously produced and reproduced after offenders have been punished and removed.<sup>164</sup> As in other public institutions, bribery is the most prevalent form of corruption. Other forms of corruption include extortion and self-enrichment by unlawfully withholding or appropriating assets seized from litigants.<sup>165</sup>

**Figure 4.2:** Regional Dataset of Chinese Judges Sanctioned for Corruption from 2000 to 2008



**Source:** Ling Li, "The Production of Corruption in China's Courts – The Politics of Judicial Decision-Making and its Consequences in a One-Party State," *Journal of Law & Social Inquiry*, (2011), 10.

Li describes a complex institutional structure which often implicates Party leadership.<sup>166</sup> During the decision-making process, instructions may be relayed through the power hierarchy, from the Party committee leader, to the court-leader, down to the judge handling the case. The instructions are outcome-focused and not supported by reasons or justifications.<sup>167</sup> This process is facilitated by a Party regulation that states that a subordinate must unconditionally implement his superior's instructions.<sup>168</sup> This means that a frontline (or rank and file) judge is not supposed to examine the legitimacy of the instructions. But it also means that the judge is not responsible for the legitimacy of his acts, when translating the instructions, even if implementation violates procedural rules and/or results in the law's misapplication.<sup>169</sup>

Except for some cases subject to simplified procedure, all cases are heard by a collegial panel.<sup>170</sup> As we described earlier, a small number are then reviewed by the court adjudicative committee when the case is deemed challenging, significant, or contro-

versial.<sup>171</sup> Every court has a "case-approval" process, which allows the court-leader to monitor the decision-making process without participating in the court hearings or trial.<sup>172</sup> This process is akin to a clearance system. One of the three panel judges, the "responsible judge," prepares draft decisions that are circulated to a hierarchy of "leader judges" for approval.<sup>173</sup> These leader judges do not hear the case, but base their decisions on the responsible judges' draft decision. Importantly, the documents recording this decision-making process, namely who has approved what, are inaccessible to litigants.<sup>174</sup> The final judgment is written by the panel judges, but it does not reference instructions from above or the decision-making process. The formal judgment may thus appear to be "incoherent, inconsistent and utterly unconvincing."<sup>175</sup>

In cases concerning Party-leader or leader-judge corruption, none of their subordinates have been punished for faithfully implementing their superior's instructions, unless the subordinate was also guilty of taking bribes. In Li's view, "this confirms the strong institutional intention to preserve this judicial decision-making mechanism so as to encourage and prompt submission to the chain of command rather than to the rule of law."<sup>176</sup> Importantly, this impunity may extend to leader judges when their subordinate frontline judges commit corrupt acts. While the leader judges hold highly concentrated power, burdensome caseloads have enabled frontline judges to acquire *de facto* decision-making power in ordinary, low-stakes cases. In such instances, frontline judges taint the oral or written summaries that they provide to leader judges. Here, the frontline judge has the opportunity to withhold evidence or pertinent facts that favour their proposed ruling.<sup>177</sup> If such corruption is discovered, leader judges are exempt from accountability for not having verified the facts.<sup>178</sup> Other examples of judicial corruption are when frontline judges broker corrupt deals with their superiors when a matter is beyond their own competence or they wish to obtain a layer of protection.<sup>179</sup> In concluding, Li states,

this decision-making mechanism is designed to allow the [Communist Party] to use the law and the judicial institution instrumentally in order to secure its monopolized interests through the adjudicative process in an institutionalized manner, ... [this] has systematically diminished the normative and regulatory potency of the law itself. ... The consequent institutionalization of this decision-making mechanism opens up the opportunities for exploitation not only for the privileged group at the top of the [Party] but also for decision-makers at all levels.<sup>180</sup>

Li explains that judicial reform has failed to deal with entrenched judicial corruption, because it has preserved these decision-making mechanisms. For example, in 2010, the Supreme People's Court issued *Directive No. 51*, which announced the be-

<sup>163</sup> Ibid., 5.

<sup>164</sup> Ibid., 6.

<sup>165</sup> Ibid., 7.

<sup>166</sup> Ibid., 11. Li explains how at the onset of the re-establishment of the Chinese courts in 1985, the Party started to equip the courts with cadres, selected by a small group of Party members with ranks equivalent to the highest rank of the court. This small group of Party leaders constitutes the court Party-group.

<sup>167</sup> Ibid., 14.

<sup>168</sup> China, *Chinese Communist Party (CCP) Charter* (2007), art 15.

<sup>169</sup> Li, "The Production of Corruption," 16-17. Li notes that "frontline" judges are becoming concerned that they may be held responsible in the future if the political climate changes.

<sup>170</sup> China, "Organizational Law Governing People's Courts" (1986), art 10.

<sup>171</sup> Ibid., art 11.

<sup>172</sup> Li, "The Production of Corruption," 19-20.

<sup>173</sup> Leader judges means judges who perform executive functions, such as court presidents, vice-presidents, court divisional directors, and vice-directors. They are distinct from frontline (or rank and file) judges.

<sup>174</sup> Li, "The Production of Corruption," 23.

<sup>175</sup> Li, "dangqian zhiding caipan wenshu zhong fang'ai shixian sifa gongzheng de zhuyao wenti yu gaige silu [Thoughts for reform to remove current problems obstructing justice in the composition of court judgments]"; Luo, "caipan wenshushang de zhuyao wenti yu gajin jianyi [Main problems and suggestion about the composition of court judgments]"; cited in *ibid.*, 24.

<sup>176</sup> Ibid.

<sup>177</sup> Ibid., 25.

<sup>178</sup> Ibid., 27. For example, according to the "Rules on Judicial Accountability for Wrongfully Decided Cases" (1998) issued by the Supreme People's Court only one article concerns accountability of leader-judges. The rest are all targeted at "frontline" judges.

<sup>179</sup> Ibid., 27-28.

<sup>180</sup> Ibid., 28.

gining of the “case guidance” system.<sup>181</sup> Under this system, lower courts must abide by guiding cases during adjudication or else articulate a compelling reason not to.<sup>182</sup> This is an attempt to combat judicial arbitrariness and promote uniformity across similar cases. Without a thorough reform of the judicial decision-making mechanism, however, there is still significant room for discretion and Li notes that it is still unclear whether guiding cases will create binding precedents.<sup>183</sup>

With Li’s study in mind, it is worth mentioning recent reforms. In 2010, the Supreme People’s Court sought to professionalize courts by issuing codes of conduct and recusal regulations. The *Model Judicial Behaviour Code* guides judges in their professional and non-professional behaviour and includes guidance on interactions with the media, interpersonal conflict, and overseas travel.<sup>184</sup> The *Basic Code of Professional Conduct for Judges* sets five principles: guaranteeing loyalty to the administration of justice, ensuring judicial fairness, ensuring judicial honesty, striving to achieve justice for the people, and defending the image of the judiciary.<sup>185</sup> In early 2011, the Supreme People’s Court issued two more regulations intended to limit improper influence on the courts. One requires court officials and some trial judges to recuse themselves when a spouse or child practices as a lawyer in the jurisdiction they oversee.<sup>186</sup> Importantly, however, this provision does not limit the Procuracy, public security personnel, or anyone who shares a close relationship with the parties or the court.<sup>187</sup> The other 2011 provision prohibits court personnel from meeting privately with litigants, litigants’ relatives, and litigants’ lawyers, whose cases are being adjudicated by the court. It also prohibits such personnel from forwarding documents, enquiring, or interceding on behalf of the parties.<sup>188</sup>

The Chinese experience reveals the complexity of judicial reform within the context of one-party rule and a socialist market economy. Significant strides have been made to ameliorate the judiciary. Issues surrounding judicial independence have revealed corresponding issues regarding judicial authority and accountability amidst active political interference. Institutionalized judicial corruption, which cuts across all levels of the decision-making mechanism, remains China’s significant challenge.

## A COMPREHENSIVE OVERVIEW OF THE JUDICIARY IN INDIA

In India, critics have called for improvements to the timely delivery of justice, because the issue of pendency has significantly blocked access to justice. Others have called for increased judicial accountability in light of corruption scandals which have threatened the legitimacy and predictability of the courts. Lack of judicial accountability is exacerbated by the fact that the judiciary has a wide scope of authority

<sup>181</sup> China, Supreme People’s Court, “Working Rules on the Guiding-Case System [guanyu anli zhidao gongzuo de guiding],” *Fa Fa* [2010] No.51 (2010) cited in *ibid.*, 38.

<sup>182</sup> An Jie, “Hu Yunteng Explains the Regulations Regarding Guiding Cases” [Hu yunteng jiedu guanyu anli zhidao gongzuo de guiding], *Dongfang Fayan*, (January 11 2011), cited in “CECC: Annual Report 2011,” 313

<sup>183</sup> Li, “The Production of Corruption,” 38-39.

<sup>184</sup> China, Supreme People’s Court, *Model Judicial Behaviour Code* [Faguan xingwei guifan], issued December 6, 2011, cited in “CECC: Annual Report 2011,” 312

<sup>185</sup> China, Supreme People’s Court, *Basic Code of Professional Conduct for Judges* [Zhonghua renmin gongheguo faguan zhiye daode jiben zhunze], issued December 6, 2011, cited in *ibid.*

<sup>186</sup> China, Supreme People’s Court, “Trial Implementation of Provisions Regarding Professional Avoidance of Trial Judges and Court Leadership When a Spouse or Child Practices as a Lawyer” [Guanyu dui peiou zinu congshi lushi zhiyede fayuan lingdao ganbu he shenpan zhixing gangwei faguan shixing renzhi huibi de guiding (shixing)], issued February 10, 2011, cited in *ibid.*, 184.

<sup>187</sup> *Ibid.*

<sup>188</sup> China, Supreme People’s Court, “Provisions Regarding the Prevention of Interference With Case-work by Internal Court Personnel” [Guanyu zai shenpan gongzuozhong fangzhi fayuan neibu renyuan ganrao banande ruogan guiding], February 15, 2011 cited in *ibid.*

and independence. In spite of the numerous consultations, resolutions, and vision statements, the government has been slow to implement most recommendations.<sup>189</sup> Recently, however, a few key reforms have been implemented. The central government substantially increased the salaries of Supreme and High Court judges. In addition, the state of Maharashtra, the geographical jurisdiction of the Bombay High Court, implemented innovative procedural reforms to reduce pendency.

We will begin our discussion with an outline of India’s court structure. Then we will discuss judicial activism and governments’ recent efforts to increase judicial accountability. We will also look at the issue of judge shortages and case backlogs and how this interacts with GDP and *Human Development Index* indicators. Lastly, we discuss the tension surrounding the push towards alternative dispute resolution.

### THE STRUCTURE OF INDIA’S JUDICIARY

The 1950 Constitution established India as a sovereign democracy, with a federal system and parliamentary form. It also provided for India’s unified national court system to administer both Union and state laws. The Supreme Court of India is at the apex of the judicial system. Below it are the high courts of each state or group of states and below them are the lower, subordinate courts. The judiciary is constitutionally independent from the executive and legislative branches of government.<sup>190</sup> The President is formally tasked with appointing Supreme and High Court judges,<sup>191</sup> but in practice, senior Supreme Court judges nominate candidates and the President approves these nominees.<sup>192</sup> In the 1990s, the Supreme Court reinterpreted the Constitution to establish its collegium system, which effectively relegated the executive’s role to a formality.<sup>193</sup> Robinson contends that this self-selection process demonstrates the judiciary’s distrust of the elected branches of government, but also raises questions of judicial accountability.<sup>194</sup> In recent years, there have been calls to reinstate the President’s role and to restore the Constitution to its original intent where the executive and the judiciary would equally have a role in appointing judges.<sup>195</sup>

The Constitution formally ensures judicial independence in various ways. Judges of the Supreme or High Courts can only be removed through a rather complicated impeachment process in Parliament.<sup>196</sup> Additionally, the Supreme and High Courts are vested with the power to punish contempt of court including contempt in its own court.<sup>197</sup> This power to punish for contempt of court, in its own court, has rarely been exercised, although critics allege that it is a looming threat which effectively insulates the judiciary from public criticism.<sup>198</sup> The Constitution also expressly allocates jurisdiction to the courts, which was a way for drafters to fortify judicial independence. This jurisdiction has expanded over time through judicial activism.

<sup>189</sup> Menaka Guruswamy and Aditya Singh, “Village Courts in India: Unconstitutional Forums With Unjust Outcomes,” *Journal of Asian Public Policy* 3, no. 3 (2010), 284.

<sup>190</sup> India, Constitution, art 50. The article directs the state to “separate the judiciary from the executive in the public services of the State.” See also *Supreme Court Advocates-on-Record Ass’n v. Union of India*, AIR 1994 S C 268. This case is known as the Second Judges Case.

<sup>191</sup> India, Constitution, art 124(2), 217.

<sup>192</sup> Theodore Eisenberg et al., “Litigation as a Measure of Well-Being,” *SSRN Electronic Journal* (2012), online: <<http://ssrn.com/abstract=2036194>>, 7.

<sup>193</sup> Nick Robinson, “Expanding Judiciaries: India and the Rise of the Good Governance Court,” *Washington University Global Studies Law Review* 8, no. 1 (2009), 25. See also *Supreme Court Advocates case; In re: Presidential Reference*, AIR 1999 SC 1.

<sup>194</sup> *Ibid.*

<sup>195</sup> *Reforms in the Judiciary – Some Suggestions*, Report No. 230 (Law Commission of India, Government of India, 2009), 32.

<sup>196</sup> India, Constitution, arts 124(4), 217(1)(b).

<sup>197</sup> India, Constitution, arts 129, 142, 215. For contempt of court cases see *Haridas Das v Smt Usha Rani Banik & Ors* (2007) Civil Appeal No. 7948 of 2004; *In Re: Arundhati Roy* (2002) 3 SCC 343.

<sup>198</sup> Prashant Bhusan, “Judicial Accountability or Illusion?: The National Judicial Council Bill,” *Economic and Political Weekly* (2006).

The Supreme Court has original, appellate, and advisory jurisdiction.<sup>199</sup> Its exclusive original jurisdiction applies to any dispute between states and/or the government and enforcement of fundamental and human rights.<sup>200</sup> It also has the power to transfer civil or criminal cases to a particular high court or from a subordinate court to a high court. In addition, where the same or substantially the same questions of law are pending before its courts or one or more high courts, it may dispose of all the cases itself.<sup>201</sup> In terms of appellate jurisdiction, it is the court of last resort and the highest appellate court, taking up appeals from the judgments of high courts. It also has wide scope to hear appeals from all courts and tribunals in India, as the Constitution gives it discretion to grant special leave to appeal from any judgment, decree, determination, sentence, or order in any cause or matter.<sup>202</sup> Regarding its advisory jurisdiction, the Supreme Court may decide matters specifically referred to it by India's President.<sup>203</sup>

Correspondingly, high courts are at the apex of states' judicial administration. They have the power to superintend and control all courts within their jurisdiction.<sup>204</sup> There are currently 21 high courts in the country, including 6 high courts that have jurisdiction over more than one state or territory.<sup>205</sup> Each high court has a Chief Justice and other judges which the President may appoint at any time, depending on need.<sup>206</sup> High Courts in India take appeals by district and subordinate courts and they also have a much wider original jurisdiction than in many other countries. This includes original jurisdiction over revenue matters and jurisdiction to issue writs of *habeas corpus*, *mandamus*, prohibition, *quo warranto*, and *certiorari*.<sup>207</sup> Eisenburg et al. emphasize how there can be upwards of tens of thousands of high court original jurisdiction cases in a given year. For example, from 2000 to 2001, there were 121,277 cases in Andhra Pradesh' High Court and in some states, like Orissa, such cases comprised over half of the high court filings in 2009.<sup>208</sup>

Underneath the high courts are lower courts including district, session, family, rent, and other subordinate courts. Each state is divided into judicial districts. There are approximately 600 district courts and these are the most important courts of general jurisdiction.<sup>209</sup> It is here that Galanter describes "long delays . . . , mounting expenses, and meager damage awards."<sup>210</sup> While tribunals, arbitration, and *lok adalats* (people's courts) enable parties to circumvent the lower courts, he underscores that these forums also display similar deficiencies, namely "crowding, excessive formalism, delay, and truncated remedies."<sup>211</sup>

## JUDICIAL ACTIVISM

In a series of landmark cases, between 1967 and 1975, the Supreme Court asserted the primacy of the Constitution's basic structure. In *Golaknath v Punjab*, it held that Parliament could not amend the Constitution to take away or abridge fundamen-

tal rights.<sup>212</sup> In response, Parliament passed the Twenty-Fourth Amendment, which stated that Parliament was not limited in its power of constitutional amendment. This amendment was challenged in *Kesavanand Bharati v Kerala*.<sup>213</sup> In that decision, a 13 member panel of the Supreme Court held that while Parliament could theoretically amend every provision of the Constitution, it could not alter its basic structure. This became known as the basic structure doctrine and was criticized for so boldly asserting the primacy of the non-elected court. The doctrine gained legitimacy, however, during the 1975 emergency, when the ruling party used its majority power to pass draconian laws in the face of little political opposition.<sup>214</sup> The Supreme Court struck down a constitutional amendment in *Indira Gandhi v Raj Narain*, which sought to validate the election of the Prime Minister by way of a dispute between private litigants.<sup>215</sup> The basic structure doctrine says that Parliament cannot use its power to repeal the Constitution. Thus this doctrine acts as a "counter majoritarian check on democracy in the interest of democracy."<sup>216</sup> According to Sathe, this power made the Supreme Court of India one of the most powerful apex courts in the world. It also politicized the judiciary since any ultimate determination of a basic structure was in essence a political judgment.<sup>217</sup>

The Supreme Court made another bold move when it recognized itself as constitutionally empowered to enforce constitutionally enshrined fundamental rights. In the early 1980s, the judiciary took an active role in governance by relaxing the standing rules for matters in which the public had an interest.<sup>218</sup> Through a process popularly known as "public interest litigation," it attempted to address the weakness of the legal system and the need to facilitate access to justice for the most vulnerable and marginalized.<sup>219</sup> Citizens may apply for public interest litigation by petitioning or simply writing a letter to the Chief Justice. This gives effect to the principle that judicial procedure should not impede constitutional empowerment. Public interest litigation has brought a certain degree of government accountability and has ensured a measure of constitutional rights for citizens. Yet it is equally prone to misuse by vested interests.<sup>220</sup> Chief Justice, A. S. Anand, facing the potential threat that lawmakers would regulate public interest litigation, took care to distinguish it from judicial activism, stating that:

It would be wrong to call [public interest litigation] as an act of judicial activism when the judiciary in discharge of its constitutional powers seeks to protect the human rights of its citizens in case after case where a citizen has been deprived of his life or liberty otherwise than in accordance with the procedure prescribed by law or when the courts insist upon 'transparency and accountability' in respect of the orders made or action taken by public servants. The requirement that every State action must satisfy the test of fairness and non-arbi-

<sup>199</sup> India, Constitution, arts 32, 131 – 140, 143, 144(A). See also "Jurisdiction of the Supreme Court," Supreme Court of India, online: <<http://supremecourtindia.nic.in/jurisdiction.htm>>.

<sup>200</sup> India, Constitution, art 32.

<sup>201</sup> India, Constitution, art 139(A).

<sup>202</sup> India, Constitution, art 136

<sup>203</sup> India, Constitution, art 143.

<sup>204</sup> India, Constitution, arts 227, 235.

<sup>205</sup> Eisenberg et al., "Litigation as a Measure of Well-Being," 7.

<sup>206</sup> India, Constitution, arts 216, 224.

<sup>207</sup> India, Constitution, arts 225, 226(1).

<sup>208</sup> Eisenberg et al., "Litigation as a Measure of Well-Being," 10-11.

<sup>209</sup> *Ibid.*, 7.

<sup>210</sup> Marc Galanter, "Part I: Courts, Institutions, and Access to Justice: 'To the Listed Field...': The Myth of Litigious India," *Jindal Global Law Review* 1 (2009), 1.

<sup>211</sup> *Ibid.*, 1-2.

<sup>212</sup> *Golaknath v Punjab* AIR 1967 S C 1643.

<sup>213</sup> *Kesavanand Bharati v Kerala* AIR 1973 S C 1461.

<sup>214</sup> S. P. Sathe, "Judicial Activism: The Indian Experience," *Washington University Journal of Law and Policy* 6 (2001), 42-43.

<sup>215</sup> *Indira Gandhi v Raj Narain* AIR 1975 S C 2299.

<sup>216</sup> Sathe, "Judicial Activism: The Indian Experience," 43. See Ronald Dworkin, *Taking Rights Seriously* (Cambridge: Harvard University Press, 1977).

<sup>217</sup> Sathe, "Judicial Activism: The Indian Experience," 42-43.

<sup>218</sup> Upendra Baxi, "The Avatars of Judicial Activism: Explorations in the Geography of (In)Justice," in *Fifty Years of the Supreme Court of India: Its Grasp and Reach*, ed. S. K. Verma and K. Kusum (Oxford: Oxford University Press, 2000), 156-209.

<sup>219</sup> Some examples of early cases are *S P Gupta v President of India*, (1982) 2 SCR 365; *Sheela Barse v State of Maharashtra*, (1983) 2 SCR 337, 342; *Upendra Baxi v State of Uttar Pradesh*, (1983) 2 SCC 308; *Bandhua Mukti Morcha v Union of India*, AIR 1984 SC 802, 813-14.

<sup>220</sup> C. R. Kumar, "Corruption and Human Rights: Promoting Transparency in Governance and the Fundamental Right to Corruption-Free Service in India," *Columbia Journal of Asian Law* 17 (2003), 49.

trariness are judicially evolved principles which now form part of the constitutional law.<sup>221</sup>

Through the mid-1980s and 1990s, the Supreme Court also expanded jurisprudence that tackled social injustices. It read a wide scope of rights into the right to life, such as the rights to fresh air and water, land for tribal populations, protection from environmental degradation, shelter, health, education, food and clothing.<sup>222</sup> As Robinson notes, this interventionism began when “Parliament and the country’s other representative institutions were increasingly politically fractured and viewed as abdicating their governance responsibilities.”<sup>223</sup> The court relied on the Constitution’s preamble and socialist principles embodied in the Directive Principles to justify these interventions. It expanded the grounds for which public actors could be held accountable and stated that their authority and conduct should be guided by public interest.<sup>224</sup> Here, the Supreme Court pushed against government authorities’ failure to look after people’s welfare and also enforced pre-existing law. Such action brings to light the judiciary’s role to ensure that written laws are activated, enforced, and in keeping with the country’s social and economic demands. In *LIC of India*, the Court explains:

When new changes are thrown open, the law must grow as a social engineering to meet the challenges and every endeavour should be made to cope with the contemporary demands to meet socio-economic challenges under rule of law and have to be met either by discarding the old and unsuitable or adjusting legal system to the changing socio-economic scenario.<sup>225</sup>

In recent years, the judiciary has been more restrained, marking a notable shift in behaviour. For example, the Public Interest Litigation Registrar has implemented a screening system according to predetermined criteria. In 2006, the Supreme Court received almost 14,000 letters requesting public interest litigation but many fewer were actually placed before the court.<sup>226</sup> The Supreme Court’s restraint has largely played out as the formal recognition that it is not its role to make policy.<sup>227</sup>

## JUDICIAL ACCOUNTABILITY

*While unconstitutional exercise of power by the executive and legislative branches of the government is subject to judicial restraint, the only check upon our own exercise of power is our own sense of self-restraint.*<sup>228</sup>

Drawing on this quote within the Indian context, Dasgupta and Agarwal contend that “accountability functions on the framework of seeking integrity [and is] a sine qua non for the efficient functioning of any authority entrusted with responsibility.”<sup>229</sup> India’s constitutional drafters did not expressly provide for any mechanism to make

the judiciary accountable and indeed there is no evidence of any discussion on the matter in the Constituent Assembly Debates.<sup>230</sup> The Constitution makes the subordinate judiciary accountable to the higher judiciary, but no similar provision was enacted for the higher judiciary.<sup>231</sup> The intention was that the Supreme and High Courts would be guided by self-regulation. Dasgupta and Agarwal argue that the momentum for judicial accountability has gained significant visibility around the world in recent years in large part due to civil society and the media assuming the role of watchdogs.<sup>232</sup> The lack of transparent mechanisms in place from within the judiciary has created the perception that it has failed to effectively sanction misconduct, especially in light of recent controversies and scandals involving judges in the media.

In 2002, Chief Justice S. P. Bharucha, reportedly stated there was a possibility that 20 percent of judges were corrupt and acknowledged that while the high courts’ record of disciplining lower courts was reasonably sufficient there was no effective mechanism for the Supreme and High Courts.<sup>233</sup> In 2005, Transparency International India commissioned the Centre for Media Studies to conduct a countrywide survey of public perception and experiences of corruption within the lower judiciary specifically. They found that bribery was pervasive.<sup>234</sup> Within a 12-month period, the estimated amount paid in bribes was approximately US\$580 million, which was broken down and paid to the following officials proportionately: 61 percent to lawyers; 29 percent to court officials; 5 percent to judges; and 5 percent to middlemen.<sup>235</sup>

Both Houses of Parliament and the President are vested with the power to remove Supreme or High Court judges on grounds of proven misbehaviour or incapacity.<sup>236</sup> *The Judges (Inquiry) Act, 1968* details and regulates this complex procedure.<sup>237</sup> The procedure begins with a motion to present a request to the President to remove a judge.<sup>238</sup> This motion requires notice given by not less than 100 members of the *Lok Sabha* (lower house) and/or not less than 50 members of the *Rajya Sabha* (upper House), following which the Speaker and/or Chairman must decide whether to admit or refuse the motion.<sup>239</sup> If admitted, the motion is kept pending while an Inquiry Committee of three members, comprised of a chief justice or judge of the Supreme Court, a chief justice of a high court, and a distinguished jurist, is formed to investigate the grounds for removal.<sup>240</sup> If the committee finds the judge not guilty of misbehaviour or not suffering from any incapacity, then no further steps are taken.<sup>241</sup> If the committee finds guilt or incapacity, the House or Houses of Parliament, in which the motion is pending, then consider the motion and the committee’s report together.<sup>242</sup>

For the motion to be adopted, it must be passed in both the *Lok Sabha* and the *Rajya Sabha* and in accordance with the two-part threshold set out in the Constitution. In each House, the motion must be passed by a majority vote of the total membership of that House and by a majority of not less than two-thirds of the members of that

<sup>221</sup> Dr. Justice A. S. Anand, “Protection of Human Rights – Judicial Obligation or Judicial Activism in (1997) 7 SCC 11” in Justice N D Krishna Rao Memorial Lecture, cited in *ibid.*, 50.

<sup>222</sup> India, Constitution, art 21. See also *MC Mehta v Union of India*, (1996) Supp 10 SCR 973; *Andhra Pradesh Pollution Control Board v MV Nayudu*, 1999 AIR SC 812 (air and water rights); *Banwasi Seva Ashram v State of Uttar Pradesh*, (1987) 1 SCR 336, 342 (tribal land); *Tarun Bharat Sangh v Union of India* AIR 1992 SC 514 (environment); *Olga Tellis v Bombay Mun Corp.*, (1985) Supp 2 SCR 51, 83 (shelter); *Consumer Educ & Research Ctr v Union of India*, AIR 1995 SC 922 (health); *Mohini Jain v Karnataka*, (1992) 3 SCR 658, 661 (education); *Shantistar Builders v Narayan Khimalal Totame*, AIR 1990 SC 630 (food and clothing).

<sup>223</sup> Robinson, “Expanding Judiciaries,” 43.

<sup>224</sup> *LIC of India v Consumer Education Research & Centre* (1995) Supp 1 SCR 349.

<sup>225</sup> *Ibid.*

<sup>226</sup> *Annual report 2005*, (Supreme Court of India, 2005), 44.

<sup>227</sup> *BALCO Employees Union v Union of India*, (2001) Supp 5 SCR 511, 539, Robinson; “Expanding Judiciaries,” 49.

<sup>228</sup> *United States v Butler* (1936) 287 US 1 [Stone J] cited in Shayonee Dasgupta and Sakshi Agarwal, “Judicial Accountability and Independence: Exploring the Limits of Judicial Power,” *NUJS Law Review* 2 (2009), 781.

<sup>229</sup> *Ibid.*

<sup>230</sup> *Ibid.*, 782.

<sup>231</sup> India, Constitution, art 235.

<sup>232</sup> Dasgupta and Agarwal, “Judicial Accountability and Independence: Exploring the Limits of Judicial Power,” 783.

<sup>233</sup> Rajeev Dhavan, “Judicial Corruption,” *The Hindu* (February 22 2002), online: <hindu.com>.

<sup>234</sup> “Indolence in India’s Judiciary,” in *Global Corruption Report 2007: Corruption in Judicial Systems*, ed. Diana Rodriguez et al. (Cambridge: Transparency International, Cambridge University Press, 2007), 215.

<sup>235</sup> *Ibid.*

<sup>236</sup> India, Constitution, arts 124(4), 218.

<sup>237</sup> India, *Judges (Inquiry) Act, 1968* No. 51 of 1968.

<sup>238</sup> India, Constitution, art 121.

<sup>239</sup> India, *Judges (Inquiry) Act, 1968*, s 3(1)(a)(b).

<sup>240</sup> India, *Judges (Inquiry) Act, 1968*, s 3(3)(2).

<sup>241</sup> India, *Judges (Inquiry) Act, 1968*, s 6(1).

<sup>242</sup> India, *Judges (Inquiry) Act, 1968*, s 6(2).

House present and voting.<sup>243</sup> To prevent unilateral action, the President can only issue an order for removal if the motion succeeds in both Houses.

In 1991, 108 members of parliament of the *Lok Sabha* brought forward the first-ever impeachment motion against Justice Ramaswami of the Supreme Court. The subsequent Inquiry Committee found him guilty of 11 of the 14 charges, based on brazen financial irregularities while serving as Chief Justice of the Punjab and Haryana High Court.<sup>244</sup> However, when the *Lok Sabha* voted on the motion 206 members of parliament abstained from voting. Thus, even though 196 members of parliament voted unanimously for his removal, the motion was defeated because it did not meet the mandated majority threshold.<sup>245</sup>

Only two motions for impeachment have been brought since. Justice P. D. Dinakaran of the Sikkim High Court faced a long list of charges that included possessing wealth disproportionate to his known sources of income, unlawfully securing property, and abuse of judicial office by passing dishonest judicial orders.<sup>246</sup> He abruptly resigned, however, during the Inquiry Committee's investigation. The controversy erupted when the Supreme Court collegium had recommended Justice Dinakaran's promotion to the Supreme Court. When that happened, the Forum for Judicial Accountability, a civil society organization, brought allegations of land grabbing to the attention of the Chief Justice of India.<sup>247</sup> The Inquiry Committee also found Justice Soumitra Sen of the Calcutta High Court guilty of misappropriating approximately US\$60,000 when he was a court-appointed receiver in 1983. In 2011, for the first time ever, the *Rajya Sabha* managed to pass an impeachment motion. But while the motion was pending before the *Lok Sabha*, Justice Sen resigned, thereby avoiding the stigma of being the first judge impeached by Parliament.<sup>248</sup>

The Indian government continues to attempt to implement judicial accountability measures. Two recent bills have failed because one lapsed and the second was withdrawn.<sup>249</sup> The *Lok Sabha* recently passed a comprehensive bill, *The Judicial Standards and Accountability Bill, 2010*, but it still needs to pass the *Rajya Sabha* to become law.<sup>250</sup> This bill seeks to replace the *Judges (Inquiry) Act, 1968* and create enforceable standards for the conduct of Supreme and High Court judges. It is an attempt to reform the process to remove judges, enable minor disciplinary measures, and require judges to declare their assets.

The controversy surrounding declaring assets is worth a brief mention. For many years, Supreme Court judges have voluntarily chosen to declare their assets to the Chief Justice as a means to hold themselves accountable to their peers. In 2007, a citizen sought to find out whether the newly enacted *Right to Information Act, 2005* applied to the Supreme Court. In 2009, the question went up to the Delhi High Court where Justice Ravindra Bhad held that the disclosure of Supreme Court judges' assets does not fall under the Acts' exemption provision.<sup>251</sup> Shortly thereafter, controversy

<sup>243</sup> India, Constitution, arts 124(4), 218; *Judges (Inquiry) Act, 1968*, s 6(3).

<sup>244</sup> Prashant Bhushan, "A Historic Non-Impeachment: An All Around System Failure," *Frontline* (June 4 1993), online: <[http://www.judicialreforms.org/files/cover\\_story\\_ramaswami.pdf](http://www.judicialreforms.org/files/cover_story_ramaswami.pdf)>.

<sup>245</sup> *Ibid.*

<sup>246</sup> J. Venkatesan, "Justice Dinakaran Face Serious Charges," *The Hindu* (July 29 2011), online: <[www.thehindu.com](http://www.thehindu.com)>.

<sup>247</sup> *Ibid.*

<sup>248</sup> "Justice Sen Resigns Ahead of Monday's Impeachment Motion," *The Hindu* (September 1 2011), online: <[www.thehindu.com](http://www.thehindu.com)>.

<sup>249</sup> India, *The Judges (Inquiry) Bill, 2006*. This bill was introduced in Parliament in December 2006 and referred to the Parliamentary Standing Committee which gave its recommendations in August 2007 but then lapsed. *The Judge's (Declaration of Assets and Liabilities) Bill, 2009*, No. 21 of 2009 was criticized when introduced for shielding judges' declaration of assets from public accessibility under the *Right to Information Act, 2005* and was withdrawn.

<sup>250</sup> India, *Judicial Standards and Accountability Bill, 2010*, No. 136 of 2010; "Lok Sabha Clears Judicial Accountability Bill," *The Times of India* (March 30 2012), online: <[articles.timesofindia.indiatimes.com](http://articles.timesofindia.indiatimes.com)>.

<sup>251</sup> India, *Right to Information Act, 2005* No. 22 of 2005; *CPIO Supreme Court of India v Subhash Chandra Agarwal* W.P. (C) no. 288/2009.

erupted in the *Rajya Sabha*, because the *Judges (Declaration of Assets and Liabilities) Bill, 2009* had prohibited the disclosure of judges' assets to the public except during court or misconduct proceedings. That bill has since been withdrawn. In its current draft, *The Judicial Standards and Accountability Bill, 2010* requires all judges, including their spouses and dependants, to declare their assets and liabilities. Such disclosure is to take place within 30 days of the judge taking his or her oath of office and thereafter during annual reports. In addition, the judges' assets and liabilities will be displayed on his or her courts' website. If the 2009 draft bill favoured privacy over public interest, the 2010 bill would mandate transparent and open disclosure of judges' assets to the public.

Perhaps the most interesting accountability development is the recently passed *High Court and Supreme Court Judges (Salaries and Conditions of Service) Amendment Bill, 2008*. The bill increased Supreme and High Court judges' salaries by an unprecedented margin – a 300 percent increase in salary, along with a substantial increase in benefits and pensions. Curiously, despite India's famously outspoken media, little was penned in reaction to this amendment.<sup>252</sup> The Parliamentary Standing Committee took this step, among other things, to ameliorate the functioning of the judiciary and people's perception of it; to ensure that esteemed judges receive the requisite compensation for their hard work and service; to attract higher quality candidates to fill vacancies; to create incentives for judges to disclose their assets; to reduce corruption; and to reduce backlog while improving the quality of judgments.<sup>253</sup> In essence, this salary increase was a strategic move to increase judicial accountability and responsibility by improving the integrity of the judicial system and in turn help to restore public trust. It can be seen as the government's attempt to restore, within the judiciary, the interconnectedness of judicial independence and accountability.

## WHAT IS THE CAUSE OF CASE BACKLOG?

The two most prevalent institutional critiques of India's judiciary relate to corruption and case backlogs. Higher branches of the judiciary are extremely reluctant to deny admissions of appeals, which in Mehta's view constitutes a "tacit acknowledgement that procedures of the lower courts are suspect and faulty."<sup>254</sup> Galanter, focusing on the lower judiciary, challenges the mistaken yet widespread belief that India is a litigious society and that this has given rise to inordinate delays and backlogs. While reliable comparative data is scarce, he argues that there is sufficient evidence that, on a per capita basis, India uses its civil courts less than most countries in the world.<sup>255</sup> What accounts for this disconnect? The desperate congestion facing Indian courts gives the appearance of overuse, even though relatively few cases are actually filed. The real cause of backlog is that there are too few courts and a shortage of judges.<sup>256</sup> Scholars like Guruswamy and Singh have also highlighted weaknesses in procedure and practices which reveal the overlap between access and accountability including:

Poor lawyering practices like seeking repeated adjournments, poorly prepared briefs, unnecessarily lengthy oral arguments and the lack of understanding of the statute and case law ... the lack of adequate number of judges, repeated transfer of judges ... generous standards

<sup>252</sup> Rakesh Bhatnagar, "300% Hike in Salary of Judges is Nominal: Government," *Daily News & Analysis* (February 25 2009), online: <[www.dnaindia.com](http://www.dnaindia.com)>.

<sup>253</sup> *34th Report on the High Court and Supreme Court Judges (Salaries and Conditions of Service) Amendment Bill, 2008*, (Parliament of India, Rajya Sabha, Department Related Parliamentary Standing Committee on Personnel).

<sup>254</sup> Pratap Bhanu Mehta, "India's Judiciary: The Promise of Uncertainty," in *Public Institutions in India: Performance and Design*, ed. Devesh Kapur and Pratap Bhanu Mehta (New Delhi: Oxford University Press, 2005), 181.

<sup>255</sup> Galanter, "To the Listed Field," 68.

<sup>256</sup> *Ibid.*, 70-71.

of admission of cases and grant of notice, inadequate use of technology and even a lack of law clerks to assist overburdened judges.<sup>257</sup>

### IMPROVING INFRASTRUCTURE

To understand the weaknesses and process of reform in infrastructure, one must understand the financial and administrative authority of the court system. While the judiciary remains effectively independent from the executive and legislature, it has suffered from critical shortages of funds for basic infrastructure, such as lack of computerized records. Importantly, the legislature controls the entirety of the court's finances.<sup>258</sup> The judiciary has no autonomy in deciding expenditures and is entirely dependent upon the central government and respective state governments to create new judicial and support staff positions, acquire land or buildings for new courts, or to modernize any infrastructure.<sup>259</sup> Yet the government has been slow to offer any tangible changes. For example, in 2005 the government created an ambitious e-courts project that envisioned digitization, library management, and e-filing by 2014. Yet, to date a total of 9,914 out of 14,229 courts have been computerized which is a far cry from the original 2005 vision.<sup>260</sup> The government did adopt the recommendations of the Thirteenth Finance Commission to earmark a grant of roughly US\$902 million for judicial reforms including increasing court working hours, promoting alternative dispute resolution, and creating new court managers in every district.<sup>261</sup> The central government implemented 1,562 fast-track courts across the country over the last ten years, which have an impressive track record despite low budgets.<sup>262</sup> However, in 2011 the government announced it would withdraw its support of the fast-track courts. As a result, some state governments have stepped in with funding to ensure continuity or they have otherwise turned them into regular courts.<sup>263</sup> For example in Maharashtra, the state government decided to pick up the cost to ensure continuity for the fast-track court scheme.

### SHORTAGE OF JUDGES AND BACKLOG

In 2002, the Supreme Court directed that the number of judges – “judicial strength” – increase five times within a period of five years.<sup>264</sup> Ten years later, outstanding vacancies remain a pressing issue. There are currently five vacancies in the Supreme Court and 271 vacancies in total (see table 4.1).<sup>265</sup> In 2012, the biggest court in India, Allahabad High Court, is functioning with only 84 judges despite a total approved strength of 160. Thus, 76 vacant positions have yet to be filled in Allahabad alone. Worse yet, in 2011, it had only 62 judges.<sup>266</sup> The Punjab and Haryana High Court has the second worst vacancy rate, functioning with only half of its approved strength.<sup>267</sup> For a breakdown of vacancy positions in the Supreme and High Courts see table 4.1 below.

<sup>257</sup> Guruswamy and Singh, “Village Courts in India: Unconstitutional Forums With Unjust Outcomes,” 283.

<sup>258</sup> “Indolence in India’s Judiciary,” 217.

<sup>259</sup> Ibid.

<sup>260</sup> K. K. Pant, “Improving the Justice Delivery System in India,” *iSikkim* (April 30 2012), online: <isikkim.com>; *National Policy and Action Plan for Implementation of Information and Communication Technology in the Indian Judiciary*, (E-Committee, Supreme Court of India, 2005).

<sup>261</sup> Pant, “Improving the Justice Delivery System in India.”

<sup>262</sup> A Subramani, “Centre Chokes off Allocation to Fast-Track Courts,” *The Times of India* (February 21 2011), online: <articles.timesofindia.indiatimes.com>.

<sup>263</sup> Ibid.

<sup>264</sup> *All India Judges’ Association v Union of India*, (2002) 4 SCC 247.

<sup>265</sup> “Vacancy Positions,” India, Department of Justice, Ministry of Law and Justice (website) online: <http://doj.gov.in/?q=node/90>.

<sup>266</sup> Maneesh Chhiber, “Justices Delayed: SC down, Judge Vacancies Pile Up,” *The Indian Express* (September 5 2011), online: <www.indianexpress.com>.

<sup>267</sup> “Vacancy Positions.”

**Table 4.1:** Vacancy Positions in the Supreme Court of India and High Courts

Name of the Court	Approved Strength	Working Strength	Vacancies as per Approved Strength
SUPREME COURT OF INDIA	31	26	5
HIGH COURT	PERMANENT & ADDITIONAL POSITIONS	PERMANENT & ADDITIONAL POSITIONS	PERMANENT & ADDITIONAL POSITIONS
ALLAHABAD	160	84	76
ANDHRA PRADESH	49	32	17
BOMBAY	75	57	18
CALCUTTA	58	43	15
CHHATTISGARH	18	12	6
DELHI	48	35	13
GAUHATI	24	23	1
GUJARAT	42	28	14
HIMACHAL PRADESH	11	11	-
JAMMU & KASHMIR	14	7	7
JHARKHAND	20	11	9
KARNATAKA	50	39	11
KERALA	38	31	7
MADHYA PRADESH	43	32	11
MADRAS	60	53	7
ORISSA	22	14	8
PATNA	43	37	6
PUNJAB & HARYANA	68	41	27
RAJASTHAN	40	24	16
SIKKIM	3	2	1
UTTARAKHAND	9	8	1
<b>HIGH COURT TOTAL</b>	<b>895</b>	<b>624</b>	<b>271</b>

**Source:** “Vacancy Positions,” India, Department of Justice, Ministry of Law and Justice (website) online: <http://doj.gov.in/?q=node/90>. (vacancies as of September 1, 2012).>



In January 2011, then Minister of Law and Justice, Dr. M. V. Moily stated that there were 52,592 cases pending in the Supreme Court, 3,955,224 cases pending in high courts and 26,752,193 cases pending in subordinate courts.<sup>268</sup> Correspondingly, there are a current total of 26 Supreme Court judges, 624 high court judges, and as of December 31, 2010, there were 13,962 district and subordinate court judges.<sup>269</sup> Using these figures, the ratio of cases pending per judge is: 2,023 for each Supreme Court judge; 6,339 for each high court judge; and 1,916 for each lower court judge. As this simple calculation demonstrates, the most severe backlog lies within the high courts. Each high court judge faces approximately 3.25 times the backlog of each judge in either the Supreme Court or in the lower courts. Keeping this in mind, the following sections will discuss the impact of backlogs on civil filings before district and high courts.

### LITIGATION RATES AS A MEASURE OF DEVELOPMENT

Eisenberg et al.'s study examined rates of civil litigation across states compared to measures of well-being, namely GDP per capita, the *Human Development Index* (HDI), and literacy rates.<sup>270</sup> Table 4.2 shows the figures used in their study. The study attempts to understand why between 1977 and 2005 there was a strong relationship between GDP and rates of civil filings, but that between 2005 and 2010, a period of substantial GDP growth, the relationship broke down. The authors demonstrate that increasing backlogs had more influence on filing changes than GDP variation had during these years.

The study provides evidence that backlogs are already discouraging use of the courts. India's case backlog ratio has increased 28 percent from 1977 to 2010. Indeed, they found that the HDI replaces GDP per capita as an explanatory variable.<sup>271</sup> GDP per capita is still an important factor explaining litigation rates, however, noneconomic well-being has also had a substantial role to play. If given a choice between the two, the HDI produces superior models.<sup>272</sup>

Eisenberg et al. caution that their findings do not “imply that filing more lawsuits will increase societal well-being” rather, they emphasize that the positive association between civil litigation and well-being is “consistent with the law and development theorists’ view that the modernization of a country increases reliance on formal institutions.”<sup>273</sup> The authors draw upon early empirical studies, such as Grossman and Sarat’s in 1975, which emphasized that an increased reliance on formal law and legal processes flows from changes produced by economic growth and development.<sup>274</sup> Similarly, as noted in the institutions section of this report, scholars such as Dixit argue that economies of scale are what distinguish the constraints of informal institutions, which is what gives rise to the primacy of formal institutions once the threshold of scale has been surpassed.<sup>275</sup>

<sup>268</sup> “Alternative Dispute Resolution Will be the Preferred Mode of Settlement of Disputes in the Future – says Dr. Veerappa Moily,” *Press Information Bureau, Press Release, 69096* (January 9 2011), online: <http://pib.nic.in/newsite/erelease.aspx>.

<sup>269</sup> *India Sup Ct*, 6 *High Court News* no. 1 (Jan-March 2011), 4, cited in Eisenberg et al., “Litigation as a Measure of Well-Being,” 7.

<sup>270</sup> *Ibid.*, 28-30.

<sup>271</sup> *Ibid.*, 32.

<sup>272</sup> *Ibid.*, 33. In a model using standardized coefficients, the HDI coefficient is 54 percent larger than the GDP coefficient.

<sup>273</sup> *Ibid.*, 34. See also Douglass C. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge University Press, 1990).

<sup>274</sup> Joel B. Grossman and Austin Sarat, “Litigation in the Federal Courts: A Comparative Perspective,” *Law and Society Review* 9 (1974), 322-25.

<sup>275</sup> Avinash K. Dixit, *Lawlessness and Economics: Alternative Modes of Governance* (Princeton, N. J.: Princeton University Press, 2004).

**Table 4.2: Indian State Civil Filings & GDP, 2005-2010, Population, HDI, Literacy, Backlog**

High Court	States Included	Union Territories Included	Population 2011 (millions)	HDI for 2011	Literacy Rate 2011 (%)	Filings per 1000 persons <sup>*</sup>	GDP per Capita (US\$) <sup>†</sup>	Years to Clear Civil Case Backlog <sup>‡</sup>
Allahabad	Uttar Pradesh		200.0	0.380	69.7	2.5	320	2.8
Andhra Pradesh	Andhra Pradesh		84.7	0.473	67.7	3.6	681	1.5
Bombay	Maharashtra		112.4	0.572	82.9	3.5	981	2.5
	Goa		1.5	0.617	87.4	7.6	1880	1.5
		Daman & Diu	-	-	-	-	-	-
		Dadra & Nagar Haveli	-	-	-	-	-	
Calcutta	West Bengal		91.3	0.492	77.1	1.5	561	4.3
		Andaman & Nicobar Islands	-	-	-	-	-	-
Chhattisgarh	Chhattisgarh		25.5	0.358	71.0	1.7	505	2.4
Delhi		Delhi	16.8	0.750	86.3	5.7	1580	1.9
Gauhati	Assam		31.2	0.444	73.2	1.2	390	2.3
	Arunachal Pradesh		1.4	n/a	67.0	0.4	674	3.1
	Manipur		2.7	n/a	79.8	1.1	415	1.4
	Meghalaya		3.0	n/a	75.5	0.7	611	2.2
	Mizoram		1.1	n/a	91.6	1.2	603	7.4 <sup>§</sup>
	Nagaland		2.0	n/a	80.1	0.3	682	4.0
	Tripura		3.7	n/a	87.8	1.6	551	1.2
Gujarat	Gujarat		60.4	0.527	79.3	3.7	863	3.2
Himachal Pradesh	Himachal Pradesh		6.9	0.652	83.8	7.5	751	1.3
Jammu & Kashmir	Jammu & Kashmir		12.5	0.529	68.7	3.9	470	1.4
Jharkhand	Jharkhand		33.0	0.376	67.6	0.5	408	2.7
Karnataka	Karnataka (formerly Mysore)		61.1 <sup>¶</sup>	0.519	75.6	4.9	721	1.9
Kerala	Kerala		33.4	0.790	93.9	8.6	811	1.5
	Laksahdweep		-	-	-	-	-	-
Madhya Pradesh	Madhya Pradesh		72.6	0.375	70.6	2.8	376	1.0
Madras	Tamil Nadu		72.1	0.570	80.3	12.4	834	0.7
		Puducherry (formerly Pondicherry)	1.2	n/a	86.5	14.1	1302	0.9
Orissa	Orissa		41.9	0.362	73.5	1.2	456	4.1
Patna	Bihar		103.8	0.367	63.8	0.5	212	5.8
Punjab & Haryana	Haryana		25.4	0.552	76.6	5.4	1022	1.7
	Punjab		27.7	0.605	76.7	5.3	842	1.9
		Chandigarh	1.1	n/a	86.4	9.2	1792	2.4
Rajasthan	Rajasthan		68.6	0.434	67.1	2.6	472	2.1
Sikkim	Sikkim		0.6	n/a	82.2	0.5	738	1.2
Uttarakhand	Uttarakhand (formerly Uttaranchal)		8.5	0.490	79.6	2.7	740	1.2

**Source:** Theodore Eisenberg et al. “Litigation as a Measure of Well-Being” (2012), 15.

**Note:** the authors’ sources are *India Sup. Ct. High Court News*; Ministry of Statistics and Program Implementation; Press Information Bureau, Government of India; India Human Development Report 2011.

\* Civil case filings based on the years 2005 to 2010 and two types of civil filings are used: one based on filings in the district courts and subordinate courts (collectively, the lower courts) and a second one based on the High Courts. This enabled authors to not only collect data on the mass of civil filings within the lower courts but also capture all of the civil High Court cases since they possess a wide scope of original jurisdiction.

† Figures have been converted into US dollars based on exchange rate for rupees of 54.5230 per dollar and rounded to the dollar (GDP per capita based on years 2005 to 2010).

‡ Years needed to clear a state’s civil case backlog is based on the number of civil cases pending versus how many are disposed in a year, based on the years 2005 to 2010.

§ This high rate of backlog is due to the year of 2005 when there were only 23 cases disposed and 834 cases pending – excluding 2005, the years from 2006 to 2010 leads to a backlog of 1.7 years.

By establishing the relationship between civil litigation rates and improved human well-being, Eisenberg et al. challenge the popular opinion, widely held in India and other countries, that increasing litigation is evidence of a malfunctioning society.<sup>276</sup> In their view, the HDI's explanatory superiority is "likely due to it having both an economic component, income per capita, and a noneconomic component, including education level and life expectancy components."<sup>277</sup> The value of their findings is that "people are more likely to use the courts to resolve disputes when they are economically, socially and physically better off."<sup>278</sup> Other studies lend support to this theory. For example, Koehling, in 2002, examined the quality of India's judiciary across states and territories to find that a weak judiciary has a negative effect on economic and social development.<sup>279</sup>

For the purposes of our report, such an interpretation may have key implications regarding the issue of access to justice and its potential to impact sustainable economic development:

Simply improving the courts or macroeconomic growth are not the most important factors in ensuring that people are able to assess the courts. Indeed, assuring access to justice which includes providing individuals with a realistic chance to vindicate rights through litigation may require governments to ensure economic opportunity and social rights to individuals; GDP growth alone does not assure all individuals a realistic opportunity to vindicate rights.<sup>280</sup>

Thus, the current challenges facing the justice delivery system have a direct impact on sustainable growth. The causes of backlog include too few allotted courts, high levels of judicial vacancies, and corruption which renders the system unpredictable.<sup>281</sup> If an effective and reliable court system impacts economic growth, fostering continued sustainable growth may well "yield important information about the need for a well-functioning judiciary to promote human well-being."<sup>282</sup>

It is relevant to recall the peculiarities of India's growth, as discussed in the institutions section of this report, as it is pertinent to the role of formal versus informal institutions. Bardhan challenges the widely held belief that India's growth results from the software and information technology sector or large-scale manufacturing.<sup>283</sup> He provides evidence that a large part of India's growth within the past decade has occurred in traditional or "unorganized sector" services.<sup>284</sup> This conclusion lends much-needed nuance to any discussion of reforms promoting informal dispute resolution to ease the pressure of court backlog. It also focuses attention on the sectors that are most vulnerable when trying to access justice. Arguably, it is smaller manufacturers that require speedy disposal of justice as delays will likely be ruinous. Especially given that the average backlog in district courts is over two years, as table 4.2 demonstrates. By contrast, larger-scale enterprises, themselves sophisticated actors and often repeat players in litigation, face different concerns. For example, they

<sup>276</sup> Eisenberg et al., "Litigation as a Measure of Well-Being," 2-3. See also Marc Galanter and Jayanth K. Krishnan, "Bread for the Poor: Access to Justice and the Rights of the Needy in India," *Hastings Law Journal* 55 (2003).

<sup>277</sup> Eisenberg et al., "Litigation as a Measure of Well-Being," 34.

<sup>278</sup> *Ibid.*

<sup>279</sup> W. Koehling, "The Economic Consequences Of A Weak Judiciary: Insights From India," *Law and Economics* (2002). Koehling discusses evidence that a weak judiciary is the strongest predictor of underdevelopment and economic stagnation.

<sup>280</sup> Eisenberg et al., "Litigation as a Measure of Well-Being," 35.

<sup>281</sup> *Ibid.*, 36.

<sup>282</sup> *Ibid.*

<sup>283</sup> Pranab K. Bardhan, *Awakening Giants, Feet of Clay: Assessing the Economic Rise of China and India* (Princeton, N.J.: Princeton University Press, 2010), 34-35. Bardhan argues that 87 percent of employment in manufacturing is in microenterprises of fewer than ten employees.

<sup>284</sup> *Ibid.*, 27-29.

rely increasingly on arbitration which raises concerns about how courts enforce arbitral awards and otherwise intersect with the arbitration process.

Through this lens, we will contrast current efforts by government in two key areas – efforts to deal with high-value commercial cases and current efforts to promote alternative dispute resolution.

## ATTEMPTS TO RESOLVE HIGH-VALUE COMMERCIAL CASE BACKLOG

India's Upper House is currently debating whether to create a commercial bench within each high court to deal exclusively with disputes of Rs 5 crores (approximately US\$900,000) or higher.<sup>285</sup> *The Commercial Division of Courts Bill, 2009* is currently pending before Parliament and is the result of recommendations by the Law Commission of India in a report entitled *Proposals for Constitution of High-tech Fast Track Commercial Division in High Courts*.<sup>286</sup> With enormous growth in the commercial and industrial sectors in India over the last two decades, the intention is to create a division that efficiently disposes of high-threshold commercial disputes, using mechanisms such as fast track. At present, the pecuniary jurisdiction of civil courts varies from state to state and only some high courts have original jurisdiction for higher threshold cases. The commercial bench would have two high court judges dedicated full-time to decide each dispute within one year and deliver a judgment within 30 days after concluding arguments.

The *Lok Sabha* passed the bill without any debate or discussion. Due to the serious implications of the bill and the manner in which it was drafted, however, the *Rajya Sabha* authorized a Select Committee to examine it, invite submissions by interested parties, and submit a report.<sup>287</sup> Some of the serious concerns include not knowing how many commercial disputes are actually pending in the various courts. While currently only six high courts have original jurisdiction to hear such commercial disputes, for the rest, the bill would carve out new original jurisdiction and create heightened pressure on these high courts which already face critical backlogs and judge shortages. No provisions in the bill increase the strength of the high courts, therefore the commercial bench would effectively eat away at resources for other cases, causing undue delay. There are also concerns about the bill's constitutionality, since the bill provides high-tech and special provisions for wealthy litigants at the expense of poor litigants and potentially discriminates in the process of dispensing justice. Finally, since the bill specifies that litigants may appeal to the Supreme Court, there would be a corresponding potential increase in delays and backlogs at the apex court.

The Select Committee, deferred to the judiciary regarding a final pronouncement on the bill's constitutionality.<sup>288</sup> Regarding pecuniary jurisdiction, the committee recognized the need for uniformity across the judicial system but felt that it was incumbent on government to make it part of comprehensive legislation on judicial reforms encompassing various issues.<sup>289</sup> Since exclusive high court jurisdiction would entail a bulk transfer of cases from the district courts, with no provisions to increase judicial

<sup>285</sup> India, *Commercial Division of High Courts Bill, 2009*, No. 139 of 2009. See PRS Legislative Research for the draft bill, online: <<http://www.prsindia.org/billtrack/the-commercial-division-of-high-courts-bill-2009-977/>>. All pecuniary thresholds are in US dollars to provide a comparative example. Original numbers are in Indian Rupees.

<sup>286</sup> *188th Report of the Law Commission on the 'Proposals for Constitution of Hi-tech Fast Track Commercial Divisions in High Courts'*, (Law Commission, Ministry of Law and Justice, 2004).

<sup>287</sup> *Report of the Select Committee on the Commercial Division of High Courts Bill, 2009 as Passed by Lok Sabha presented to the Rajya Sabha*, (Parliament of India, 2010).

<sup>288</sup> *Ibid.*, 3.

<sup>289</sup> *Ibid.*

strength, the committee recommended that vacancies be filled quickly and that judicial strength be increased. To not do so would clog the judicial system further and defeat the objective of the bill.<sup>290</sup> It also suggested creating a Commercial Division in the Supreme Court to handle the influx of commercial cases on appeal.<sup>291</sup>

The Select Committee recommended the following modifications to the bill's current draft: providing more clarity in the definition of commercial dispute to avoid ambiguity and potential disputes regarding jurisdiction; allocating one judge instead of two; reducing the threshold limit of Rs 5 crores to Rs 1 crore (approximately US\$900,000 to US\$180,000); and suggesting consultation with the high courts and state governments to establish a relevant specified value of a commercial dispute. Its procedural recommendations included a 30-day extension in the event of practical difficulties. Two members of the committee attached dissents to the report.<sup>292</sup> They objected to the bill on constitutional grounds, because of its potential to create two classes of litigants, one rich and the other poor. They claimed that judicial reform needed to address all types of cases. They also emphasized that there was no accurate or relevant data to justify or ground many of the bill's intentions. For example, the decision to set the pecuniary threshold at Rs 5 crores (US\$900,000), was completely arbitrary. Despite these strong objections, however, these members did suggest that the bill should go ahead on a trial basis or as a pilot project.

This example shows the critical role played by the *Rajya Sabha*, which is clearly more active and accountable than the *Lok Sabha*. It also reveals the difficulties that governments face in drafting good laws at the outset. It is clear that a major obstacle is the lack of data supporting the bill's stated intentions. This has further fueled questions over its constitutionality because without supporting data there is no reason to give specialized treatment to high-value commercial cases. The committee worked with extremely sparse data and the Ministry of Law and Justice conceded that "they were informed by the High Courts that such data was not being maintained by the subordinate courts."<sup>293</sup> Only 4 out of 21 High Courts were able to specify the number of commercial disputes involving Rs 5 crores (US\$900,000) or above that were instituted and pending within their jurisdiction.<sup>294</sup> With poor infrastructure and the process of computerization only three-quarters complete, such lack of data is not surprising. Galanter describes how even 40 years ago policy makers had a poor understanding of district level courts due in part to poor record-keeping.<sup>295</sup> This lack of understanding is a long-standing issue that continues to impede reforms. It is clear, however, that such information is critical for judicial reforms to be effective, well-designed, and respond to courts' actual needs, particularly at the district level. Perhaps the committee could have drawn upon empirical studies that suggest the type and size of enterprises that make-up the bulk of growth in India. Here Bardhan's findings become all the more significant. Certainly, his findings would have supported the committee's recommendation to reduce the threshold limit from Rs 5 crores to Rs 1 crore (approximately US\$900,000 to US\$180,000), as small firms are the major source of India's growth.<sup>296</sup> The Second Report of the National Commission on Labour, released in 2002, states:

<sup>290</sup> Ibid.

<sup>291</sup> Ibid., 4.

<sup>292</sup> Ibid., 9-15.

<sup>293</sup> Ibid., iv.

<sup>294</sup> Ibid., Annexure III.

<sup>295</sup> M. Galanter, "Introduction - The Study of the Indian Legal Profession," *Law and Society Review* 3 (1968), 209. See also Robert S. Moog, "The Study of Law and India's Society: The Galanter Factor," *Law and Contemporary Problems* 71 (2008), 134. Moog discusses how the poor record-keeping in the lower courts and the lack of annual reports on the administration of justice at the state level makes it impossible to know who is using these courts and for what purposes. This makes it difficult to gain an understanding of variance across or within states.

<sup>296</sup> Bardhan, *Awakening Giants*, 34-35. Bardhan does not directly speak about lowering high court thresholds, but rather that small firms are the major source of India's growth.

When one surveys the problems and needs of workers in the organised and unorganised sectors, one has also to take special note of workers who are employed in small-scale industries and tiny industries. There are many minds in which the word 'Industry' invokes only the picture of big industry. But statistics reveal that a much larger section of the workforce is employed in small-scale industries than large-scale industrial undertakings. In 1999, while the organized industry, both in public and private sectors together employed [6,740,000] workers, the small-scale sector employed [17,160,000] workers, almost thrice the number. The problems of the entrepreneurs and the workers in this field need special attention.<sup>297</sup>

While up-to-date figures are required, this passage reveals the importance of extending the benefit of the Commercial High Court bench to more firms by reducing the threshold limit. The bill's objectives are to increase foreign investment, bearing in mind how privatization, liberalization, and globalization boosted India's economy and increased competition. The bill aims to provide a speedy and effective mechanism for resolving high-stakes commercial disputes, without which economic progress will be retarded.<sup>298</sup> Based on this rationale and in view of statistical data available, it appears that the bill seeks to support an exclusive niche of large commercial domestic players and foreign investors, to the exclusion of the very firms that have driven economic growth.

Commentators have cautioned that reform efforts need to be thoughtful to be able to serve and meet expected results. A subtext of these cautions is an acknowledgement of a global trend towards specialized courts and also a general mistrust in India that general courts will make good decisions.<sup>299</sup> Accordingly, would this bill create an uneven playing field for firms based on size and begin to re-shape the particularities that have defined India's commerce and trade? The impact this may have on sustainable growth requires closer attention. Such key issues have generally not been raised by the media and were absent in the committee report.

### BEST PRACTICE – THE BOMBAY HIGH COURT AND THE MAHARASHTRA CABINET

The jurisdiction of commercial disputes currently varies from state to state. In some states, district courts have unlimited pecuniary jurisdiction, while in others, original jurisdiction of higher value commercial cases is vested in the high court. For example, the High Court of Delhi has original civil jurisdiction for commercial disputes where the value exceeds approximately Rs 5 lakhs (approximately US\$9,000).<sup>300</sup> Despite the limited data supplied to the Select Committee on high-value cases, the Bombay High Court was able to specify certain figures for commercial cases of US\$900,000 or above: 3,111 cases were instituted, 921 were pending, and only 6 judges were designated to these cases. These are by far the most significant figures of the all the data provided.<sup>301</sup> The *Commercial Division of High Courts Bill, 2009* is still pending before the *Rajya Sabha*, but in the meantime the state of Maharashtra has recently granted

<sup>297</sup> *2nd Report of the National Commission on Labour*, (Government of India, Ministry of Labour and Employment, 2002), para 1.17.

<sup>298</sup> India, *Commercial Division of High Courts Bill, 2009*, No. 139 of 2009, 9.

<sup>299</sup> N. Rehn et al., "Justice Without Delay: Recommendations for Legal and Institutional Reforms in the Indian Courts," *Research Paper No. 4, O.P. Jinal Global University* (2011), 29.

<sup>300</sup> India, *The Delhi High Court Act, 1966*, No. 26 of 1966, s 5(2).

<sup>301</sup> Parliament of India, *Report of the Select Committee on the Commercial Division of High Courts Bill, 2009 as Passed by Lok Sabha, presented to the Rajya Sabha on 29 July 2010* online: <<http://www.prsindia.org/uploads/media/Division%20High%20Courts/Select%20Committee%20Report.pdf>>, Annexure III.

more powers to civil judges of the lower judiciary. Maharashtra's reforms are a notable example of best practices for judicial reform.

As of January 16, 2012, the *Bombay Civil Courts (Amendment) Act, 2011* has increased the district court's pecuniary jurisdiction from approximately Rs 2 lakhs (approximately US\$3,600) to Rs 10 lakhs (approximately US\$18,000).<sup>302</sup> This also empowers these courts to hear all appeals for disputes up to Rs 10 lakhs (approximately US\$18,000), which means there will be an automatic transfer of such cases from the High Court when the amendment comes into force.<sup>303</sup> Prior to this amendment, such low limits forced most, if not all, litigants to travel to Bombay to file civil cases and appeals. This was not only an inconvenience to litigants but resulted in high rates of pendency before the Bombay High Court, which already had a backlog of over 350,000 cases.<sup>304</sup> Subordinate courts have similarly been empowered to hear matters up to Rs 5 lakhs (US\$9,000) and Rs 7.50 lakhs (US\$13,500), up from Rs 1 lakh (US\$1,800). In addition, to deal with the rising offense of cheque bouncing, the amendments set up ten special metropolitan magistrate courts in Bombay to quickly dispose of cheque bouncing cases under Rs 3 lakhs (US\$5,400).<sup>305</sup> As mentioned above, given that high court judges face 3.25 times the backlog of Supreme Court and district court judges, it is clear that state governments have a critical role to play in judicial reform. Thus, Maharashtra has modernized its pecuniary jurisdiction to better reflect the value of ordinary commercial disputes. These are reforms that target certain types of cases that are known to contribute to backlogs.

### ALTERNATIVE DISPUTE RESOLUTION AS A WAY FORWARD

As India enters the 21st century and its economy continues to grow, its judicial institutions must modernize to adapt to changing circumstances. There has been a concerted effort to move cases out of the formal court system into alternative processes such as arbitration, government-sponsored *panchayats*, tribunals, consumer courts, fast-track courts, or a disparate collection of *lok adalats* (peoples' courts).<sup>306</sup> As scholars such as Moog, Galanter, and Krishnan emphasize, alternative dispute resolution in India is unavoidable, but also quite diverse in its advantages and disadvantages.<sup>307</sup> While alternative dispute resolution enables parties to bypass lower courts, these alternative forums face similar deficiencies including excessive formalism, expense, delay, and truncated remedies.<sup>308</sup> Given that alternative dispute resolution in India is both diverse and complex, the following discussion will focus on a few select issues pertaining to arbitration and *lok adalats*.

In January 2012, then Minister of Law and Justice Dr. M. V. Moily reiterated that alternative dispute resolution is the primary means to reduce backlogs.<sup>309</sup> In July 2012,

India's Chief Justice, not only lent his support to commercial courts, but also paved the way to build a culture of out-of-court settlements, which he conceded was not yet popular in India.<sup>310</sup> The pending *Commercial Division High Courts Bill, 2009* would give the commercial division jurisdiction over arbitration cases that deal with commercial matters of specified value and similarly, appeals would lie to the Supreme Court. If the bill passed, there would need to be a corresponding amendment to the current *Arbitration and Conciliation Act, 1996*.

Over 40 years ago, Galanter recognized the need for lawyers, in his view one of the most crucial actors within the judicial system, to shift from litigation skills to skills that emphasize advising, negotiating, and drafting.<sup>311</sup> In other words they needed to shift from court-room advocacy to risk management. Today, the formalism that pervades arbitration reflects these ingrained litigant strategies. This includes the way in which lawyers conduct and challenge proceedings in court, which the Supreme Court described as "legalese of unforeseeable complexity."<sup>312</sup> Nariman describes the situation as follows:

Indian sentiment has always abhorred the finality attaching to arbitral awards. A substantial volume of Indian case-law bears testimony to the long and arduous struggle to be freed from binding arbitral decisions. Aided and abetted by the legal fraternity, the aim of every party to an arbitration (domestic or foreign) is: 'try to win if you can; if you cannot, do your best to see that the other side cannot enforce the award for as long as possible.'<sup>313</sup>

In the mid-1990s, legislators overhauled the whole legislative architecture for arbitration. The *Arbitration and Conciliation Act, 1996* (1996 Act) replaced and repealed all former statutes.<sup>314</sup> The 1996 Act covered both domestic and international arbitration and effectively rendered an entire body of case law under the *Arbitration Act, 1940* (1940 Act) outdated and inapplicable.<sup>315</sup> This change precipitated courts to refine statutory interpretation, but it soon became clear that certain provisions of the 1996 Act were problematic. For example, an application to set aside an award operates as an automatic stay and parties have notoriously brought applications to set aside awards with the aim of delaying execution proceedings.<sup>316</sup> No amendments to improve the legislative framework have passed despite one attempt in 2003 that was withdrawn, several reports, and most recently a 2010 consultation paper.<sup>317</sup> A recent 2009 study describes the present arbitration system in India as "plagued with many loopholes and shortcomings, and the quality of arbitration has not adequately developed as a quick and cost-effective mechanism for resolution of commercial disputes."<sup>318</sup>

<sup>302</sup> India, *Maharashtra Act No. XLIV of 2011*, Government of Maharashtra Extraordinary Gazette (December 30 2011).

<sup>303</sup> See *Shri Vijay @ Ambadas Dattatraya ... vs Ramappa Ambannappa Masare And...* February 22, 2012, mst 1 FA-1081-1996 with FA-1158-1996.

<sup>304</sup> Sukanya Shetty, "Now, District Courts to Hear Civil Appeals on Property up to Rs 10 lakh," *The Indian Express* (January 14 2012), online: <www.indianexpress.com>. See also Prafulla Marpakwar, "Government Gets Cracking at Court Pendency," *The Times of India* (April 28 2011), online: <articles.timesofindia.indiatimes.com>.

<sup>305</sup> Marpakwar, "Government Gets Cracking at Court Pendency."

<sup>306</sup> Moog, "The Study of Law and India's Society: The Galanter Factor," 133.

<sup>307</sup> Ibid. See also Robert S. Moog, "Conflict and Compromise: The Politics of Lok Adalats in Varanasi District," *Law and Society Review* 25, no. 3 (1991), 562; Robert S. Moog, "Democratization of Justice: The Indian Experiment with Consumer Forums," in *Beyond Common Knowledge: Empirical Approaches to the Rule of Law*, ed. Thomas C. Heller and Erik G. Jensen (Princeton, NJ: Princeton University Press, 2004), 150-56; Marc Galanter and Jayanth K. Krishnan, "Debased Informalism: Lok Adalats and Legal Rights in Modern India," in *Beyond Common Knowledge: Empirical Approaches to the Rule of Law*, ed. Erik Jensen and Thomas Heller (Stanford: Stanford University Press, 2005), 113-16; Galanter and Krishnan, "Bread for the Poor," 792-94.

<sup>308</sup> Galanter, "To the Listed Field," 77.

<sup>309</sup> "Alternative Dispute Resolution Will be the Preferred Mode of Settlement of Disputes in the Future – says Dr. Veerappa Moily."

<sup>310</sup> "Chief Justice Roots For Commercial Courts to Speed up Settlements," *Deccan Herald* (July 10 2012), online: <www.deccanherald.com>.

<sup>311</sup> Galanter, "Introduction - The Study of the Indian Legal Profession," 216-17.

<sup>312</sup> *Guru Nanak Foundation v Mis Rattan Singh & Sons*, AIR 1981 SC 2075, cited in Galanter, "To the Listed Field," 77.

<sup>313</sup> F. S. Nariman, "Arbitration and ADR in India," in *Alternative Dispute Resolution: What It Is and How It Works*, ed. P. C. Rao and W. Sheffield (Delhi: Universal Law Publications, 1997), 49 cited in Galanter, "To the Listed Field," 77.

<sup>314</sup> India, *Arbitration and Conciliation Act, 1996*, No. 26 of 1996.

<sup>315</sup> India, *Arbitration Act, 1940*, X of 1940; *Sundaram Finance v NEPC Ltd* (1999) 2 SCC 479, 484. The Supreme Court states that provisions of the 1996 Act must be interpreted and construed independently and reference to the 1940 Act may lead to misconstruction.

<sup>316</sup> India, *Arbitration and Conciliation Act, 1996*, No. 26 of 1996, s 34.

<sup>317</sup> India, *The Arbitration and Conciliation (Amendment) Bill, 2003* was introduced in Parliament on December 22, 2003 but was not taken up for consideration and was subsequently withdrawn based on committee recommendations; See also *176th Report*, (Law Commission of India, 2001).

<sup>318</sup> Krishna Sarma et al., "Development and Practice of Arbitration in India – Has it Evolved as an Effective Legal Institution?" in *CDDR Working Paper No. 103* (Center on Democracy Development, and the Rule of Law, Freeman Spogli Institute for International Studies, 2009), 1.

By 2009, the Supreme Court of India declared an urgent need to develop institutional arbitration as the means to save arbitration from excessive arbitrators' fees.<sup>319</sup> In large part, much of the litigation before the courts involves ad hoc arbitration, which offers parties the freedom to choose arbitrators, the type of proceedings, and the applicable rules. This also means, however, that arbitrators' fees range dramatically and that there is much additional litigation.<sup>320</sup> Ad hoc procedures are popular in India due to their accessibility and are especially used for smaller claims. But the flexibility of the ad hoc procedure creates greater potential for disagreement between the parties, necessitating recourse to the courts.<sup>321</sup>

Institutional arbitration offers numerous advantages such as prescribed rates for arbitrators' fees and administrative fees based on claim amounts. They also oversee the quality of arbitrators, set out applicable rules, and scrutinize awards before they are finalized. It is widely thought that institutional arbitration will increase the efficiency and effectiveness of arbitration by reducing potential litigation before the courts. The 2010 consultation paper advances a key role for institutional arbitration. Some of its proposals include amending the Chief Justice's current power to appoint arbitrators, allowing any high court judge to refer a matter to an institute to select from their panel of arbitrators, and making institutional arbitration the default forum.<sup>322</sup> Emphasizing the need to ensure proper accreditation and uphold arbitrators' integrity, former Minister of Law and Justice, Dr. M. V. Moily reportedly acknowledged the state's agenda to institutionalize the system of arbitration in the country, because "in a democracy, we can work on a system, not individuals."<sup>323</sup> However, a full 16 years later, still no amendments have been made to the 1996 Act and indeed the loopholes and shortcomings persist.

In 2002, amendments to the *Code of Civil Procedure* sought to overcome the courts' reluctance to refer cases to alternative dispute resolution processes.<sup>324</sup> The amendments mandated judges to refer appropriate cases to alternative dispute resolution processes at the pre-trial phase and specified five possible modes: arbitration, conciliation, mediation, *lok adalats*, and judicial settlement. However, much like the 1996 Act, section 89 of the *Code of Civil Procedure* suffers from a series of anomalies and imperfections that, among other things, fail to distinguish these five modes of alternative dispute resolution. In a series of leading cases the Supreme Court upheld the validity of section 89 despite all its imperfections and liberally applied the principle of purposive construction to make it workable. It held that, despite the mandatory nature of the provision, unwilling parties to arbitration or conciliation cannot be referred by the court without their consent.<sup>325</sup> In one of these cases, *Afcons Infrastructure*, the court comprehensively guides judges regarding the procedure they should take under section 89, even providing non-exhaustive categories of cases that are suitable or unsuitable for alternative dispute resolution.<sup>326</sup> The court concluded that while implementing section 89 in its literal sense would "be a Trial Judge's nightmare," its objective is "is laudable and sound."<sup>327</sup>

<sup>319</sup> *Union of India v Singh Builders Syndicate* (2009) 4 SCC 523.

<sup>320</sup> Sarma et al., "Development and Practice of Arbitration in India," 16. Arbitrators' fees are said to vary from Rs 1000 to Rs 50,000 (approx. US\$18 to US\$907) per hearing depending on their professional standing and the size of the claim.

<sup>321</sup> Namrata Shah and Niyati Gandhi, "Arbitration: One Size Does Not Fit All: Necessity of Developing Institutional Arbitration in Developing Countries," *Journal of International Commercial Law and Technology* 6, no. 4 (2011).

<sup>322</sup> "Govt Proposes Major Changes in Arbitration Act," *The Times of India* (April 9 2010), online: <articles.timesofindia.indiatimes.com>.

<sup>323</sup> *Ibid.*

<sup>324</sup> *Afcons Infrastructure Ltd v Cherian Varkey Consturction Co (P) Ltd* (2010) 8 SCC 24, para 7; *Salem Advocate Bar Association v Union of India* 2003 (1) SCC 49; *Salem Advocate Bar Association v Union of India* 2005 (6) SCC 344.

<sup>325</sup> *Afcons*.

<sup>326</sup> *Afcons*, paras 29-33.

<sup>327</sup> *Afcons*, para 7.

There is a parallel here with public interest litigation whose goal was for courts to uphold law in action and ensure that written laws are activated, enforced, and relevant.<sup>328</sup> In *Afcons*, judge-made law fills in the significant procedural gaps and ambiguities left open by the poorly scripted yet commendable intentions of the provision promoting alternative dispute resolution. In 2011, the Law Commission of India responded with a report proposing amendments to section 89 stating, "it is high time that the section is recast on the lines suggested by the Supreme Court."<sup>329</sup>

The Court has taken necessary steps to ensure judges have the tools to embrace the intent of section 89 of the *Code*, but it also specified that for mediation, *lok adalats*, and judicial settlements, the judge does not require the parties' consent. Recent amendments to *lok adalats* have raised concerns over the voluntariness of the process itself. The 2002 amendment to the *Legal Services Authority Act, 2002*, specifies that:

The Permanent Lok Adalat shall, while conducting conciliation proceedings or deciding a dispute on merit under the Act, be guided by the principles of natural justice, objectivity, fair play, equity and other principles of natural justice, and shall not be bound by the Code of Civil Procedure, 1908 and the Indian Evidence Act, 1972 [emphasis added].<sup>330</sup>

Some *lok adalats* are therefore authorized, upon a plain reading of this provision, to go beyond arranging settlements and may decide disputes on their merits, guided only by broad principles of natural justice. Galanter and Krishna argue that not only does a claimant risk being diverted into alternative dispute resolution against his or her wishes, but they may have a judgment issued against them based on the merits, which would be "final and binding" with no appeal.<sup>331</sup>

In Galanter and Krishnan's view, such amendments and reform efforts raise important questions about the limitations of informal justice. They dispel the "romantic illusion" that informal justice can be an effective alternative to a strong, proficient, and formal system and that it could be enjoyed without the cost of repairing the formal system.<sup>332</sup> Rather, the authors argue that informal systems work because parties could otherwise bring the matter before the courts and for this reason the remedies sought informally cannot be detached from a flourishing formal court system: "the only way to give better remedies by informal settlements in the shadow of law is to give better remedies in the courts."<sup>333</sup>

In effect, by diverting resources and reform energy away from improving the efficiency and effectiveness of lower courts, this has impacted both the court system and alternative dispute resolution by imposing costs on the settlements achieved. Galanter and Krishnan argue that potential users avoid the lower courts primarily

<sup>328</sup> *LIC of India v Consumer Education Research & Centre* (1995) Supp 1 SCR 349, cited in Robinson, "Expanding Judiciaries," 48.

<sup>329</sup> *Amendment of Section 89 of the Code of Civil Procedure, 1908, Report No. 238*, (Government of India, Law Commission of India, 2011), 5.2.

<sup>330</sup> India, *Legal Services Authority (Amendment) Act, 2002*, No 37 of 2002, s 22D.

<sup>331</sup> Galanter and Krishnan, "Bread for the Poor," 832.

<sup>332</sup> Galanter and Krishnan, "Debased Informalism," 120.

<sup>333</sup> *Ibid.* The notion of bargaining in the shadow of the law derives from Mnookin & Kornhauser's 1979 work and empirical studies such as Coursey and Stanley's in 1988 and Korobkin and Guthrie's in 1994 and 1997. They have examined the process of negotiation and settlement in the shadow of formal litigation procedures. R. H. Mnookin and L. Kornhauser, "Bargaining in the Shadow of the Law: The Case of Divorce," *Yale Law Journal* 88 (1978). D.L. Coursey and L. R. Stanley, "Pretrial Bargaining Behavior Within the Shadow of the Law: Theory and Experimental Evidence," *International Review of Law and Economics* 8, no. 2 (1988); R. Korobkin and C. Guthrie, "Psychological Barriers to Litigation Settlement: An Experimental Approach," *Michigan Law Review* 93 (1994); R. Korobkin and C. Guthrie, "Psychology, Economics, and Settlement: A New Look at the Role of the Lawyer," *Texas Law Review* 76 (1997).

because “lawyers and courts are able to deliver so little in the way of remedy, protection, and vindication.”<sup>334</sup> Instead, courts are useful for those who want to postpone paying their debts or to stall legal action: “Generally, they serve those who benefit from delay and non-implementation of legal norms – that is, parties who are satisfied with the status quo (as it is *ex ante* or after obtaining an interim order)”<sup>335</sup> Moreover, the quality of settlements negotiated by way of alternative dispute resolution may be efficient but are discounted to the extent that they factor in the remedial deficits of the court system – an outcome which Galanter and Krishnan describe as “debased informalism.” They state,

ideally the flaws in the system would act as a stimulus for reform; in reality, they simply have led to the creation of institutions to bypass the courts. Reformers take pride in delivering needed compensation more expeditiously to victims. But the elements of the system that make discounted compensation appear to be a benefit go unexamined. *Lok adalats* then, are an instance of *debased informalism* – debased because they are commended not by the virtues of the alternative process but by the need to escape the formal institutional process.<sup>336</sup>

These issues raise a variety of fundamental questions over the limitations of alternative dispute resolution within the Indian context. Generally, a well-functioning arbitration system is essential to accommodate demand for dispute resolution efficiently and effectively within the realm of commerce and trade. If there is political will to improve and raise arbitration to world standards, in practice, the legislative framework still awaits necessary amendments. As for *lok adalats*, the issue of parties’ consent, binding awards without appeals, and the extent to which parties participate in the settlement process raises serious concerns. Moog raises the following key issues:

Questions remain surrounding the quality of justice dispensed, the impact an alternative has on the case flow in the formal courts, whether access to justice is facilitated, and whether the legal culture of the courts bleeds into the new forums, corrupting their processes and negating some of the intended benefits. All these issues require far more intensive study before conclusions regarding the value of courtroom alternatives can be reached.<sup>337</sup>

Galanter and Krishnan’s contribution to this field is valuable because they emphasize that reform of alternative dispute resolution cannot be achieved at the expense of efforts to improve the formal court system, especially the lower courts. Lack of consent undermines the voluntariness that is an integral part of compromise and settlement. Thus, the extent of dysfunction within the court system will continue to distort the quality of settlements that could otherwise be achieved. In their view, without direct reform towards the lower and subordinate courts that alternative dispute resolution is intended to supplant, the means to build a culture of settlement will remain compromised.

## CONCLUSION

The overarching objective of this examination into the judiciary across the BRICs has sought to highlight the rise of the judiciary’s unique potential to enforce the principles of democratic accountability. This is especially in light of decentralization and in the face of public authorities abdicating their responsibilities. It is here that judicial authority has the capacity to supplant deficiencies in the other branches of government by taking a leadership role, putting law in action, and upholding a system that is predictable and non-arbitrary. India’s public interest litigation exemplifies how an active judiciary can shape and preserve constitutional principles in the face of political conflict. The discussion surrounding alternative dispute resolution in India reveals how judge-made law has attempted to rectify serious deficiencies in a poorly crafted law, to make it workable, and to activate its objectives.

The judiciary across Brazil, Russia, and India has struggled in varying degrees to achieve an optimal balance between judicial independence and judicial accountability, despite distinctions between the scope of judicial power each enjoys. Of notable mention is the recent approach taken by India’s government to ameliorate accountability within the judiciary through a significant increase in judges’ salaries. Global actors and the media have exposed corruption which has shed light on the need for transparent mechanisms to hold public actors accountable. The judiciary is not immune to corrupt practices, but accountability measures have proven difficult to implement for fear of encroaching upon judicial independence. China’s judiciary stands out as unique given the regime’s autocratic one-party rule and the judiciary’s embedded position in government. A key challenge for China in the coming years is to slowly expand the scope of judicial authority so that judges can begin to resolve the wide number of disputes that are currently impeded from accessing courts. China’s judiciary is defined by great deference to hierarchical structures which, in its opacity, creates conditions that give rise to corruption.

Of the four countries, Russia’s judiciary stands out as the outlier for several reasons. Russia ranks as the weakest overall in *de facto* judicial independence, significantly lower than China even, which reveals the extent to which meaningful and real independence has not yet been achieved. Such results suggest powerful vested interests are capable of exerting substantial influence to produce “correct” judgments – as the 2004 *Three Whales* case and the 2008 *Boyev v Solovyov* libel case demonstrate. The European Court of Human Rights has emerged as a key check on domestic disputes involving Russian authorities. To curb this process, Russia has begun reform efforts to impede access to justice beyond its borders, a phenomenon that sets Russia apart and solidifies its outlier status. This represents a critical juncture for the judiciary to build legitimacy where expanded judicial authority may provide the opportunity to demonstrate strengthened judicial independence. Drawing on the Indian experience, Russia may also take its cue to occupy a greater presence in governance, especially in light of the wide disparity between written law and law in practice. For this reason, the Russian judiciary is at a distinct juncture in its political and economic development – the judiciary ought to have space to occupy a greater interventionist role and activate the potential of its governance responsibilities. In Russia, it is clear that the opportunity to build the rule of law to foster economic development may be measured in the years to come by the extent to which the judiciary takes up this challenge.

<sup>334</sup> Galanter and Krishnan, “Debased Informalism,” 100.

<sup>335</sup> Jagannadha M. Rao, “Arbitration and ADR in India,” in *Alternative Dispute Resolution: What It is and How It Works*, ed. P. C. Rao and W. Sheffield (Delhi: Universal Law Publications, 1997) cited in Galanter, “To the Listed Field,” 73.

<sup>336</sup> Galanter and Krishnan, “Debased Informalism,” 116.

<sup>337</sup> Moog, “The Study of Law and India’s Society: The Galanter Factor,” 135.

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# SECTION 5:

## Corruption Across the BRIC Countries

### INTRODUCTION

The BRIC countries have achieved high levels of economic growth in the last decade despite high levels of corruption in every sector. Corruption and economic growth are so intertwined that it is difficult to tell whether corruption hinders what would otherwise be faster growth or if the economic growth will eventually hinder corruption.<sup>1</sup> This riddle may be answered in part by Glaeser and Goldin's research in 2006, which surveyed corruption in the US for a period of nearly 100 years.<sup>2</sup> Their research showed that corruption increased in periods of rapid economic growth but fell again in periods of slower growth when regulation and governance were able to catch up. Their theory was that in periods of steady but not too frenzied growth institutions became more robust and could catch up to new illegal practices and stamp them out. Corruption is a challenge for every economy and in some ways the BRIC's experiences are not unique.<sup>3</sup> All countries struggle with the grey areas between patronage and cronyism, lobbying and influence peddling, regulation and regulatory capture. Yet the sheer importance of these emerging economies coupled with the scale of the problem makes it important to comprehend their unique challenges.

It is impossible to accurately measure corruption because by its very nature it is murky, non-transparent, deceptive, secret, complicit, and above all complex. Indices can give us a picture of certain types of corruption or perceptions of corruption but they fail to capture complex phenomena involved in influence peddling and patronage. Indeed, empirical studies are increasingly revealing that in China, Brazil, and Russia incidences of bribery and extortion are decreasing, but it appears as though other types of more sophisticated corruption are growing. This makes the nature of corruption more reminiscent of western developed nations, but unfortunately the BRIC countries rapid growth has far outpaced the growth of their institutions. Below we will analyze the scale and nature of corruption in the BRIC countries by focusing on aspects of corruption in each country. Following that we will examine the accountability mechanisms, formal and informal, that exist to combat corruption in each country. It would be simply impossible to give a complete picture of each country so we have chosen to highlight practices that provide particular challenges to the economy and institutions and offer opportunities for comparison.

### WHY CORRUPTION?

Corruption has always been a salient moral and political issue, yet in the early 1990s it was recast as a global economic problem. Since then, corruption discourse has taken on a different magnitude and has come to dominate the field of development

<sup>1</sup> Alan Heston and Vijay Kumar, "Institutional Flaws and Corruption Incentives in India," *Journal of Development Studies* 44, no. 9 (2008), 1257-60.

<sup>2</sup> E. L. Glaeser and C. Goldin, *Corruption and Reform: Lessons from America's Economic History* (Chicago: University of Chicago Press, 2006); Jens C. Andvig et al., *Research on Corruption: A Policy Oriented Survey* (Norway: Chr. Michelsen Institute & Norwegian Institute of International Affairs (NUPI), 2000), 11.

<sup>3</sup> Daniel Kaufmann, "Corruption, Governance and Security: Challenges for the Rich Countries and the World," *SSRN Electronic Journal* (October 2004), online: <<http://ssrn.com/abstract=605801>>; 89.

studies, globalization studies, and any meaningful analysis of political institutions or economics.

In the 1980s following the Washington Consensus, the international financial institutions – the World Bank and International Monetary Fund – had predominantly been concerned with fostering economic development without overtly engaging in politics. They remained reluctant to engage with the issue of corruption as it was deemed too political, hence beyond their scope. In the 1990s, however, it became increasingly clear that in order to achieve long-term economic growth, close attention must be paid to the role of institutions and governance. Until the 1990s, corruption was defined primarily using a cultural or moral definition – one that lacked universal applicability. Once it became clear, however, that corruption was detrimental to economic efficiency, the World Bank and International Monetary Fund started to address the issue of combating corruption by building in anti-corruption clauses to various aid and loan arrangements. This coincided with the emergence of a universal redefinition of corruption as "abuse of public office for private gain" spearheaded by the NGO Transparency International.<sup>4</sup> Rather than an intractable moral issue, corruption became "an economic development issue, a competitiveness issue and an issue of political accountability" and one that meshed well with overall discussions of governance and development.<sup>5</sup> Thus, the World Bank and International Monetary Funds' concerns with overstepping political boundaries have largely informed the new notions of governance and corruption.<sup>6</sup>

1996 was a turning point in the globalization of corruption discourse. James Wolfensohn, director of the World Bank, stated that "corruption is a cancer" and one of the single most important impediments to economic growth.<sup>7</sup> The US government also played a significant role in directing the discourse on corruption control. By the end of the 1990s the European Union; the G7; the OECD; the Inter-American, European, and Asian Development Banks; the Asia-Pacific Economic Cooperation Forum; the Global Coalition for Africa; the Organization of American States; the International Chamber of Commerce; the World Economic Forum; and the Open Society Institute had all made corruption a priority. In 1996 the UN adopted the *Declaration against Corruption and Bribery in International Commercial Transactions*.<sup>8</sup> The result is that there is now an "anti-corruption consensus" supported by most international organizations.

### DEFINITION

Corruption often eludes definition and the way that a researcher defines it can shape their outcomes and conclusions. It is generally understood to mean some form of wrongdoing that is hurtful to a country's economic or democratic development. As such, there is a consensus that it has negative consequences, even if its actual meaning is not fixed. Its meaning is tainted by moral considerations, as Haller and Shore have argued, as corruption is added to the list of those negative characteristics that

<sup>4</sup> Vinay Bhargava, "Curing the Cancer of Corruption," in *Global Issues for Global Citizens* (The World Bank, 2006), 1. See also Hongying Wang and James N. Rosenau, "Transparency International and Corruption as an Issue of Global Governance," *Global Governance* 7, no. 1 (2001), 31-40.

<sup>5</sup> R. Michael Gadbow, "International Anticorruption Initiatives: Today's Fad or Tomorrow's New World," *American Society of International Law Proceedings* 91 (1997), 112.

<sup>6</sup> Dieter Haller and Cris Shore, *Corruption: Anthropological Perspectives* (Ann Arbor, M.I.: Pluto, 2005), 17-19.

<sup>7</sup> James D. Wolfensohn, "People and Development: Address to the Board of Governors at the Annual Meetings of the World Bank and the International Monetary Fund," in *Voice for the World's Poor: Selected Speeches and Writings of World Bank President James D. Wolfensohn 1995-2005* (Washington: World Bank, 1996), 50 cited in Bhargava, "Curing Cancer of Corruption," 1.

<sup>8</sup> UN, *United Nations Declaration Against Corruption and Bribery in International Commercial Transactions*, 86th Plenary Meeting (December 16 1996).

are typically applied to the “other” such as “underdevelopment, poverty, ignorance, repression of women, fundamentalism, fanaticism, and irrationality.”<sup>9</sup> Academics, policy makers, and economists have all attempted to define corruption in some way, but all definitions are either too narrow or too broad, all are incomplete. The following are a few ways that academics have sought to define corruption.

The World Bank and OECD adhere to a variant of the definition “abuse of public office for private gain.”<sup>10</sup> This definition is a category of the “arms-length” principle which posits that public and private interests must remain distinctly separate and no personal relationship should play a role in administrative or economic decision-making. This definition is problematic, on the one hand, because it does not adequately describe “abuse.” Abuse could constitute breaking laws. Yet, positive laws often don’t address all types of corruption and poorly reflect the public’s normative notions of corruption.<sup>11</sup>

Some adherents to the “abuse of public power” definition have suggested that this definition is necessarily abstract and that “public interest,” “abuse,” and “public office” are all inherently flexible terms that can be adapted to different contexts and must be viewed according to subjective standards.<sup>12</sup> Such a position suggests that the definition can be adapted to different national domestic contexts that have alternative norms. Yet, it is still premised on the notion that there is a distinct difference between public and private spheres. In reality, all countries grapple with blurred boundaries between public and private. Finally, this definition implies that corruption emanates from the state and does not take into account corruption that occurs between private agents or the influence that private agents may wield over a public official.

Another type of definition of corruption known as the “transaction” or “interaction” model suggests that instead of looking at behaviour it is necessary to look at the nature of transactions or interactions between actors. It is argued that corruption arises at the point when a public official “transacts” with a private actor through which collective goods are illegitimately converted into private-regarding payoffs.<sup>13</sup> This definition is closely linked to Principal-Agent-Client model of corruption in which an agent (perhaps civil servant) interacts with a client (member of public) on behalf of the principal (state or government). This definition of corruption “defines corruption in terms of the divergence between the principal’s or the public’s interests and those of the agent or the civil servant: corruption occurs when an agent betrays the principal’s interest in pursuit of her own.”<sup>14</sup> Corruption occurs when the *transaction* between the agent and the client is either in direct conflict with the principal’s (public’s) interest or else the benefits of the transaction are not passed on to the principal. While this definition is compelling, it is not easy to define what is in the principal’s interest, especially when it can be as abstract as “public interest.” In many situations, especially that of grand corruption, it is next to impossible to separate the agent from the principal.<sup>15</sup>

Another way to define corruption is to classify it in terms of its consequences, often known as “levels of corruption.” These levels are petty corruption, mid-level corrup-

tion, grand corruption, and systemic corruption. This categorization is concerned with all actors in the corrupt transaction and not just the integrity of state officials. Ouzounov argues that this model classifies corruption “based not only on the size of the bribe, but also on the motive behind the bribe.”<sup>16</sup> Thus petty corruption is explained on the basis of poorly remunerated administrators, scarce public resources, red tape, and complicated bureaucracy. Grand corruption is more complicated and is motivated by greed rather than need. It includes administrative corruption, bid-rigging, public procurement kickbacks, and other complicated forms of private wealth gain. This way of understanding corruption, however, becomes murky when deciding the boundaries between petty and mid-level corruption and so on.

A cultural definition of corruption rejects the notion that corruption has a universal definition or that the term itself is apolitical. It goes beyond the study of corruption as related to political institutions and asks whether the problem is even translatable across cultures. Anthropologists have argued for sensitivity to different cultural contexts, without going so far as to relativize or essentialize the culture to the point of justifying the corruption.<sup>17</sup> As Lovell argues:

In many countries corruption is a much more complex problem connected with transition from one political, cultural and organizational culture to another. The normative basis of ‘corruption’ in such countries is not established, and public officials rely now on one and now on another understanding of their role.<sup>18</sup>

We believe that Transparency International’s definition “the misuse of entrusted power for private benefit” is the best working definition.<sup>19</sup> It manages to capture the actions of the state as well as private actors in positions of trust. We acknowledge that it still lacks specificity about what standards must be applied to the words “misuse,” “entrusted power,” and “private benefit.” We also acknowledge that it places undue emphasis on the originators of corruption rather than the facilitators of corruption. In our section on tax evasion we will discuss why corruption needs to take into account the agents who facilitate corruption through tax avoidance and secrecy jurisdictions. As a result, we compliment this definition by examining corruption through different angles, by looking at types of corruption, levels of corruption, and corruption as a transaction. Where possible we are careful to acknowledge the limitations of a particular approach as well as understand cultural nuances and differences in the application of the definition.

## SCALE AND NATURE OF CORRUPTION

In the following section we will discuss the nature and scale of corruption in the BRIC countries, focusing mostly on the experience of Russia, but looking at China, Brazil, and India to provide comparisons. We will begin by looking at petty corruption and its effect in increasing economic inequalities and weakening the public’s trust in institutions in India and Russia. Then we will look at mid-level corruption, through the lense of administrative corruption or transaction based corruption in the business sector in Russia, India, and Brazil. Next we will look at the role of informal patronage networks in the business environments of China and Russia, fol-

<sup>9</sup> Haller and Shore, *Corruption: Anthropological Perspectives*, 3.

<sup>10</sup> Bhargava, “Curing Cancer of Corruption,” 1; OECD, “Corruption,” *Glossary of Statistical Terms* (2002), online: <<http://stats.oecd.org/glossary/detail.asp?ID=4773>>.

<sup>11</sup> Michael Johnston, “The Search for Definitions: the Vitality of Politics and the Issue of Corruption,” *International Social Science Journal* 48, no. 149 (1996), 323.

<sup>12</sup> Heba Shams, “Globalisation and the Definition of Corruption: Implications for Criminal Law,” *Yearbook of International Financial and Economic Law* 4 (1999), 378.

<sup>13</sup> Arnold J. Heidenheimer, “Perspectives on the Perception of Corruption,” in *Political Corruption: A Handbook*, ed. Arnold J. Heidenheimer, Michael Johnston, and Victor T. LeVine (Transaction Publishers, 1989), 149.

<sup>14</sup> Robert E. Klitgaard, *Controlling Corruption* (Berkeley: University of California Press, 1988), 24.

<sup>15</sup> For criticism of the Principal-Agent-Client model see Johnston, “The Search for Definitions,” 326.

<sup>16</sup> Nikolay A. Ouzounov, “Facing the Challenge: Corruption, State Capture and the Role of Multinational Business,” *John Marshall Law Review* 37 (2003), 1186.

<sup>17</sup> Haller and Shore *Corruption: Anthropological Perspectives*, 232.

<sup>18</sup> David Lovell, “Corruption as a Transitional Phenomenon: Understanding Endemic Corruption in Postcommunist States” in Shore and Haller, *Corruption: Anthropological Perspectives*, 70.

<sup>19</sup> Jeremy Pope, *Confronting Corruption: The Elements of a National Integrity System*, Transparency International Sourcebook, (Berlin: Transparency International, 2000), 13.

lowed by a description of the effect of corruption on foreign investors in all four economies. We will also look at the interaction between corruption, tax evasion, and capital flight and the challenges that they pose for rule of law and the economic development. Lastly we acknowledge briefly the role of organized crime in corruption.

Before embarking on the analysis, a word of caution on quantitative analyses. One of the largest problems in studying BRIC economies is the sheer size of the countries and diversity of sectors. While one region in India may be making great strides in combatting corruption it may be tarnished with the reputation of the entire country. Corruption perception surveys notoriously exaggerate “experiences” of corruption, yet this may not mean that their results are in themselves unimportant. Perception indices may be capturing types of information and corruption that cannot be captured in “experiences” of corruption surveys.<sup>20</sup> “Experiences” surveys are often only able to measure instances of specific transactions rather than more tangled webs of collusion.<sup>21</sup> Collusion often does not involve specific transaction amounts but rather trades in influence, privilege, or the offer of a benefit rather than a specific monetary amount. For example, according to Russia’s Federal Security Agency and General Prosecutor’s Office the greatest number of complaints received from citizens involves extortion by a public official rather than bribery, yet surveys repeatedly show that incidences of extortion are decreasing.<sup>22</sup> For these kinds of results it is more productive to look at qualitative studies, mostly offered by the media, which may present a glimpse, if incomplete, of the nature of systemic corruption, grand corruption, or state capture.

## PETTY CORRUPTION

*Vishal is a street vendor who sells chicken takeaway to the citizens of New Delhi. Every month he is required to pay off the police officers so he can stay open late; health inspectors, safety inspectors, and hygiene inspectors; his children’s headmaster; and the official regulating drivers’ licences. He estimates that a third of his income goes to paying bribes so that he can run his business and keep his children in a good school.<sup>23</sup>*

The very name – petty – underestimates the importance of this type of corruption. Petty corruption often involves payments of small bribes, kickbacks, or incidences of extortion. Businesses and citizens engage in petty corruption to access services either with the state or the private sector. This type of corruption involves persons in positions of trust distorting the *implementation* of rules. These involve small sums and are often associated with essential government services such as healthcare, secondary education, utilities, law enforcement, safety inspections, or licensing businesses. Quantitatively, petty corruption has a small impact on the economy, but it still has devastating repercussions. First, since petty corruption occurs at the interface between citizen and enterprise (public or private) it can undermine the entire credibility of the institution. Second, petty corruption has a greater impact on the most economically vulnerable people whether they are citizens or small businesses. Third, it distorts the quality of the service delivered. Finally, petty corruption has been shown to alienate citizens from institutions either because they wish to avoid the bribery or

because it can create a barrier to entering new sectors or accessing services. Russia and India provide interesting comparisons, which exemplify these repercussions.

Most empirical evidence on petty corruption analyzes incidences between citizens and the state. This is a natural result of defining corruption as “abuse of public office for private gain.”<sup>24</sup> We emphasize, however, that petty corruption can exist in the private sphere, for example, where a bank manager asks for a bribe to approve a loan.

**Table 5.1:** Percentage of People who have Paid a Bribe in the last year (2009)

BRAZIL	4%
CHINA	9%
INDIA	54%
RUSSIA	26%

Source: *Global Corruption Barometer, Global Dataset 2009* online: <[http://www.transparency.org/research/gcb/gcb\\_2009](http://www.transparency.org/research/gcb/gcb_2009)>.

Everyday Russian citizens perceive petty corruption to be high, yet recent surveys indicate that their actual experiences are relatively low compared to India. According to the *Global Corruption Barometer* only 26 percent of Russians said that they had paid a bribe in the last year compared to 54 percent of those surveyed in India (see table 5.1).<sup>25</sup> In a 2007 study from the Centre for Study of Public Policy, Russian citizens were asked what their perception of corruption in a certain sector was and then later asked if they or anyone in their household had paid a bribe in that sector in the past two years (see figure 5.1). Across seven sectors (health, education, military service, education, permit office, social security, and tax inspectors) an average of 70 percent of those surveyed believed these sectors to be corrupt while only 5.5 percent had paid a bribe in the last two years to access those services.<sup>26</sup> The *Global Corruption Barometer 2010* indicates a similarly wide gap between perception and experience (see table 5.2). The discrepancy between perceptions of corruption and actual contact with corruption is similar for China and Brazil.<sup>27</sup> In their work on the gap between perception and experience of corruption, Rose and Mishler theorize that the perception of corruption is largely fuelled by hearing about corruption from friends and the media.<sup>28</sup> Importantly, the perception of the corruption in turn fuels distrust in the state, delivery of services and social goods, and undermines state institutions.

<sup>20</sup> Charles Kenny et al., “A Trio of Perspectives on Corruption: Bias, Speed Money and ‘Grand Theft Infrastructure,’” *SSRN Electronic Journal* (2011), online: <<http://ssrn.com/abstract=1965920>>, 6.

<sup>21</sup> “TII-CMS India Corruption Study 2007: With Focus on BPL Households,” (Transparency International CMS India, 2007).

<sup>22</sup> “Scorecard: Russian Federation 2010,” in *Global Integrity Report* (Washington, DC: Global Integrity, 2010), 76a.

<sup>23</sup> Jason Burke, “Corruption in India: All Your Life You Pay For Things That Should Be Free,” *The Guardian* (August 19 2011), online: <<http://www.guardian.co.uk>>.

<sup>24</sup> Kaufmann, “Corruption, Governance, and Security,” 89.

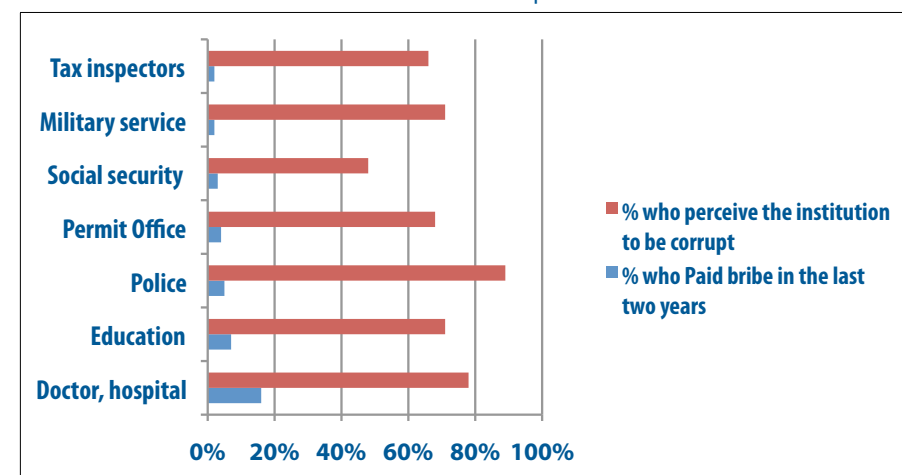
<sup>25</sup> *Global Corruption Barometer, Global Data Set 2009*, (Berlin: Transparency International, 2009) online: <<http://www.transparency.org/research/gcb/overview>>.

<sup>26</sup> Centre for the Study of Public Policy, *New Russia Barometer XV 13-24 April, 2007* cited in Richard Rose and William Mishler, “Experience versus Perception of Corruption: Russia as a Test Case,” *Global Crime* 11, no. 2 (2010), 153.

<sup>27</sup> *Global Corruption Barometer, Global Data Set 2010*, (Berlin: Transparency International, 2010) online: <<http://www.transparency.org/research/gcb/overview>>.

<sup>28</sup> Rose and Mishler, “Experience v Perception,” 156.

**Figure 5.1:** Percentage of Individuals who Experience Corruption versus Percentage of Individuals who Perceive those Institutions as Corrupt in Russia



Source: Centre for the Study of Public Policy, New Russia Barometer XV 13-24 April, 2007.

Note: Chart comes from Richard Rose and William Mishler "Experience versus Perception of Corruption: Russia as a Test Case" *Global Crime* 11 no. 2, 145-63.

**Table 5.2:** Percentage of Individuals who Experience Corruption versus Percentage of Individuals who Perceive that those Institutions are Corrupt

	Public Officials/ Civil Servants						
	POLICE	JUDICIARY	EDUCATION SYSTEM	REGISTRY AND PERMIT SERVICES	TAX REVENUE	TAX REVENUE	LAND SERVICES
<b>BRAZIL</b>	6%	2%	1%	3%	2%	1%	0%
	62%	42%	19%		36%		
<b>CHINA</b>	9%	14%	4%	10%	8%	10%	28%
	48%	37%	35%		52%		
<b>INDIA</b>	64%	45%	23%	62%	51%	63%	41%
	75%	41%	51%	54%			
<b>RUSSIA</b>	28%	18%	19%	9%	6%	20%	11%
	68%	57%	58%		66%		

White row represents the percentage who have paid a bribe to the institution in the last year  
 Gray row represents the percentage of respondents who view institution as corrupt

Source: Transparency International *Global Corruption Barometer*, Global Dataset 2010/2011, online: <[http://gcb.transparency.org/gcb201011/in\\_detail/](http://gcb.transparency.org/gcb201011/in_detail/)>.

Nevertheless, Russian experiences of corruption are still relatively high and citizens appear to prefer to avoid the service than engage with the corruption. Information Science for Democracy (INDEM) statistics, which compare consumers' experiences of corruption, suggest that pressure to bribe was rising whereas consumers' willing-

ness to pay is actually decreasing.<sup>29</sup> Whereas in 2001 75 percent of citizens seemed ready to pay a bribe in 2005 only 53 percent of citizens were.<sup>30</sup> Thus, even though slightly more citizens were *expected* to pay bribes, citizens were less willing to actually pay the bribe. Of those who were not willing to give a bribe they resolved the problem by finding other solutions or gave up altogether (see table 5.3). This suggests that a majority of Russians have found alternative methods of accessing services, potentially through informal networks or else they are choosing to avoid the services altogether. INDEM does seem to indicate, however, that for those who do decide to bribe the rates are going up steeply – they estimate that the total amounts spent on bribes were US\$2,825 billion in 2001 and US\$3,014 billion in 2005.<sup>31</sup> The unfortunate consequence of this trend is that a large portion of citizens are avoiding these services to avoid the corruption. This is corroborated by the fact that non-optional services, such as healthcare, still retain the highest incidences of bribery (see figure 5.1).<sup>32</sup> Thus petty corruption may be causing citizens to avoid services rather than engage in bribery.

**Table 5.3:** Reasons why Individuals did not Give a Bribe

The individuals who did not give a bribe when confronted with corruption were asked: "Were you able to resolve the problem without giving a bribe or "gift," or did you give up on your attempts to resolve the problem?"	2005	2001
<b>YES, I WAS ABLE TO RESOLVE THE PROBLEM WITHOUT A BRIBE OR GIFT.</b>	68.3%	49.8%
<b>NO, I WAS NOT ABLE TO RESOLVE THE PROBLEM WITHOUT GIVING A BRIBE OR GIFT AND I GAVE UP ON ATTEMPTS TO RESOLVE THE PROBLEM.</b>	31.7%	45.1%
<b>REFUSED TO RESPOND</b>	0%	5.1%

Source: Sigsbee, Cheryl Ann, and Victor Konovalenko. "The Mirror of Russian Corruption: Are We Foreigners In It? A Review of Indem's Research on Corruption in Russia" (2005) online: <[www.indem.ru/en/publicat/CherylCorrup09.htm](http://www.indem.ru/en/publicat/CherylCorrup09.htm)>.

Indian private citizens and businesses experience the highest levels of petty corruption among all the BRIC economies. Business surveys and surveys of private citizens consistently indicate that they experience corruption roughly 50 percent of the time when interacting with the state (see tables 5.1 and 5.3).<sup>33</sup> This remains true despite the fact that Indian citizens have the lowest frequency of contact with the state compared to the citizens of other BRIC countries.<sup>34</sup>

Petty corruption devastates those that are most economically disadvantaged.<sup>35</sup> A seven dollar bribe will have much more of an impact for someone who earns one dollar a day than someone who earns ten dollars a day.<sup>36</sup> One of the most extensive

<sup>29</sup> "Diagnostics of Russia Corruption 2005 – Preliminary Results," (2005), online: <[www.indem.ru/en/Publicat/2005diag\\_engV.htm](http://www.indem.ru/en/Publicat/2005diag_engV.htm)>.

<sup>30</sup> Cheryl Ann Sigsbee and Victor Konovalenko, "The Mirror of Russian Corruption: Are We Foreigners In It? A Review of INDEM's Research on Corruption in Russia," (2005), online: <[www.indem.ru/en/publicat/CherylCorrup09.htm](http://www.indem.ru/en/publicat/CherylCorrup09.htm)>.

<sup>31</sup> "Diagnostics of Russia Corruption 2005 – Preliminary Results."

<sup>32</sup> Centre for the Study of Public Policy, New Russia Barometer XV 13-24 April, 2007 cited in Rose and Mishler, "Experience v Perception," 153.

<sup>33</sup> *Global Corruption Barometer*, Global Data Set 2010; *Global Corruption Barometer*, Global Data Set 2009.

<sup>34</sup> *Global Corruption Barometer*, Global Data Set 2010.

<sup>35</sup> Celia W. Dugger, "Where a Cuddle with Your Baby Requires a Bribe," *The New York Times* (August 30 2005), online: <[www.nytimes.com](http://www.nytimes.com)>.

<sup>36</sup> *Ibid.*

ongoing surveys of petty corruption India is the Transparency International partnership with the Centre for Media Studies.<sup>37</sup> Their research has discovered that one of the most important reasons for bribing in “basic” and “needs based” services is when the citizen wishes to *enter* the sector. For example, they are asking for their utilities to be hooked up for the first time, they are wishing to *enter* school for the first time, or they are asking for a *new* land-registry permit. This is as opposed to bribing for ongoing maintenance, repair, changing a certificate, or requesting a scholarship at school.<sup>38</sup> This indicates another way in which petty corruption increases inequality, since new users are automatically required to pay a “new-user” tax in the form of a bribe. Thus the poor are charged a regressive tax and are being shut out from services before ever engaging with them. This “shutting-out” conclusion applies equally to start-up businesses. Indeed, research detailed in the institutions section of this report reveals how institutions play an important role in regulating new firm entry. Graf Lambsdorff showed how petty corruption does more to deter foreign direct investment than grand corruption, precisely because it puts up barriers to entry. He found a direct correlation between petty corruption in utilities and low levels of foreign direct investment.<sup>39</sup>

Petty corruption is likely to distort the intended quality of the service. In a case study involving obtaining drivers’ licences, Bertrand discovered that bribery significantly distorts and undermines the quality of regulating drivers’ licences. Bribes are not just paid to jump lines, but often allow an individual, who does not have the qualifications, to obtain a driver’s licence.<sup>40</sup> This distortion of services is liable to occur in any sector that is intended to regulate quality such as health and building inspections. Indeed, this is thought to be the reason why so many buildings collapsed unnecessarily during the earthquake in Sichuan province in China.<sup>41</sup>

Petty corruption damages the economy by preventing citizens from accessing services which could otherwise level the economic playing field and help the poorest out of poverty. It erodes public trust in those institutions, even if the actual experiences of corruption are not very high. Many of the conclusions of this section relating to access to services and economic inequalities can equally apply to forms of transactional corruption in the business sector.

### TRANSACTIONAL CORRUPTION IN THE BUSINESS SECTOR

This section looks at the nature and scale of what is sometimes called *administrative corruption* or *transactional corruption* which affects the business sector. This type of corruption is more often than not based on gifts, payments, or some sort of transaction which has been made to influence the implementation of administrative rules.<sup>42</sup> Because of its transactional nature it is slightly easier to measure by asking respondents to identify when they last paid a bribe, how much, and how often. The only difference between this analysis and the analysis above is a question of degree, higher monetary amounts, and the particular distorting effects it has on the economy. While the amounts are significantly higher the repercussions for business can be similar to those of petty corruption. It can create and exacerbate inequalities between newer

<sup>37</sup> “TI-CMS India Corruption Study 2007”

<sup>38</sup> Ibid.

<sup>39</sup> J. Graf Lambsdorff, “Between Two Evils: Investors Prefer Grand Corruption!”, *Passauer Diskussionspapiere, Volkswirtschaftliche Reihe* 31, no. 05 (2005).

<sup>40</sup> Marianne Bertrand et al., “Obtaining a Driver’s License in India: An Experimental Approach to Studying Corruption,” *The Quarterly Journal of Economics* 122, no. 4 (2007), 1640.

<sup>41</sup> Tania Branigan, “China Jails Investigator into Sichuan Earthquake Schools,” *The Guardian* (February 9 2010), online: <guardian.co.uk>.

<sup>42</sup> Joel S. Hellman et al., “Seize the State, Seize the Day: State Capture, Corruption, and Influence in Transition,” *Policy Research Working Paper*, no. 2444 (2000), 2.

and older companies, state-owned and non-state owned, and large, medium, and small enterprises. The upper limit of this type of corruption is what is often referred to as state or regulatory capture, which we will discuss later in comparison with “influence” and grand corruption.

While a lot of valuable information exists on India, Russia, and Brazil, there is little information on China, which means that it is next to impossible to draw comparisons. Russian experts are lucky to possess a wealth of information on corruption in business because of successive *Business Environment and Enterprise Performance Surveys* (BEEPS) conducted by the European Bank for Reconstruction and Development (EBRD) and the World Bank in 1999, 2002, 2004, 2005, and 2009.<sup>43</sup>

**Table 5.4: Percentage of People Required to Give a Gift**

	Brazil (2009)	Russia (2009)	India (2006)
% OF FIRMS EXPECTED TO GIVE GIFTS TO PUBLIC OFFICIALS “ TO GET THINGS DONE”	11.9	39.6	47.5
% OF FIRMS EXPECTED TO GIVE GIFTS IN MEETINGS WITH TAX OFFICIALS	16.4	17.4	52.3
% OF FIRMS EXPECTED TO GIVE GIFTS TO SECURE A GOVERNMENT CONTRACT	0.7	39.0	23.8
% OF FIRMS EXPECTED TO GIVE GIFTS TO GET AN OPERATING LICENCE	5.4	22.2	52.5
% OF FIRMS EXPECTED TO GIVE GIFTS TO GET AN IMPORT LICENCE	1.2	50.2	46
% OF FIRMS EXPECTED TO GIVE GIFTS TO GET A CONSTRUCTION PERMIT	8.5	39	67
% OF FIRMS EXPECTED TO GIVE GIFTS TO GET AN ELECTRICAL CONNECTION	6.1	21.9	39.6
% OF FIRMS EXPECTED TO GIVE GIFTS TO GET A WATER CONNECTION	2.1	13.2	26.6
% OF FIRMS EXPERIENCING AT LEAST ONE BRIBE PAYMENT REQUEST	14.9	27.3	0.0

**Source:** World Bank, *IFC Enterprise Survey*, *Russian Federation Country Profile 2009*, *Brazil Country Profile 2009*, *India Country Profile 2006* (The World Bank: International Finance Corporation, 2009).

Enterprise surveys of Russia and Brazil indicate that contact with corruption is on average greater for businesses than it is for private citizens.<sup>44</sup> India’s statistics are staggering compared to Brazil and Russia. It appears to be the only BRIC country in which private citizens experience the same or more corruption than businesses. In

<sup>43</sup> Daniel Kaufmann et al., “Measuring Governance, Corruption, and State Capture: How firms and Bureaucrats Shape the Business Environment in Transition Economies,” *World Bank Policy Research Working Paper*, no. 2312 (2000); EBRD, “Business Environment and Enterprise Performance Survey (BEEPs)” *European Bank for Reconstruction and Development* (website) (May 8 2012) online: <http://www.ebrd.com/pages/research/economics/data/beeps.shtml>

<sup>44</sup> There are no current enterprise surveys that exist on China.



2006, an average 47.5 percent of firms report that they are expected to give gifts to public officials “to get things done” (see table 5.4). This is in contrast to 39.6 percent of Russian firms and 11.9 percent of Brazilian firms.

The International Finance Corporation’s *Enterprise Survey* for Brazil in 2009 shows that Brazilian entrepreneurs face few incidences of corruption.<sup>45</sup> Brazil, on average, experiences lower rates of bribery than other Latin American countries and far lower rates than both Russia and India. Interestingly, Brazil, experiences some of the longest administrative wait times and regulatory hurdles of any country in the world, including 139 days to obtain a construction related permit and 83 days to obtain an operating licence (see figure 5.2). These numbers are even higher for small and medium enterprises where the average time for a medium enterprise to obtain a construction permit is 202 days and it takes 115 days for a small enterprise to obtain an operating licence. Correspondingly, small and medium enterprises on average report that they are more often expected to give “gifts” to secure government contracts or construction permits than are larger enterprises. These administrative burden numbers are far higher across the board than the equivalent rates in India, Russia, and China (see figures 5.3 and 5.4). Considering experiences of corruption in the other BRIC countries are higher, this seems to suggest that the burden of regulation does not necessarily translate into higher rates of transactional corruption.

Figure 5.2: Number of Days to Overcome Regulatory Hurdles in Brazil



Source: *Brazil Country Profile 2009, IFC Enterprise Survey*, (The World Bank: International Finance Corporation, 2009)

Note: in the IFC survey a large enterprise is over 100 employees, a medium enterprise is 20-99 employees, and a small enterprise is 1-19 employees.

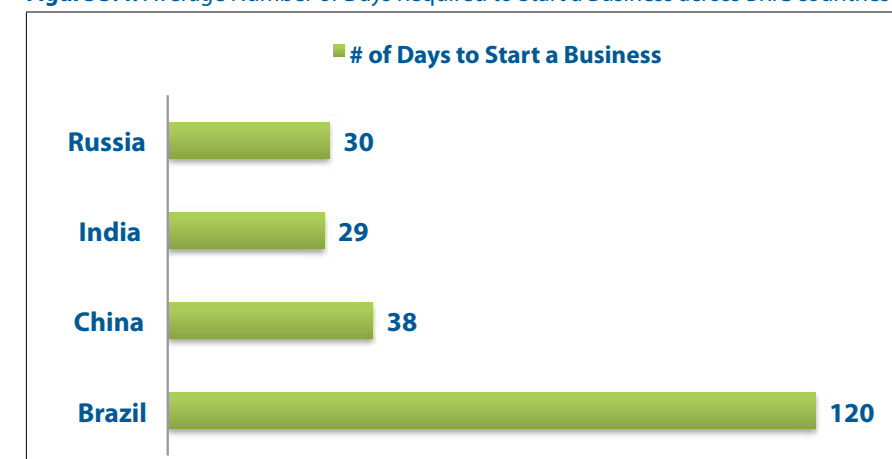
<sup>45</sup> *Brazil Country Profile 2009, IFC Enterprise Survey* (The World Bank: International Finance Corporation, 2009).

Figure 5.3: Number of Days to Overcome Regulatory Hurdles in Russia



Source: *Russia Country Profile 2009, IFC Enterprise Survey*, (The World Bank: International Finance Corporation, 2009)

Figure 5.4: Average Number of Days Required to Start a Business across BRIC countries



Source: *The Global Competitiveness Report 2011-2012*, ed. Klaus Schwab (Geneva: World Economic Forum, 2011).

Brazil’s statistics also highlight the great disparity between the weight of regulation experienced by large enterprises and small and medium enterprises (see figure 5.2). This suggests either that large enterprises have more experienced regulatory and legal teams who can navigate hurdles, they are favoured by administrators, or else that they are more prone to corrupt practices. The Hallward-Driemeier and Pritchett analysis explores differences between *Doing Business Indicators*, which reflect officially stated timelines, and enterprise surveys, which show actually experienced timelines.<sup>46</sup> They allude to the possibility that corruption may play a role in helping large firms navigate these regulations. The picture of Brazil’s entrepreneurial landscape suggests that rates of transactional corruption are on the decline despite high administrative hurdles. This in itself is a positive trend for corruption, but also highlights the inequalities faced by small and medium enterprises. It might also mask a phenomenon of more sophisticated corruption that is based less on transactions and more on influence.<sup>47</sup>

<sup>46</sup> Mary Hallward-Driemeier and Lant Pritchett, “How Business Is Done and The ‘Doing Business’ Indicators: The Investment Climate When Firms Have Climate Control,” *Policy Research Working Paper*, no. 5563 (2011), 7.

<sup>47</sup> The phenomenon of political interference is discussed at length in this report’s section on governance.

Unlike Brazil, large firms in Russia appear to be more appealing targets for corruption than small and medium enterprises (see figure 5.3).<sup>48</sup> Bureaucrats tend to target large rapidly growing “entrepreneurial” firms more often, but tend to avoid the firms that are growing more slowly or not doing as well.<sup>49</sup> They do so in an effort to extract more rents as they see more prosperous firms as wealthier and less vulnerable targets. This process has the effect of discouraging entrepreneurialism and effectively taxing successful firms.

Simply because large firms are more appealing targets of bribery in Russia, does not mean that small and medium enterprises are unaffected, however. Safavian et al. have studied the burden of corruption on small and very small enterprises in Russia.<sup>50</sup> They describe it as a regressive tax because small businesses are subjected to proportionally the same administrative corruption, compared to their means, as larger enterprises. Although larger firms are targeted they are better able to absorb the costs or wield influence that might offset the cost of bribing.<sup>51</sup> As a result, it has been detrimental to fostering an economy of small and medium enterprises in Russia because the “corruption tax” is so prohibitive.<sup>52</sup>

Much like petty corruption, bribery has the effect of widening the inequalities between small and larger enterprises because the costs to smaller businesses are much greater. Despite the seemingly high rates of corruption reported by Russian enterprises, large businesses do not report that corruption is their biggest obstacle. Instead they report that access to finance, political instability, and tax rates are far greater obstacles.<sup>53</sup> Interestingly, however, Russian medium sized firms do report that corruption is one of their biggest obstacles (20 to 99 employees).<sup>54</sup> This has had a major impact on the diversity of firms in the market. The *Global Competitiveness Report* ranks Russia 124th out of 142 countries for intensity of local competition.<sup>55</sup> In addition, Russia ranks 101st out of 142 for the extent to which the market is dominated by a few business groups (see table 5.5).<sup>56</sup> There is little market diversity in Russia and the market is dominated by a few large businesses. This is likely a result of the poor environment for start-ups and small and medium enterprises, due in part to the burden of corruption.<sup>57</sup>

<sup>48</sup> Mohsin Habib and Leon Zurawicki, “Corruption in Large Developing Economies: The Case of Brazil, Russia, India, and China,” in *Emerging Economies and the Transformation of International Business: Brazil, Russia, India, and China (BRICs)*, ed. S. C. Jain (Northampton M. A: Edward Elgar, 2006), 463, 468.

<sup>49</sup> Mehnaz S. Safavian et al., “Corruption and Microenterprises in Russia,” *World Development* 29, no. 7 (2001), 1222.

<sup>50</sup> Ibid.

<sup>51</sup> Ibid., 1222.

<sup>52</sup> Ibid., 1216.

<sup>53</sup> *Russia Country Profile 2009, IFC Enterprise Survey* (The World Bank: International Finance Corporation, 2009), 4.

<sup>54</sup> Ibid.

<sup>55</sup> *The Global Competitiveness Report 2011-2012*, ed. Klaus Schwab (Geneva, Switzerland: World Economic Forum, 2011), 307.

<sup>56</sup> Ibid.

<sup>57</sup> For more on the burden faced by small and medium enterprises across the BRIC countries, especially in relation to firm entry, see the institutions section of this report.

**Table 5.5:** BRIC Business Competitiveness Rankings (out of 142 countries – 142<sup>nd</sup> being the worst score)

	Intensity of Local Competition	Extent to which the market is dominated by a few businesses
<b>BRAZIL</b>	48 <sup>th</sup>	40 <sup>th</sup>
<b>CHINA</b>	22 <sup>nd</sup>	20 <sup>th</sup>
<b>INDIA</b>	31 <sup>st</sup>	23 <sup>rd</sup>
<b>RUSSIA</b>	124 <sup>th</sup>	101 <sup>st</sup>

Source: *Global Competitiveness Report 2011-2012*.

In Russia, there is no evidence to suggest that paying bribes actually decreases the amount of time that micro and small enterprises spend with officials. This lends strength to the argument that Russian corruption is as arbitrary as it is pervasive and that bribe payments do not mitigate against an unpredictable business environment. Similarly, the BEEP 2000 survey showed that firms who gave bigger bribes were not necessarily likely to do any better.<sup>58</sup>

The BEEP surveys show how corruption affects different types of firms in Russia. Successive BEEP surveys in 1999, 2002, 2005, and 2009 have shown that there has been a decline in direct extortion and bribery.<sup>59</sup> Ledeneva has conducted a survey of entrepreneurs working in Russian regions to determine the nature and types of corruption employed by business people and officials.<sup>60</sup> She has found that extorting favours for job candidates, paying exorbitant board of director’s fees to cronies, and extortion by regional officials is rarely if never employed. Indeed, providing trips or services to regional officials and paying prosecutors to open or close cases is also a decreasing, if never used, practice. Instead of one time transactions like these, she notes that there is an increasing practice of relying on long-term mutual relationships to foster a better business environment for the entrepreneur and favourable political backing for the politician. These approaches involve leveraging power and cementing long-term connections with the hopes of shaping the economic and political landscape. She notes that there is still a high prevalence of using company resources, be it state-owned or not, for private purposes.<sup>61</sup>

The picture of business corruption in Brazil and Russia reveals that administrative corruption poses a particularly high burden for small and medium enterprises. This has weakened the market’s competitiveness so that only a few large firms dominate. Furthermore, in Russia these high rates of administrative corruption have not led to any kind of stability or predictability in business interactions. Instead they have created an unfriendly environment for business. Brazil experiences the highest regulatory burdens of any of the BRIC countries, yet its rates of corruption are relatively low. The steady decline in transactional corruption in these countries masks an increase in sophisticated influence based corruption, which will be discussed in the next section with relation to China and Russia.<sup>62</sup>

<sup>58</sup> Hellman et al., “Seize the State, Seize the Day” (2000), 19.

<sup>59</sup> Alena V. Ledeneva, “Corporate Corruption in Russian Regions,” *Russian Analytical Digest* 22, no. 92 (2011), 3.

<sup>60</sup> Alena V. Ledeneva and Stanislav Shekshnia, “Doing Business in Russian Regions: Informal Practices and Anti-Corruption Strategies,” *Russie.Nei. Visions*, no. 58 (2011), 14-16.

<sup>61</sup> Ibid., 15-16.

<sup>62</sup> For more discussion on political influence in Brazil see the governance section of this report.

## CAPTURE OR MUTUAL EXCHANGE?

Starting in the early 2000s Kaufman and Hellman changed the analysis of corruption studies by focusing on the influence exerted by private entities on former Eastern bloc states.<sup>63</sup> Their broad, nuanced, and extensive studies reoriented corruption discourse by focusing on the role and initiative of private enterprises. They revealed the unsettling extent of businesses' influence on laws, rules, and regulations – especially in Russia. Part of the great utility of their studies is the extent to which they were able to get a sense of corruption that went beyond bribery and were able to capture influence. Building on this analysis, researchers have suggested that influence does not flow in one direction, but may be better described as mutual exchange with actors exchanging obligations for benefits through extensive, informal, and sophisticated patronage networks. China and Russia both have strong historical traditions of informality which has insinuated itself into the market reform process. The nature of this informality – known as *guanxi* in China and *blat* in Russia – are similar in many ways but are also highly culturally specific.<sup>64</sup>

Kaufman and Hellman coined the term state capture, which they defined as “the efforts of firms to shape the formation of basic rules of the game ... through illicit non-transparent private payments to public officials, [these] firms do not exert direct power over politicians.”<sup>65</sup> The term has been reinterpreted loosely by different experts to convey the extent to which business has infiltrated the decision-making process in government.<sup>66</sup> Kaufman and Hellman had a nuanced approach to defining the different levels of corruption drawing a distinction between influence, state capture, and administrative corruption. According to their definition, influence means a firm's capacity to have an impact on the formation of basic rules of the game *without* involving private payments to public officials.<sup>67</sup> Administrative corruption is what they described as “private *payments* to public officials to distort the prescribed *implementation* of official rules and policies [italics different than in original].”<sup>68</sup> State capture and influence are fundamentally important because the very institutions which are meant to guard against corruption are being influenced and held back by private interests:

By capturing state institutions, firms are able to encode preferences for themselves in the basic rules of the game for the market economy, creating a wide range of policy and institutional distortions that generate highly concentrated gains to narrow sectors and groups, often at a high social cost.<sup>69</sup>

When BEEPS did its first enterprise survey in 2000, Hellman and Kaufman discovered that Russia had one of the highest degree of “concentration of state capture” amongst former Soviet bloc transition economies. High capture economies are those in which more than 25 percent of firms report a significant impact of state capture on their business.<sup>70</sup> Their 2000 study found that in high-capture economies large state-owned firms exerted more *influence* over politicians whereas captor firms tended to be *de novo* private firms (i.e. those with no state-owned predecessor). Interestingly,

they discovered that there was little overlap between the influencing firms and the captor firms. Rather they found that captor firms, as new actors in the market were attempting to gain a competitive edge over the influential firms.<sup>71</sup> The pay-off for captor firms is that they demonstrated a much higher rate of sales and investment growth than non-captor firms and experienced an increase in their security and property rights.<sup>72</sup> On the other hand, privatized firms and *de novo* firms had not seen any improvement in their property and contract rights over time relative to state-owned firms, which Kaufman and Hellman theorized cast doubt on the view that privatization and new entry had created a constituency to push for institutional reform.<sup>73</sup>

The BEEP survey also found that corruption was moving beyond incidences of discreet payments and transactions and more into the realm of influence. Enterprises responded that patronage, taxes and regulation, and the Central Bank had a major impact on their business and that arbitration court decisions, political contributions, and criminal court decisions had somewhat of an impact.<sup>74</sup> By contrast, however, few Russian firms (compared to other Eastern European countries) agreed that it was common to make irregular payments to get things done.<sup>75</sup> This data reflects firms' confidence that they could bend rules through influence. This influence has resulted in state officials failing to enforce contracts, implement antitrust and bankruptcy laws, or implement economic policies.<sup>76</sup> This strongly underscores the point that starting in the early 2000s businesses had moved beyond *administrative* and *transactional* corruption into more sophisticated and complex forms of influence and capture.

In more recent years Frye has built on the BEEPS research and perceives a difference in Russian firm behaviour.<sup>77</sup> He analyzed 500 Russian firms and came up with largely consistent results to the BEEP Survey, but with added nuance. He decided to study the role of lobbying in Russian business and discovered that contrary to popular to academic wisdom, firms exerted most of their lobbying power through business associations. While informal personal ties were a major source of power the firms that were most successful were actually those that belonged and exerted influence through a business association. As is consistent with other analysis, small and medium enterprises are rarely included or supported by these associations. It seems that rather than protect the wider business community the associations lobby for the specific interests of large established entities.<sup>78</sup> The major breakthrough of his analysis was that corruption involved a mutual exchange of obligations and benefits. He found that firms that had the most lobbying success were subject to higher regulatory burden (including more bureaucratic inspections) and intrusive price controls.<sup>79</sup> Thus, the gains they made in influencing government policy were offset by other regulatory drawbacks. Furthermore, the state and firms were engaged in an unhealthy relationship of mutual exchange which usually only benefited the actors involved. Only sometimes did the effects trickle down to the public. For example, a way for high-level officials to exert power over influential firms was to impose price

<sup>63</sup> Hellman et al., “Seize the State, Seize the Day” (2000), 11.

<sup>64</sup> For additional discussion on *guanxi* see the section on the Chinese judiciary in the judiciary section of this report.

<sup>65</sup> Joel S. Hellman et al., “Seize the State, Seize the Day: State Capture and Influence in Transition Economies,” *Journal of Comparative Economics* 31, no. 4 (2003), 756.

<sup>66</sup> See Timothy Frye, “Capture or Exchange? Business Lobbying in Russia,” *Europe-Asia Studies* 54, no. 7 (2002), 1021.

<sup>67</sup> Hellman et al., “Seize the State, Seize the Day” (2003), 755.

<sup>68</sup> Hellman et al., “Seize the State, Seize the Day” (2000), 2.

<sup>69</sup> Hellman, Joel S. “Strategies to Combat State Capture and Administrative Corruption in Transition Economies” background paper prepared for the Conference: “Economic Reform and Good Governance: Fighting Corruption in Transition Economies” (Beijing, 2002) online: <<http://siteresources.worldbank.org>>, 2.

<sup>70</sup> Hellman et al., “Seize the State, Seize the Day” (2003), 758.

<sup>71</sup> Hellman et al., “Seize the State, Seize the Day” (2000), 11.

<sup>72</sup> Hellman et al., “Seize the State, Seize the Day” (2003), 764.

<sup>73</sup> *Ibid.*, 769.

<sup>74</sup> Kaufmann et al., “Measuring Governance, Corruption, and State Capture,” 20.

<sup>75</sup> *Ibid.*, 36.

<sup>76</sup> J. David Brown et al., “Helping Hand or Grabbing Hand? State Bureaucracy and Privatization Effectiveness,” *American Political Science Review* 103, no. 02 (2009), 264; Anna Grzymala-Busse and Pauline Jones Luong,

“Reconceptualizing the State: Lessons from Post-Communism,” *Politics and Society* 30, no. 4 (2002); A. L. Mogiliansky et al., “Capture of Bankruptcy: Theory and Russian Evidence,” *SSRN Electronic Journal* (2003), online: <<http://ssrn.com/abstract=243334>>.

<sup>77</sup> Frye, “Capture or Exchange?”

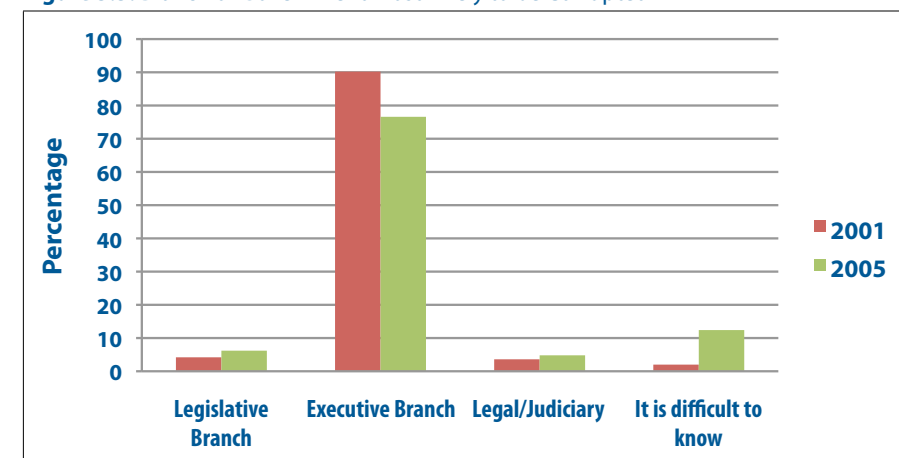
<sup>78</sup> *Ibid.*, 1027.

<sup>79</sup> *Ibid.*, 1029-30.

controls – a popular political move. Mostly the effect was to distort the market by making it less competitive and based on influence rather than merit.

The 2005 INDEM survey shows that when entrepreneurs were asked to identify which branch of government was most likely to involve corruption 76.6 percent of firms cited the executive branch (see figure 5.5).<sup>80</sup> This suggests that the nucleus of power and influence rests in the executive branches at both the federal and regional levels in Russia. Considering that the Russian executive branch has wide unchecked discretionary power, this poses considerable problems for accountability, governance, and a healthy institutional environment.<sup>81</sup>

**Figure 5.5: Branch of Government Most Likely to be Corrupted**



Source: "Diagnostics of Russia Corruption 2005 – Preliminary Results." (2005) online: <[www.indem.ru/en/Publicat/2005diag\\_engV.htm](http://www.indem.ru/en/Publicat/2005diag_engV.htm)>.

A compelling picture of Russia's business environment and governance system is described by Ledeneva and the researchers at INDEM.<sup>82</sup> As we described in detail in the institutions section of this report, Russia is plagued by a large discrepancy between *de facto* and *de jure* laws. While Russia is formally governed by laws and rules, informal networks drive most transactions. As Ledeneva puts it "informality is the pattern of governance, even if hidden behind the formal discourses."<sup>83</sup> One of the most common terms used in Russian business today after "business" and "money" is *sistema*, which is:

A kind of collective mind, collective smartness, mutual support when someone is lobbying the interests of somebody other, and their interests overlap. They all take care of each other although they may be not aware of it.<sup>84</sup>

It involves a complex set of networks based on reciprocity, blurred boundaries of friendship and business, and influence and loyalty. An integral part of *sistema* is *blat* which Ledeneva defines as "the use of personal networks for obtaining goods

in short supply and for circumventing formal procedures."<sup>85</sup> Few indices can capture the sophistication or depth of this type of influence. Instead, Ledeneva details the practice of "oral commands" where official orders are carried out by phoning or having a conversation with an individual rather than relying on written orders. She has collected and detailed common practices, catch-phrases, and idioms which capture this phenomenon such as a bosses' exhortations to their employees to not "complicate life to yourself or others," "don't go overboard," "don't make a circus," "don't be more saintly than the pope," and "cut corners and don't focus on them where unnecessary."<sup>86</sup> In economic terms this method of governance is not based on competition, merit, or professionalism.

Golovshinskii in his research for INDEM has identified informal practices used by business people as a means of survival. For example, he shows how entrepreneurs spend a great deal of time cultivating relationships with inspectors to avoid paying bribes or suffer undue regulatory burdens. He relates how increasingly frequently small and medium enterprises hire special members of staff, accountants, or managers whose role is to cultivate informal relationships.<sup>87</sup> The result is that, in order to survive in this environment, entrepreneurs beat out their competition not through entrepreneurship, but through informal networks which impedes the overall business environment's ability to foster free and fair competition.<sup>88</sup>

In the Soviet Union, private citizens engaged in *blat* as a way to overcome the deficiencies of the planned economy, to acquire access to valuable goods, access services, get an apartment in a good area, or be hired in a good job. Ledeneva argues that *blat* has been transformed in the new market economy in the corporate sphere making it much less pervasive, but much more devastating.<sup>89</sup> Thus, fewer people are engaging in the process but it is having greater repercussions.<sup>90</sup> Now that state property has been privatized, *blat* is no longer used to attain the goals of personal consumption, rather it is used to open a business and maintain a business – that is, to serve business.<sup>91</sup> The rapid and shock privatization process handed most of the economic wealth to a small elite and for the rest of the population survival depended on informality. She argues that only 10 percent of all corruption in Russia is carried out by private citizens, but that businessmen undertake 90 percent of the corruption economy.<sup>92</sup>

Like Russia, the particular forms of corruption that exist in China today are a product of its transition to a market economy. Unlike Russia, its transition has been much more gradual, incremental, and carried out through existing structures. Before market liberalization, China already had a small legitimate non-state sector. The dual track system was an innovative reform process which allowed a market to develop outside of state planning. As described in detail in the institutions section of this report, the dual track system also had built-in political incentives because it compensated potential losers by protecting the status quo. The system also created unintentional rents.<sup>93</sup> The gap between the two tracks was 20 to 25 percent of the domestic national economy, which presented sizable rents and huge incentives for officials in charge of allocating goods.<sup>94</sup> Following market reforms members in the non-state

<sup>80</sup> "Diagnostics of Russia Corruption 2005 – Preliminary Results," 11.

<sup>81</sup> For more on this see the governance section, institutions section, and accountability sub-section of this report.

<sup>82</sup> Ledeneva, "Corporate Corruption in Russia"; Ledeneva and Shekshnia, "Doing Business In Russian Regions"; Alena V. Ledeneva, "From Russia with Blat: Can Informal Networks Help Modernize Russia?" *Social Research: An International Quarterly* 76, no. 1 (2009); Alena V. Ledeneva, *How Russia Really Works: the Informal Practices that Shaped Post-Soviet Politics and Business* (Ithaca, Cornell University Press, 2006); "Diagnostics of Russia Corruption 2005 – Preliminary Results."; K. I. Golovshinskii et al., "Business and Corruption: How To Combat Business Participation In Corruption," Information Science for Democracy (INDEM) (2004).

<sup>83</sup> Ledeneva, "From Russia with Blat," 268.

<sup>84</sup> Respondent quoted in Golovshinskii et al., "Business and Corruption," 22.

<sup>85</sup> Ledeneva, "From Russia with Blat," 257.

<sup>86</sup> *Ibid.*, 271.

<sup>87</sup> Golovshinskii et al., "Business and Corruption," 24.

<sup>88</sup> *Ibid.*, 26.

<sup>89</sup> Alena V. Ledeneva, "Blat and Guanxi: Informal Practices in Russia and China," *Comparative Studies in Society and History* 50, no. 01 (2008).

<sup>90</sup> *Ibid.*, 133.

<sup>91</sup> *Ibid.*

<sup>92</sup> *Ibid.*

<sup>93</sup> Yingyi Qian, "How Reform Worked in China," *SSRN Electronic Journal* (2002), online: <<http://ssrn.com/abstract=317460>>.

<sup>94</sup> Yan Sun, "Reform, State, and Corruption: Is Corruption Less Destructive in China than in Russia?" *Comparative Politics* 32, no. 1 (1999), 4.

sector used corruption to compete with state enterprises on the market and compensate for lack of access.<sup>95</sup> Sun has argued that this was almost a necessary evil in order for party cadres to reconcile themselves to a new market ideology.<sup>96</sup> Because of China's particular path to market reform, rent-seeking has been a dominant form of corruption. Rent-seeking is associated with creating monopolies in sectors to allow actors to regulate entry, take advantage of the monopoly, or to obtain economic benefits from scarce resources. As markets were liberalized, officials were also given more power to take advantage of their positions to extract rents. In addition, they were presented with much more power since they were now required, among other things, to give out business licences and control exports, imports, and contract bidding.<sup>97</sup>

A major feature of the new market economy is the prevalence of *guanxi* – which involves “the exchange of gifts, favours, and banquets; the cultivation of personal relationships and networks of mutual dependence; and the creation of obligation and indebtedness.”<sup>98</sup> Since the market reforms Ledeneva has argued that *guanxi* has become monetized and commercialized. Businessmen rely on it to start a business, get a licence, find work space, and find export or import opportunities.<sup>99</sup> *Guanxi*, unlike its Russian equivalent, is considered quite predictable and reliable and players in the game can articulate its standards. It is also considered a reliable alternative form of governance and protection against risk.<sup>100</sup> An important difference between China and Russia's governance system is that China is often characterized as more predictable whereas Russia's business environment is more arbitrary.<sup>101</sup> To use an example cited by Sun, a businessman is more certain that his agreement will hold if he offers a bribe or gift to a Chinese official because of the nature of *guanxi* or “giving face.” Whereas in Russia, the bribe is more like extortion where there may not be a guarantee of results.<sup>102</sup> Indeed, as the discussion in the institutions section of this report revealed, China's informal institutions make up for deficiencies in its formal institutions, whereas in Russia informal institutions have been worsening the formal institutions that already exist. In China, it appears that *guanxi* can help protect a high-risk business against a high-risk environment.<sup>103</sup>

Since China is still rooted in a planned economy it still largely retains an administrative monopoly over many sectors. The most corrupt sectors are power generation, tobacco, banking, financial services, and infrastructure which, according to Pei, are heavily represented by state-controlled monopolies.<sup>104</sup> This can become problematic when the state-owned enterprises are not at arms-length from the government body that regulates that sector. It creates a situation where “the government is not only the maker of the rules of the game, but also the sportsman competing in the game,” as well as the referee.<sup>105</sup> The result is that officials may either inadvertently or intentionally provide comparative advantages for certain sectors, individuals, or enterprises.<sup>106</sup> It is often difficult to untangle what in this process is deliberate (corrupt) or a by-product of a planned economy and transition to the free market. The intercon-

<sup>95</sup> Ibid.

<sup>96</sup> Ibid., 5.

<sup>97</sup> Ibid., 4.

<sup>98</sup> Ledeneva, “Blat and Guanxi,” 120.

<sup>99</sup> Ibid., 137.

<sup>100</sup> Shaomin Li, “Why a Poor Governance Environment Does Not Deter Foreign Direct Investment: The Case of China and Its Implications For Investment Protection,” *Business Horizons* 48, no. 4 (2005), 299.

<sup>101</sup> Sun, “Reform, State, and Corruption,” 11; Li, “Why a Poor Governance Environment Does Not Deter FDI.”

<sup>102</sup> Sun, “Reform, State, and Corruption,” 11.

<sup>103</sup> Ledeneva, “Blat and Guanxi,” 138.

<sup>104</sup> Minxin Pei, “Corruption threatens China's future,” *Policy Brief: Carnegie Endowment for International Peace* 55 (2009), 3.

<sup>105</sup> Yong Guo and Angang Hu, “The Administrative Monopoly in China's Economic Transition,” *Communist and Post-Communist Studies* 37, no. 2 (2004), 272.

<sup>106</sup> Ibid., 269.

nectedness of politics and business, however, means that the Chinese Communist Party has become the major player and source of corruption.

#### Box 5.1: Corruption Scandals in China

**Yuanhua Group:** said to be the biggest scandal in Chinese Communist Party history. China accused Lai Changxing of running a multibillion-dollar smuggling network with the help of Communist Party officials in the 1990s. He fled to Canada and lived there for 12 years but was deported back to China in 2011 to stand trial. He confessed to bribery and corruption. Officials implicated in the scandal include Jian Qinglin former head of Fujian and later head of the Communist Party in Beijing.<sup>i</sup>

**High-speed rail scandal:** China is spending US\$120 billion to expand its high-speed rail network, which is considered one of the single biggest infrastructure projects ever in one country. It has emerged that officials have embezzled billions of dollars in funds. A former deputy engineer is accused of having bank deposits abroad that amounted to US\$2.8 billion. Railway Minister Liu Zhijun, who was fired, is alleged to have obtained US\$155 million and his brother has been convicted and sentenced to a suspended death sentence for embezzlement and accepting bribes.<sup>ii</sup>

**Li Wei:** In 2011, billionaire businesswoman Li Wei was implicated in a corruption scandal and convicted of tax evasion. She received a light sentence for testifying against former lovers. Her cooperation led to the conviction of: Li Jiating, former governor of Yunnan province, who was sentenced to death for embezzling millions; Chen Tonghai, the ex-chairman of China's second-largest oil company, Sinopec, who was given a suspended death sentence for taking US\$30 million in bribes; Liu Zhihua, a former vice-mayor of Beijing who supervised construction of the Beijing Olympics and was sentenced to death for taking US\$1.45 million in bribes; Zheng Shaodong, the former head of China's Economic Criminal Investigation Bureau, who was sentenced to death; and Huang Songyou, a deputy head of the Supreme Court who received US\$1 million worth of bribes.<sup>iii</sup>

**Chongqing Corruption Scandal:** In the late 2000s Bo Xilai, the now disgraced Communist Party secretary, launched a crackdown on organized crime in Chongqing (the largest city in China). Gangsters had infiltrated the police force, municipal government, and even the judiciary. The crackdown purged up to one-fifth of the police force and in 2009 Wen Qiang, the former director of the Chongqing Municipal Judicial Bureau was the highest ranking official charged in the scandal. He was convicted of rape, shielding criminal gangs, and taking more than US\$1.76 million in bribes. He was later executed.<sup>iv</sup>

<sup>i</sup> Edward Wong, “Former Insider Indicted in Chinese Corruption Scandal,” *The New York Times* (2011) online: <www.nytimes.com>; “Alleged Chinese Smuggling Kingpin Lai Changxing ‘Confesses’” *BBC news* (December 30 2011). online: <www.bbc.co.uk>.

<sup>ii</sup> Peter Goodspeed, “Goodspeed Analysis: Bo Xilai Scandal a Symbol of Corruption that has Surged with Chinese Economy” *National Post* (2012) online: <fullcomment.nationalpost.com>.

<sup>iii</sup> Ibid.

<sup>iv</sup> Malcolm Moore, “China Corruption Trial Exposes Capital of Graft” *The Telegraph* (2009) online: <www.telegraph.co.uk>; “Wen Qiang Given Death for Rape, Corruption” *China.org* (April 14 2010) online: <www.china.org.cn>.

Pei estimates that 81 percent of the chief executives of state-owned enterprises and 56 percent of all senior corporate executives are members of the Communist Party.<sup>107</sup> This is all based on a wide system of patronage which rewards loyalty with economic

<sup>107</sup> Minxin Pei, “The Dark Side of China's Rise,” *Foreign Policy* 153 (March/April 2006), 4.

benefits in state-owned and non-state owned corporations. One of the side effects is that economic projects, known as “image projects,” are often based on scoring political points and money is poured into vanity projects such as luxury shopping malls, factories in remote districts, and unnecessary infrastructure.<sup>108</sup> While there are many capable Chinese entrepreneurs, a significant amount of their success lies in being politically connected, hence the large number of wives and children of Chinese officials with multi-billion dollar businesses.

Since there is a dearth of empirical data on levels of corruption in China it is difficult to estimate whether corruption is on the rise or if it has reached a plateau.<sup>109</sup> The number of recent scandals suggests that it is on the rise. For example, in 2008, 2,700 officials were referred for prosecution in the land administration sector alone and another 31,000 cases of corruption were under investigation.<sup>110</sup> It appears as though corruption levels are higher amongst younger officials, which suggests that the younger generation’s new practices may become more problematic in several years.<sup>111</sup> The Peterson Institute theorizes that corruption rises in China in conjunction with frenzied economic growth but subsides in periods of stability or decline, which mirrors Glaeser and Goldin’s conclusions on corruption in the US.<sup>112</sup>

The picture of high-level corruption in China and Russia reveals a sophisticated network of patronage and influence between businesses and the state – more specifically the executive. While some businesses may engage in these practices out of necessity to advance themselves, others use it to shape the business environment in their own image. Much of this corruption is not strictly illegal since the system is often not properly set up to regulate informality, but it nevertheless distorts the economy, diverts public funds, and can undermine the public interest. This makes it much more difficult to regulate or penalize corruption with formal laws and instead requires a different understanding of conflict of interest, education, and a shift in cultural attitudes. We address the problem of combatting corruption in China and Russia later in the section on accountability.

## CORRUPTION AND FOREIGN INVESTMENT

Researchers have been preoccupied with the effect of corruption on foreign investment for many years now.<sup>113</sup> Foreign direct investment is one of the indicators of economic growth and development because it can provide much needed access to financial capital, technology, and employment.<sup>114</sup> It has long been found that there is a significant correlation between high foreign direct investment, strong institutions, and governance.<sup>115</sup> However, there is not the same correlation between levels of corruption and foreign investment. While Transparency International insists that cor-

ruption impedes foreign investment the picture is a lot more complicated.<sup>116</sup> Several writers have noticed a negative correlation between high levels of corruption and foreign direct investment,<sup>117</sup> others find no statistical significance,<sup>118</sup> and others find a positive correlation.<sup>119</sup>

China ranks third in the world for overall foreign direct investment inflow, Russia eighth, Brazil ninth, and India thirteenth.<sup>120</sup> They all showed a significant dip in foreign direct investment following the 2008 crisis.<sup>121</sup> Buchanan et al. have demonstrated that there is a correlation between levels of foreign direct investment and market volatility.<sup>122</sup> This is particularly important for the BRIC countries which have attracted large amounts of foreign direct investment, but rather than steady growth the foreign investment is volatile increasing and decreasing quickly. For example, in 2002 levels of foreign direct investment in Brazil plummeted following the presidential election, but rebounded after President da Silva promised to be market friendly.<sup>123</sup> Poor regulation and institutions affect market volatility.<sup>124</sup> In addition to this, foreign direct investment seems to increase when investors perceive that governments are implementing better institutions, including anti-corruption plans.<sup>125</sup> This is confirmed by Caetano and Caleiro’s study, which shows that countries with high levels of corruption low levels of foreign direct investment, but countries with low levels of corruption who also seem to be reforming their institutions have higher levels of foreign direct investment. They theorize that foreign investors put up with a threshold acceptable corruption as long as it is associated with genuine efforts to improve institutions.<sup>126</sup>

Brouthers et al. have found that attractive markets compensate for high levels of corruption, although the correlation is not very robust.<sup>127</sup> They show that for investors seeking to invest in resources rather than markets, greater resource attractiveness does not compensate for high levels of corruption.<sup>128</sup> The study seems to suggest that corruption deters resource-seeking investors, but market-seeking foreign direct investment appears to be able to adapt to corruption if market attractiveness can compensate for the additional costs of corruption.<sup>129</sup>

Cuervo-Cazurra’s study from 2006 found that corruption does not have the same impact on all investors.<sup>130</sup> Investors from countries that had signed the *OECD Convention on Combating Bribery of Foreign Public Officials* (OECD convention)

<sup>108</sup> Ibid., 4-5.

<sup>109</sup> C.F. Bergsten, “Corruption in China : Crisis or Constant?” ed. C.F. Bergsten (Washington, DC: Peterson Institute for International Economics, 2008), 91. For data on corruption in the Judiciary see case study of Chinese Judiciary in the judicial institutions section of this report.

<sup>110</sup> Ibid., 96.

<sup>111</sup> Ibid., 94.

<sup>112</sup> Ibid.; Glaeser and Goldin, *Corruption and Reform: Lessons from America’s Economic History*.

<sup>113</sup> Paolo Mauro, “Corruption and Growth,” *The Quarterly Journal of Economics* 110, no. 3 (1995); Yuan-Ho Hsu, “Is Corruption a Grabbing Hand? A Panel Data Study of FDI”; Azmat Gani, “Governance and Foreign Direct Investment Links: Evidence From Panel Data Estimations,” *Applied Economics Letters* 14, no. 10 (2007); Alvaro Cuervo-Cazurra, “Who Cares about Corruption?” *Journal of International Business Studies* 37, no. 6 (2006).

<sup>114</sup> Bonnie Buchanan et al., “Crisis to Crisis: FDI Redux,” *SSRN Electronic Journal* (2010) online: <<http://ssrn.com/abstract=1616004>>, 3.

<sup>115</sup> OECD, *Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs* (OECD Publishing, 2002). There is also a strong correlation between the ease with which businesses can start up and governance institutions see Kaufmann, “Corruption, Governance, and Security,” 86.

<sup>116</sup> Deborah Hardoon and Finn Heinrich, *Bribe Payers Index 2011* (Berlin: Transparency International, 2011); Alexandr Akimov et al., “Financial Development and Economic Growth: Evidence From Transition Economies,” *Applied Financial Economics* 19, no. 12 (2009); Cuervo-Cazurra, “Who Cares about Corruption?,” 807.

<sup>117</sup> Shang-Jin Wei, “How Taxing is Corruption on International Investors?” *Review of Economics and Statistics* 82, no. 1 (2000); Gani, “Governance and FDI Links.”

<sup>118</sup> David Wheeler and Ashoka Mody, “International Investment Location Decisions: The Case of US firms,” *Journal of International Economics* 33, no. 1-2 (1992); James R. Hines Jr, “Forbidden Payment: Foreign Bribery and American Business After 1977,” *NBER Working Paper*, no. 5266 (1995).

<sup>119</sup> N. H. Leff, “Economic development through bureaucratic corruption,” *American Behavioral Scientist* 8, no. 3 (1964); Sotirios Bellos and Turan Subasat, “Corruption and Foreign Direct Investment: A Panel Gravity Model Approach,” *Bulletin of Economic Research* (2011).

<sup>120</sup> Pravin Jadhav, “Determinants of Foreign Direct Investment in BRICS Economies: Analysis of Economic, Institutional and Political Factor,” *Procedia - Social and Behavioral Sciences* 37 (2012), 8.

<sup>121</sup> Ibid., 9.

<sup>122</sup> Buchanan et al., “Crisis to Crisis: FDI Redux.”

<sup>123</sup> Ibid., 5.

<sup>124</sup> Ibid., 3.

<sup>125</sup> Jadhav, “Determinants of Foreign Direct Investment in BRICS.”

<sup>126</sup> L. Zurawicki and M. Habib, “Corruption And Foreign Direct Investment: What Have We Learned?” *International Business and Economics Research Journal (IBER)* 9, no. 7 (2010), 6; J. M. M. Caetano and A. Caleiro, “Corruption and Foreign Direct Investment: What Kind of Relationship is There?” *Economics Working Papers 18\_2005*, University of Évora, Department of Economics (Portugal) (2005).

<sup>127</sup> Lance Eliot Brouthers et al., “Corruption and Market Attractiveness Influences on Different Types of FDI,” *Strategic Management Journal* 29, no. 6 (2008), 677.

<sup>128</sup> Ibid., 678.

<sup>129</sup> Ibid.

<sup>130</sup> Cuervo-Cazurra, “Who Cares about Corruption?”

tended on average to invest less in countries that had high corruption, preferring instead to invest in countries that had also signed the convention.<sup>131</sup> Interestingly, Cuervo-Cazurra found that countries that have not signed the convention are not deterred from investing in countries with high levels of corruption.<sup>132</sup> Since his study all the BRIC countries have now passed laws on bribery of foreign corrupt officials, so it remains to be seen whether or not the laws will have an effect. In keeping with the analysis below on implementation of laws, the outcomes depend on proper enforcement, implementation, and *de facto* rules.

Cuervo-Cazurra's study confirms a ground-breaking study done by Hines in 1995.<sup>133</sup> Hines analyzed US firms' practices before and after the 1977 *Foreign Corrupt Practices Act*. He found that after 1977 American investors significantly stopped investing in countries with high levels of corruption. Before 1977, however, corruption did not deter investors from investing in countries with high levels of corruption. Importantly, it is not corruption *per se* which deters foreign direct investment, but rather whether there is an effective law which deters bribing foreign officials.<sup>134</sup> One of the important outcomes of Cuervo-Cazurra's study is that a country that tries to reduce corruption may be rewarded with higher levels of foreign direct investment. Furthermore, the investment would be coming from countries with relatively low corruption which would reinforce the government's efforts.<sup>135</sup>

Russia and China present peculiar paradoxes since they attract high levels of foreign direct investment, despite high levels of corruption. Transparency International's *Bribe Payers Index* asks business executives from all over the world how they perceive the practices of businessmen in other jurisdictions.<sup>136</sup> China and Russia were at the bottom of the list of 28 countries and both had scores significantly below the other countries measured.<sup>137</sup> Yet foreign direct investment in Russia and China was US\$120 billion which is more than five times the value of foreign direct investment in Brazil and India combined.<sup>138</sup>

China experiences the highest levels of foreign direct investment despite consistently rating poorly on corruption perception indices and having a poor institutional governance environment. Li has theorized that the so-called China paradox can be explained by looking at the types of foreign investment.<sup>139</sup> He notes that China has little foreign *indirect* investment, which is characterized by buying stocks in listed companies or bonds on the stock market. Most of China's foreign investment – he estimates 95 percent – is direct investment coming from Chinese nationals living in foreign countries such as the US and Taiwan.<sup>140</sup> Yet direct investment is more time consuming, hands on, and complicated. Direct investors are protected not by rules based systems but they mitigate their risks by engaging in the “relation-based” governance system known as *guanxi* which acts as an alternative form of protection. He argues that China's dominant governance system, while not being based on rules, is based on a strong foundation of “relation-based” governance, thus any investor who can navigate these relationship networks is attracted to invest in China. He argues that since enforcement of rules-based governance is so poor, this discourages indirect foreign investment because minority shareholders will more often than not be

at a disadvantage. Thus, a foreign investor choosing to invest in a country, such as China, with strong “relation-based” governance systems will prefer direct investment over indirect investment.

Li contrasts this with India, which has a parliamentary system with checks and balances, a developed legal system, and relatively good protection of property rights. India attracts much less foreign direct investment than China but its ratio of foreign direct investment to foreign indirect investment is roughly 50:50.<sup>141</sup> Li theorizes that India's higher levels of foreign indirect investment arise because it has a better rule-based governance system than China and indirect investors feel more secure. Indeed, these findings, that India has a better rule-based system, may be corroborated by looking at each country's domestic markets. A World Bank study concluded that, where the type of corruption was predictable, levels of foreign direct investment were higher than where corruption was unpredictable (defined as opportunistic).<sup>142</sup> If this is the case, then in China's transition from a relation-based system to a rule-based system, it must be careful of the vacuum left when the relationships begin to weaken, but rules are not yet well enough enforced.

The paradoxes of China and Russia may also be explained by the fact that they have relatively low levels of petty corruption (see table 5.1 and figure 5.1). Lambsdorff's findings suggest that petty corruption deters foreign direct investors much more than grand corruption.<sup>143</sup> This may be because investors feel secure within an inner elite circle and therefore shielded from the negative impact of petty corruption, while engaging in the grand corruption themselves. Whereas grand corruption may be more predictable and relationship based, petty corruption can create organizational barriers that impede entry or add a large tax on new entrants.<sup>144</sup>

Using subsidiaries or partnerships is a common practice for firms seeking to enter foreign markets. It can be practical for legal reasons, as it may only be possible to operate in a jurisdiction if the firm is incorporated in that jurisdiction. It also allows a multinational or foreign investor to partner with a local entity that has local knowledge. Often, in order for a company to survive in Russia it must partner with local Russian firms who have local knowledge, can introduce them to the business landscape, and open up informal networks.<sup>145</sup> With this local knowledge comes a tendency to engage in local practices some of which might involve corruption. Transparency International has identified the use of subsidiaries, joint ventures, and intermediaries as a primary source of foreign bribery.<sup>146</sup> In Brazil, India, and Russia, foreign firms appear to be more concerned with corruption and economic uncertainty than domestic firms.<sup>147</sup> Furthermore, BEEPS 2000 suggests that high-capture economies (namely Russia, Moldova, and Azerbaijan) fall into a trap whereby foreign investors are nearly twice as likely to engage in corruption through partnerships or ownership of domestic firms.<sup>148</sup> Siemens in Germany and Alstom in France have both adopted a global practice of using subsidiaries to carry out their business in foreign jurisdictions, many of whom have subsequently been convicted of bribing foreign officials.<sup>149</sup> It is not clear whether the practices of local subsidiaries are known or approved by

<sup>131</sup> Ibid., 807.

<sup>132</sup> At the time, in 2006, only Brazil had signed the convention, today each of the BRICs have signed a version of a bribery of foreign corrupt officials law.

<sup>133</sup> Hines Jr, “Forbidden Payment.”

<sup>134</sup> Zurawicki and Habib, “FDI: What Have We Learned,” 3.

<sup>135</sup> Cuervo-Cazurra, “Who Cares about Corruption?” 819.

<sup>136</sup> Hardoon and Heinrich, *Bribe Payers Index 2011*, 5.

<sup>137</sup> Ibid.

<sup>138</sup> Ibid., 12.

<sup>139</sup> Li, “Why a Poor Governance Environment Does Not Deter FDI.”

<sup>140</sup> Ibid., 300.

<sup>141</sup> Ibid.

<sup>142</sup> World Bank, *World Development Report 1997: The State in a Changing World*, vol. 20 (A World Bank Publication, 1997), 34 & 103.

<sup>143</sup> Graf Lambsdorff, “Investors Prefer Grand Corruption,” 5.

<sup>144</sup> Ibid.

<sup>145</sup> Ledeneva and Shekshnia, “Doing Business In Russian Regions,” 11.

<sup>146</sup> F. Heimann and G. Dell, “Progress Report 2009: Enforcement of the OECD Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions,” *Transparency International* (2009), 9 & 14.

<sup>147</sup> Habib and Zurawicki, “Corruption in Large Developing Economies,” 463.

<sup>148</sup> Joel S. Hellman et al., “Far From Home: Do Foreign Investors Import Higher Standards of Governance in Transition Economies?” *SSRN Electronic Journal* (2002), online: <<http://ssrn.com/abstract=386900>>.

<sup>149</sup> Heimann and Dell, “Progress Report 2009,” 15.

the parent company. In some cases Transparency International has identified that the parent company is not aware of local practices and would otherwise require the subsidiary to conform to their own compliance programs. In Siemens' case the bribery was sometimes actively condoned or the parent company turned a blind eye to what should have been evident.<sup>150</sup>

#### Box 5.2: Bribery of Foreign Officials

**Foreign Bribery, Brazil:** The French branch of Alstom is alleged to have paid US\$6.8 million in bribes to Brazilian public officials to win a US\$45 million contract to expand São Paulo's subway system. To date three high-level Alstom officials have been arrested.

**Foreign Bribery, China:** A major Chinese supplier of telecommunications equipment, ZTE Corporation, was alleged to have colluded with Philippino officials for a proposed National Broadband Network project. In 2008, the losing bidder claimed he had been offered a bribe to withdraw his bid and remain silent. ZTE has also been disbarred for bidding misconduct in Norway in 2008 and an official was charged with bribery in Liberia in 2006.

**Sources:** F. Heimann and G. Dell "Progress Report 2009: Enforcement of the OECD Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions" (Transparency International, 2009); "Alstom Bosses Held in Fraud Case" *BBC News* (2010) online: <bbc.co.uk>; *Transparency International Global Corruption Report 2009: Corruption and the Private Sector* ed. Dieter Zinnbauer et al. (Cambridge: Cambridge University Press, 2009), 67-70.

Siemens and Alstom have been dogged with allegations of corrupt behaviour in foreign jurisdictions, but their visibility is largely due to the German and French governments' willingness to prosecute their parent companies and the local countries' willingness to investigate. For example, Brazilian prosecutors have actively investigated allegations that Alstom bribed officials in the São Paulo subway project. This system relies heavily on mutual legal assistance, strong legal foundations, and the will to go after the offenders. Not all countries, notably Canada, have adequately implemented legal frameworks to prosecute parent companies for the wrongdoing of a subsidiary.<sup>151</sup>

This analysis demonstrates that foreign direct investment is responsive to stability and predictability whether it is fostered through institutions or, in China's case, reliable and stable patronage networks. There appears to be a threshold of corruption which investors accept as long as they perceive that institutions are being strengthened. Foreign investors frequently engage in corruption through their subsidiaries by deliberately condoning the behaviour or choosing to turn a blind eye to what should be evident. Corruption is not important to investors *per se*, unless investors originate from a country with well enforced foreign bribery rules or the corruption is arbitrary. Foreign investors are not averse to engaging in corruption abroad and appear to see it as a necessary evil to start up a business and keep it going. The types of investors that tend to invest in the BRIC countries also hail from other BRIC countries which suggests that it might exacerbate those governments' efforts to credibly combat corruption.

<sup>150</sup> See details of Siemens cases in *ibid.*, 16-17, 20, 28, 29.

<sup>151</sup> *Ibid.*, 13, 22-23.

## TAX EVASION AND CAPITAL FLIGHT

*Tax avoidance corrupts the revenue systems of the modern state and undermines the ability of the state to provide the services required by its citizens. It therefore represents the highest form of corruption because it indirectly deprives society of its legitimate public resource.*<sup>152</sup>

Capital flight and corruption are theoretically two distinct concepts, yet in recent years writers such as Baker, Joly, and Christensen have argued that tax evasion should be considered "Phase II" of corruption discourse.<sup>153</sup> At a basic level, corruption affects the tax system when bribery and extortion undermine tax collection. In this section we are more concerned with tax evasion as the other side of the corruption "coin." This shifts the focus from the "criminals" or originators of corruption to those who facilitate corruption by receiving, hiding, laundering, and managing its proceeds. As Christensen argues, tax havens encourage and enable grand-scale corruption by providing an operational base used by legal and financial institutions and their clients to exploit legislative gaps and lax regulation.<sup>154</sup> In so doing, tax avoidance and capital flight have a similarly debilitating effect on economic development because they divert money away from public services, force developing states to accumulate larger debts, and exacerbate economic inequalities.<sup>155</sup> The problem of capital flight poses challenges to international governance and rule of law but ultimately has the greatest effect on domestic developing economies. The BRIC economies may do everything in their power to strengthen their institutions to enforce anti-corruption and tax evasion penalties, but so long as secrecy jurisdictions exist, the developing world will be ineffective in combatting corruption.

The term capital flight broadly encompasses any money that leaves a country either legally or illegally. In this section we are mostly interested with capital flight as a result of illegality which includes tax evasion and corruption. This encompasses what the Global Financial Integrity group calls illicit financial outflows, which they define as "funds that are illegally earned, transferred, or utilized and cover all *unrecorded* private financial outflows that drive the accumulation of foreign assets by residents in contravention of applicable laws and regulatory frameworks."<sup>156</sup> We are interested in both tax evasion and illegal capital flight since, as Christensen states, "the techniques used for tax dodging and laundering dirty money involve identical mechanisms and financial subterfuges: complex multi-jurisdiction structures, offshore companies and trusts, foundations, correspondent banks, nominee directors, dummy wire transfers etc."<sup>157</sup> To date most studies of illicit outflows have focused on money-laundering for the purposes of drug crimes and terrorism, but this is only the tip of the iceberg. A much larger portion of capital flight is a result of embezzlement, grand corruption, and tax evasion. We are interested in the methods used to secret away capital because of their repercussions for rule of law and economic development. We will look specifically at India. Although the scale of capital flight is not nearly as high as Russia's or China's, it has been the subject of more detailed analysis.

<sup>152</sup> John Christensen, "The Looting Continues: Tax Havens and Corruption," *Critical Perspectives on International Business* 7, no. 2 (2011), 189.

<sup>153</sup> Raymond W. Baker, *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System* (Hoboken, N. J.: John Wiley & Sons, 2005); Christensen, "The Looting Continues"; "Financial Secrecy - Profits from the Laundry," *Africa Confidential* 48, no. 6 (2007).

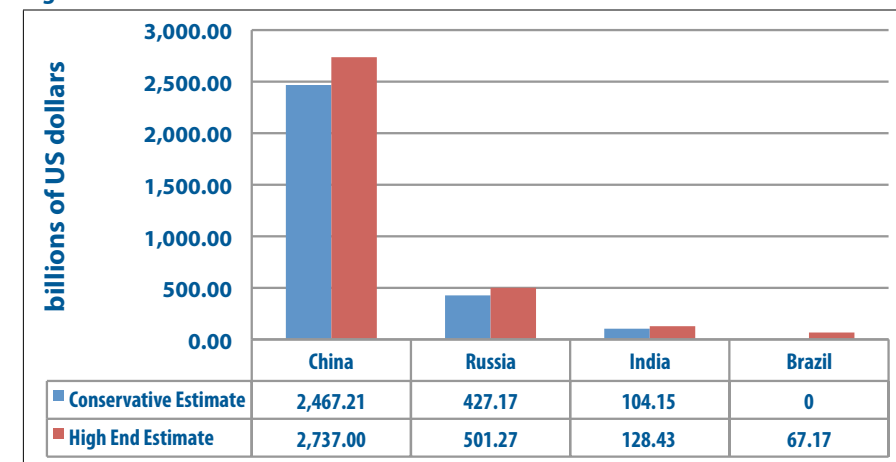
<sup>154</sup> Christensen, "The Looting Continues," 178.

<sup>155</sup> Roy Cerqueti and Raffaella Coppier, "Tax Revenues, Fiscal Corruption and 'Shame' Costs," *Economic Modelling* 26, no. 6 (2009), 1239.

<sup>156</sup> Dev Kar and Sarah Freitas, *Illicit Financial Flows from Developing Countries Over the Decade Ending 2009* (Washington DC: Global Financial Integrity, 2011), 28.

<sup>157</sup> John Christensen, "The Hidden Trillions: Secrecy, Corruption, and the Offshore Interface," *Crime, Law and Social Change* 57, no. 3 (2012), 333.



**Figure 5.6: Total Illicit Outflows 2000-2009**

Source: Dev Kar and Sarah Freitas, *Illicit Financial Flows from Developing Countries Over the Decade Ending 2009* (Washington DC: Global Financial Integrity, 2011), 56-57.

China, Russia, and India experience some of the highest rates of illicit financial outflows in the world (see figure 5.6). Global Financial Integrity's numbers include the proceeds of bribery, theft, kickbacks, and tax evasion combined.<sup>158</sup> The People's Bank of China estimates that roughly US\$123 billion has been transferred overseas by members of the Communist Party and other government officials since 1990. This is equivalent to China's entire education budget between 1978 and 1998.<sup>159</sup> Global Financial Integrity also estimates that global rates of outflow have increased by 14.9 percent per year between 2000 and 2009.<sup>160</sup> China has by far the highest rates of any country in the world, but year to year the rates are declining, whereas the rates in Russia are rapidly increasing. If the trend continues, Global Financial Integrity estimates that Russia will outpace China in the next few years.<sup>161</sup> India also has a large challenge with illicit capital outflows, estimated at US\$462 billion in total between 1948 and 2008.<sup>162</sup>

In India, the issue of capital flight has attracted significant attention from economists, policy makers, and politicians because they recognized early on that it was having a devastating impact on economic development. The effect on India's economy has been devastating. It has deprived the country of US\$462 billion which might have been spent on education, health, infrastructure, and other public services that might have improved the socio-economic well-being of its citizens. It would also have made the country less reliant on foreign aid and might have helped it decrease its domestic debt.

Global Financial Integrity has researched illicit outflows from India between 1948 and 2008. This unique study captures the rates of outflows through the period of trade liberalization in the 1990s. It found that trade liberalization, which led to more trade openness and deregulation also provided more opportunities to transfer capital illicitly overseas through mispricing.<sup>163</sup> Global Financial Integrity estimates that 77.6

percent of illicit capital outflows from India are the result of trade mispricing.<sup>164</sup> It argues that the fast pace of economic growth in India has led to worsening rates of illicit capital flight which is also correlated with worsening income distribution.<sup>165</sup> It states that "as income distribution worsens, there are a larger number of high net worth individuals who are the main drivers of illicit financial flows. In this way, faster economic growth can actually drive capital flight."<sup>166</sup> The Financial Action Task Force estimates that the most prevalent forms of capital flight come from bribe-taking or kickbacks, extortion, self-dealing and conflict of interest, and fraudulently embezzling the country's treasury.<sup>167</sup> According to the Financial Action Task Force, the majority of money-laundering done by organized crime is done through offshore corporations and trade-based money laundering.<sup>168</sup> Illicit capital flight cannot be thought of as "transactional corruption" because it is more often than not based on mispricing related to bookkeeping and faulty invoicing.<sup>169</sup> Global Financial Integrity estimates that 72 percent of illicit assets held abroad represent India's underground economy, whereas only 28 percent of illicit assets are held domestically, which bolsters the argument that agents desire to accumulate wealth without attracting government attention.<sup>170</sup>

Some have argued that tax sheltering is a necessary response to high taxes and is a sound management strategy to maximize shareholder profit.<sup>171</sup> Some tax shelters do offer low or no tax rates, yet it appears as though their main appeal is the secrecy laws and high levels of confidentiality.<sup>172</sup> For example, agents can rely on legal arrangements which do not make it mandatory to register a trust or the name or place of a company's true beneficial owner.<sup>173</sup> The Financial Action Task Force experts believe that the best vehicles for money laundering the proceeds of corruption are corporate vehicles, trusts, and non-profit entities.<sup>174</sup> Launderers also rely on the jurisdictions' laws which make it easy to create and dissolve corporate entities, use nominee directors to disguise ownership, and for intermediaries to create multi-jurisdictional structures.<sup>175</sup> Furthermore, secrecy jurisdictions lack adequate information exchange mechanisms with other countries.

This is being seen on a large scale today in Russia. Following the Magnitsky Affair, *Novaya Gazeta* uncovered a large network straddling several jurisdictions of shell companies and nominee directors. These have been used to funnel money from the state revenue service and state-owned enterprises to offshore accounts and real estate developments in Montenegro – which coincidentally also belong to high-level bureaucrats.<sup>176</sup> Another scheme involves collusion between government officials and organized crime, as well as shell companies, nominee directors, and multiple offshore jurisdictions including in the UK, Switzerland, New Zealand, China, Latvia, and Ukraine.<sup>177</sup>

<sup>158</sup> Kar and Freitas, *Illicit Financial Flows 2009*, viii.

<sup>159</sup> Xin Haiguang, "China's Great Swindle: How Public Officials Stole \$120 Billion and Fled the Country," *Time World* (2011), online: <www.time.com>.

<sup>160</sup> Kar and Freitas, *Illicit Financial Flows 2009*, vii.

<sup>161</sup> Ibid.

<sup>162</sup> Vrishi Beniwal, "India Wants Foreign Govts to Seize Assets of Tax Evaders," *Business Standard* (2011), online: <www.business-standard.com>; Dev Kar, *The Drivers and Dynamics of Illicit Financial Flows from India: 1948-2008* (Washington DC: Global Financial Integrity, 2010), iii.

<sup>163</sup> Kar, *Drivers and Dynamics*, vii-ix.

<sup>164</sup> Ibid., 47.

<sup>165</sup> Ibid.

<sup>166</sup> Ibid.

<sup>167</sup> *Laundering the Proceeds of Organized Crime*, (Paris: Financial Action Task Force, 2011), 16.

<sup>168</sup> Kar, *Drivers and Dynamics*, 48.

<sup>169</sup> Ibid.

<sup>170</sup> Ibid., vii.

<sup>171</sup> Christensen, "The Looting Continues," 190.

<sup>172</sup> Christensen, "The Hidden Trillions: Secrecy, Corruption, and the Offshore Interface," 329.

<sup>173</sup> Ibid., 333.

<sup>174</sup> *Laundering the Proceeds of Organized Crime*, 17.

<sup>175</sup> Ibid., 18.

<sup>176</sup> Roman Anin, "Russian Money Buried in Montenegro," *Novaya Gazeta* (2011), online: <en.novayagazeta.ru>.

<sup>177</sup> Roman Anin, "Suspicious Activity Report: How does the Global Money Laundering Machine Work?" *Novaya Gazeta* (2011), online: <en.novayagazeta.ru>.

Capital flight is a problem that transcends the governance of individual states, because it involves extrajurisdictional laws and international cooperation. The era of the Washington Consensus espoused the virtues of trade liberalization, deregulation, small governments, and free trade, but with this also broke down international rules regulating money laundering and secrecy jurisdictions.<sup>178</sup> Capital flight is dependent on jurisdictions that have deliberately opaque laws, high confidentiality, and lax requirements for reporting beneficial owners. Thus, even if the BRIC countries could do everything in their power to enforce compliance, without adequate international rules and cooperation they can achieve very little. India, has tried to overcome this problem by creating an incentive program which would allow agents with foreign capital to repatriate their money without suffering severe penalties.<sup>179</sup> The program works by allowing individuals to transfer money back to an India bank and pay a 15 percent tax on the money without any questions asked. This incentive is similar to other schemes created in the US and European Union.<sup>180</sup> These programs have had moderate success and are contingent on the government carefully calibrating the periods of amnesty with the periods of enforcement.<sup>181</sup>

The BRIC countries, nevertheless, have a role to play in improving the regulations governing tax evasion and capital flight. For example, a major driver of capital flight in India is the large underground economy and inadequate tax-collection mechanisms. The result of which is that only a fraction of the population – mostly the middle class – actually pays its taxes.<sup>182</sup> In China an estimated 18,000 Communist Party officials have managed to secret money away by taking advantage of lax government oversight and no laws on disclosure of income and assets (see box 5.1).<sup>183</sup> Lax monitoring of financial institutions and due diligence are some of the largest risk factors for money laundering of corruption proceeds.<sup>184</sup> For example, in the Russian money laundering case described above, a St Petersburg construction company transferred 7.5 million rubles, roughly US\$240,000, a day for two months to a Latvian company that was considered inactive.<sup>185</sup> This should have immediately been investigated under Russia's anti-money laundering legislation, but wasn't.<sup>186</sup> These problems may be improved by strengthening tax collection, regulatory oversight of financial institutions, strengthening laws on asset disclosure, and law enforcement to ensure that enforcement is implemented swiftly and effectively.

## ORGANIZED CRIME

Organized crime and corruption are so intrinsically linked that it is next to impossible to separate them. Organized crime can be any number of things but generally includes “the extension of legitimate market activities into areas which are normally proscribed ... for the pursuit of profit and in response to latent illicit demand.”<sup>187</sup> Reed breaks the difference down into primary and enabling activities of which corruption is part of the latter category.<sup>188</sup> Primary activities include everything from counterfeiting; drug and human trafficking; protection rackets; prostitution and gambling; and fraud and white-collar crime. Corruption is used by organized crime

<sup>178</sup> Christensen, “The Hidden Trillions: Secrecy, Corruption, and the Offshore Interface,” 331.

<sup>179</sup> Sugata Ghosh, “Black Money: Legitimise it by Paying 15% tax, Park it in India,” *The Economic Times* (2011), online: <articles.economictimes.indiatimes.com>.

<sup>180</sup> Nandini Ramanujam et al., “US Economic Regulation – Current Mechanisms for Enforcement,” (McGill University Faculty of Law, 2011).

<sup>181</sup> Ibid.

<sup>182</sup> Kar, *Drivers and Dynamics*, 47.

<sup>183</sup> Haiguang, “China's Great Swindle.”

<sup>184</sup> *Laundering the Proceeds of Organized Crime*, 29.

<sup>185</sup> Anin, “Suspicious Activity Report.”

<sup>186</sup> Ibid.

<sup>187</sup> Dwight C. Smith, *The Mafia Mystique* (New York: Basic Books, 1975), 335.

<sup>188</sup> Quentin Reed, *Squeezing a Balloon?: Challenging the Nexus between Organised Crime and Corruption* (Bergen: U4 Anti-Corruption Resource Centre, 2009), 11.

to protect and advance its primary activities. Thus the only real difference between organized crime and corruption in business is that the activity protected is not authorized or legitimate. Corruption can exist in any form: from petty corruption and bribery to state capture by criminal groups to bias law making, law enforcement, and judicial decisions.<sup>189</sup> Corruption is also one of the best ways for organized crime to infiltrate the state.<sup>190</sup>

**Table 5.6:** The Extent to Which Organized Crime Influences Policy

Country	Rank
BRAZIL	120 <sup>th</sup>
CHINA	88 <sup>th</sup>
INDIA	82 <sup>nd</sup>
RUSSIA	119 <sup>th</sup>

**Source:** *The Global Competitiveness Report 2011-2012* edited by Klaus Schwab (Geneva: World Economic Forum, 2011).

**Note:** rank out of 142 countries

In Russia's case the mafia benefitted from the collapse of the Soviet Union and took over much of the economic space left by the collapse of its institutions. By 1993 it was thought that organized crime controlled 40 percent of the turnover in goods and services and 50 percent of privatized capital.<sup>191</sup> Organized crime in Russia took on three particularly disturbing characteristics early in the 1990s which included indiscriminate violence, transnational networks, and infiltration of law enforcement.<sup>192</sup> The most notable examples involved the privatization process, in which a small group of individuals with close political links to President Yeltsin's inner circle rigged the privatization process in their favour. In so doing, these “oligarchs” acquired privatized businesses and banks at incredibly low prices. Instead of investing their new wealth back into the economy they stashed billions away in Swiss bank accounts.<sup>193</sup> Some of these oligarchs had links to organized crime. For example, the oligarch Berezovsky had strong relationships with Russian gangsters especially the Chechen mafia.<sup>194</sup> Since the 1990s organized crime has become less overtly violent and instead infiltrated large parts of the legitimate economy.<sup>195</sup> It has retained its close but complex relationship between private businesses and the state. Today the most prevalent form of organized crime in Russia is infiltration in the political arena which has enabled it to influence law making and enforcement of judicial decisions.<sup>196</sup> Russian organized crime is notably not based on hierarchy, but rather, according to Finckenauer and Waring it operates in a mix of opportunistic groupings of individuals involved in small networks; it is rarely centralized or if it is it rarely outlives the lives of the central actors.<sup>197</sup> These types of relationships are evident in recent investigations relating to the Magnitsky Affair and other money-laundering schemes.<sup>198</sup>

<sup>189</sup> Ibid., 12.

<sup>190</sup> Ibid., 8.

<sup>191</sup> Sun, “Reform, State, and Corruption,” 3.

<sup>192</sup> Leslie Holmes, “Corruption and Organised Crime in Putin's Russia,” *Europe-Asia Studies* 60, no. 6 (2008), 1013.

<sup>193</sup> Johanna Granville, “Review Article: The Rise of Russian Organised Crime and Russian Kleptocracy,” *Global Society* 17, no. 3 (2003), 324.

<sup>194</sup> Ibid., 326.

<sup>195</sup> Holmes, “Corruption and Organised Crime in Putin's Russia,” 1014-15.

<sup>196</sup> Marie Chêne, *Organized Crime and Corruption*, ed. Robin Hess (Berlin: U4 Anti-Corruption Resource Centre, 2008), 5.

<sup>197</sup> James O. Finckenauer and Elin J. Waring, *Russian Mafia in America: Immigration, Culture, and Crime* (Boston: Northeastern University Press, 1998), 198-99.

<sup>198</sup> Anin, “Suspicious Activity Report.”

**Box 5.3: Magnitsky Affair**

Hermitage Capital had been one of the largest foreign investors in Russia and had a reputation in the early 2000s of exposing corruption in large corporations. In 2005 tax officials raided its offices, charged it with tax evasion and banned its CEO, William Browder, from Russia. Later, officials transferred all of its legal certificates to Victor Markelov, a convicted murderer. Next, according to Browder, a strange series of events transpired whereby Markelov first attempted to liquidate the fund's assets with the help of fake judgments, but when he failed to do so he claimed US\$230 million in tax rebates from the Russian government based on fraudulent information. Although this was the largest tax rebate request in Russian history, the tax authorities granted it to him one day later.<sup>v</sup> In 2008, Sergei Magnitsky, one of Hermitage Capital's lawyers, testified to the Russian State Investigative Committee against police officers and Interior Ministry officials regarding the allegedly fraudulent US\$230 million tax rebate. Days later the same police officers he testified against arrested him for tax evasion. In pretrial detention he was tortured and subjected to extreme forms of exposure. A year after his arrest he died after being refused medical treatment.

Fuelled largely by Browder, the international media reported widely on Magnitsky's death. In 2010 the EU and US released the so-called "Magnitsky List" of 60 Russian officials, including judges, who have been implicated in the scandal. The US has imposed a visa ban on those officials and various EU countries have also considered imposing a visa ban and freezing their assets.<sup>vi</sup> Many western countries have called for an inquiry into the whole affair.<sup>vii</sup>

Following Magnitsky's death, President Medvedev authorized the independent watchdog Moscow Public Oversight Commission to investigate his death. It released a report which stated that Magnitsky had been deliberately neglected and probably beaten to death by prison officials.<sup>viii</sup> As a result, a doctor has been charged with negligence.<sup>ix</sup> President Medvedev also fired 20 top federal prison officials in December 2009 and the head of the tax crimes department in Moscow. He then announced that the case will lead to a reform of pretrial detention procedures. No other officials have been charged in the case, however, a judge who was on the "Magnitsky List" has been suspended as head of Moscow's Judicial Qualifications Committee, although he is still a sitting judge.<sup>x</sup> In February 2012, Russian police stated that they were resubmitting Magnitsky's case for trial which would make Magnitsky the first person to be tried posthumously in Russian history. Browder will be tried as his co-defendant in absentia.<sup>xi</sup>

<sup>v</sup> Bill Browder on Russian Corruption and the Experience of Losing \$900 million, (Cambridge Judge Business School: YouTube, 2011).

<sup>vi</sup> "British MPs Urge Magnitsky List Sanctions," *Ria Novosti* (March 8 2012), online: <en.rian.ru>; Philip Aldrick, "Bill Browder: the Man Making Moscow Squirm over the Death of Sergei Magnitsky," *The Telegraph* (2011), online: <www.telegraph.co.uk>.

<sup>vii</sup> Andrew Rettman, "European MPs Call for International Enquiry into Magnitsky Affair," *EU Observer* (2012), online: <euobserver.com>.

<sup>viii</sup> "Russian Lawyer was Probably Beaten to Death in Jail, says Kremlin Council," *The Guardian* (2011), online: <www.guardian.co.uk>; "British MPs Urge Magnitsky List Sanctions."

<sup>ix</sup> Michael Schwartz, "In Russia, Charges Are Dropped in Jail Death," *The New York Times* (2012), online: <www.nytimes.com>.

<sup>x</sup> "Magnitsky List' Court Chairman Fired," *Ria Novosti* (April 28 2012), online: <en.rian.ru>.

<sup>xi</sup> Andrew E. Kramer, "Russia Plans to Retry Dead Lawyer in Tax Case," *The New York Times* (February 7 2012), online: <www.nytimes.com>.

**Source:** William E. Pomeranz "The Magnitsky Case and the Limits of Russian Legal Reform." *Russian Analytical Digest* 92 (2011).

Organized crime and corruption are so interrelated that they thrive from the same factors. They both thrive in countries with lax regulation of financial institutions, poor oversight of banks and the private sector, and weak money laundering legislation.<sup>199</sup> Organized crime is lower in countries where conviction rates per crime are higher and studies have shown that the integrity and independence of the judiciary is the most important predictor of the extent of organized crime.<sup>200</sup> It is also associated with jurisdictions that have poor enforcement of property rights.<sup>201</sup> Thus, it can easily be said that where rule of law is weak, especially where the independence and integrity of institutions is concerned, organized crime is more prevalent.

## ANTI-CORRUPTION ACCOUNTABILITY ACROSS THE BRICS

The BRIC countries each struggle with creating accountability for corrupt behaviour. Most of the anti-corruption laws are poorly implemented, especially in India which has had anti-corruption laws for decades but seen poor enforcement. In each country there is a large discrepancy between *de jure* and *de facto* law. In addition, each country's government has favoured a top-down approach to reforms. India, Russia, and China are unwilling to grant sufficient independence to the institutions which investigate and discipline corruption. Since much of the anti-corruption effort is controlled by the centre, especially in Russia and China where it emanates from the President and the Chinese Communist Party respectively, it does not leave much room for other monitoring institutions such as media or civil society to have any meaningful impact. This section is complemented by a database of anti-corruption legislation in each BRIC country.

### LEGAL FRAMEWORK

*The government is overly exuberant in making laws but equally lax in enforcing them.*<sup>202</sup>

Each of the BRIC countries has made great strides in the last decade to update their anti-corruption laws. They have actively adopted national anti-corruption strategies, signed international conventions, and implemented a version of foreign bribery laws. The *Global Integrity Report* judges that the legal framework to combat corruption in each country is strong, but that actual practices and arbitrary implementation renders it largely ineffective.<sup>203</sup> Many of these laws are so fresh that their effectiveness is still untested. Yet overwhelming evidence shows that the success of a law rests on its implementation, which is largely a function of political will. Thus, to understand mechanisms for corruption accountability that exist it is important to put the legal framework context.

<sup>199</sup> E. Buscaglia, "Controlling Organized Crime and Corruption in the Public Sector" (2003), 11.

<sup>200</sup> Chêne, *Organized Crime and Corruption*, 4.

<sup>201</sup> Buscaglia, "Controlling Organized Crime," 7.

<sup>202</sup> This statement was about India, but could equally apply to the outcomes of many of the other BRIC countries; Heston and Kumar, "Institutional Flaws and Corruption Incentives in India," 1253.

<sup>203</sup> "Scorecard: Russian Federation 2010"; "Scorecard: India 2011," in *Global Integrity Report* (Washington, DC: Global Integrity, 2011); "Scorecard: Brazil 2009," in *Global Integrity Report* (Washington, DC: Global Integrity, 2009); "Scorecard: China 2011," in *Global Integrity Report* (Washington, DC: Global Integrity, 2011).

All four BRIC countries have criminalized bribe giving and bribe taking.<sup>204</sup> In each it is also a criminal offense for a public official to extort the public<sup>205</sup> and launder money.<sup>206</sup> In all of these countries it is also illegal to “attempt” or offer a bribe.<sup>207</sup> Neither Russia nor Brazil subject legal persons to criminal sanctions for bribery. Bill No. 6826/2010 addresses corporate civil liability in Brazil but has not yet passed.<sup>208</sup> Russia has created penalties for legal persons in the *Code of Administrative Offenses*. The Group of States Against Corruption (GRECO) concludes that this provision is insufficient, however, because criminalization is different from an administrative offense.<sup>209</sup> The offense’s location in the *Code of Administrative Offenses* does not make it weak *per se*, but it means that the offense does not have the same broad scope nor is it complemented by lesser included offenses. For example, the elements of the offense of bribery in the *Criminal Code* include attempts, whereas the *Code of Administrative Offenses* provision does not include attempts. Thus, it follows that, while natural persons can be penalized for *attempting* bribery, legal persons cannot.

Each country has signed the *United Nations Convention Against Corruption* (UNCAC). Much of the effort that China has put into updating its corruption laws are as a direct result of ratifying this convention. Each country has taken steps to adopt legislation on bribery of foreign officials. Brazil adopted the *OECD Convention on Combating Bribery of Foreign Public Officials* early in 1996, while Russia signed it in February 2012 and is in the process of ratifying it. Neither China nor India have signed the OECD convention, but in May 2011 China adopted an amendment to its *Criminal Code* that includes bribery of foreign officials.<sup>210</sup> In 2011 India tabled a bill in Parliament entitled *The Prevention of Bribery of Foreign Public Officials and Officials of Public International Organisations*.<sup>211</sup>

There has equally been a lot of activity in the BRIC countries to adopt “Sunshine Laws,” including regulations on accessing government documents and publishing public officials’ asset information.<sup>212</sup> In Brazil this led to the *Ficha Limpa* law which was a result of a popular referendum following a series of political corruption scandals.<sup>213</sup> The law makes it illegal for officials who have been convicted of a list of crimes including fraud and corruption from running for office. India’s *Right to Information Act, 2005* has proved to be incredibly popular among citizens’ and media who have used it to expose incidences of maladministration and corruption. It is particularly effective since officials are penalized if they take longer than 30 days to release information. Central Information Commission data reveals that between 2009 and 2010 only 6.43 percent of information requests made were denied.<sup>214</sup> India’s *Representation of the Peoples’ Act* is meant to disqualify people with criminal backgrounds (like *Ficha Limpa*) but the law has rarely been enforced. In 2009, as many as

150 newly elected members of parliament in the *Lok Sabha* (lower house) had criminal cases pending against them for offenses such as murder, kidnapping, forgery, and theft.<sup>215</sup> Russia has no laws on asset disclosure for government officials in the executive branch, whereas as of 2011, members of the legislative branch are required to submit asset information.<sup>216</sup> Russia’s access to information law was enacted in 2009, but its effectiveness is limited because it does not contain clear grounds on which a request may be denied, therefore refusals are often made without clear justifications.<sup>217</sup> China’s access to information law is applicable to government agencies and extends down to provinces and townships. Like Russia, the law’s main drawback is that there is no clear line between what is considered a state secret and a government document and therefore requests may be denied for unclear reasons.<sup>218</sup>

### ANTI-CORRUPTION LEGISLATION IN PRACTICE IN INDIA, RUSSIA, AND CHINA

Ironically, India has the longest history of anti-corruption laws amongst all of the BRIC countries. The debate over the extent and interpretation of the legislation has gone to the very core of constitutional debates on the accountability of politicians, rule of law, and division of powers. As early as 1860, the Indian *Penal Code* contained a punishment for corruption defined as “acceptance by public servants of any gratification, other than legal remuneration, in exchange for an official act.”<sup>219</sup> Next came the *Prevention of Corruption Act, 1947*. The Act’s powers have been gradually expanded over the years, notably following recommendations by the 1964 Santhanam Commission which recommended the creation of an independent anti-corruption watchdog. The *Prevention of Corruption Act, 1988* consolidated several other pieces of anti-corruption legislation, expanded the definition of corruption and increased penalties.<sup>220</sup> In 1997 the Supreme Court pronounced on fundamental aspects of rule of law and the accountability of politicians stating that, “none stands above the law so that an alleged offense by him is not required to be investigated.”<sup>221</sup> Before the ruling, the law contained several grey zones which allowed prosecutors to dither when high-profile individuals were involved. The Supreme Court stated in 1997 that: “Inertia was the common rule whenever the alleged offender was a powerful person.”<sup>222</sup> Ultimately, this decision stated that politicians were subject to investigation by the anti-corruption watchdog. Despite these major breakthroughs, India maintains one of the highest rates of corruption in the public sector of the all the BRIC countries, a problem due in large part to a slow cumbersome judicial system, under-funding of the independent watchdog, and lingering political interference (of which more later).

<sup>204</sup> Brazil, *Penal Code*, Law 2,848/40, art 317, 333; Russia, *Criminal Code*, No. 63-FZ of June 13, 1996, art 290, 291; India, *Prevention of Corruption Act, 1988*, No. 49 of 1988; China, PRC Criminal Law, arts 385, 388, 389.

<sup>205</sup> Brazil, *Penal Code* art 158; Russia, *Criminal Code* art 163; India, *Penal Code*, No. 45 of 1860 s. 383; China, PRC Criminal Law, art 274.

<sup>206</sup> Brazil, Law 9,613/98; Russia, *Criminal Code* art 174; Russia, “Federal Law on Combatting Legalization (Laundering) of Criminally Gained Income and Financing Terrorism, 2001” No. 115-FZ; India, *Prevention of Money Laundering Act, 2002*, No. 15 of 2003; China, Criminal Law, art 191; China “Anti-Money Laundering Law, 2006.”

<sup>207</sup> Brazil, *Penal Code* art 333; Russia, *Criminal Code*, art 229-230; India, *Prevention of Corruption Act, 1988* s. 12, 14; China, PRC Criminal Law art 23.

<sup>208</sup> Brazil, Draft Bill No. 6,826/2010.

<sup>209</sup> “Compliance Report on the Russian Federation,” in *Joint First and Second Round Evaluation*, adopted by GRECO at its 49th Plenary Meeting (Strasbourg: Group of States Against Corruption, 2010), 7.

<sup>210</sup> China, PRC Criminal Law, art 164 & eighth amendment.

<sup>211</sup> India, *The Prevention of Bribery of Foreign Public Officials and Officials of Public International Organisations*, Bill No. 26 of 2011.

<sup>212</sup> Brazil, Constitution of the Federative Republic of Brazil of 1988, art 4 item 33; Russia, “On Providing Access to Information on the Activities of State Bodies and Bodies of Local Self-Government, 2009,” No. 8-FZ; India, *Right to Information Act, 2005*, No. 22 of 2005; China, “Regulations of the People’s Republic of China on Making Public Government Information, 2008.”

<sup>213</sup> Brazil, “Clean Record Law” [*Ficha Limpa*], Lei 9840/1999.

<sup>214</sup> “Scorecard: India 2011,” 13a.

<sup>215</sup> India, *Representation of the Peoples’ Act, 1951*; “150 Newly Elected MPs Have Criminal Records,” *Hindustan Times* (May 17 2009), online: <www.hindustantimes.com>; Gurmukh Singh, “India’s Culture of Black Money,” *The Globe and Mail* (August 18 2011), online: <www.theglobeandmail.com>.

<sup>216</sup> Russia, “Amendment to Law ‘On Combatting Corruption’ and ‘On Banks and Banking Activities,’” 2011, No. 329-FZ.

<sup>217</sup> Russia, “On Providing Access to Information on the Activities of State Bodies and Bodies of Local Self-Government, 2009,” No. 8-FZ.

<sup>218</sup> “Scorecard: China 2011.”

<sup>219</sup> V. K. Shunglu, “India’s Anti-corruption Strategy,” *Combating Corruption in Asian and Pacific Economies*. Manila: Asian Development Bank (2000), 13 cited in Jon S. T. Quah, “Curbing Corruption in India: An Impossible Dream?” *Asian Journal of Political Science* 16, no. 3 (2008), 245.

<sup>220</sup> Heston and Kumar, “Institutional Flaws and Corruption Incentives in India,” 1252.

<sup>221</sup> Supreme Court quoted in Krishn K. Tummala, “Combating Corruption: Lessons out of India,” *International Public Management Review* 10, no. 1 (2009), online: <www.ipmr.net>, 48.

<sup>222</sup> Supreme Court quoted in *ibid*.

President Medvedev passed wide sweeping anti-corruption legislation in 2008 to bring Russia up to date with its obligations under UNCAC.<sup>223</sup> He amended twenty federal laws regulating the activities of government agencies, the police, and courts. Nevertheless, Russia's anti-corruption legislation still suffers from several important weaknesses. While the penalties for corruption are quite high, and have even been expanded, they are severely undermined by the practice of suspended sentences. The punishment for bribe taking is five to ten years in prison and a three year prohibition on holding certain positions or engaging in certain activities.<sup>224</sup> When the crime is extortion associated with an organized group and committed on a large scale, the sentence is seven to twelve years.<sup>225</sup> In 2011, Medvedev announced that he would increase fines for corruption offenses based on the size of the bribe making fines range from between 25,000 and 500 million rubles – roughly US\$792 and US\$15,8 million.<sup>226</sup> Despite the relatively severe penalties the conviction rates for corruption cases are dismally low. The rates for high-level officials included three who were convicted in 2003, thirteen in 2004, and six in 2005.<sup>227</sup> In 2005, the total number of convictions for bribe taking and giving was 2,652.<sup>228</sup> In 2010, the Ministry of the Interior stated that it had initiated 10,000 cases for bribery and 1,700 cases for bribery in business transactions and that 8,500 had been convicted of these crimes.<sup>229</sup>

When a person is convicted in Russia, a majority of sentences are suspended. Of those convicted in 2005, 86 percent of bribe-taking convictions and 64 percent of bribe-giving convictions resulted in a suspended sentence.<sup>230</sup> A real life example of this involved the conviction of former Atomic Energy Minister Yevgeny Adamov to 5.5 years in jail for defrauding the government of US\$31 million. After two months in prison, a judge suspended his sentence and he did not have to serve out the rest of his jail time.<sup>231</sup> One of the most important flaws of the suspended sentences is that there are no criteria for their application. This system can be distorted by corrupt judges who can impose a tough sentence to be seen to do justice, but later suspend it. Thus, the implementation of anti-corruption laws in Russia has largely targeted low-level officials and the majority of those convictions have resulted in suspended sentences.

The implementation of China's anti-corruption legislation has led to dozens of high profile convictions. Investigations, arrests, and convictions have been steadily rising over the last decade with 32,439 officials charged in 2009.<sup>232</sup> The penalties for corruption and abuse of public trust in China are the most severe of any BRIC country and include large fines, long prison sentences, and even the death penalty.<sup>233</sup> China does not appear to shy away from convicting high-profile individuals such as the former Mayor of Beijing, the former chairman of Sinopec (China's largest state-owned

enterprise), or a former top judge in the province of Chongqing.<sup>234</sup> It is a common practice in China, as in Russia, to couple harsh penalties with suspended sentences.<sup>235</sup> Thus, in 2009 the Chairman of Sinopec was convicted of bribery and received a death sentence which was commuted to a two-year reprieve.<sup>236</sup> Nevertheless, China has followed through with many of its sentences including the judge in Chongqing who was actually executed for corruption (see corruption box 5.1).<sup>237</sup>

Death sentences in corruption convictions are a uniquely Chinese phenomenon. They are used for their strong deterrent effect and are symbolic of the state handing down exaggerated sentences as a way to be seen to combat corruption. Besides the important human rights implications, there is no evidence that death sentences actually deter rates of corruption. Most corruption convictions are not in fact handed down by courts but by the extra-legal Party Disciplinary Committee which only relies on the *Criminal Code* for reference and does not follow strict procedural rules.<sup>238</sup> For example, China prides itself on a 99 percent conviction rate, due in large part to procedural rules which effectively view the defendant as guilty until proven innocent.<sup>239</sup> They rarely take into account the defendant's rights and can impose harsh sentences which far outweigh the original crime. The implementation of China's anti-corruption laws appears to go hand in hand with large-scale political crackdowns and the sentences act as a dramatic deterrent to potential wrongdoers. It is a potent example of state heavy handedness. It shows the state exerting its authority to crack-down on an economic and political threat rather than dealing with the culture and institutions that perpetuate corruption.

### ANTI-CORRUPTION AGENCIES AND POLITICAL INTERFERENCE IN CHINA, RUSSIA, INDIA, AND BRAZIL

An overwhelming problem in India, Russia, and China is the government's unwillingness to grant independence to the bodies that investigate corruption. Institutional independence is a necessary component in oversight agencies to insulate its actors from political interference. Yet it is not always easy to define or adequately create independence. Often a legal framework is the starting point as it creates a foundation upon which institutions may build their practices. While a legal framework may exist to keep an institution economically, administratively, and politically independent other extralegal factors may undermine this independence. The practice of political control is highly dependent on context and can be fostered by extralegal practices, education, and institutional culture which promote independence.

On paper, India has a comprehensive state mandated system of anti-corruption oversight. It has the Central Vigilance Commission and the Central Bureau of Investigation. Under the *Prevention of Corruption Act, 1988* and the *Central Vigilance Commission Act, 2003* the Central Vigilance Commission is an independent watchdog which has a mandate to make inquiries, supervise the integrity of administration, and oversee the investigations of the Central Bureau of Investigation. The Central Bureau of Investigation is under the Ministry of Personnel and is made up of several divisions which have the power to investigate cases of alleged corruption in

<sup>223</sup> Russia, "On Combating/Counteracting Corruption" No. 273-FZ of December 25, 2008; "On Amendments to Certain Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Law on Combating Corruption," No. 274-FZ of December 25, 2008; "On Amendments to Certain Legislative Acts of the Russian Federation in Relation to Ratification of the United Nations Convention on Countering Corruption, dated 31 October 2003 and the Criminal Law Convention on Corruption of January 27, 1999, and Adoption of the Federal Law 'On Counteraction to Corruption'" No. 280-FZ of December 25, 2008.

<sup>224</sup> Petr A. Skoblikov, "How is Corruption Punished in Present Day Russia: A Comparative Legal Analysis of Criminal Legislation and Judiciary Practice," *European Journal of Crime, Criminal Law and Criminal Justice* 14, no. 4 (2006), 442.

<sup>225</sup> *Ibid.*, 441.

<sup>226</sup> "Медведев Подписал Закон О Кратных Штрафах За Взятки," ["Medvedev Signs a Law on Fines for Taking Bribes"] *Ria Novosti* (2011), online: <en.rian.ru>.

<sup>227</sup> Skoblikov, "How is Corruption Punished in Present Day Russia?" 442.

<sup>228</sup> *Ibid.*, 444.

<sup>229</sup> Alexander Yakovenko, "Statement by Mr. Alexander Yakovenko, Deputy Minister of Foreign Affairs, Russia: Fighting Corruption in Russia," (Rome: OECD, November 27 2007), 2.

<sup>230</sup> Skoblikov, "How is Corruption Punished in Present Day Russia?" 444.

<sup>231</sup> Charles Digges, "Former Russian Atomic Minister Adamov Freed From Jail on a Suspended Sentence," *Bellona* (2008), online: <www.bellona.org>; "High-ranking Police Officer Gets Suspended Sentence for Fraud," *Russian Legal Information Agency* (2012), online: <www.rapsinews.com>.

<sup>232</sup> Zhang Yan, "Bribery Cases on the Rise in China," *China Daily* (2010), online: <www.chinadaily.com>.

<sup>233</sup> "China Mobile Executive Gets Death in Bribery Case," *China.org* (2011), online: <www.china.org.cn>.

<sup>234</sup> "China Country Profile: Political Climate," Business Anti-Corruption Portal (2011) online: <www.business-anti-corruption.com>; "Wen Qiang Executed by Lethal Injection," *China.org* (2010), online: <www.china.org.cn>.

<sup>235</sup> "Ex-China Mobile Official Gets Suspended Death Sentence," *China Daily* (July 23 2011), online: <www.chinadaily.org>.

<sup>236</sup> Yan, "Bribery Cases on the Rise in China."

<sup>237</sup> "Wen Qiang Executed by Lethal Injection."

<sup>238</sup> Teng Biao, "Blood, Justice and Corruption: Why the Chinese Love Their Death Penalty," *Time World* (2011), online: <www.time.com>.

<sup>239</sup> Stanley Lubman, "Rio Tinto Trial Shines Harsh Spotlight on Chinese Criminal Justice," *The Wall Street Journal* (2010), online: <blogs.wsj.com>.

all branches of the central government, ministries, public sector entities, and states (as long as it asks states' permission first). The Central Vigilance Commission is the only anti-corruption body of the BRICs which is legally protected from political interference. No matter, since in practice all of the anti-corruption agencies in India are riddled with allegations of political interference and irregularities in the appointment process.<sup>240</sup> In a groundbreaking case, the Supreme Court of India ruled in March 2011 that the government's appointment of P. J. Thomas as the head of the Central Vigilance Committee was illegal.<sup>241</sup> The Leader of the Opposition, who was supposed to be part of the appointment process, strongly objected to Thomas' appointment on the grounds that he was accused of corruption. The court did not rule that Thomas was incompetent, but in strong terms stated that there had been irregularities in his appointment and stated that the process had been vitiated by "official arbitrariness."<sup>242</sup> In that decision, the Supreme Court also provided guidelines for all future appointments. Considering the scandal and media attention that this trial provoked it is possible that in the short term at least, the position might be protected from political interference. This case illustrates that the courts, as well as the media's coverage of the case, may yet play a role in curbing political interference in the anti-corruption body.

The appointment and tenure the Central Bureau of Investigation's head is covered by the *All India Service Act, 1961*.<sup>243</sup> His appointment is made by a committee of the Central Vigilance Committee, thus its independence is contingent on the independence of the Central Vigilance Committee.<sup>244</sup> Until recently the Central Vigilance Committee and Central Bureau of Investigation were greatly impeded in their mandate since they could not proceed with an investigation until they obtained permission from a "higher authority," which was a major source of political interference.<sup>245</sup> The Central Bureau of Investigation has been exempted from the *Right to Information Act, 2005*, therefore information is contingent on the bureau's willingness to self-publish. The Central Bureau of Investigation is widely perceived to be a "pliable tool of the ruling party" and has had a poor record in investigating cases, receiving complaints, and seeing them through to trial.<sup>246</sup> The Central Bureau of Investigation's overall budget is less than half Hong Kong's Independent Commission Against Corruption which services a population a fraction of the size of India's (see box 5.4).<sup>247</sup> In addition, the Central Bureau of Investigation is overextended as it must also investigate terrorist activity. The statistics that exist suggest a poor record; in 2010 only 1,000 cases of corruption were registered with no statistics on how many actually got to court.<sup>248</sup> In 2011 the Central Bureau of Investigation registered a total of 689 cases with a monthly average of 86 cases.<sup>249</sup> Of that number only 502 cases were disposed of in 2011.<sup>250</sup>

<sup>240</sup> "Scorecard: India 2011," 75b.

<sup>241</sup> India, *Centre of India & Anr. Petitioner(s) v Union of India & Anr (Respondents)*, Writ Petition No. 355 of 2010.

<sup>242</sup> "Thomas no longer CVC: Supreme Court," *NDTV* (2011), online: <[www.ndtv.com](http://www.ndtv.com)>; Ibid para 33.

<sup>243</sup> India, *All India Services Act, 1951*, No. 61 of 1951.

<sup>244</sup> "Scorecard: India 2011," 75c.

<sup>245</sup> Ibid., 75h; Heston and Kumar, "Institutional Flaws and Corruption Incentives in India," 1252.

<sup>246</sup> S. S. Gill, *The Pathology of Corruption* (New Delhi: HarperCollins Publishers India, 1998), 238.

<sup>247</sup> Quah, "Curbing Corruption in India: An Impossible Dream?" 252.

<sup>248</sup> "Scorecard: India 2011," 75i.

<sup>249</sup> *Monthly Crimes Report of CBI*, (Central Bureau of Investigation, Policy Division, North Block, New Delhi, August 2011), 1.

<sup>250</sup> Ibid., 15.

#### Box 5.4: Hong Kong's Independent Commission Against Corruption (ICAC)

This agency was created in 1974. It is mandated to enforce anti-corruption law, prevent corruption, and engage in community education to fight corruption. It is mandated to introduce corruption resistant practices for compliance by, among others, government personnel. ICAC was set up following several highly publicized corruption scandals in Hong Kong in the 1970s and following a Commission of Inquiry into those scandals. In response to the recommendations by the Commission of Inquiry the government created ICAC. The agency was born out of political scandals, but also in an effort to reassure foreign investors that Hong Kong was a stable business environment.

Countries have focused much attention on ICAC because of its operational successes, relative freedom from internal corruption, and freedom from outside interference. Some of its major successes have been its ability to attract public support, its capacity to fit into a heterogeneous society, and ability to work across both public and private sectors. In addition, it has a strong focus on educational and preventative programs as well as intelligence gathering and a public complaints system. This commission has been so successful that it has inspired others in the world including the current *Lokpal Bill* in India.

The ICAC's success is largely due to the government's genuine will to create a strong institutional framework to combat corruption, by giving the agency enough formal and informal independence and resources. It is thus a leading example of the effectiveness of institutions over policy.

**Source:** Alan Doig, "Good Government and Sustainable Anti-Corruption Strategies: A Role for Independent Anti-Corruption Agencies?" *Public Administration and Development* 15, no. 2 (1995), 151-65; China, Hong-Kong, Independent Commission Against Corruption (website) online: <<http://www.icac.org.hk/en/home/index.html>>.

Most Indian states have a Lokayukta (Ombudsman) who receives complaints of corruption from citizens and has the power to advise and recommend actions to state officials.<sup>251</sup> More often than not Lokayukta are independent, but have few powers. Lokayukta have powers of investigation against state officials, but they may only make recommendations for action and thus have no direct powers of enforcement. They do, however, play a role in addressing systemic corruption in the public service. A popular movement led by Anna Hazare has tried to prompt the government to finally pass a national Ombudsman bill. His campaign has ignited a debate about the role, scope, and powers of the Lokpal in the Indian state. It has also become a lightning rod for the entire anti-corruption debate in the country. An ombudsman can be an effective institution to address systemic corruption in states which already have strong supporting institutions such as independent inquiries, effective law enforcement, and adequate bureaucratic oversight (see figure 5.5). In India's case, however, citizens have perhaps over exaggerated the potential of an ombudsman and see him as a figure that can do everything and anything.

Russia does not have a single unified anti-corruption body which is tasked with investigating corruption, monitoring implementation of laws, and proposing amendments to legislation. Instead, anti-corruption laws are enforced by the Federal Security Agency and the General Procurator's Office. In addition several parts of government have their own anti-corruption bodies including the Presidential Council on Combatting Corruption, the Duma's anti-corruption commission, and the Ministry of the Interior's anti-corruption body.<sup>252</sup>

<sup>251</sup> For more information see corruption laws database at the end of this report.

<sup>252</sup> "Scorecard: Russian Federation 2010," 74.

**Box 5.5:** Quebec's Public Protector (Ombudsman)

The Public Protector is neither a public servant nor politician, but instead a voice or intermediary for the public. She has the power to intervene in 90 government departments and agencies and at any level in the Quebec government's hierarchy. This is in contrast to parallel Canadian federal ombudspersons who have specialized mandates, such as Procurement Ombudsman and Military Ombudsman rather than government wide mandates. She may intervene on her own initiative when she has reasonable cause to believe that a person or group has suffered prejudice. The position is mandated to protect the values of justice, fairness, respect, and transparency. Her powers are defined by statute, yet they are still very broad. Her independence is guaranteed by fixed five-year terms and her nomination or dismissal by the Prime Minister must be approved by two-thirds of the National Assembly.

The ombudsman seeks to both prevent harm and correct it after it occurs. The office issues regular reports and recommendations for eliminating potential sources of problems. It also takes complaints from the public. When a complaint is admissible the ombudsman intervenes in the department or agency, using its investigative power if necessary, with the aim of correcting the wrongdoing. Notably, however, its powers are not coercive but advisory and it does not have powers of adjudication, only investigation. Importantly the ombudsman seeks to remedy problems that would not otherwise be actionable in courts. This recognizes that not all problems are suitable for adjudication.

Traditionally, these were roles performed by members of the legislative assembly, but as government has expanded to deliver more services they no longer have the ability or time to deal with the volume of complaints. The ombudsman derives most of her legitimacy as a public figure who disseminates her reports publicly and is respected as an informed but independent voice on the state of government administration.

**Sources:** Stewart Hyson, "A Primer on Federal Specialty Ombuds Offices" (2011) *Parliamentary Review* 34, 41; *Public Protector Act*, RSQ 1968, c P-32 s 13; D. Jacoby and P. Robardet "The Protecteur du Citoyen du Quebec as an Agent of Change" *Ombudsman Journal* (1993); Rhéal Séguin, "Quebec Ombudsman Urges Stronger Civilian Oversight of Police" *The Globe and Mail* (2012) online: <[www.theglobeandmail.com](http://www.theglobeandmail.com)>.

The Federal Security Agency and General Procurator's Office do all the heavy lifting by investigating and enforcing the laws. In law, the head of the Federal Security Agency and the General Procurator's Office are protected from political interference, but in practice they are appointed and dismissed by the President who often does not give a specific rationale for dismissing officials. For example, in 2011 President Medvedev dismissed the deputy head of the Federal Security Agency for "shortcomings in his work and code of ethics violations."<sup>253</sup> Although both the Federal Security Agency and General Procurator's Office receive adequate funding, they do not hire staff according to formalized merit criteria, they do not generally initiate investigations independently, nor do they regularly report their findings.<sup>254</sup> Encouragingly, however, the Federal Security Agency recently instituted a public complaint's system that has received many calls by citizens complaining about specific incidences of corruption, although they are rarely and only selectively acted on.<sup>255</sup> Unfortunately a similar system which was set up by the General Procurator's Office for businesspersons has remained unused.<sup>256</sup> GRECO had recommended that the General Procurator's Office take certain measures such as reorganizing the administrative structure, to make it

<sup>253</sup> Ibid., 75; "Medvedev Fires FSB Deputy Chief," *Ria Novosti* (2011), online: <[en.rian.ru](http://en.rian.ru)>.

<sup>254</sup> "Scorecard: Russian Federation 2010," 75.

<sup>255</sup> Ibid., 76.

<sup>256</sup> Ibid.

more professionally accountable, but Russia has taken no steps towards strengthening the operational independence or accountability of personnel.<sup>257</sup>

The question of who investigates corruption in Russia has been a component of a larger political struggle surrounding the incredibly powerful head of the General Procurator's Office, Yuri Chaika. Chaika has been pushing to control corruption investigations. In 2006 he created a unified anti-corruption department under the General Procurator's Office. Yet, he was butting heads with the Investigative Committee, which had been set up as a relatively independent oversight department within the General Procurator's Office. In 2009 Chaika dismissed heads of the Investigative Committees' Moscow branch for violating their oaths of office.<sup>258</sup> He later publicly criticized officials in the Investigative Committee for lack of professionalism.<sup>259</sup> In January 2011, Chaika lost his struggle when Medvedev created the Investigative Committee of the Russian Federation which is thought to be analogous to America's Federal Bureau of Investigation. It was set up to investigate any government official, public organization, or member of the media attempting to influence federal investigators.<sup>260</sup> The Investigative Committee is now institutionally distinct from the General Procurator's Office and removes much of its power. It answers only to the President and has the power to investigate most government departments and agencies including the General Procurator's Office.<sup>261</sup> In 2012 President Medvedev announced that this committee would include a special anti-corruption unit. The first chairman is Aleksandr Brastrykhin who was a former classmate of Putin's. The Investigative Committee may overcome many of the problems associated with the General Procurator's Office's lack of accountability and oversight. But the history of its creation suggests that it was created to wrest power from the formerly powerful Chaika and is just another example of political control. It is too new to tell if it will have the institutional structures that are required to make it independent and accountable.

As part of Russia's National Anti-Corruption Plan, Medvedev created the Presidential Council on Combatting Corruption. The council prepares proposals for the President on setting and implementing anti-corruption strategies, coordinates anti-corruption work with other regional authorities, and monitors the implementation of legislation. According to Russia's obligations under GRECO this body should be institutionally independent. GRECO, in its review of Russia's efforts, notes that this council is not independent from the President, that it has not set up a comprehensive plan to monitor legislation, nor has it gone far enough to engage with independent members of civil society.<sup>262</sup> The council is still in its infancy and has already made efforts to conduct broad based sociological surveys as a way to monitor the status of corruption work and legislation implementation. So far, the National Anti-Corruption Plan has done little to improve corruption. Indeed, President Medvedev noted that the results had been mediocre and added that a broader strategy should encourage independent organizations and the media to play a role in combatting corruption.<sup>263</sup>

In China, the Communist Party's strong grip on power means that when corruption is uncovered the Party has an efficient way of disciplining wrongdoers. The Party

<sup>257</sup> "Compliance Report on the Russian Federation," 10.

<sup>258</sup> Ethan S. Burger and Rosalia Gitau, "The Russian Anti-Corruption Campaign: Public Relations, Politics or Substantive Change?" *Georgetown Law Faculty Working Papers* (2010), 38.

<sup>259</sup> Ibid., 39.

<sup>260</sup> "Medvedev Sets up Independent Investigative Committee," *Ria Novosti* (2010), online: <[en.rian.ru](http://en.rian.ru)>.

<sup>261</sup> Brian Whitmore, "Russia: Powerful New Investigative Body Begins Work," *Radio Free Europe Radio Liberty* (2007), online: <<http://www.rferl.org/content/article/1078611.html>>.

<sup>262</sup> "Compliance Report on the Russian Federation," 5.

<sup>263</sup> Ellen Barry, "Medvedev, Unscripted, Admits Disappointments," *The New York Times* (April 26 2012), online: <[www.nytimes.com](http://www.nytimes.com)>; "Russia Country Profile: Public Anti-Corruption Initiatives," *Business Anti-Corruption Portal* (2011) online: <[www.business-anti-corruption.com](http://www.business-anti-corruption.com)>.

has displayed great resolve in combatting incidences of corruption and there have been waves of corruption crackdowns in 1982, 1985, 1988, 1989, 1992, the late 1990s, and the late 2000s.<sup>264</sup> The Party has more often than not been the instigator of anti-corruption efforts as well as the investigator and ultimate disciplinor of wrongdoers. This happens mostly through the extralegal Discipline Inspection Committee and is the result of anti-corruption campaigns which take the form of “five-year plans.” Thus, the party picks up all the slack left behind from weak rules, weak law enforcement, and a corrupt judiciary. This is no coincidence as these weak institutions are a result of Party interference. This has created a particular problem since anti-corruption crackdowns are often the outcome of a political struggle and only target politically undesirable individuals. Unfortunately, this is a situation of the wolf wearing sheep’s clothing. The Party is at once the most effective punisher of wrongdoing as well as its greatest source: “As long as the Party officials retain authority over the judicial system through the political-legal committees and the selection of personnel through the nomenklatura system, the problem of undue influence will remain.”<sup>265</sup> As one expert has said: “Fight corruption too little and destroy the country; fight it too much and destroy the Party.”<sup>266</sup>

The Discipline Inspection Committee undermines existing laws since Party censure and discipline often replace criminal prosecution.<sup>267</sup> There is overlap between the functions of the committee and the people’s state procuratorates. The committee is responsible for the vast majority of anti-corruption enforcement as it investigates cases of corruption amongst Party members. As stated earlier, the committee only relies on the *Criminal Code* for reference and does not follow strict procedural rules. In 2010 it punished 146,517 members for corruption which led to 5,737 criminal prosecutions.<sup>268</sup> In addition, party cadres are often appointed to the procuratorates, which leaves politicians essentially policing themselves or their cronies.<sup>269</sup> This committee is also secretive and has been accused of being one of the most secret agencies in China.<sup>270</sup> Although it has launched crackdowns on high-level officials it has rarely provided specific details to the public on the nature of charges and alleged offenses.<sup>271</sup>

The Chinese Procuratorate is the sole agency in charge of investigating and enforcing violations of laws on behalf of the state for non-party members. While it is formally independent, in practice the procuratorate falls under Party rule.<sup>272</sup> Uniquely to the Chinese Constitution, the Procuratorate plays a key role in exercising “external supervision” of judges during trials, which adds to the difficulty of guaranteeing judicial impartiality.<sup>273</sup>

The National Corruption Prevention Bureau was set up in September 2007 and has been tasked with fulfilling China’s responsibilities under UNCAC. It is a unified single body which amalgamated anti-corruption departments across different ministries, formulates policies, and coordinates work on corruption prevention. The

<sup>264</sup> “Compliance Report on the Russian Federation,” 7; Edward Wong, “Former Insider Indicted in Chinese Corruption Scandal,” *The New York Times* (2011), online: <www.nytimes.com>; Peter Goodspeed, “Goodspeed Analysis: Bo Xilai Scandal a Symbol of Corruption that has Surged with Chinese Economy,” *National Post* (2012), online: <fullcomment.nationalpost.com>.

<sup>265</sup> Bergsten, “Corruption in China : Crisis or Constant?” 99.

<sup>266</sup> Communist Party official quoted in *ibid*.

<sup>267</sup> *Ibid*.

<sup>268</sup> Jaime FlorCruz, “Chinese Communist Chief Vows to Fight Corruption,” *CNN World* (2011), online: <articles.cnn.com>.

<sup>269</sup> Bergsten, “Corruption in China : Crisis or Constant?” 99.

<sup>270</sup> McAnsh Law, “China’s Anti Corruption Body Secretive, Least Transparent,” *The Indian Express* (2011), online: <www.indianexpress.com>.

<sup>271</sup> Bergsten, “Corruption in China : Crisis or Constant?” 99.

<sup>272</sup> China, PRC’s Constitution, art 131.

<sup>273</sup> Huang Songyou, “Procuratorial Supervision and the Independence of Trial,” *CASS Journal of Law* (2000), online: <en.cnki.com.cn>; Chen Weidong, “On the Procuratorial Integration and the Independence of Procurator,” *Chinese Journal of Law* (2006), online: <en.cnki.com.cn>.

National Corruption Prevention Bureau is not legally protected from political interference as it falls under the Communist Party and its leader is appointed by the Party.<sup>274</sup> Thus, while China has made many dramatic anti-corruption efforts, they are severely hampered by key institutions’ lack of independence. This renders the entire system vulnerable to ignoring systemic corruption.

Like China and Russia, Brazil does not have a unified anti-corruption agency. Brazil manages anti-corruption investigation and enforcement through different bodies such as the Comptroller General, law enforcement, and the Public Prosecutor’s office. It also has a body which monitors, studies, and proposes laws to aid in anti-corruption efforts called the Council for Public Transparency and Against Corruption. The council does not have any powers to change the administration of government ministries and acts instead in an advisory capacity.

Brazil’s Comptroller General has not been suspected of political interference despite a lack of any formal guarantees of political independence.<sup>275</sup> The office was created in 2003 to inspect and audit municipal and state governments to promote transparency and prevent corruption. The Comptroller General is appointed by and reports directly to the President. The President may arbitrarily remove the Comptroller General at any point in his mandate, which formally makes him very vulnerable to political manipulation. Yet, the Comptroller General appears to be doing a moderately effective job at investigating corruption. It has released regular public reports on its activities, its staff are considered professional and hired on a competitive basis.<sup>276</sup> It is relatively efficient and has been able to carry out regular investigations.<sup>277</sup> The Comptroller General’s lack of formal legal protections against political interference means that its integrity is dependent on the ability and skill of the sitting Comptroller General at the time, which has potential to make him vulnerable. Yet unlike China or Russia, this office appears to operate with relative integrity as a result of informal practices and professionalism. This implies that institutional independence is reliant on conventions and informal practices as well as formal guarantees, which also work in concert with other institutional guarantees such as democratic accountability, independent media, and civil society.

India, like Brazil fares well in terms of democratic accountability. Free media and active civil society organizations proactively maintain pressure on government to account for graft and corruption. Yet its anti-corruption watchdogs are inefficient, underfunded, and slow to deliver on their promises to weed out corruption. China has selective political will to combat corruption – that is, only in so far as it does not touch those who are in political favour. All anti-corruption efforts emanate from the Communist Party, which is highly secretive and prone to overly harsh sentences. This has the effect of rendering the crackdowns dramatic, but arbitrary. Russia’s anti-corruption strategy is suffering due to political infighting and lack of political will to tackle systemic corruption.

## BUREAUCRATIC INTEGRITY IN RUSSIA AND INDIA

Bureaucracies are the arm of government that implements policies and carries out day-to-day administration for the benefit of the public. A good bureaucracy is one of the main stakeholders required in the collaborative process of good governance.<sup>278</sup>

<sup>274</sup> “Scorecard: China 2011,” 75.

<sup>275</sup> Brazil, Federal Constitution, art 128.

<sup>276</sup> “Scorecard: Brazil 2009,” 75.

<sup>277</sup> “Anti-Corruption Profile - Brazil,” *TrustLaw: Thomson Reuters* (2012) online: <http://www.trust.org/trustlaw/country-profiles/good-governance.dot?id=09c59db9-55cf-42d3-a4e3-b3b584f20151>.

<sup>278</sup> See “The State of Governance Today” in the section on governance of this report.



Das suggests that a healthy bureaucracy must maintain four factors: meritocracy in the selection of candidates, an adequate reward system, internal and external control, and identification of the individual with the institution.<sup>279</sup>

India inherited a bureaucracy from the British and overtime it became renowned for recruiting only top candidates. Indeed, bureaucrats were revered by the public.<sup>280</sup> Following independence, the Indian Civil Service changed to the Indian Administrative Service which continued to attract top candidates until the early 1990s. Following market liberalization, the Indian Administrative Service could no longer compete with salaries in the private sector which in turn discouraged the best applicants from applying. Internal and external controls were loosened through degradation of oversight bodies because of political interference.<sup>281</sup> While members of the Indian Civil Service had been given a great deal of discretion in their decision making this potential problem seemed to be outweighed by strong professionalism, generous remuneration, and external and internal control. As these other factors weakened in the Indian Administrative Service, the bureaucrats' levels of discretion remained high.

The Indian Civil Service had been criticized for not being sufficiently responsive to the Indian public and following independence it readapted. Rather than becoming responsive to the needs of the public, however, it went one step too far and became overly responsive to political interference.<sup>282</sup> Politicians wielded power over bureaucrats by threatening transfer to distant or undesirable positions. This effectively silenced those who were ambitious and wished to retain their positions.<sup>283</sup> To respond to this growing problem, in 1962 the government set up an independent commission to study corruption in the civil service, known as the Santhanam Commission.<sup>284</sup> Among other findings, the commission reported that politicians were not sufficiently accountable for their actions, for example they were not subject to the *Prevention of Corruption Act, 1947*. The activities of the Central Vigilance Commission and Central Bureau of Investigation are largely directed towards the civil service, thus in principle it has an independent oversight mechanism. However, as we discussed earlier this is not entirely effective.

Russia also has a long bureaucratic tradition dating back to imperial times. Unlike, India's it has never attained the same level of prestige for its professionalism and integrity. The "Federal Law on Public Civil Service" mandates that the Russian public service be impartial and independent from government.<sup>285</sup> Yet even laws which are meant to regulate and encourage integrity have not been implemented. For example, the "Federal Law on Public Civil Service" states that a civil servant should inform an authorized person of any real or potential conflicts of interest, however, the procedure to effect this regulation has never been set up.<sup>286</sup> The commissions which regulate conflicts of interest in the service are opaque in the extreme and the commissions in charge do not release information on their activities or disclose conflicts of interest.<sup>287</sup> In practice this means that many public servants work in business and are in danger of conflict of interest. Recent legislation passed by President Medvedev

requiring civil servants to disclose their assets appears to be having a moderate effect in detecting corruption.<sup>288</sup> This includes raising red flags when officials purchase assets that are disproportionate to their stated incomes.

In practice, the service is heavily influenced by politics to the point where bureaucrats have been pressured into joining the governing United Russia Party.<sup>289</sup> Medvedev is thought to have populated the bureaucracy with officials who had backgrounds in civil law to counter the high numbers of security service veterans that had arrived under Putin.<sup>290</sup> It is rather exceptional for a civil servant to be hired on the basis of merit rather than personal connections, a problem which President Medvedev himself acknowledged.<sup>291</sup> Even amongst officials who consider it improper to accept outright bribes there appear to be no qualms about hiring based on family connections. Furthermore, formal restrictions on post-employment in the private sector are rarely enforced.<sup>292</sup> Medvedev has attempted to imbue the civil service with a culture of professionalism by restructuring the process of making high-level political appointments.<sup>293</sup> He has added strict new hiring guidelines based on merit, integrity, and professionalism for high-level political appointments in the regions. This is a positive step towards instilling a culture of meritocracy in government, which may yet trickle down to the bureaucracy.<sup>294</sup>

A groundbreaking analysis of Russian bureaucracy has shown that it still plays an important role in combatting corruption. Brown et al. studied the effectiveness of privatization against the size of regional bureaucracies in different Russian regions.<sup>295</sup> After studying the data from the 2009 BEEP survey, they discovered that the regions with larger bureaucracies had a more effective post-privatization business environment. The results also pointed to diminished rent-seeking behaviour. Their interpretation of the data was that large bureaucracies do not inherently produce inefficiencies or slow down efficient regulation, but instead allow bureaucrats to do their jobs more effectively with fewer delays and constraints. This study points to the positive impact that a bureaucracy can still play in fostering a competitive business environment.

If the bureaucracies of India and Russia are to play an effective role in state governance, they must effectively address the issues of professionalism, conflict of interest, merit, and oversight. As it is, positions in these bureaucracies are perceived as sources of private wealth accumulation rather than for public service. In general, the definition of administrative independence is variable, but in any administration independence can be bolstered by practices that foster professionalism, loyalty to the position, and openness rather than cronyism and group loyalty.

<sup>279</sup> S. K. Das, *Public Office, Private Interest: Bureaucracy and Corruption in India* (New Delhi: Oxford University Press, 2001); Paul H. Appleby, *Public Administration in India: Report of a Survey* (Manager of Publications, 1953) cited in Heston and Kumar, "Institutional Flaws and Corruption Incentives in India," 1249-50.

<sup>280</sup> Heston and Kumar, "Institutional Flaws and Corruption Incentives in India," 1249.

<sup>281</sup> *Ibid.*

<sup>282</sup> *Ibid.*, 1250.

<sup>283</sup> Pranab K. Bardhan, *Awakening Giants, Feet of Clay: Assessing the Economic Rise of China and India* (Princeton, N. J.: Princeton University Press, 2010), 38.

<sup>284</sup> Heston and Kumar, "Institutional Flaws and Corruption Incentives in India," 1252.

<sup>285</sup> Russia, "Federal Law on Public Civil Service, 2004," No. 79-FZ of July 27, 2004, art 4.

<sup>286</sup> "Scorecard: Russian Federation 2010," 46h.

<sup>287</sup> *Ibid.*

<sup>288</sup> Masha Charnay, "Dmitry Medvedev's New Assault on Corruption in Russia," *The Telegraph* (2012), online: <www.telegraph.co.uk>.

<sup>289</sup> Galina Stolyarova, "Civil Service: Join the Party ... Or Else," *Transitions Online* (2009), online: <http://www.ceool.com/asp/issuedetails.aspx?issueid=f3bb1acd-4a30-4701-9d6f-6889e003d4bc&articleId=39d94a9c-c89c-425b-a52f-8fb78d3512c6>

<sup>290</sup> Brian Whitmore quoted in Burger and Gitau, "The Russian Anti-Corruption Campaign: Public Relations, Politics or Substantive Change?" 4 in note 15.

<sup>291</sup> "Scorecard: Russian Federation 2010," 45b.

<sup>292</sup> *Ibid.*, 46f.

<sup>293</sup> Joel C. Moses, "Medvedev, Political Reform, and Russian Regions," *Problems of Post-Communism* 58, no. 1 (2011).

<sup>294</sup> *Ibid.*

<sup>295</sup> Brown et al., "Helping Hand or Grabbing Hand? State Bureaucracy and Privatization Effectiveness," 282.

## CONCLUSION

Rose-Ackerman's study of anti-corruption practices across different jurisdictions revealed that no one solution was more effective than another.<sup>296</sup> She looked at ombudsmen, freedom of information legislation, public reviews of department budgets, and procurement practices, but could not find anything that worked well in every jurisdiction or worked better than others. Her suggestion was instead that each country needed to assess its own corruption situation and take broad steps within institutions to combat corruption. India, for example, needs to follow through on repeated recommendations by the Supreme Court to make the Central Vigilance Committee and Central Bureau of Investigation truly effective, independent, and well-funded. Brazil reveals that despite lack of formal independence its Comptroller General has been able to foster a culture of integrity. It has also adopted creative strategies that support features of democratic accountability and effective media participation. In 2003 as part of the government's anti-corruption efforts it began to do random audits of municipal governments. This was a creative way to overcome information asymmetries and disseminate information to voters.<sup>297</sup> Where the audits were publicly released and widely disseminated by local media, allegations of corruption and maladministration had a strong impact on voters' choices. Thus, Brazilian voters are responsive to allegations of corruption and punish corrupt politicians through the democratic process. It shows that Brazil is fostering corruption accountability through democracy.

Russia will never be able to combat systemic corruption without genuine political will, an effective watchdog, and effective anti-corruption legislation. It has adopted a top-down approach which does not take into account the importance of civil society and the media nor is it effectively trying to reform the key institutions that support good governance. The citizen's movement that sprouted in India surrounding Anna Hazare and the *Lokpal Bill* shows the extent to which civil society and the media are necessary features of anti-corruption strategies. Alexei Navalny has capitalized on Russian's relative Internet freedom to do just such a thing.<sup>298</sup> These efforts show that the Russian public has a genuine will to combat corruption which can flourish if it is given an outlet. There appears to be an increase in public awareness and activism about corruption in China, such as the media storm that erupted following the earthquakes in Sichuan province. There, thousands were killed due in part to poorly enforced infrastructure regulations as a result of corruption.<sup>299</sup> China still favours a top down approach which is meant to deter corruption through dramatic show trials and harsh sentences. Yet if legislation continues to be applied arbitrarily without following legal procedures and using the court system it will never be able tackle systemic corruption in a fair and non-arbitrary way. China has shown political will but only in so far as it does not dismantle or interfere with the current ruling elites. Incremental change coupled with creative strategies tailored for the specific country context are often more effective than the types of dramatic crackdowns favoured by the Chinese. Above all, the BRIC countries must avoid the trap which India has fallen into of systematically reforming legislation without effective implementation. Otherwise, they too could end up with decades old legislation and rising corruption rates.

<sup>296</sup> Susan Rose-Ackerman, *Corruption and Government: Causes, Consequences, and Reform* (New York: Cambridge University Press, 1999).

<sup>297</sup> Miguel F. P. de Figueiredo et al., "When Do Voters Punish Corrupt Politicians? Experimental Evidence from Brazil," unpublished paper, University of California at Berkeley, Berkeley, CA (2010); Claudio Ferraz and Frederico Finan, "Exposing Corrupt Politicians: The Effects of Brazil's Publicly Released Audits on Electoral Outcomes," *The Quarterly Journal of Economics* 123, no. 2 (2008).

<sup>298</sup> See media and civil society section of this report.

<sup>299</sup> Branigan, "Chian Jails Investigator."

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# SECTION 6:

## Media and Civil Society

### INTRODUCTION

Civil society and the media, sometimes called “the fourth estate of government,” have received comparatively less attention in rule of law and economic development discourse.<sup>1</sup> Active citizens and media are ancillary, but no less important, to formal legal and economic institutions. An effective media spreads development policies sown in formal institutions. Together media and civil society ensure that officials remain faithful to their mandates and respond to popular needs. Besley, Prat et al. write that “a free and independent media should not be viewed as a luxury that only rich countries can afford.”<sup>2</sup> Bruszt, Campos, et al. state that “countries with a vibrant pre-transition civil society have embarked on a path towards sound political institutions [and] economic reforms ... [while] countries that had little in a way of civil society and/or whose governments repressed it have ... at best, dragged their feet.”<sup>3</sup> To date, there are no comprehensive academic examinations of media and civil society and we do not pretend to fill such a void. Nevertheless, we have several useful insights which add to any rule of law and economic development study. The goal of this section is to survey current literature and present case studies. In particular, we will examine how responsible media and effective civil society foster institutional transparency and accountability, curb corruption, and enhance legitimacy for development initiatives in emerging and transition economies.

### A THEORY OF HOW RESPONSIBLE MEDIA AND EFFECTIVE CIVIC PARTICIPATION CAN SUPPORT THE RULE OF LAW AND ECONOMIC DEVELOPMENT

Information and participation are fundamental to how media and citizens can further development.

Information seems more valuable today than it has ever been with the rise of the Internet and the lucrative “information economy.” Yet information need not be so avant-garde. Public opinion polls and demographic studies have always aided governments to form policies and strategies. Indeed, the Romans used Tribunes of the Plebeian council and the census to formulate policies. On the flip side, citizens use government information to hold officials accountable and ensure governance, just as information for consumers’ and investors’ allows them to make sound economic choices vital to functioning markets, economic efficiency, personal savings, and productivity growth.

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<sup>1</sup> Timothy Besley et al., “Mass Media and Political Accountability,” in *The Right to Know: Institutions and the Media*, ed. Roumeen Islam (Washington DC: World Bank Publications, 2002), 1.

<sup>2</sup> *Ibid.*, 16.

<sup>3</sup> László Bruszt et al., “Civil Society, Institutional Change and the Politics of Reform,” *UNU-WIDER Working Paper*, no. 38 (2010), 21.



The citizen, consumer, or investor's ability to gather such information is limited, however. Downs realized this difficulty as early as 1957 when he reasoned that citizens would be "rationally ignorant" whenever the costs of self-informing were greater than the benefits.<sup>4</sup> For an individual, this would occur in the majority of cases, because a citizen typically casts only one vote among millions – the cost of self-informing would outweigh the benefit received by the vote. Similarly, the cost of self-informing about a routine economic decision outweighs the benefit of the transaction. The solution to these critical information deficits is in collective action and resource pooling. The media pursues this end by disseminating information at a low cost to citizens, consumers, and investors.

The media helps citizens *ex ante* by vetting political officials and policies during elections and referenda; it helps discipline the governmental agenda by drawing attention to important issues of law or development; and it can expose and thus deter official corruption, abuse of power or other misconduct by officials of any branch of the state. Where official misconduct has already occurred, *ex post* media coverage informs citizens enabling them to hold officials accountable by whatever means afforded by law.<sup>5</sup> In these ways, a responsible and reliable media can strengthen institutions and the rule of law by serving as a potent check against government power.<sup>6</sup>

A responsible and reliable media does more than merely "check" government power. It also diffuses information about officials pursuing constructive policies. This gives officials legitimacy and popular support and they may be rewarded through re-election, reappointment, promotion, or formal recognition). The media also provides consumers and investors with accessible and affordable information which elucidate their economic options. This improves market function, and efficiency, minimizes risks and maximizes savings, and ultimately fosters national productivity.

From a long-term perspective, an uncensored media promotes public confidence and the overall legitimacy of the system. This is regardless of whether a politician's actions are regressive or progressive. This helps especially in situations where officials require citizens' cooperation to successfully implement policies and programs. Trust and support are particularly valuable to ride out long periods of economic strain or short-term hurdles that accompany long-term readjustments and reforms.

Thus far we have assumed that media is inherently responsible and reliable. Yet, it is as naive to assume that the media is unblemished as it is to assume that institutions and officials are incorruptible. It would be senseless to grant this attribute to the media when we have not extended the same benefit to state institutions. However, this report is meant to be read and understood in its entirety – that is, all sections taken together. We do well to remember the influence of governance and institutions on other agents in society.<sup>7</sup> Government and media exist in a circle of mutual interaction in which neither could function without the influence of the other. It is within the state's power to foster a media market and craft media regulation to maximize media responsibility and reliability – just as it is within the media's power to influence government.

Citizens play an equally important role by demanding and acting on information disseminated by the media. Effective civic participation boosts rule of law and economic development in several significant ways. Patterns of consumer demand are a way of letting state officials and suppliers of economic goods know what people need or

want. Citizens that demand to know about good governance, conformity to law, and economic development participate in pursuing these goals. For citizens to participate effectively, they must respond to information by: supporting or opposing candidates based on qualifications and performance; expressing approval for progressive measures and capable officials; and expressing disapproval for regressive measures and corrupt officials. Citizens may also participate through civil society organizations (CSOs). This might be through policy deliberations, raising support for necessary reforms, or helping implement programs that require substantial public cooperation. For the consumer or investor, effective participation means making better decisions about products or services.

The benefit of citizen participation depends on its effectiveness. Citizens must be interested in news affecting their institutions, governance, and economy. The effectiveness of their participation is neutralized where citizens demand tabloid media. Similarly, to function well, citizens must respond rationally and intelligently. The ideal will far short where media is skewed by state indoctrination, pervasive political ideologies, fears of government reprisals, superstitions, impulsivity, and personal and tribal allegiances and conflicts. Finally, effective participation requires a suitable blend of state governance policies and non-state institutional organizations in order for citizen participation to get "uptake" into the system. Government bans and crackdowns on CSOs can discourage civic participation, but so too can lack of leadership and disorganization within CSOs. State institutions, government officials, active citizens, and CSOs must be willing to engage with one another in order to be optimally effective in promoting rule of law and economic development.<sup>8</sup>

"New Media" straddles both civil society and traditional media. Some forms of new media have the same function and potential impact as traditional media. Other new media looks more like a CSO because it provides a framework for citizens to meet, plan, and discuss strategies. New media is presumed to have played an important role in the Arab Spring, protests in Russia, and the "Occupy" movement. Development activists see new media as a powerful new weapon, while unpopular or authoritarian leaders see it as a threat. Is new media really an emerging force or is it just hyped? It is too soon to say. Nevertheless, it is worth surveying and we will do so with case studies and surveys.

## MEDIA AND CIVIL SOCIETY IN THE BRIC COUNTRIES

Our analysis must account for each BRIC country's form of government, media, and civil society profile and the way these systems interact formally and informally.

Recalling our discussion in the governance section, Brazil is a young democracy, China is a single-party authoritarian state pursuing liberal economic reforms, India is an old democracy with a colonial legacy, and Russia is a fledgling democracy with authoritarian tendencies.

State dominance characterizes China's civil society and media profile. The mainstream media organizations are state enterprises, the Internet is tightly controlled and regulated, and the Communist Party is the main vehicle for civic engagement. Russia also has strong state television stations which dominate mainstream media

<sup>4</sup> Anthony Downs, *An Economic Theory of Democracy*, (New York: Harper, 1957).

<sup>5</sup> Besley et al., "Mass Media and Political Accountability," 6-7.

<sup>6</sup> Ibid.

<sup>7</sup> For more information on this subject see the institutions and governance sections of this report.

<sup>8</sup> For a nuanced discussion of the definition, role, and effectiveness of civil society see Thomas Carothers and William Barndt, "Civil Society," *Foreign Policy*, no. 117 (1999).

as well as strict rules on CSOs.<sup>9</sup> Russia does not have tight control over the Internet the way that China does. As a result, the Internet has become the main medium for exposing corruption, airing dissent, and organizing civil society. Brazil has a highly concentrated media ownership typically tied to government elites – Globo is a media conglomerate that exemplifies this type of ownership. According to Hughes and Lawson, “[Globo’s] support from Brazil’s military government in the 1960s and 1970s propelled the Globo network beyond its competitors.”<sup>10</sup> Globo retains that dominance today.<sup>11</sup> Brazilian CSOs have played a prominent role in governance since the 1988 Constitution in a process known as participatory publics and participatory budgeting.<sup>12</sup> Although India is the poorest of the BRICs it has a famously free and independent press.<sup>13</sup>

The interplay between the state, media, and CSOs determines any potential impact on rule of law or development. Media and CSOs can only contribute to the extent that a country’s citizens have the capacity to effect change. This ability is not confined to democracies, despite the obvious benefits of voting. As Weingast notes, even the most arbitrary autocratic ruler faces popular constraints.<sup>14</sup> Conversely, democratic regimes do not necessarily guarantee development as politicians may seek short-term but popular policies that undermine long-term development.<sup>15</sup>

We will now analyze the role of media and CSOs in furthering rule of law and development in the BRIC countries: first we will focus on traditional media, then we will examine CSO activity. After that we will examine new media and finally we will consider state control of media or CSOs.

## TRADITIONAL MEDIA

In his 1981 Coromandel lecture, Sen sparked interest in the role of media in development. He stated that:

India has not had a famine since independence, and given the nature of Indian politics and society, it is not likely that India can have a famine even in years of great food problems. The government cannot afford to fail to take prompt action when large-scale starvation threatens. Newspapers play an important part in this, in making the facts known and forcing the challenge to be faced.<sup>16</sup>

He contrasted this with China, which did not have similar freedom of information and where almost 30 million died in its Great Leap Forward from 1958 to 1961.<sup>17</sup>

<sup>9</sup> For example, the Russian government recently tabled a bill that would require political NGOs that receive foreign donations to register as “foreign agents” a term synonymous with terrorist activity. Considering that NGOs receive most of their funding from abroad this would severely undermine their ability to work effectively. See “Russian Parliament Gives First Approval to NGO Bill,” *BBC News* (July 6 2012), online: <www.bbc.co.uk>.

<sup>10</sup> Sallie Hughes and Chappell Lawson, “The Barriers to Media Opening in Latin America,” *Political Communication* 22, no. 1 (2005), 14.

<sup>11</sup> *Ibid.*, 13.

<sup>12</sup> Brian Wampler and Leonardo Avritzer, “Participatory Publics: Civil Society and New Institutions in Democratic Brazil,” *Comparative Politics* 36, no. 3 (2004).

<sup>13</sup> N. Ram, “An Independent Press and Anti-Hunger Strategies: The Indian Experience,” in *The Political Economy of Hunger*, ed. Jean Drèze and Amartya Sen (Oxford: Clarendon Press, 1990).

<sup>14</sup> Douglass C. North and Barry R. Weingast, “Constitutions and Commitment: The Evolution of Institutional Governing Public Choice in Seventeenth-Century England,” *The Journal of Economic History* 49, no. 4 (1989); Barry R. Weingast, “Constitutions as Governance Structures: The Political Foundations of Secure Markets,” *Journal of Institutional and Theoretical Economics* 149, no. 1 (1993); Barry R. Weingast, “The Political Foundations of Democracy and the Rule of Law,” *The American Political Science Review* 91, no. 2 (1997). See also the institutions section of this report.

<sup>15</sup> For more on this topic, see the governance section of this report.

<sup>16</sup> Amartya Sen, “Food Battles: Conflicts in the Access to Food,” *Food and Nutrition* 10 (1984), 84.

<sup>17</sup> Besley et al., “Mass Media and Political Accountability,” 12.

Using empirical research, Besley and Burgess followed up on Sen’s hypothesis.<sup>18</sup> Due to the complexity of cross-country comparisons, they limited their study to India. They designed the study to compare India’s sixteen major states between 1958 and 1992.<sup>19</sup> The study analyzed the volume of regional newspaper circulation, which served as a measure of media development in each state. Food distribution and calamity programs served as a measure of the government’s response to famines and natural disasters. Such state responsiveness is a particularly important development issue as India is regularly hit by natural disasters and has a large vulnerable population dependent on the state for disaster relief.<sup>20</sup> The authors explain that, “a key issue is what institutions – economic, social and political – can be built to enhance the effectiveness of the state in social protection. ... Mass media can play a key role by enabling vulnerable citizens to monitor the actions of” governance bodies.<sup>21</sup> Besley and Burgess looked for a correspondence between newspaper circulation and government responsiveness.<sup>22</sup> The results confirmed a correlation between media development and government responsiveness. In fact, they found significant media impact: a 1 percent increase in newspaper circulation was associated with a 2.4 percent increase in public food distribution and a 5.5 percent increase in calamity relief expenditures.<sup>23</sup> By contrast, the pre-existing level of economic development in each state was relatively unimportant.<sup>24</sup> This suggests that media’s potential benefit is not limited to states that are well-off. The authors concluded that:

The results point to the centrality of mechanisms for improving accountability beyond the role of economic development as a means of encouraging government activism. This resonates with recent calls to improve ‘governance’ in low income countries as a means of enhancing the well-being of the poor.<sup>25</sup>

Similar studies of different countries have found similar results. For example, Stromberg found that US regions with higher radio access attracted New Deal government spending more successfully.<sup>26</sup> Yates and Stroup found that the US Environmental Protection Agency created stricter pesticide standards in regions where more stories were published about environmental safety.<sup>27</sup>

These empirical studies support Sen’s theory that media coverage fosters good governance by drawing the population’s attention to the most important issues of law and development. This in turn inspires public officials to respond promptly and more effectively to problems of general welfare. Importantly, an institutional framework must support the media to foster such positive results.<sup>28</sup> This can take place through political governance. Besley and Burgess as well as Besley, Burgess, and Prat emphasize the media’s role in providing critical information to citizens on politicians’ performances, which citizens can use during elections.<sup>29</sup> In this way, the media deters politicians from using political power for private gain and ensures that they are accountable to their mandates and the country’s development needs. This is supported

<sup>18</sup> Timothy Besley and Robin Burgess, “The Political Economy of Government Responsiveness: Theory and Evidence from India,” *The Quarterly Journal of Economics* 117, no. 4 (2002).

<sup>19</sup> *Ibid.*, 2.

<sup>20</sup> *Ibid.*, 1-2.

<sup>21</sup> *Ibid.*, 1.

<sup>22</sup> *Ibid.*, 6-7.

<sup>23</sup> *Ibid.*, 10-11.

<sup>24</sup> *Ibid.*, 15.

<sup>25</sup> *Ibid.*, 11.

<sup>26</sup> D. Strömberg, “Radio’s Impact on the New Deal,” typescript, (Department of Economics, IES, Stockholm, 2000).

<sup>27</sup> Andrew J. Yates and Richard L. Stroup, “Media Coverage and EPA Pesticide Decisions,” *Public Choice* 102, no. 3 (2000).

<sup>28</sup> Kevin E. Davis and Michael J. Trebilcock, “The Relationship between Law and Development: Optimists versus Skeptics,” *American Journal of Comparative Law* 56, no. 4 (2008), 20-21.

<sup>29</sup> Besley et al., “Mass Media and Political Accountability”; *ibid.*

by Larcinese who found that, in the United Kingdom, the media drove voter turnout and determined citizen's political knowledge.<sup>30</sup>

The media may also further economic development through political intermediaries. Djankov et al. write that:

In modern economies and societies, the availability of information is central to better decision making by citizens and consumers. In political markets, citizens require information about candidates to make intelligent voting choices. In economic markets, including financial markets, consumers and investors require information to select products and securities. The availability of information is a crucial determinant of the efficiency of political and economic markets. ... In most countries, citizens and consumers receive the information they need through the media, including newspapers, television, and radio. The media serve as the intermediaries that collect information and make it available to citizens and consumers.<sup>31</sup>

Djankov et al. further argue, that informed by media, citizens are better capable through political action of “limiting the ability of the government to hurt them economically by, for example, confiscating property or over-regulating businesses. Economic governance indicators, such as the security of property rights ... and the quality of regulation should therefore be higher in countries where media function more effectively.”<sup>32</sup>

The media may also facilitate economic development through direct and non-political channels. Djankov et al. cite financial markets, which are especially sensitive to information: better information flow facilitates better securities pricing, reveals abuse by corporate insiders, and thus enhances market efficiency and financial development.<sup>33</sup> Vélez describes how the media has had a direct impact on the rule of law in India.<sup>34</sup> She describes the impact of an Indian newspaper article, which in 1979 exposed how citizens were incarcerated beyond the terms of their official sentences. In response to this exposé, a lawyer filed a petition to the Supreme Court and the judiciary took up the issue. Vélez calls the case “the birth of judicial activism in India.”<sup>35</sup> The judiciary took up many other issues initially reported by the media, including several connected to development, such as the right to information (which led to an important *Freedom of Information Bill* in 2002); gender jurisprudence; Dalit jurisprudence; and health and child protection.<sup>36</sup>

These conclusions have global implications for rule of law and economic development. There are huge variations in access to media across the world. This means that citizens and consumers are not assured access to traditional media in many places. Besley, Burgess, and Prat show that daily newspaper circulation in St Vincent and the Grenadines is 0.008 per 1000 persons, while it is 792 per 1000 in Hong Kong.<sup>37</sup> They also show the large discrepancy in television ownership which ranges from 0.1 per

1000 in Rwanda to 850 per 1000 in the US.<sup>38</sup> They add that, “not surprisingly, there are strong links between media development and other development indicators such as income per capita and literacy.”<sup>39</sup>

Implicit in the above analysis is the link between media and governance. Specifically, the media is capable of making an important contribution to improving governance – a key piece of any development puzzle.

## CIVIL SOCIETY

Besley and Burgess also argue that their results “underline the potential role of civil society” in furthering rule of law and development outcomes. In particular, their focus is on informal political institutions necessary for organizing responses to media coverage in order to further accountability. This may occur, for example, as a result of organized informal groups spurring political competition, influencing the timing of elections, or generating voter turnout.<sup>40</sup> Peruzzotti and Smulovitz conceive civil society's role as going beyond informal political institutions. For them it comprises:

a diverse group of civil society initiatives ... organized around demands for the rule of law and due process. By exposing and denouncing cases of governmental wrongdoing, activating horizontal agencies of control, and monitoring the operation of those agencies, mechanisms of social accountability make a crucial contribution to the enforcement of the rule of law.<sup>41</sup>

Peruzzotti and Smulovitz provide an example from Brazil and Argentina, where unrelated episodes of police violence spawned local social movements. These local movements ultimately led to permanent non-state police monitoring associations.<sup>42</sup>

Vélez notes that another area “ripe for research” is “how civil society plays a role in ensuring the [that] rule of law is accessible and meaningful to society.”<sup>43</sup> This may include informal participation in education initiatives, tracking and reporting instances of corruption, or raising support for institutional reforms.

Wampler and Avritzer describe a case that illustrates the impact of civil society on development in Brazil.<sup>44</sup> They focus on how, during the military government's gradual withdrawal, CSOs challenged regressive practices leftover from Brazil's history of patriarchal hierarchy. Such practices included patronage, clientelism, and corruption. CSOs played a role in redesigning institutions by creating practical alternative social organizations.<sup>45</sup> Wampler and Avritzer studied groups seeking to overcome socio-political exclusion. They included unionized workers, Christian communities, reformist political parties, and other social movements. They encouraged open meetings, public deliberation, and accountability. They also advocated for policies designed to solve dire social problems and they demanded that these policies be implemented transparently.<sup>46</sup> Between 1978 and 1985, the number of voluntary associations dramatically increased in Brazil: in Belo Horizonte, the number tripled; in

<sup>30</sup> Valentino Larcinese, “Information Acquisition, Ideology and Turnout: Theory and Evidence From Britain,” *Journal of Theoretical Politics* 21, no. 2 (2009).

<sup>31</sup> Simeon Djankov et al., *Who Owns the Media?* (National Bureau of Economic Research, 2001), 1. See also Henry Calvert Simons, *Economic Policy for a Free Society* (Chicago: University of Chicago Press, 1948); George J. Stigler, “The Economics of Information,” *Journal of Political Economy* 69, no. 3 (1961); Joseph E. Stiglitz, “The Contributions of the Economics of Information to Twentieth Century Economics,” *The Quarterly Journal of Economics* 115, no. 4 (2000).

<sup>32</sup> Djankov et al., *Who Owns the Media?*, 26.

<sup>33</sup> Ibid.

<sup>34</sup> Maggie Gorman Vélez, “Literature Review on the Rule of Law,” (Ottawa: International Development Research Centre, 2009), 14.

<sup>35</sup> Ibid.

<sup>36</sup> Ibid.

<sup>37</sup> Besley et al., “Mass Media and Political Accountability,” 3.

<sup>38</sup> Ibid.

<sup>39</sup> Ibid.

<sup>40</sup> Besley and Burgess, “The Political Economy of Government Responsiveness,” 16.

<sup>41</sup> Enrique Peruzzotti and Catalina Smulovitz, *Enforcing the Rule of Law: Social Accountability in the New Latin American Democracies* (Pittsburgh: University of Pittsburgh Press, 2006), 11.

<sup>42</sup> Vélez, “Literature Review on the Rule of Law,” 23.

<sup>43</sup> Ibid.

<sup>44</sup> Wampler and Avritzer, “Participatory Publics.”

<sup>45</sup> Ibid.

<sup>46</sup> Ibid., 291-95.

Rio de Janeiro, it doubled; and in São Paulo it increased by a third.<sup>47</sup> Neighbourhood associations increased in Belo Horizonte from 71 to 534. In São Paulo and Rio de Janeiro, respectively, 98 percent and 91 percent of neighbourhood associations were created after 1970. When elections began, CSOs sought to translate their numbers and influence into formal political power. They linked themselves to political parties to encourage the institutionalization of the civic deliberative practices that they had developed. The result was that Brazil's 1988 Constitution gave official status to hybrid institutions known as "participatory publics."<sup>48</sup> Thus, CSOs were co-opted into the formal political process through a variety of local formats. A notable example is participatory budgeting, in which citizens deliberate and decide on discretionary spending.<sup>49</sup> Participatory budgeting is now the only mechanism for discretionary spending in Porto Alegre. In Belo Horizonte participatory budgeting accounts for 50 percent of discretionary spending and in Recife it accounts for 10 percent of discretionary spending.<sup>50</sup> Another CSO success has been to recast the distribution of public goods to the poor as a right rather than as a favour. This movement was known as "the right to have rights."<sup>51</sup> Wampler and Avritzer conclude that citizen participation and CSO action "has been an important but often overlooked facet" of Brazil's institutional renewal.<sup>52</sup> Such renewal was not the result of "abstract institutional engineering," but rather happened from on-the-ground challenges to regressive traditions and activism for progressive reforms that were then institutionalized, politically and legally.<sup>53</sup>

India's anti-corruption movement, led by Anna Hazare, exemplifies effective citizen engagement. Hazare is an elderly ex-soldier from Maharashtra whose hunger strikes and peaceful marches evoke Gandhi's anti-colonial activism.<sup>54</sup> Hazare's influence has grown over two decades, during which he has earned two of India's highest civilian awards for creating Gandhian sustainable model villages and his drought-relief efforts. As we discuss in our section on corruption, corruption is one India's major development challenges. Hazare has successfully pressured the state to remove allegedly corrupt state officials. He is now joined by a group of prominent lawyers and social activists, who have formed a CSO, nicknamed "Team Anna." Recently, the organization spent months across the country campaigning for an independent anti-corruption commission, known as Lokpal. Thousands of people unexpectedly demonstrated in support of Hazare's *Lokpal Bill*. This spurred the government to invite Team Anna to a *Lokpal Bill* drafting committee. The committee's results did not satisfy Team Anna, so the organization resumed criticizing the government. In August 2011, Hazare was arrested while on his way to start an anti-corruption hunger strike in New Delhi, which led thousands of people across the country to protest. The authorities tried to release him, but Hazare refused to leave unless they released him unconditionally. Hazare may seem like a figure from simpler times, but his team is up to date with the latest technology and social trends. Hazare's aides distribute numerous daily e-mail updates to India's ravenous free press and adeptly leverage social media to connect with young followers. During Hazare's arrest, Team Anna kept followers abreast of the negotiations concerning his release via Twitter. Team Anna is a good example of how Indian CSOs have effectively mobilized to fight development issues.

<sup>47</sup> Statistics on the numbers of voluntary associations in Brazil in this paragraph all come from *ibid.*, 296.

<sup>48</sup> *Ibid.*, 293.

<sup>49</sup> For more on the governance role of participatory publics see the governance section of this report.

<sup>50</sup> Recife is still only in the early stages of developing its participatory budgeting mechanism, see Wampler and Avritzer, "Participatory Publics," 307.

<sup>51</sup> Christopher J. Coyne and Peter T. Leeson, "Read All About It! Understanding the Role of Media in Economic Development," *Kyklos* 57, no. 1 (2004), 297.

<sup>52</sup> Wampler and Avritzer, "Participatory Publics," 308.

<sup>53</sup> *Ibid.*, 309.

<sup>54</sup> All details on Hazare's life, work, and campaign in this paragraph come from Jim Yardley, "Unlikely Echo of Gandhi Inspires Indians to Act," *The New York Times* (August 18 2011), online: <[www.nytimes.com](http://www.nytimes.com)>.

Further north, Bruszt and Campos investigate the relationship between CSOs and development in 27 former Eastern bloc countries.<sup>55</sup> Bruszt and Campos focused on the countries' final years of communism and their transition after 1989. The study looked at the number and pervasiveness of CSOs before transition by measuring the number and types of dissident activities. Dissident activities included meetings, petitions, issuing statements, strikes, rallies, and demonstrations.<sup>56</sup> CSOs in Central Europe and the Baltic focused on human rights, democracy, and development, whereas CSOs in the Soviet Union and Yugoslavia focused less on these issues.<sup>57</sup> Using this information, Bruszt and Campos looked for a correspondence with the patterns of institutional, economic, and political developments that followed. Central European and Baltic economies developed, grew, and stabilized relatively quickly, while former Soviet and Yugoslavian countries experienced a severe and protracted drop in output and slower economic recovery.<sup>58</sup> Similarly, the study found that Central European and Baltic countries quickly stabilized and liberalized their political systems, including guaranteeing political freedoms and free elections. This contrasted with the former Soviet countries, which experienced limited democratization before drifting back to authoritarianism and the former Yugoslav countries, which erupted in war before significant political liberalization could take place. The authors conclude that differences in CSO development in the 1980s played a key role in determining the nature and pace of economic development and political reform.<sup>59</sup> Economically, they state that "a more vibrant and organized civil society at the start of economic reforms was an asset both for launching and implementing these reforms."<sup>60</sup> Politically, a weaker pre-transition CSO environment is directly linked to regimes with concentrated political power, few checks and balances, and poor human rights records.<sup>61</sup> Thus, while the success and failure of transition are often attributed to the role of institutions, Bruszt writes that "a potentially important causal channel has been neglected: differences in the development of civil society ... prior to the fall of communism."<sup>62</sup>

A strong CSO sector is no *guarantee* of economic growth, however. As an example, Carothers cites India's neighbour Bangladesh.<sup>63</sup> Bangladesh, he writes,

is rich in civil society, with thousands of NGOs, advocacy groups, and social service organizations operating at the national and local levels. Yet this wealth of NGOs, by no means a new phenomenon in Bangladesh, has not translated into wealth for the people. Bangladesh remains one of the poorest countries in the world.<sup>64</sup>

In addition, Carothers notes that sometimes CSOs can actually be counterproductive: the "wrong type of civil society can be economically harmful. Some economists believe, for example, that Latin American labor unions, a mainstay of the region's civil society, have been one of the largest obstacles to Latin America's economic growth and stability."<sup>65</sup> Other examples of CSOs that can impede economic development and the rule of law are organized crime groups such as the mafia, ethnic hate groups (the origins of the Holocaust were in the rise to power of the Nazi party CSO), or

<sup>55</sup> Bruszt et al., "Civil Society, Institutional Change and the Politics of Reform."

<sup>56</sup> *Ibid.*, 6.

<sup>57</sup> *Ibid.*, 7-10.

<sup>58</sup> *Ibid.*, 1.

<sup>59</sup> *Ibid.*, 1, 20-21.

<sup>60</sup> *Ibid.*, 4.

<sup>61</sup> *Ibid.*, 20.

<sup>62</sup> *Ibid.*, 1.

<sup>63</sup> Carothers and Barndt, "Civil Society."

<sup>64</sup> *Ibid.*, 27.

<sup>65</sup> *Ibid.*, 24.

self-sustaining lobby groups for powerful corporations which have a chokehold over a national economy.

As with the particular need for *responsible* media, it is important to remember that the positive potential role to be played by civil society groups depends, first of all, on the given group being oriented towards furthering legal and economic development. Secondly, active CSOs with good intentions are not sufficient to achieve development results. As in the Brazilian, Indian, and Eastern European examples, civil society efforts are most effective when they engage institutions directly and become part of a new and improved governance system. As we shall see, development becomes more difficult where civil society groups lack inter-cohesion in identifying a development path or if the state is not receptive to their advocacy. In other words, the potential positive role that civil society groups can play in development is to counter-weigh and complement other forces.

If CSOs can play a beneficial role in development, what factors influence the development of CSOs? Adequate incentives are an obvious factor to induce general civic engagement. Coyne and Leeson found, for example, that consumer demand is correlated with the impact of media monitoring.<sup>66</sup> CSO leaders' strategies are also important. For example, Besley, Burgess, and Prat write that citizens are more likely to inform themselves on civic issues that are bundled with stories on sports or entertainment. Thus, instead of regarding the process of informing themselves as a chore they view it as a pleasure.<sup>67</sup> As for professional journalists, Hughes describes a case study involving journalists in Brazil, who saw the creation and organization of a training association, Grupo Abril, as an important investment in their careers.<sup>68</sup> In general, what seems to matter is not who the members of a given group are, or what type of incentive they have for engagement, but merely that enough people are motivated to develop a vibrant civil society sector.

It is not unreasonable to assume that incentives for CSOs will always naturally be present. Thus, it is more important to understand how the state shapes CSO development. CSOs can only exist and have an impact to the extent that the state allows them. Wampler writes that "Brazil is home to some of the most successful experiences in participatory local government."<sup>69</sup> CSOs flourished in Brazil because of the way the state accommodated and nurtured them. Brazil's 1988 Constitution decentralized political authority and delegated resources and independence to municipalities. This process enabled CSOs to access local governments and gain political influence. Article 29 of the Constitution endorsed this influence declaring that municipalities should adopt laws that open access to public decision-making venues and incorporate "the cooperation of civic associations in city planning and the possibility of popular initiative in legal projects of interest to the city population."<sup>70</sup>

The Brazilian example contrasts again with former Soviet countries, including Russia. Bruszt notes that government repression of CSOs was low and diminishing in Central Europe from 40 percent in 1985 to 20 percent in 1989, whereas in the former Soviet countries it increased over the same period (before declining in 1990/91).<sup>71</sup> Bruszt adds that "not surprisingly, there seems to be a negative correlation between repression and dissident activity: the more repressive countries displayed less dissident activity."<sup>72</sup> Thus there was a correspondence between relatively low levels of

repression and high levels of CSO activity, which also correlated with rapid redevelopment after transition. Conversely high levels of repression were tied to low levels of CSO activity, which were tied to weak development during transition.<sup>73</sup> This pattern of repressive state reaction to CSO activity continues in Russia today. Recently, following a number of large anti-government protests, Russia enacted a controversial law which raised the fines for breaking protest laws from 5,000 to 600,000 rubles (approximately US\$157 to US\$18,840) – that is, 120 times more.<sup>74</sup>

A strong civil society is strongly linked to successful institutions. Bruszt notes that one of the reasons CSOs played an important role in stabilization and redevelopment is their "demand for implementing and consolidating institutional checks and balances."<sup>75</sup> He adds that "in countries with a more vibrant civil society, incentives of the incumbents to introduce encompassing and sustainable economic reforms were different from those of incumbents who faced a silenced civil society."<sup>76</sup> Thus, CSOs partly contributed to building institutions. In Brazil, this process came full circle: CSO activity led to institutional reform which formally co-opted CSO resources into the "official" development process. Wampler writes that this demonstrates "the viability of [the participatory-public] concept in bridging the unnecessary gap between institutional and civil society theories" and creating institutions with new themes, strategies, and practices.<sup>77</sup> Much like the connection between the media and governance, civil society is closely affiliated with the life cycles of institutions – from their formation to maturity, as well as through their reform and reincarnation.

## NEW MEDIA

In between traditional media and CSOs is new media. On the one hand, new media may be a virtual incarnation of traditional media – think of online newspapers or web simulcasts of television and radio shows. On the other hand, new media is a platform to connect citizens engaging in civil society activity. One example is of groups that form on social media sites around specific issues. Another example is using mass-SMS communication to notify people of developments during the Arab Spring. New media is also able to fulfill the functions of both traditional media and CSOs. For example, popular blog sites can reach huge audiences and also mimic CSOs by linking to, incorporating participation from, and organizing the blog's followers. New media is also rapidly evolving new functions, whose characteristics, capabilities, and impact cannot be predicted. In short, new media is an area of much interest to rule of law and development. At this early stage, it is also difficult to offer a systematic appraisal. Nevertheless, we analyze its impact so far and imagined potential through a few illustrative case studies.

Russia offers the first illustrative case. RosPil is a website run by a Russian lawyer, blogger, and anti-corruption activist, named Alexey Navalny.<sup>78</sup> President Dmitry Medvedev's initiative to require all government tenders to be posted online inspired the site.<sup>79</sup> The site seeks to expose state corruption by inviting visitors to submit suspicious tenders. One of the hundreds of experts associated with the site then evaluates the submissions and announces the ones involving probable corruption. Officials have often cancelled tenders due to the resulting embarrassment. RosPil claims to have saved millions of dollars for Russian citizens, which might have been spent

<sup>66</sup> Coyne and Leeson, "Read All About It," 28, 32-33.

<sup>67</sup> Besley et al., "Mass Media and Political Accountability," 6.

<sup>68</sup> Hughes and Lawson, "Barriers to Media in Latin America," 20.

<sup>69</sup> Wampler and Avritzer, "Participatory Publics," 291.

<sup>70</sup> Brazil, Federal Constitution, art IXXX cited in *ibid.*, 298.

<sup>71</sup> Bruszt et al., "Civil Society, Institutional Change and the Politics of Reform," 10.

<sup>72</sup> *Ibid.*, 11.

<sup>73</sup> *Ibid.*, 19-20.

<sup>74</sup> "Russian Parliament Backs Huge Protest Fines," *BBC News* (June 6 2012), online: <www.bbc.co.uk>.

<sup>75</sup> Bruszt et al., "Civil Society, Institutional Change and the Politics of Reform," 1.

<sup>76</sup> *Ibid.*

<sup>77</sup> Wampler and Avritzer, "Participatory Publics," 309.

<sup>78</sup> Julia Ioffe, "Net Impact: One Man's Cyber-Crusade Against Russian Corruption," *The New Yorker* (April 4 2011).

<sup>79</sup> *Ibid.*

on corrupt contracts on projects ranging from the military to the Bolshoi Theatre. Navalny has also tackled corruption in powerful state-owned enterprises including oil and transport companies and banks. RosPil is supported by voluntary financial contributions from thousands of users.<sup>80</sup> A *New Yorker* article on the project describes it as:

An attempt to crowdsource Navalny's [anti-corruption] work, which, given the dangers ... seems wise. RosPil spreads the risk involved in exposing corruption, and provides a kind of insurance: if anything happens to Navalny, RosPil can continue to function, and may embarrass the government into reforming itself.<sup>81</sup>

Part of the reason for the site's existence – and success – is the Russian government's tight control over traditional media and journalists. Several mainstream reporters and lawyers investigating similar abuses have been beaten, murdered, or imprisoned.<sup>82</sup> According to a 2009 article in the *Moscow Times*, Russia leads Europe in reporter killings.<sup>83</sup> Notable deaths include Kremlin-critic and human rights advocate Anna Politkovskaya, who was shot dead in her apartment elevator in 2006.<sup>84</sup> She focused on stories that other Russian media outlets considered too sensitive or “Western” to tackle, such as Chechnya, corruption in the Russian military, and Russia's human rights record.<sup>85</sup> In previous attempts to intimidate her, she was buried alive in Chechnya, thrown into a dungeon, threatened with rape, and poisoned on a plane to Beslan.<sup>86</sup> Another journalist, Mikhail Beketov, was beaten and left crippled and mute.<sup>87</sup> Lawyers have also been targeted for pursuing alleged corruption in the legal system.<sup>88</sup> Lawyer Sergei Magnitsky, who had been pursuing allegations of tax fraud, died under questionable conditions in prison at age 37 (see box 5.3 in corruption section). Navalny believes that these people's deaths occurred more easily because they acted alone.<sup>89</sup> In this respect, RosPil is as much a CSO as a media blog as it invites others “to become civic activists without joining an NGO or a political party.”<sup>90</sup> Navalny cites the Tea Party movement in the US as inspiration: “It's an incredible thing: some old ladies got together and are now hammering at Obama from all sides.”<sup>91</sup> Navalny himself, is a controversial figure, whose ambition for power and ultra-nationalist political views raise doubts about his motives. Nevertheless, his initiatives demonstrate that new media can foster dissent in Russia.

Russia's most powerful new media is the blog platform LiveJournal, known in Russian as Zhivoy Zhurnal, or simply ZheZhe.<sup>92</sup> As Russia has a highly controlled television market and few independent newspapers or radio stations, the Internet in general and LiveJournal in particular are the likeliest venues for dissent. Westerners mainly use LiveJournal as an open diary for members to stay in touch with friends, rather than for its interactive functions which are comparatively limited. In Russia, however, it has become the main social network. The Russian portion of the site has about 6 million users in close to 200,000 communities and some blogs have around 2

<sup>80</sup> Ibid.

<sup>81</sup> Ibid.

<sup>82</sup> Ibid.

<sup>83</sup> Alexandra Odynova, “Russia Leads Europe in Reporter Killings,” *The Moscow Times* (June 16 2009), online: <www.themoscowtimes.com>.

<sup>84</sup> Ibid.

<sup>85</sup> Daria Solovieva, “Politkovskaya's Death, Other Killings, Raise Questions About Russian Democracy,” *World Politics Review* (October 31 2006), online: <www.worldpoliticsreview.com>.

<sup>86</sup> Ibid.

<sup>87</sup> Ioffe, “Net Impact.”

<sup>88</sup> Ibid.

<sup>89</sup> Ibid.

<sup>90</sup> Elena Panfilova quoted in *ibid.*

<sup>91</sup> Ibid.

<sup>92</sup> All details in this paragraph relating to Russians' use of LiveJournal come from Robert Greenall, “LiveJournal: Russia's Unlikely Internet Giant,” *BBC News* (February 29 2012), online: <www.bbc.co.uk>.

million followers. Medvedev even hosts a blog on the site. It is also the main site for Medvedev and Putin's political opponents. Acting like traditional media and a CSO, LiveJournal hosted information on public protests following the recent presidential elections. For example, Ilya Yashin used it to organize a group of activists who hung a giant anti-Putin poster across from the Kremlin. The activists photographed the poster and disseminated the photograph across the blogosphere before authorities could take the poster down. Unlike traditional media, the government does not control or censor Russia's Internet (Runet). Some analysts believe that when the Russian government created media controls, it underestimated the power of social media, believing television was the only medium that mattered. The government created Runet on a model favoured in the liberal political climate of the 1990s, which limited top-down interference. Russia could try to punish individual bloggers, but countries that do this, such as Iran, have failed to deter Internet dissent.

Russia's Internet policy notably contrasts China's policy, which blocks LiveJournal and many other popular western social networking sites.<sup>93</sup> From the beginning, the Chinese government understood the Internet's economic potential. The Internet also fit into the government's economic strategy of prioritizing science and technology.<sup>94</sup> China, therefore, welcomed the Internet and promoted it for economic purposes. At the same time, however, the government did not intend the Internet to be a tool for political dissent and organization. As a result, from the start, China's government did everything it could to control online communication in order to preserve social stability and “harmony.”<sup>95</sup> Eko, Yao et al. describe the government's multiple layers of control.<sup>96</sup> Users can only go online through a closed national intranet, known as a gateway. This allows the government to police Internet access for China's billion-plus citizens. The gateway employs a variety of restraints including tampering with Internet addresses and domain names, blocking IP addresses, blocking websites, and filtering key-words. Besides these infrastructural controls, a three-tiered regulatory regime targets Internet service providers, Internet content providers, and Chinese citizens using the Internet. An Internet police squad, with thousands of members, enforces the numerous regulations.<sup>97</sup> Together, all of these Internet restrictions form a sophisticated censorship system known as “The Golden Shield” or to foreigners as “The Great Firewall of China.”<sup>98</sup> More recently, China has also required that all new computers have “Green Dam” software, which monitors users' Internet surfing.<sup>99</sup> Thus, there is no anonymity on the Internet in China – everything is tracked and retained and ultimately reportable to the authorities. Among those in prison for violating the rules and “subverting the state” is Dr. Liu Xiaobo, who is a blogger, human rights activist, and winner of the 2010 Nobel peace prize.<sup>100</sup>

In spite of these Internet restrictions, however, new media still has a prominent presence in China. Recently, it was used to organize a protest march of 12,000 people in Dalian against a chemical plant built inside the city.<sup>101</sup> Environmental concerns have become prominent in China since rising incomes have created demands for a better quality of life and public services.<sup>102</sup> Government officials responded to the Dalian protest by announcing they would close the plant and move it outside the city. This

<sup>93</sup> Ibid.

<sup>94</sup> Lyombe Eko et al., “Google This: The Great Firewall of China, the It Wheel Of India, Google Inc., and Internet Regulation,” *Journal of Internet Law* 15, no. 3 (2011), 4.

<sup>95</sup> Ibid.

<sup>96</sup> Ibid.

<sup>97</sup> Ibid., 5-6.

<sup>98</sup> Ibid., 5.

<sup>99</sup> Ibid.

<sup>100</sup> Ibid., 6.

<sup>101</sup> David Wivell et al., “Concessions Show Influence of China's Middle Class,” *Yahoo News* (August 15 2011), online: <news.yahoo.com>.

<sup>102</sup> Ibid.

followed an almost identical series of events in the city of Xiamen in 2007.<sup>103</sup> In a country where demonstrators usually face armed resistance, the Dalian and Xiamen protestors were able to influence the authorities and achieve successful results. Such concessions are rare in China. Analysts speculate that the authorities were motivated by the rising power of Dalian and Xiamen's middle class residents who enjoy relative wealth and high education and are fond of communicating via text messaging and social media.<sup>104</sup> The Communist Party is keen to fulfill the aspirations of the wealthier classes to ensure its continued hold on power, even if it means responding to dissidence.

The Dalian and Xiamen protest case raises general questions about the relationship between new media and development: Is a certain level of economic development necessary in order to provide access to new media and for citizens to be able to utilize it effectively to promote further development? How can poorer states be incentivized to provide popular access to new media for reasons of economic growth, if, even with the sophisticated controls in place in China, it can equally be used to organize and empower political dissent? The answers to these questions are not yet clear. Nevertheless, new media has distinguished itself as an important new area for understanding rule of law and economic development.

### STATE CONTROL OF MEDIA OR CSOS

We now consider the relationship between the state, civil society, and the media. At this point we recall are discussion in the introduction about the role government plays in fostering media and civil society. The way that governments deal with the media industry and CSOs profoundly affects their evolution and potential impact on development.

Davis and Trebilcock state that if the press is free and competitive, journalists will have incentives to discover and report corruption and abuse of power.<sup>105</sup> India exemplifies this phenomenon, as Sen showed in his discussion on famine, the media, and governance. Indeed, the interaction between state and media influenced Besley and Burgess to study media accountability in India in the first place.<sup>106</sup>

A free and competitive media provides more than just an incentive to report government abuses, however. Specifically, a free, open, and competitive media *market* improves media's quality, reliability, and efficacy. Competition between independent media firms should lead to better services, including more pertinent and reliable information for media's consumers. A plurality of media voices also empowers the public to make reasoned choices about their politicians. Whereas the state has a greater opportunity to manipulate state-run media enterprises for its own purposes, it will have much more difficulty manipulating a free and competitive press.<sup>107</sup> As we shall see, the Chinese and Russian states heavily control their countries' media through state owned-enterprises and majority ownership. The extent to which the media can scrutinize government will depend on the extent to which it is controlled, repressed, or captured by state or private interests. The state might control the press in a variety of ways through owning media, regulating media ownership, legal barriers to entry, censorship, bribery, threats, or outright violence. We have already looked at structural, regulatory, and violent ways the Chinese state represses new media. These same controlling mechanisms can also be applied to traditional media.

<sup>103</sup> Ibid.

<sup>104</sup> Ibid.

<sup>105</sup> Davis and Trebilcock, "The Relationship Between Law and Development," 21.

<sup>106</sup> Besley and Burgess, "The Political Economy of Government Responsiveness," 2.

<sup>107</sup> Davis and Trebilcock, "The Relationship Between Law and Development," 21.

As with Bruszt's conclusions on CSOs in former Eastern bloc countries, a weak and uncompetitive media environment leads to weak private media organizations, which in turn leads to poorer development.

A number of international studies have tested the theory that free press favours development. Brunetti and Weder as well as Ahrend have found that, across different countries, greater press freedom is associated with lower corruption.<sup>108</sup> India, which has a free press but high levels of corruption, is one notable exception. Besley, Burgess, and Prat discovered three things in their own cross-country study.<sup>109</sup> First, press capture – that is, capture of the press by vested interests – is more likely where there is greater state ownership and greater concentration of ownership, which suggests that a free and competitive press is optimal. Second, press freedom is greater where the media penetration is greater – that is it brings more information to more citizens and consumers. Third, low-income democracies tended to have lower press freedom scores. This last conclusion establishes a connection between press freedom and economic development, although it is not entirely clear which element causes the other.<sup>110</sup>

Coyne and Leeson address the impact of pre-existing levels of economic development on media.<sup>111</sup> They argue that, in addition to the state, market forces play a role in media industry development.<sup>112</sup> These conditions are mutually reinforcing and in a bleak business environment could produce a vicious circle. Specifically, if there is little opportunity for independent media to flourish on its own, this might lead the state to financially support media enterprises. This might weaken media's independence and in turn its effectiveness in overseeing government and improving the economic environment.<sup>113</sup> Coyne contends that to overcome this challenge domestic media should seek foreign direct investment.<sup>114</sup> He cites Poland's previously state-owned newspaper, *Rzeczpospolita*. In 1991, the state stopped funding it and later privatized it. Foreign investment was the key to its survival and development.<sup>115</sup> Furthermore, foreign firms bring skills and capital which enable domestic media to enrich their expertise.<sup>116</sup> Coyne also cites the example of TV-2 in Russia. TV-2 went from being completely inexperienced in the 1990s to becoming a sophisticated self-sufficient media outlet through the assistance of foreign consultants.<sup>117</sup> However, while foreign investment may provide an alternative to state support, governments in developing nations are wary that foreign involvement might subvert domestic political loyalty. This is especially true when the investor nation and recipient nation follow significantly different political and economic models. Indeed, China and Russia are among those countries that are suspicious and hostile of western involvement in domestic media.

Djankov et al. produced one of the most wide-ranging studies on media control. The study focuses on patterns of ownership (state ownership, family ownership, or diverse ownership) and levels of concentration of ownership (up to and including monopoly) in the media across 97 countries.<sup>118</sup> The study revealed several significant results. Poorer countries had higher levels of state ownership. Dividing the countries

<sup>108</sup> Aymo Brunetti and Beatrice Weder, "A Free Press is Bad News for Corruption," *Journal of Public Economics* 87, no. 7-8 (2003); Rudiger Ahrend, "Press Freedom, Human Capital and Corruption," *DELTA, Paris* (2000).

<sup>109</sup> Besley et al., "Mass Media and Political Accountability," 3.

<sup>110</sup> Ibid.

<sup>111</sup> Coyne and Leeson, "Read All About It!"

<sup>112</sup> Ibid., 28.

<sup>113</sup> Ibid., 29.

<sup>114</sup> Ibid.

<sup>115</sup> Tim Carrington and Mark Nelson, "Media in Transition: The Hegemony of Economics," in *The Right to Tell: The Role of Mass Media in Economic Development*, ed. Roumeen Islam (Washington DC: World Bank, 2002), 232-33.

<sup>116</sup> Coyne and Leeson, "Read All About It!," 32.

<sup>117</sup> Ibid.

<sup>118</sup> Djankov et al., *Who Owns the Media?*

into GNP quartiles, Djankov et al. found that state ownership by market share in newspapers was 49.7 percent for the lowest national income quartile and 0 percent for the highest income quartile. The market share of state ownership in television was 78.0 percent for the lowest income quartile and 52.7 percent for the highest income quartile.<sup>119</sup> Poor countries were also far more likely to have state monopolies.<sup>120</sup> Djankov et al. also found that greater state ownership of the media corresponded with less press freedom, including more censorship and more journalists arrested and imprisoned.<sup>121</sup> Politically, countries with greater state ownership of media had weak human rights records, ineffective governments, and more corruption.<sup>122</sup> Economically, greater state ownership was associated with weaker security of property rights, lower quality economic regulation, fewer firms per capita listed on national stock exchanges, and weaker banking systems.<sup>123</sup> Socially, countries with higher state ownership of the media had lower education enrollment and teacher-to-pupil ratios as well as citizens with inferior education levels.<sup>124</sup> These countries also had worse health, lower life expectancy, higher infant mortality, higher malnutrition, less access to sanitation, and poorer healthcare system responsiveness. In summary, Djankov et al.'s study revealed that greater media control, measured by ownership, corresponded with greater poverty, less press freedom, weaker rights, worse political governance, underdeveloped economic markets, and inferior health and education.<sup>125</sup> In addition, the authors found that while countries with state media monopolies had the worst development outcomes, results progressively deteriorated with increasing marginal rates of government ownership of the media.<sup>126</sup> While direct causation between these factors is questionable, the authors note that their results are robust in the face of controls, such as pre-existing level of economic development, state ownership in the economy as a whole, and the degree of autocratic governance.<sup>127</sup> They conclude that "increasing private ownership of the media ... can advance a variety of political and economic goals, and especially the social needs of the poor."<sup>128</sup>

We turn now to some final individual country observations on media control. Russia tightly controls its traditional media.<sup>129</sup> With Vladimir Putin's election in 2000 came the end of a relatively liberal period for Russian media and the beginning of greater state involvement.<sup>130</sup> Russian state control takes the form of market domination rather than Soviet-style censorship.<sup>131</sup> The state controls Russia's major national television broadcasters and state-owned or state-controlled companies own the country's most influential newspapers and magazines.<sup>132</sup> Three national networks dominate news coverage today.<sup>133</sup> Of these, the state owns *Rossiya* and Channel One and Gazprom owns NTV. During Yeltsin's presidency, the oligarch Boris Berezovsky effectively controlled Channel One. But after Channel One negatively portrayed Putin during the Kursk submarine accident, Berezovsky sold his minority stake and fled to the UK. The oligarch Vladimir Gusinsky started NTV under Yeltsin but sold it under

duress to Gazprom in 2001 and also fled the country.<sup>134</sup> Today, Gazprom controls numerous influential media interests in television, radio, and publishing.<sup>135</sup> The government has also encouraged Kremlin-friendly businessmen to invest in the media, such as billionaire Alisher Usmanov's control of Russian daily business newspaper *Kommersant*.<sup>136</sup> Television is the most popular form of media in Russia. According to Gehlbach other media's ability to penetrate Russian society pales in comparison to the three big television networks.<sup>137</sup> Indeed, print media circulation has dropped sharply during Putin's presidency, falling behind even the Internet's slow growth.<sup>138</sup>

Russia has adopted a system of tactical domination rather than totalitarian control. Indeed the state has not attempted to nationalize smaller less influential television, radio, newspaper, or online news sources.<sup>139</sup> In television, government and station executives determine what news to air during weekly meetings, but the government grants the stations latitude to determine non-news programs.<sup>140</sup> This helps the stations find ways to maintain and increase channel viewership, which has the added effect of supporting the strategy of domination of opinion *through* media.<sup>141</sup> Besides ownership, Russia employs other means to restrain the media. Gehlbach writes that Putin has often relied on surrogates and economic pressure to keep editors and journalists in line.<sup>142</sup> For example, journalists at the Russian News Service radio network have been warned that 50 percent of reports on Russia must be positive.<sup>143</sup> In addition, the state maintains control by pressuring or threatening journalists, such as Politkovskaya and Beketov (described above in the section on new media). Thus, rather than incur the state's ire, journalists censor themselves.

Although criticized by the West, Putin's moves to increase media control appeal to Russians that are attracted to order and stability rather than press freedom and political pluralism.<sup>144</sup> For example, 44 percent of Russians felt that a development model built around "a centrally controlled government such as China's" had more to offer Russia.<sup>145</sup> Furthermore, 56 percent supported "increased government control of the media" like the type exercised by Putin.<sup>146</sup> These findings have important implications for development. Does Russian public support for state-controlled media drive that state control or does Russian state-control drive the public support? How does one balance fulfilling a popular desire for press restriction, with the stark economic results presented by Djankov et al. and Bruszt regarding media and CSO repression?

As the above survey results show, China is associated with tight media control. According to Eko, Yao, et al., the Chinese government views the media merely as an instrument of socialist propaganda and economic development.<sup>147</sup> Laws prohibit disseminating information that undermines state security, national unity, and power; damage state honour and secrets; instigate ethnic or religious hatred; and promote superstition, gambling, pornography, and violence.<sup>148</sup>

<sup>119</sup> Ibid., 20.

<sup>120</sup> Ibid.

<sup>121</sup> Ibid., 23.

<sup>122</sup> Ibid., 24.

<sup>123</sup> Ibid., 25-27.

<sup>124</sup> Ibid., 27-28.

<sup>125</sup> Ibid., 31.

<sup>126</sup> Ibid., 29-30.

<sup>127</sup> Ibid., 31.

<sup>128</sup> Ibid., 32.

<sup>129</sup> This control parallels Russia's control of CSOs as noted by Bruszt in his study of CSOs in the former Eastern bloc. See also Scott Gehlbach, "Reflections on Putin and the Media," *Post-Soviet Affairs* 26, no. 1 (2010), 77.

<sup>130</sup> Ibid., 79.

<sup>131</sup> Ibid., 78-80.

<sup>132</sup> "Russians Support Putin's Re-Nationalization of Oil, Control of Media, But See Democratic Future," *World Public Opinion.org* (July 10 2006), online: <www.worldpublicopinion.org>.

<sup>133</sup> Gehlbach, "Reflections on Putin and the Media," 80.

<sup>134</sup> Ibid., 80-81.

<sup>135</sup> Ibid., 81.

<sup>136</sup> Ibid.

<sup>137</sup> Ibid.

<sup>138</sup> Ibid., 84.

<sup>139</sup> Ibid., 78-80.

<sup>140</sup> Ibid., 80.

<sup>141</sup> Ibid., 83-84.

<sup>142</sup> Ibid., 78.

<sup>143</sup> Ibid., 79.

<sup>144</sup> "Russians Support Putin's Re-Nationalization of Oil."

<sup>145</sup> Ibid.

<sup>146</sup> Ibid.

<sup>147</sup> Eko et al., "Google This," 4.

<sup>148</sup> Ibid., 5.



Domestic Chinese-language media is state controlled and highly regulated.<sup>149</sup> Indeed, this led Sen to theorize that tight censorship led to between 16.5 and 29.5 million famine deaths between 1958 and 1961.<sup>150</sup> In 1998, *Der Spiegel* correspondent Juergen Kremb was expelled from China for allegedly possessing state secrets.<sup>151</sup> According to the BBC, Kremb said he never saw the incriminating documents. He also said that Chinese authorities made up the accusations to justify expelling him over his book about prominent Chinese dissident Wei Jingsheng.<sup>152</sup> More recently, Al Jazeera closed its English-language bureau in Beijing after the channel allegedly failed to comply with Chinese regulations on content restrictions.<sup>153</sup> Analysts have speculated that the Chinese government used Al Jazeera as a scapegoat to signal to the general media its displeasure over recent coverage of former political heavyweight Bo Xilai's sacking as well as activist Chen Guangcheng's six-day stay in the US embassy after escaping house arrest.<sup>154</sup> Bo Xilai was one of the most high profile members of the Chinese Communist Party. While the Chinese state continues to maintain significant control over traditional media, it has been slightly more lenient over rules pertaining to new media.

India enjoys relative media freedom, especially compared to Russia and China. The *Right to Information Act, 2005* has been critical to India's free press.<sup>155</sup> The Act enables citizens and the media to demand information about government, which in turn enables them to monitor these activities. According to Coyne, once the media has "access to some degree of government information, it will continue to pressure government agents to increase transparency, strengthening previous [freedom of information] laws, and seeking to broaden the scope of such laws."<sup>156</sup> Indeed, this is presently occurring in the judiciary. In the face of rampant corruption, public demands for disclosure of judges' assets, has led to a new bill pending before Parliament, called *The Judicial Standards and Accountability Bill, 2010*. This bill requires all judges to declare their assets and liabilities on the court website to which he or she belongs.<sup>157</sup> Furthermore, the snowballing success of the Team Anna movement also reveals how fulfilling the public's demand for information has led to greater freedom of opinion, fuelled an appetite for more information, and led to less public tolerance of attempts to repress dissent.

Squarely between China and India's contrasting media environments is Brazil. There, the media market is highly concentrated. The top two television networks control 76 percent of the market. According to Hughes and Lawson, this market concentration is the result of media owners' collusive relationships with political elites, both democratic and autocratic. They state, for instance that "Brazil's Globo emerged and expanded with the aid of authoritarian regimes that protected and promoted those companies."<sup>158</sup> However, the number of alternative channels has exploded in recent years. Furthermore, the bulk of social media exists outside of the domestic media powerhouses. Hughes also notes that Brazil has made progress in regulating media with instruments such as a financially autonomous nonpartisan board that oversees Brazilian pay television. This, she believes, suggests that reformers will be able to push through promising legal reforms that will facilitate investigative reporting.<sup>159</sup>

<sup>149</sup> Martin Patience, "China Expels Al-Jazeera English Reporter," *BBC News* (May 8 2012), online: <www.bbc.co.uk>.

<sup>150</sup> Besley et al., "Mass Media and Political Accountability," 12.

<sup>151</sup> Patience, "China Expels Al-Jazeera English Reporter."

<sup>152</sup> "China Expels German Journalist," *BBC News* (November 18 1998), online: <www.bbc.co.uk>.

<sup>153</sup> Patience, "China Expels Al-Jazeera English Reporter."

<sup>154</sup> *Ibid.*

<sup>155</sup> India, *Right to Information Act, 2005, No. 22 of 2005*.

<sup>156</sup> Coyne and Leeson, "Read All About It!," 30-31.

<sup>157</sup> For more information see judiciary section.

<sup>158</sup> Hughes and Lawson, "Barriers to Media in Latin America," 13-14.

<sup>159</sup> *Ibid.*, 19.

## CONCLUSION

Interest in the "fourth estate of government" and its contribution to the rule of law and development, has risen in recent years. In 2002, the *World Development Report* dedicated a chapter to the importance of media on development.<sup>160</sup> Besides the studies discussed in the present report, the role of media and CSOs in development projects has been the subject of enquiries in relation to government transparency and accountability by Stiglitz,<sup>161</sup> public policy by Spitzer,<sup>162</sup> and corporate governance by Dyck and Zingales.<sup>163</sup> This emerging interest in the role of media and CSOs in furthering the rule of law and development is almost certainly with good reason. While there are still more questions than answers about why media and CSOs influence and are influenced by law and economic development, the overall literature consistently shows a correlation between effective media and civil society and desirable governance and economic outcomes. While the case of China seems to contradict Coyne's conclusion that "a free media is a necessary ... condition for economic development," we may have enough evidence by now to accept Besley, Burgess, and Prat's softer conclusion that "there may be significant costs associated with having an underdeveloped media."<sup>164</sup> This is a conclusion that is equally applicable to civil society. Prime among these costs may be lost contributions from media and CSOs to improving the political, economic, and judicial institutions that are so crucial to development.

<sup>160</sup> *World Development Report 2002: Building Institutions for Markets*, (Washington: World Bank, 2001).

<sup>161</sup> Joseph E. Stiglitz, "Transparency in Government," in *The Right to Tell: The Role of Mass Media in Economic Development*, ed. Roumeen Islam (Washington DC: World Bank, 2002).

<sup>162</sup> Robert J. Spitzer, *Media and Public Policy* (Westport, Connecticut: Praeger, 1993).

<sup>163</sup> A. Dyck and L. Zingales, *The Corporate Governance Role of the Media* (National Bureau of Economic Research, 2002).

<sup>164</sup> Besley et al., "Mass Media and Political Accountability," 1; Coyne and Leeson, "Read All About It!," 27.

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# CONCLUSION

This study aims to provide a comparative interdisciplinary perspective on rule of law and economic development in the BRIC countries, based on a comprehensive survey of empirical data and theoretical literature. The underlying objective of the study is to compare, where possible, and contrast the processes of legal and economic development in Russia against those of other emerging economies. With the aim of giving a clear focus to this vast area of inquiry the study is organized around the following five components related to the rule of law: governance, institutions, the judiciary, corruption, and media and civil society.

The paths taken by each BRIC country demonstrate that there are no clear answers or obvious interpretations to the complex relationship between rule of law and economic development. This intricate yet tenuous relationship has preoccupied scholars and policy makers for decades. These undertakings are all the more complex given that rule of law and its components have multi-dimensional meanings and can be defined along a broad spectrum of concepts. We chose to use a minimalist procedurally oriented definition of rule of law which focuses on the legitimacy, predictability, uniformity with which laws are created, applied, and enforced.

The difference between *de facto* and *de jure* rule of law remains a central theme throughout this study. All the evidence consistently indicates that the BRIC countries have relatively well-developed institutional and legal frameworks necessary for fostering a rule of law regime. However, rampant corruption and political complacency have led to erosion in political, economic, and legal institutions, leading to varying degrees of weakening rule of law. Some of the reasons for institutional weakening which we identify are, under-resourced anti-corruption agencies, weak law enforcement, and most of all lack of political will, which undermine any substantive efforts to tackle corruption in practice. As demonstrated in the case of China and India, *de facto* practices can make up for or overcome weak rules or institutions. China provides a good example of how weak enforcement of property rights is overcome by a relation-based governance system based on networks and informality. In contrast, Russia's judiciary provides a stark example of how laws which can appear to be strong are in fact severely undermined by informal practices. Taking into account these domestic particularities it would be unwise to devise a strategy to combat corruption without addressing particularities specific to each system and its institutions.

Governance is a complex component of rule of law that attempts to make sense of a state's mechanisms and processes. We chose a definition that considers both the state's function and the role of various stakeholders. We acknowledge that while the role of the state is critical, governance goes further and must account for non-state actors who exert oversight and accountability. We found that the particular form of governance alone may not have considerable bearing on its economic outcomes. Indeed, a constitutional democracy may be overtaken by special interests, voting irregularities, and empty political promises. On the other hand, authoritarian regimes still face political and economic constraints that can make it beneficial for them to act in the interests of their people. The 18<sup>th</sup> Communist Party congress, which started in Beijing as we write these conclusions, is grappling with the issue of corruption in China. This leadership transition in China is centred around the issues of political and economic reforms, which could sustain China's economic growth and development. We argue that irrespective of the form of governance, long-term economic growth can only be sustained by addressing the issues of transparency and accountability in political and economic institutions. Indeed, Putin's repressive regime in

Russia is being held accountable by its electorate. It seems to us that increasingly draconian measures introduced to stifle popular demand for accountability may not be able to contain the growing discontent among Russians. The first signs of the regime being forced to respond to democratic forces are the recent sackings of the Minister of Defense and the chief of Russia's armed forces for major corruption and fraud scandals.

Institutions are some of the most compelling, if complex, pieces of the rule of law puzzle. Theoretical literature has repeatedly demonstrated that it is nearly impossible to disaggregate distinct institutional variables and draw a causal relationship to economic growth. Instead, we must look at multiple, interrelated variables that make up the rule of law "complex." In addition to the distinction between formal and informal institutions, we emphasized the interplay between political and economic institutions. China and India have both demonstrated how unorthodox policies have been able to foster successful economic growth. We highlighted the importance of incentives for political and economic actors. Indeed, China's unorthodox but innovative policies succeeded because they created incentives for political and economic actors. In Russia, on the other hand, the process of privatization and subsequent reconfiguring of inter-governmental revenue sharing removed incentives for local governments to support local small businesses.

We highlighted the unique role played by the judiciary in maintaining the rule of law through independent and predictable judgments, and in the case of democracies to enforce democratic accountability. The tension between judicial accountability and independence is an ongoing and fundamental balancing act in any state. The judiciary, as we saw in India and Brazil, can play an important role in supplanting the deficiencies of the legislative and executive branches of government. Yet in both India and Brazil, excessive judicial independence has compromised judicial accountability. Perhaps the more important, if more subtle, role of the judiciary is in the everyday work of disposing of cases independently, professionally, predictably, reliably, efficiently, and with regard for procedural fairness. The judiciary in China is embedded in the government's structure to an extent that it is difficult to delineate a clear line between the two. Judges lack necessary professional training, they are not shielded from political interference, – indeed they actively and openly acknowledge the role of politics in their decisions – and litigants do not benefit from open courts. In India, we saw in detail how a highly inefficient and underfunded court system means that many cases never get to court, but if they do they may be locked into a never ending cycle of litigation. Recent reforms in alternative dispute resolution are attempting to unclog the regular courts, but as we found this is merely a stop-gap measure which will never truly be effective until the regular court system is adequately reformed. Russia has by far the weakest judiciary of all of the BRIC countries. *De facto* independence is considered lower even than in China. And the stark difference between *de facto* and *de jure* measures highlights that there has been a fundamental breakdown in formal judicial institutions that requires more dedicated attention and fundamental reform.

Although we are unable to establish a direct causal link between robustness of judicial institutions and economic development there is enough evidence that increased social well-being increases citizens' and entrepreneurs' use of formal institutions such as the court system. In Russia, however, we have seen a dramatic criminalization of entrepreneurialism through application of outdated and arbitrary sanctions to businesspeople. Indeed, in India, small manufacturers and businesses, which have driven growth for the last decades, are not being considered in reforms of the judicial system, instead their needs are being overlooked. Thus, judicial reforms must consid-

er the role of the courts in fostering and sustaining economic well-being, especially of the most productive, but potentially vulnerable, players.

Each of the BRIC countries experience high levels of corruption, but India stands out for the unusually high rates experienced by citizens and entrepreneurs. This is despite decades old legislation and anti-corruption agencies. China, Brazil, and Russia, are moving towards more sophisticated corruption in the business sector, even if levels for everyday citizens are decreasing. Inadequate international and domestic measures to combat money laundering and capital flight have facilitated corrupt practices and made it much more difficult for emerging economies to effectively combat corruption. Each of the BRIC countries have made concerted efforts to reform their legal frameworks to combat corruption, but, with the exception of Brazil, have made few practical improvements to ensure that the laws will be enforced. In China and Russia this results largely from the fact that most anti-corruption initiatives stem from the state and do not incorporate outside voices.

Interestingly, India's vibrant civil society has supplanted the deficiencies of its formal anti-corruption agencies. A flourishing grassroots anti-corruption movement led by Anna Hazare has focused much needed attention on government deficiencies and accountability. While there are still more questions than answers to why "the fourth estate of government" influences law and economic development, the overall literature consistently shows a correlation between effective media and civil society and desirable governance and economic outcomes. It is too soon to tell the impact of new media on economic development, yet in Russia low censorship on the Internet means that an increasingly vocal opposition and anti-corruption movement have been allowed to blossom. While we may not know why or how well media and civil society foster economic development, it is almost certain that without them there may be lost opportunities to improve the political, economic, and judicial institutions that are so crucial to development. Along these lines, the greatest strength for both Brazil and India, as opposed to China and Russia, can be found in the degree of pluralism and inclusivity that persists within their political institutions and governance framework, which may prove to be a determining factor for robust and sustainable economic growth.

As we conclude this report, Russia is exhibiting some disturbing trends that undermine what exist of civil society organizations, political opposition, and judicial institutions. In early October, Russia announced it would broaden the legal definition of treason in a move calculated to crack down on political opposition.<sup>1</sup> In July the government passed a bill that would require non-governmental organizations that engage in political activity and receive foreign funding to register as "foreign agents."<sup>2</sup> This move is intended to discourage foreign aid to non-governmental organizations – considering that the majority of funding comes from outside Russia, this will severely weaken an already weak civil society. Finally, Russia is considering limiting the extent to which Russians can seek judicial remedies outside Russia at the European Court of Human Rights. Based on the global trend in popular movements challenging rot in political institutions and demanding democratic accountability, we argue that Russia cannot remain immune to democratic forces.

<sup>1</sup> Charles Clover, "Russia broadens definition of treason," *Financial Times* (October 23 2012) online: <www.ft.com>.  
<sup>2</sup> "Russian Parliament Gives First Approval to NGO Bill," *BBC News* (July 6 2012), online: <www.bbc.co.uk>

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## APPENDIX A – LAWS OF BRAZIL

### HIERARCHY OF LAWS:<sup>1</sup>

- Emendas constitucionais (Constitutional Amendments)
- Leis (Laws)
- Medidas provisórias (Provisional Measures/Complementary laws)
- Decretos legislativos (Legislative Decrees)
- Resoluções do Congresso Nacional (Resolutions of National Congress)
- Resoluções do Congresso Senado Federal (Resolutions of Federal Senate)

The legal framework for tackling corruption in Brazil is contained mostly in provisions of the *Penal Code* and federal laws. According to the 2008 *Global Integrity Report* this framework is “very strong.”<sup>2</sup> Unless otherwise indicated, the sources of most of the information contained in this section on Brazil comes from the *Business Anti-Corruption Portal*.<sup>3</sup> All of these charts are up to date as of September 21, 2012.

**Constitution of the Federative Republic of Brazil:** The Brazilian Constitution was passed by referendum and promulgated on October 5, 1988. It lays the legal foundation for the Brazilian democratic state, establishes the framework of the federation and details the relationship between the federal government and the states. The Constitution was written in part as a reaction to the decades of military dictatorship and enshrines fundamental human and civil rights.

<b>Art 5, XXXIII</b>	Access to information is constitutionally protected by art 5, XXXIII, however, it is not backed up by regulation which details how access to information should work.
<b>Art 37, XXII</b>	This article establishes penalties for acts of official misconduct in the public administration.

<sup>1</sup> Thomas H. Reynolds and Arturo A. Flores, “Brazil” *Foreign Law Guide* (2000) online: <<http://foreignlawguide.com/ip/flg/Brazil%20Introduction.htm>>.

<sup>2</sup> “Scorecard: Brazil 2009,” in *Global Integrity Report* (Washington, DC: Global Integrity, 2009), VI-1.

<sup>3</sup> Global Advice Network, “Brazil Country Profile” *Business Anti-Corruption Portal* (Copenhagen, Denmark: 2011) online: <<http://www.business-anti-corruption.com/country-profiles/latin-america-the-caribbean/brazil/initiatives/public-anti-corruption-initiatives/>>.

**Penal Code, Law 2,848/40:** Brazil has had a *Penal Code* since 1940. The *Penal Code* has two sections: the first distinguishes between felonies and misdemeanours and outlines the individual citizen’s responsibilities under the law and the second section defines criminal behaviour more comprehensively, spelling out crimes against persons, property, customs, public welfare, and public trust.<sup>i</sup> **Law 10,467** of June 11, 2002 adds chapter II-A to section XI of the *Penal Code* which rules on the crimes of money laundering and corruption.<sup>ii</sup>

<b>Art 14</b>	<b>Attempts</b> are governed by art 14, clause II of the <i>Penal Code</i> , which applies to all criminal offenses, including the offense of foreign bribery. Under this provision, a crime is attempted “when the performance is begun, but it is not carried out through circumstances foreign to the wishes of the offender.”
<b>Art 29</b>	This article establishes liability for <b>complicity</b> , including for the offense of foreign bribery. This article provides: the penalties prescribed for the criminal offense also apply to whomever, in any way, conspires in the criminal offense, insofar as the person concerned is found guilty.
<b>Art 288</b>	This article covers the offense of <b>conspiracy</b> . It provides a penalty from three to six years imprisonment where “more than three people associate together in a gang or band, for the purpose of committing a crime.”
<b>Art 317</b>	This article makes <b>active bribery</b> of a Brazilian public official a criminal offense. Active bribery is also known as bribe giving.
<b>Art 333</b>	This article makes it an offense for a Brazilian (domestic) public official to accept a bribe under the <i>Penal Code</i> . This is known as <b>passive bribery</b> .
<b>Art 337 (B)</b>	This article covers active bribery in an international business transaction. The article was introduced to the <i>Penal Code</i> following the ratification of <i>OECD Convention on Combating Corruption of Foreign Corrupt Officials</i> . It falls under the chapter of the <i>Penal Code</i> entitled “Crimes Committed by Individuals Against a Foreign Public Administration.”  A sample of the provision states: “Promising, offering or giving, directly or indirectly, an improper advantage to a foreign public official or to a third person, in order for him or her to put into practice, to omit, or to delay any official act relating to an international business transaction.” <sup>iii</sup>  The penalty is deprivation of liberty from one to eight years plus a fine. The penalty is increased by one-third if, because of the advantage or promise, the foreign public official delays or omits, or puts into practice the official act in breach of his or her functional duty.
<b>Art 337 (D)</b>	This clause defines the term “foreign public official.”

<sup>i</sup> US, Library of Congress, “Legal Research Guide: Brazil” (2012) online: <<http://www.loc.gov/law/help/brazil.php>>.

<sup>ii</sup> OECD, “Brazil: the Law 10,427 implementing the Convention Amending the Brazilian Penal Code and Provisions on Corruption Both on Domestic and on the International Level, Including any Type of Sanctions” online: <<http://www.oecd.org/dataoecd/43/26/33783624.pdf>>.

<sup>iii</sup> OECD, Working Group on Bribery in International Business Transactions, *Brazil: Phase 1, Review of Implementation of the Convention and 1997 Recommendation*, (August 31 2004).

<b>Laws of Brazil Relating to Corruption:</b> This chart includes federal laws related to embezzlement, bribery, procurement, money laundering, regulation of public officials, and ratification of multilateral treaties on corruption. The laws are listed in the order of the date they were enacted.		
Name of Law	Legal Citation	Notes/Description
<b>“Official Misconduct law” or “Against Corruption and Illicit Enrichment”</b>	Law 8,429/92 of June 12, 1992	This is the main law dealing with the corruption of public officials in Brazil. This law applies sanctions to public employees who gain illegal enrichment in the exercise of their mandate, office employment, or function of their office. It talks about general provisions, acts of administrative dishonesty, crimes, statement of assets, administrative procedure, and judicial process.
<b>“Public Procurement Law” or “Tendering Law”</b>	Law 8,666/93 of June 21, 1993	This is a law on tenders and contracts. It regulates public bidding procedures of the federal, state, and municipal governments. It covers the procedures for signing administrative contracts by the relevant public entities and activities such as public works; services (including advertising); and purchasing, transferring, and leasing property. This law has been modified numerous times over the years by other laws and provisional amendments.
<b>“Violations Against Economic Order” or “Brazilian Anti-trust law”<sup>i</sup></b>	Law 8,884/94 of June 11, 1994	This law prohibits illegal agreements (cartels), collusion with competitors on prices and conditions for the sale of specific products, obtaining or procuring the adoption of uniform business practices among competitors, and apportioning markets for finished or semi-finished products. Cartels are considered to be a civil violation. <sup>ii</sup>
<b>“Law on the Prevention and Repression of Criminal Organizations’ Activities”</b>	Law 9,034/95 of May 3, 1995	This law describes several investigative methods that can be used by judges when dealing with criminal organizations.
<b>“Access to Information Law”</b>	Law 9,265/96 of February 12, 1996	This law regulates Art 5(LXXVII) of the Constitution which states that certain acts (interactions of citizens with government officials) must be free of charge. These acts include requests for information from public officials and contestations of elected mandate for abuse of economic power, corruption, or fraud.
<b>“Money Laundering Law”</b>	Law 9,613/98 of 1998	This law pertains to the crimes of money laundering or concealment of assets, rights, and valuables. It sets forth measures designed to prevent the misuse of the financial system for illicit actions. It also creates the financial Activities Control Council.
<b>Election Corruption Law, “Clean Record law,” or <i>Ficha Limpa</i></b>	Law 9,840/99 of December 29, 1999	This is a law on electoral corruption. It is a wide sweeping new anti-corruption law which prevents candidates who have been convicted of any one of a range of crimes, including electoral fraud, from running for public office.  It was Amended in June 2010 following a petition, known as <i>Ficha Limpa</i> , which was signed by 1.6 million Brazilians.

<b>“Fiscal Responsibility Law”</b>	Law 101/00 of May 4, 2000	This law imposes a series of rules on all levels of government to try to ensure fiscal responsibility, debt control, expenditure goals, and transparency in public finance. <sup>iii</sup> This law is mainly about regulating spending as between the different parts of the federation and it imposes strict spending constraints on each level of government. It also imposes strict transparency obligations, including publishing fiscal targets, report debts, receipts and expenditures, and quarterly reports. Failures to comply are punished under Law 10,028.
<b>“Executive Power Internal Control Law”</b>	Law 10,180/01 of February 6, 2001	This law establishes the Federal Secretariat for Control which takes care of auditing, inspection, and assessment of administration activities. Together with the Comptroller General’s Office it may oversee defence of public assets, growth of administrative transparency through internal control activities, public auditing, honesty, prevention, and fight against corruption. <sup>iv</sup>
<b>“Regulation on Politically Exposed Persons of the Central Bank”</b>	Circular 3,339/06 of 2006	This circular determines the adoption of special procedures in relation to the businesses and financial transactions of bank customers considered to be politically exposed persons. <sup>v</sup> “Politically exposed persons” refers to all persons that hold or have held prominent public offices as well as their families and close collaborators.
<b>“Freedom of Information Law”</b>	Law 41/10 of 2010	This law forces the authorities to publish spending information and to respond to citizens’ requests for information.
<p><sup>i</sup> Unless stated otherwise all information in this table derives from the Library of Congress Global Legal Information Network Database. US, Library of Congress, <i>Global Legal Information Network Database</i> (2012) online: &lt;<a href="http://www.glin.gov/search.action">http://www.glin.gov/search.action</a>&gt;.</p> <p><sup>ii</sup> Demarest e Almeida, “Intellectual Property and Competition law: Brazil” <i>Lex Mundi Publication</i> (São Paulo, Brazil, 2011) online: &lt;<a href="http://www.lexmundi.com/Document.asp?DocID=2696">www.lexmundi.com/Document.asp?DocID=2696</a>&gt;.</p> <p><sup>iii</sup> Global Legal Group, “Brazil” in <i>The International Comparative Legal Guide to Cartels &amp; Leniency 2010</i> (London: Global Legal Group Ltd, 2010), 33.</p> <p><sup>iv</sup> K.S. Rosenn, “Federalism in Brazil,” <i>Duquesne Law Review</i> 43 (2004), 595.</p> <p><sup>v</sup> Natan Morelo, “The Importance of Internal Control in the Brazilian Public Administration” (2011) <i>Minerva Program</i>, 17.</p> <p><sup>vi</sup> UN, Office on Drugs and Crime, <i>Self-Assessment Checklist on the Implementation of the United Nations Convention Against Corruption: Brazil</i> (August 24 2007).</p>		



**Tax Laws:** Brazil has had a widespread problem of tax avoidance and tax evasion which was mainly the result of deficiencies in the tax system as well as inefficiencies in tax administration and enforcement. In the 1990s Brazil implemented some very harsh anti-avoidance measures including tough sanctions for tax crimes.<sup>i</sup> The main rules on Brazilian tax law are set out in the Brazilian Constitution which creates the principle of legality and circumscribes governments' ability to tax. The principle of legality means that Brazilian taxpayers can structure their tax arrangements to avoid paying taxes as long as the action is not expressly prohibited by law or does not constitute fraud or "simulated action."<sup>ii</sup> Tax evasion is defined either as fraud or "simulated actions" taken by taxpayers to evade, reduce, or delay paying taxes. Tax fraud is covered by Law 4,502 and simulated actions are defined by the *Brazilian Civil Code* and include actions taken where there is no connection between the transaction that the parties intend to accomplish and the transaction that is actually accomplished.<sup>iii</sup>

Name	Brief Description
<b>National Tax Code Law 5,172/66 of October 15th, 1966</b>	After the Constitution, this is the second most important source of tax law in Brazil.
<b>Complementary Law 104/01 of January 10th, 2001</b>	This law authorizes the tax authorities to disregard certain transactions structured by the taxpayer in such a way as to conceal the occurrence of a taxable event. <sup>iv</sup>
<b>Law 4,729/65 of July 14, 1965</b>	This law defines and penalizes crimes of fiscal fraud, including tax evasion, contraband, fraudulent invoicing, clandestine trade, and others. It also amends art 334 of the <i>Criminal Code</i> .
<b>Law 4,502/64 of November 30, 1964</b>	This law defines tax fraud.
<b>Law 8,137/90 of December 27, 1990</b>	This law imposes criminal charges for tax evasion including up to five years on the taxpayer who uses any illegal device for reducing his tax liability. Some sanctions are so severe that courts have been inhibited from applying them.
<b>Law 9,430/96 of December 27th, 1996</b>	This law imposes a penalty equivalent to 150 percent of the total amount of tax evaded.

<sup>i</sup> Phyllis Lai Lan Mo, *Tax Avoidance and Anti-Avoidance Measures in Major Developing Economies* (Westport, Connecticut: Praeger, 2003), 123.  
<sup>ii</sup> Roberto Greco de Souza Ferreira, "Form versus Substance: A Comparison of Brazil's Tax System to the Tax System of the United States of America," *The University of Miami Inter-American Law Review* 35, no. 2 (2004), 327.  
<sup>iii</sup> *Ibid.*  
<sup>iv</sup> *Ibid.*, 322.

**Pending Legislation**

Name	Brief Description
<b>Draft Bill 6,826/10</b>	This would be an overhaul of Brazil's current law on foreign bribery. It would bring it up to date with all the international agreements that it has signed on bribery, including the <i>OECD Convention on Combating Bribery of Foreign Corrupt Officials in International Business Transactions</i> . According to Matteson Ellis this marks a dramatic change in the Brazilian legal system. The draft bill establishes direct civil liability for corporations for the bribery of foreign public officials. It also makes corporations liable for the acts of their directors, officers, employees, and agents. <sup>i</sup>

<sup>i</sup> Matteson Ellis, "Another BRIC in the Anti-Corruption Wall: Brazil Considers Foreign Bribery Law Overhaul" *FCPA Professor* (January 12 2012) online: <<http://www.fcpaprofessor.com/another-bric-in-the-anti-corruption-wall-brazil-considers-foreign-bribery-law-overhaul>>.

**Federal Agencies Responsible for Tackling Corruption, Tax Evasion, and other Economic Crimes**

Name of Agency	Relevant Legislation	Brief Description
<b>Office of the Comptroller General of Brazil</b>	Law 10,683/03	This is the organ responsible for immediately briefing the President on subjects of defence of public assets, growth of administrative transparency through internal control activities, public auditing, honesty, and prevention of corruption. <sup>i</sup>
<b>Federal Public Prosecutor's Office</b>	Complementary Law 75/93	Brazil's Constitution states that the Public Prosecutor's Office exists to defend the constitutional interests of citizens and society at large and ensure that public administration fulfils all its constitutional responsibilities and adheres to existing legal norms. In a significant change from the pre-1988 constitution the office was guaranteed independence from the executive, legislative, and judicial branches of government. <sup>ii</sup>
<b>Financial Activities Control Council –Brazil's Financial Intelligence Unit</b>	Law 9,613/98	This is the body that addresses money laundering. It was created pursuant to the ratification of <i>OECD Convention on Combating Bribery of Foreign Corrupt Officials in International Business Transactions</i> .
<b>Federal Court of Accounts/Audit</b>	Law 8,443/92	In Brazil this body is called the "Tribunal de Contas." It is the supreme government audit institution and oversees the executive branch of power.
<b>Federal Revenue Secretariat</b>	<i>National Tax Code</i>	Falls under the Ministry of Finance which is responsible for administrating the federal tax system. It also helps the government formulate tax policy in Brazil and works to prevent tax evasion, commercial fraud, and other economic crimes.
<b>Department of Assets Recovery and International Cooperation</b>	Decree 4,991/04	This department is subject to the National Secretariat of Justice of the Ministry of Justice. It recovers assets of illicit origin both at home and abroad. This department is the responsible central authority in Brazil for mutual legal assistance in criminal matters and civil matters. Brazil can provide mutual legal assistance either by means of letters rogatory or directly with the foreign requesting authority on recovering assets obtained from illegal origins.
<b>Council for Public Transparency and Against Corruption</b>	Decree 4,923/03	This is a collegiate advisory body linked to the Federal Comptroller General's Office. It has the function of proposing and discussing improvement measures to the strategies and systems to control and fight corruption. It also ensures transparency in public administration.

<sup>i</sup> Natan Morelo, "The Importance of Internal Control in the Brazilian Public Administration" (2011) *Minerva Program*.  
<sup>ii</sup> Maria Tereza Sadek, "The Public Prosecutor's Office and Legal Change in Brazil," *IDS Bulletin* 32, no. 1 (2001).

Multilateral Agreements		
Name	Signed	Ratified/Enabling Legislation
<i>Inter-American Convention Against Corruption</i> <sup>i</sup>	March 29, 1996	Decreets 4,534/02 and 4,410/02
<i>UN Convention Against Transnational Organized Crime (UNTOC)</i> <sup>ii</sup>	December 12, 2000	Entry into force January 29, 2004
<b>Financial Action Task Force (FATF)</b> <sup>iii</sup>	Member since 2000	
<i>OECD Convention on Combating Corruption of Foreign Public Officials</i> <sup>iv</sup>	August 24, 2000	Decree 125/00 Decree 3,678 Law 10,467/02 Law 9,613/02
<i>United Nations Convention Against Corruption (UNCAC)</i> <sup>v</sup>	December 9, 2003	January 31, 2006 Decree 5,687/06
<i>Convention on Mutual Administrative Assistance in Tax Matters (Updated Protocol)</i> <sup>vi</sup>	November 3, 2011	Not yet in force

<sup>i</sup> OAS, Department of International Law, "Signatories and Ratifications" (Washington, 2012) online: <<http://www.oas.org/juridico/english/Sigs/b-58.html>>.

<sup>ii</sup> UN, *Treaty Collection*, "Status as at 21-09-2012 United Nations Convention against Transnational Organized Crime" online: <[http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtsg\\_no=XVIII-12&chapter=18&lang=en](http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtsg_no=XVIII-12&chapter=18&lang=en)>.

<sup>iii</sup> FATF, "Who We Are" (2012) online: <<http://www.fatf-gafi.org/pages/aboutus/>>.

<sup>iv</sup> OECD, Directorate for Financial and Enterprise Affairs, "OECD Convention on Combating Bribery of Foreign Public Officials in International Business: Ratification Status as of April 2012" online: <[http://www.oecd.org/document/21/0,3746,en\\_2649\\_34859\\_2017813\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/21/0,3746,en_2649_34859_2017813_1_1_1_1,00.html)>.

<sup>v</sup> UN, United Nations Office on Drugs and Crime, "United Nations Convention Against Corruption: UNCAC Signature and Ratification Status as of 24 September 2012" (2012) online: <<http://www.unodc.org/unodc/en/treaties/CAC/signatories.html>>.

<sup>vi</sup> OECD, "Status of the Convention on Mutual Administrative Assistance in Tax Matters and Amending Protocol – 30 August 2012" (August 30 2012) online: <<http://www.oecd.org/tax/Status%20of%20convention%2030%20August%202012.pdf>>.

### Bilateral Treaties on Double Taxation and/or Tax Information Exchange Agreements:

Brazil has signed 33 double tax avoidance treaties with other countries and one tax information exchange agreement. These agreements are up to the OECD standards on exchange of tax information which include exchange of information on request where it is foreseeably relevant to the administration and enforcement of the domestic tax laws of the requesting jurisdiction. Effective exchange of information requires that jurisdictions ensure information is available, that it can be obtained by the tax authorities, and that there are mechanisms in place allowing for the exchange of that information.<sup>i</sup> In this table we include the agreements that Brazil has signed with the other BRIC countries as well as the US and Canada.

Country	Treaty Signed	Date Signed	Date Entered Into Force
<b>United States</b>	Tax Information Exchange Agreement	March 20, 2006	Not yet in force
<b>Canada</b>	Double Taxation Treaty	June 4, 1984	December 23, 1985
<b>China</b>	Double Taxation Treaty	August 5, 1991	January 6, 1993
<b>Russian Federation</b>	Double Taxation Treaty	November 22, 2004	January 19, 2009
<b>India</b>	Double Taxation Treaty	April 26, 1988	March 11, 1992

<sup>i</sup> OECD, "Brazil" *Exchange of Tax Information Portal* online: <<http://www.eoi-tax.org/jurisdictions/BR#agreements>>.

## APPENDIX B – LAWS OF RUSSIA

The legal framework for tackling corruption in Russia is contained mostly in provisions of the *Criminal Code*, *Code of Administrative Offenses*, and other federal legislation. Unless otherwise indicated the sources of most of the information contained in this section on Russia comes from the *Business Anti-Corruption Portal*.<sup>4</sup> All of these charts are up to date as of September 21, 2012.

<p><b>Russian Criminal Code, No. 63-FZ of June 13, 1996:</b> This <i>Criminal Code</i> replaced the previous Soviet <i>Criminal Code</i>. It was updated to include economic crimes and property crimes. Only natural persons can be convicted of offenses (art 19), thus Russia has not complied with various parts of the <i>OECD Convention on Combating Bribery of Foreign Corrupt Officials in International Business Transactions</i> and GRECO recommendations to make legal entities liable for giving and taking bribes. In April 2012 the Duma started to consider amending provisions of the <i>Criminal Code</i> related to fraud to clarify definitions and expand different types of fraud.<sup>i</sup></p>	
<b>Art 19</b>	Only <b>physical persons</b> can be subject to liability under the <i>Criminal Code</i> . The <i>Strasbourg Criminal Law Convention on Corruption</i> (art 18) states that there must be some kind of criminal liability for <b>legal persons</b> who commit bribery. The Group of States Against Corruption <i>Compliance Report</i> suggests that this article be amended. <sup>ii</sup>
<b>Arts 29 - 30</b>	These articles define <b>attempts</b> under the <i>Criminal Code</i> . This means that attempted bribery is punishable under the Code.
<b>Art 73</b>	This article relates to <b>suspended sentences</b> , which are often used to let convicted bribe takers evade criminal liability. An amendment in December 2003 (No. 162-FZ), makes this clause incredibly ambiguous and seems to encourage judges to use suspended sentences in cases of bribery. <sup>iii</sup>
<b>Art 160</b>	This article describes the offense of <b>embezzlement</b> .
<b>Art 169</b>	This article describes the offense of <b>obstruction of lawful business activity</b> . This article concerns public officials who obstruct the lawful activity of a business (for example by refusing to grant a licence). The crime is punishable by fines.
<b>Art 174</b>	This article describes the offense of money laundering, which is punished by imprisonment and confiscation of property
<b>Art 176 - 179</b>	These articles create the offense of illegal activities in the business realm, using unlawful pressure to execute a contract, receiving unlawful credit from banks, monopolies (restricting competition), and deliberate evasion of payment of debts.
<b>Art 183</b>	This article describes the offense of illegally stealing a company's banking information and other trade information, through use of bribes or other means.
<b>Art 184</b>	This article creates the offense of <b>bribery</b> of organizers of sports events or entertainment events which are profit making.
<b>Art 204</b>	This article describes the offense of <b>bribery</b> in profit making organizations.
<b>Art 285 - 289</b>	These articles create the offense of <b>abuse of power by state officials</b> . The articles cover everything from illegal participation in business activity to refusing to submit information for an audit.

<sup>4</sup> Global Advice Network, "Russia Country Profile" *Business Anti-Corruption Portal* (Copenhagen, Denmark: 2011) online: <<http://www.business-anti-corruption.com/country-profiles/europe-central-asia/russia/?pageid=277>>.

<b>Art 290</b>	This article creates the offense of <b>bribe taking</b> by a public official. The offense carries a high penalty but only three persons were convicted in 2003, thirteen in 2004, and six in 2005. In May 2011 this article was amended to make it an offense to bribe a foreign public official. <sup>iv</sup>
<b>Art 291</b>	<b>Bribe Giving</b> (punished less severely than bribe taking). In May 2011 this article was amended to make it an offense to bribe a foreign public official, to bring it into compliance with the <i>OECD Convention on Combating Bribery of Foreign Corrupt Officials</i> .
<p><sup>i</sup> "Fraud Draft Law Submitted to Parliament" <i>Russian Legal Information Agency</i> (12 April 2012) online &lt;<a href="http://www.rapsinews.com/legislation_news/20120412/262782233.html">http://www.rapsinews.com/legislation_news/20120412/262782233.html</a>&gt;.</p> <p><sup>ii</sup> GRECO, Directorate General of Human Rights and Legal Affairs, <i>Compliance Report on the Russian Federation</i>, Greco RC-I/II (2010) 2E, (Strasbourg, 2010), 28.</p> <p><sup>iii</sup> Petr A. Skoblikov, "How is Corruption Punished in Present Day Russia: A Comparative Legal Analysis of Criminal Legislation and Judiciary Practice," <i>European Journal of Crime, Criminal Law and Criminal Justice</i> 14, no. 4 (2006), 442.</p> <p><sup>iv</sup> Ibid.</p>	

<p><b>Criminal Procedure Code, No. 174-FZ of December 18, 2001:</b> This Code compliments the <i>Criminal Code</i> by outlining procedures for investigations, trials, and appeals.</p>	
<b>Art 447</b>	This article provides a special procedure for initiating criminal procedures against certain categories of persons (mostly state officials). It effectively gives immunity from prosecution to certain persons. A draft law is in the works to reduce this category of persons significantly. <sup>32</sup>
<p><sup>i</sup> GRECO, Directorate General of Human Rights and Legal Affairs, <i>Compliance Report on the Russian Federation</i>, Greco RC-I/II (2010) 2E, (Strasbourg, 2010), 16.</p>	

<p><b>Russian Civil Code:</b> This Code governs private law in Russia and is made up of four parts: General Provisions, the Law of Obligations, Succession Law, and Intellectual Property Law.</p>	
<b>Art 575(3)</b>	This article makes it impermissible to give a gift to a government or public official of a value of over 3000 rubles (approximately US\$90). The offense is punished by a fine.

<p><b>Code of Administrative Offenses of the Russian Federation (CAO), No. 195-FZ of December 30, 2001:</b> This Code came into force on July 1, 2002 and is a comprehensive Code which deals with administrative offenses related to the right to seek, receive, and impart information. It also includes tax, currency, labour, and antimonopoly provisions. This Code can impose sanctions for violations of administrative offenses on both natural and legal persons. These are all administrative offenses and are not punished with criminal sanctions (as the GRECO report suggests they should be).<sup>i</sup> There seems to be a lot of overlap between these provisions and the <i>Criminal Code</i> which gives a judge a lot of discretionary power to decide which punishment should be enforced.</p>	
<b>Art 19.28</b>	This is the only type of offense that punishes corruption by a legal entity. It establishes sanctions in the form of administrative fines. In May 2011 this provision was amended to create fines, the most stringent of which imposes a fine 100 times the advantage, but not less than 100 million rubles (approximately US\$ 3,2 million). It includes punishing corruption with foreign and international public officials.
<p><sup>i</sup> GRECO, Directorate General of Human Rights and Legal Affairs, <i>Compliance Report on the Russian Federation</i>, Greco RC-I/II (2010) 2E, (Strasbourg, 2010), 6.</p>	

<b>National Anti-Corruption Plan:</b> This table covers federal legislation that was created under the National Anti-Corruption Plan. As part of its participation in the Group of States Against Corruption (GRECO), Russia adopted the National Anti-Corruption Strategy and the National Anti-Corruption Plan. The strategy provides for an updated legal and organizational basis for fighting and preventing corruption at the federal, regional, and local levels. <sup>i</sup>		
Name of Law	Legal Citation	Notes/Description
<b>“On Combating/Counteracting Corruption”</b>	No. 273-FZ of December 25, 2008	This law establishes the general framework for anti-corruption law in Russia and is a direct consequence of the National Anti-Corruption Plan. It is part of package of laws introduced on December 25, 2008 as part of an anti-corruption initiative.
<b>“On Amendments to Certain Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Law On Combating Corruption”</b>	No. 274-FZ of December 25, 2008	This law was passed to amend other federal acts to work in concert with No. 273-FZ (see above). It is a law that amends previous federal legislation, such as the 1992 law “On the Status of Judges.” Those amendments create more specific requirements such as rules on conflict of interest, qualification and requirements of candidates, and submission of data on the income of judges and their property.
<b>“On Amendments to Certain Legislative Acts of the Russian Federation in Relation to Ratification of the United Nations Convention on Countering Corruption, dated 31 October 2003 and the Criminal Law Convention on Corruption of January 27, 1999, and Adoption of the Federal Law ‘On Counteraction to Corruption’”</b>	No. 280-FZ of December 15, 2008	This law was passed in conjunction with No. 273-FZ and No. 274-FZ (see above) and amended federal legislation to bring federal legislation in line with <i>UN Convention Against Corruption</i> , the <i>Strasbourg Criminal Law Convention on Corruption</i> . This law amends the <i>Civil, Criminal and Administrative Codes</i> to bring them up to date with the international conventions. See for example arts 290-291 of the <i>Criminal Code</i> , art 575 of the <i>Civil Code</i> , and art 19.28 of the <i>Code of Administrative Offenses</i> .
<b>“On Introduction of Amendments in the Russian Criminal Code and the Code of Administrative Offenses to Counter Corruption and Improvement of a Public Administration Strategy”</b>	No. 97-FZ of May 4, 2011	This legislation was enacted to bring Russia into compliance with the <i>OECD Convention on Combating Bribery of Foreign Corrupt Officials</i> . Among other things it amended arts 290 and 291 of the <i>Criminal Code</i> to add bribery of foreign officials to the crimes of bribe given and taking.
<b>Amendment to Law “On Combating Corruption” and “On Banks and Banking Activities”</b>	No. 329-FZ of November 23, 2011	Under this law, members of parliament from both houses and regional legislators must submit income information to parliamentary commissions. It must include information about their income and assets as well as those of their family members. The law also punishes state and municipal officials who fail to take measures to prevent conflict of interest, fail to submit information about their income and property. <sup>ii</sup> It also amends law No. 395-1 FZ “On Banks and Banking Activities” to force banks to declare information and assets of government officials and their family to an anti-corruption body. This amendment was done in compliance with Financial Action Task Force recommendations.

<sup>i</sup> GRECO, Directorate General of Human Rights and Legal Affairs, *Compliance Report on the Russian Federation*, Greco RC-1/II (2010) 2E, (Strasbourg, 2010).

<sup>ii</sup> “On 21 November 2011 the President Signed Federal Law No. 329-FZ Amending Certain Legislative Acts of the Russian Federation Due to the Development of Anticorruption Practices” *Russian Law Online* (2011) online: <<http://www.russianlawonline.com/content/anti-corruption-practices>>.

<b>Federal Legislation:</b> This table contains federal legislation that pertains directly or indirectly to corruption, transparency, and governance.		
Name of Law	Legal Citation	Brief Description
<b>“On Combating Legalization (Laundering) of Criminally Gained Income and Financing Terrorism”</b>	No. 115-FZ of August 7, 2001	This is the main anti-money laundering law in Russia. It applies requirements to financial organizations which carry out operations involving monetary resources or assets, such as banks, credit unions, insurance companies, and leasing companies. This law was updated in July 2010 by Law No. 176-FZ and Law No. 197-FZ.
<b>“On Procurement of Goods, Works, and Services for State and Municipal Needs”</b>	No. 94-FZ of July 21, 2005	This law regulates state procurement. It contains a number of mechanisms for making public procurement more efficient, transparent, and fair, such as open calls for applications via the Internet and media; a prohibition on contracts and negotiations between purchasers and prospective contractors; public disclosure of applicant’s offers; transparent process of decision making; public access to the winners’ offers; and possibility to disclose unfair contractors. <sup>i</sup>
<b>“On Providing Access to Information on the Activities of State Bodies and Bodies of Local Self-Government”</b>	No. 8-FZ of February 9, 2009	This law is meant to make government bodies more transparent and provide access to information. It gives Russian citizens the positive right to request and receive information and outlines a procedure for those requests. It gives a time frame of 30 days to receive the requested information.  Unlike other access to information laws it does not contain details of the grounds for which a request may be refused, which may significantly undermine the legislation.  Since coming into force the law has not actually been obeyed and officials have been ignoring provisions or hiding behind exemption provisions. <sup>ii</sup>

<sup>i</sup> Swiss Business Hub, “The Russian State Procurement System” *Business Network Switzerland*, (Moscow, 2011) online: <[www.osec.ch/sites/default/files/PublicProcurement040411.pdf](http://www.osec.ch/sites/default/files/PublicProcurement040411.pdf)>.

<sup>ii</sup> Article 19, Memorandum on the Russian Federal Law “On Access to Information Concerning Activities of Government Departments and Local Self-Government,” (15 March 2003) online: <<http://www.unhcr.org/refworld/docid/4756cfe10.html>>.

<b>Tax Code, No. 146-FZ of July 31, 1998:</b> This Code was enacted on July 31, 1998. It regulates tax agents, tax-collecting, tax audit procedures, enforcement of law, and relations between taxpayers.	
<b>Art 6</b>	This article deals with types of tax offenses and liability for committing them under the Code.

**Federal Anti-Corruption Oversight Bodies:** Russia does not currently have an independent federal anti-corruption oversight body which is authorized to investigate and oversee activities of top-ranking officials.

Name of Body	Relevant Legislation	Brief Description
<b>Presidential Anti-Corruption Council<sup>i</sup></b>	“On Measures Against Corruption” Presidential Decree No. 815 of May 19, 2008	The council’s main tasks are to prepare proposals for the President on setting and implementing state anti-corruption policy, coordinate anti-corruption work by the executive authorities at the different levels, and monitor implementation of the measures set out in the National Anti-Corruption Plan. In 2010 a Presidential Decree amended the Anti-Corruption Council to include scientists, thinkers, and wider regional representation. This council was established by Presidential Decree in May 2008. The decree establishes a presidium within the Council to deal with day-to-day matters. The presidium is chaired by the Chief of Staff of the Presidential Executive Office. Among other things the National Anti-Corruption Council has established a Working Group on cooperation with civil society representatives. In early 2012 President Medvedev tasked the council with creating an institution to regulate lobbying. <sup>ii</sup>
<b>Russian Federal Financial Monitoring Service<sup>iii</sup></b>	“On Combating Legalization (Laundering) of Criminally Gained Income and Financing of Terrorism” Law No. 115-FZ of August 7, 2001  “On the Authorized Agency for Combating Legalization (Laundering) of Proceeds of Crime and Financing of Terrorism.”  Law No. 1263 of November 1, 2001	This service is a division of the Ministry of Finance which was created by President Putin on February 1, 2002. It is an executive body aimed at combating money laundering and coordinating activities of other federal bodies.  It controls and supervises the process of implementing the requirements of legislation on combating money laundering. It collaborates with regional divisions of law enforcement bodies. Part of its role is to ensure that Russia complies with anti-money laundering legislation.
<b>Federal Antimonopoly Service of the Russian Federation</b>	“On Placement of Orders to Supply Goods, Carry out Works and Render Services for Meeting State and Municipal Needs” No. 94-FZ of July 21, 2005	In March 2004 this service took over the responsibilities formerly held by the Ministry of the Russian Federation for Antimonopoly Policy and Support to Entrepreneurship. It controls the activity of natural monopolies and legislation on monopolies including Russia’s main procurement law. This service is currently considering doubling fines against a company for abusing market dominance. <sup>iv</sup>
<b>Financial Stability Council and Financial Ombudsman</b>		This body does not yet exist, but in March 2012 President Medvedev tasked the Central Bank to propose amending legislation to establish both a Financial Stability Council and financial ombudsman. <sup>v</sup>

<sup>i</sup> Russia, “National Anti-Corruption Plan” *President of Russia* (website) (2008) online: <<http://archive.kremlin.ru/eng/articles/corruption.shtml>>.  
<sup>ii</sup> Ian Pryde, “A New Way to Get What You Want” *Russia Beyond the Headlines* (March 20 2012), online: <[http://rbth.ru/articles/2012/03/20/a\\_new\\_way\\_to\\_get\\_what\\_you\\_want\\_15128.html](http://rbth.ru/articles/2012/03/20/a_new_way_to_get_what_you_want_15128.html)>.  
<sup>iii</sup> Russia, *Federal Financial Monitoring Service* (website), online: <<http://archive.fedfsm.ru/eng/>>.  
<sup>iv</sup> “Antitrust Watchdog to Increase Fines for Abuse of Market Dominance” *Russian Legal Information Agency* (12 April 2012), online: <[http://www.rapsinews.com/legislation\\_news/20120412/262785542.html](http://www.rapsinews.com/legislation_news/20120412/262785542.html)>.  
<sup>v</sup> “President Proposes Financial Ombudsman Amendments” *Russian Legal Information Agency* (March 22 2012), online: <[http://www.rapsinews.com/legislation\\_news/20120322/262299765.html](http://www.rapsinews.com/legislation_news/20120322/262299765.html)>.

**Bilateral Treaties on Double Taxation and/or Tax Information Exchange Agreements:** Russia has signed 88 double tax avoidance treaties with other countries and no tax information exchange agreements. For the most part, these agreements are up to the OECD standards on exchange of tax information which include exchange of information on request where it is foreseeably relevant to the administration and enforcement of the domestic tax laws of the requesting jurisdiction. Effective exchange of information requires that jurisdictions ensure information is available, that it can be obtained by the tax authorities, and that there are mechanisms in place allowing for the exchange of that information.<sup>i</sup>

Country	Treaty Signed	Date signed	Date Entered into Force
<b>United States</b>	Double Tax Agreement	June 17, 1992	January 1, 1994
<b>Canada</b>	Double Tax Agreement	October 5, 1995	May 5, 1997
<b>Brazil</b>	Double Tax Agreement	November 22, 2004	January 19, 2009
<b>China</b>	Double Tax Agreement	May 27, 1994	January 1, 1998
<b>India</b>	Double Tax Agreement	March 25, 1997	April 11, 1998

<sup>i</sup> OECD, “Russia” *Exchange of Tax Information Portal* (website) online: <<http://www.eoi-tax.org/jurisdictions/RU#agreements>>.

<b>Multilateral Treaties:</b> According to Russia's Constitution, all international law and international treaties of the Russian Federation are part of the Russian domestic legal system and if an international agreement sets norms different from those established by a national law then the norms of the international agreement are applied. <sup>i</sup>		
Name	Date Signed	Entry Into Force
<b>Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime<sup>ii</sup></b>	May 7, 1999	Ratified August 2, 2001 Entry into force February 1, 2001
<b>Strasbourg Criminal Law Convention of 1999<sup>iii</sup></b>	February 27, 1999	Ratified October 4, 2006 Entry into force February 1, 2007
<b>UN Convention on Transnational Organized Crime (UNTOC)<sup>iv</sup></b>	December 12, 2000	Accession 26 May 26, 2004
<b>UN Convention Against Corruption (UNCAC)<sup>v</sup></b>	December 9, 2003	May 9, 2006
<b>Financial Action Task Force (FATF)<sup>vi</sup></b>	Member since 2003	
<b>Group of States Against Corruption (GRECO)<sup>vii</sup></b>	Member since February 1, 2007	
<b>Convention on Mutual Administrative Assistance in Tax Matters (Updated Protocol)<sup>viii</sup></b>	November 3, 2011	Not yet ratified
<b>OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions<sup>ix</sup></b>	February 17, 2012 (signed the accession instrument)	

<sup>i</sup> Russia, The Constitution of the Russian Federation, Article XV (4), 1993.  
<sup>ii</sup> Council of Europe, Treaty Office, "Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime CETS No.: 141, Status as of 21/09/2012" (2012) online: <<http://conventions.coe.int/Treaty/Commun/ChercheSig.asp?NT=141&CM=&DF=&CL=ENG>>.  
<sup>iii</sup> Council of Europe, Treaty Office, "Criminal Law Convention on Corruption CETS No.: 173, Status as of 21/09/2012" (2012) online: <<http://conventions.coe.int/Treaty/Commun/ChercheSig.asp?NT=173&CM=&DF=&CL=ENG>>.  
<sup>iv</sup> UN, Treaty Collection, "Status as of 24-04-2012 United Nations Convention against Transnational Organized Crime" online: <[http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mdsg\\_no=XVIII-12&chapter=18&lang=en](http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mdsg_no=XVIII-12&chapter=18&lang=en)>.  
<sup>v</sup> UN, United Nations Office on Drugs and Crime, "United Nations Convention Against Corruption: UNCAC Signature and Ratification Status as of 24 September 2012" (2012) online: <<http://www.unodc.org/unodc/en/treaties/CAC/signatories.html>>.  
<sup>vi</sup> FATF, "FATF Members and Observers" FATF-GAFI (website) (2012) online: <<http://www.fatf-gafi.org/pages/aboutus/>>.  
<sup>vii</sup> Council of Europe, GRECO, "What is GRECO?" Council of Europe (website) online: <[http://www.coe.int/t/dghl/monitoring/greco/general/3.%20What%20is%20GRECO\\_en.asp](http://www.coe.int/t/dghl/monitoring/greco/general/3.%20What%20is%20GRECO_en.asp)>.  
<sup>viii</sup> OECD, "Status of the Convention on Mutual Administration Assistance in Tax Matters and Amending Protocol – 30 August 2012" (August 30 2012) online: <<http://www.oecd.org/tax/Status%20of%20convention%2030%20August%202012.pdf>>.  
<sup>ix</sup> OECD, Directorate for Financial and Enterprise Affairs, "OECD Convention on Combating Bribery of Foreign Public Officials in International Business: Ratification Status as of April 2012" online: <[http://www.oecd.org/document/21/0,3746,en\\_2649\\_34859\\_2017813\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/21/0,3746,en_2649_34859_2017813_1_1_1_1,00.html)>.

## APPENDIX C – LAWS OF INDIA

The legal framework for tackling corruption in India is contained mostly in the *Prevention of Corruption Act, 1988*. Unless otherwise indicated the sources of most of the information contained in this section on India comes from the *Global Integrity Report 2011* and the *Business Anti-Corruption Portal*.<sup>5</sup> All of these charts are up to date as of September 21, 2012.

<b>Indian Penal Code, No. 45 of 1860:</b> Until more recent legislation the <i>Penal Code</i> was the main tool to combat corruption of public officials in India. It also is one of the primary tools for sanctioning economic crimes including fraud.	
<b>Section 169</b>	This section pertains to a public servant unlawfully buying or bidding for property. The public servant shall be punished with imprisonment of up to two years or with a fine or both. If the property is purchased, it shall be confiscated.
<b>Section 409</b>	This section pertains to criminal breach of trust by a public servant. The public servant shall be punished with life imprisonment or with imprisonment of up to ten years and a fine.

<sup>5</sup> "Scorecard: India 2011," in *Global Integrity Report* (Washington, DC: Global Integrity, 2011); Global Advice Network, "India Country Profile" *Business Anti-Corruption Portal* (Copenhagen, Denmark: 2011) online: <<http://www.business-anti-corruption.com/country-profiles/south-asia/india/initiatives/public-anti-corruption-initiatives/>>.

<b>Federal Anti-Corruption Legislation:</b> This table includes Indian federal legislation enacted to combat corruption. To date most federal legislation deals with the corruption of public officials, but many initiatives by the government and the Central Vigilance Commission have attempted to broaden the scope of anti-corruption legislation to include private parties and the bribery of foreign officials. There is currently no definition of foreign bribery in India and there are no provisions on foreign bribery in the <i>Prevention of Corruption Act, 1988</i> .		
Name of Legislation	Legal Citation	Brief Description
<i>The Benami Transactions (Prohibition) Act, 1988</i>	No. 45 of 1988	Most of the wealth in India which is acquired through corruption is invested in benami immovable property, gold and jewellery, high-value consumer goods, and other conspicuous consumption. This Act prohibits <i>benami</i> transactions and even provides for Government acquisition of property held <i>benami</i> . However, the regulations to make confiscation of property effective have not been enacted which hampers the Government's ability to take steps under this legislation.
<i>Prevention of Corruption Act, 1988</i>	No. 49 of 1988 Amended in 2008	This law was enacted to consolidate and amend the law relating to the prevention of corruption. It criminalizes corruption in the form of attempted corruption, active and passive bribery, extortion, abuse of office, and money laundering. Until recently, one of the major roadblocks of this legislation was that courts required prior sanction from an appropriate authority before they could recognize an offense by a public servant. <sup>i</sup> There are also no provisions that protect whistleblowers. The Act also does not punish corrupt acts of private parties except in a very circumscribed way.
<i>The Competition Act, 2003</i>	No. 12 of 2003	This law provides for the establishment of a commission to prevent practices having adverse effect on competition. It is meant to promote and sustain competition in markets, to protect the interests of consumers, and to ensure freedom of trade carried on by participants in the markets in India. It was amended by the <i>Competition (Amendment) Act, 2007</i> .
<i>Prevention of Money Laundering Act, 2002</i>	No. 15 of 2003	This law is applicable to all states and Union Territories of India including Jammu and Kashmir and overrides the provisions of any other statute in force. The Act seeks to combat money laundering in three ways: to prevent, combat, and control money laundering; to confiscate and seize property obtained from the laundered money; and to deal with any other issue connected with money laundering in India. The Act imposes obligations on banks, financial institutions, and intermediaries to verify the identity of clients, maintain records and furnish information to the Financial Intelligence Unit of India. <sup>ii</sup> The minimum penalty for committing an offense under the Act is imprisonment for three years along with a fine. <sup>iii</sup> The Act was amended in 2009 by the <i>Prevention of Money-Laundering (Amendment) Act, 2009</i> . This amendment seeks to check the use of black money for financing terror activities.
<i>Right to Information Act, 2005</i>	No. 22 of 2005	This law has played a central role in fighting corruption in India. Citizens have the right to access government documents within 30 days from filing the request which has proved to be mechanism for ordinary citizens to control public spending. One of the major grounds of criticism of this Act is that there are many grounds for exemptions from disclosure.

<sup>i</sup> Alan Heston and Vijay Kumar, "Institutional Flaws and Corruption Incentives in India" *Journal of Development Studies* 44, no. 9 (2008), 1252.

<sup>ii</sup> Animesh Bharti, "Legislative Measures to Deal with Economic Crimes in India" (Tokyo: Institute for Prevention of Crime and Treatment of Offenders, 2005).

<sup>iii</sup> *Ibid.*

Pending Legislation		
Name of Legislation	Legal Citation	Brief Description
<i>The Prevention of Bribery of Foreign Officials and Officials of Public International Organisations Bill, 2011</i>	Bill No. 26 of 2011	There is currently no definition of foreign bribery in India and there are no provisions on foreign bribery in the <i>Prevention of Corruption Act, 1988</i> . The Indian government has not signed the <i>OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions</i> . India has signed the United Nations Convention Against Corruption and this bill is necessary to ratify that convention. The Minister of State for Personnel introduced this bill in March 2011 to the <i>Lok Sabha</i> . It states that any person "holding a legislative, executive, administrative, or judicial office of a foreign country" and accepts or gives bribes to secure a contract in India can be punished with up to seven years imprisonment. At present, the bill is under the review by the <i>Lok Sabha</i> . <sup>i</sup>
<i>The Public Interest Disclosure and Protection of Persons Making the Disclosures Bill, 2010</i>	Bill No. 97 of 2010	This bill is commonly known as the whistleblowers bill. It applies to authorities and companies under central and state government control and covers all public servants and ministers. It empowers the Central Vigilance Commission to penalize those who reveal the identity of whistleblowers or who threaten them. This bill contains major deficiencies including the severe punishment of individuals found to be making false or frivolous complaints. The bill is still being debated by the <i>Rajya Sabha</i> .
<i>Lokpal and Lokayuktas Bill, 2011</i>	Bill No. 134 of 2011	A <i>Lokpal Bill</i> was first introduced to Parliament in 1968 following the Administrative Reforms Commission report of 1966. It has subsequently been reintroduced in 1971, 1977, 1985, 1989, 1996, 1998, 2001, 2005, and 2008 but was never passed by parliament. On December 27, 2011 the <i>Lok Sabha</i> passed the <i>Lokpal Bill</i> and it is currently under consideration in the <i>Rajya Sabha</i> . The <i>Lokpal Bill</i> is meant to create advisory body only. <sup>ii</sup> This bill has caused a lot of controversy in India and led to the popular anti-corruption movement spearheaded by Anna Hazare.
<i>Jan Lokpal Bill, 2011</i>		In 2011 Anna Hazare proposed a new bill called the <i>Jan Lokpal Bill</i> , which means "Citizen's Ombudsman Bill." The bill aims to sanction and deter corruption, redress the grievances of citizens, and protect whistleblowers. Unlike the <i>Lokpal and Lokayuktas Bill, 2011</i> the <i>Jan Lokpal Bill</i> is to include input from Indian Citizens. It was created to redress some of the perceived failures of the <i>Lokpal Bill</i> such as its failure to include in its mandate oversight of the Judiciary, the Indian Army, and the Prime Minister's office.

<sup>i</sup> India, Bill 26, *The Prevention of Bribery of Foreign Public Officials and Officials of Public International Organisations Bill 2011*, No. 26 of 2011 online: <<http://www.prsindia.org/billtrack/the-prevention-of-bribery-of-foreign-public-officials-and-officials-of-public-international-organisations-bill-2011-1601/>>.

<sup>ii</sup> Global Advice Network, "India Country Profile" *Business Anti-Corruption Portal* (Copenhagen, Denmark: 2011) online: <<http://www.business-anti-corruption.com/country-profiles/south-asia/india/initiatives/public-anti-corruption-initiatives/>>.

**State Anti-Corruption Legislation:** This table contains a list of notable anti-corruption legislation that exists widely across different India states. The table is not exhaustive.

<b>Lokpal/Lokayukta/Lok Aayog Legislation</b>	Following the Administrative Reform Commission's <i>Problems of Redressal of Citizen's Grievances</i> report in 1966, many states enacted Lokpal or Lokayukta Acts to address the public's grievances against public officials. The office of a Lokayukta exists in Maharashtra, Bihar, Rajasthan, Uttar Pradesh, Madhya Pradesh, Andhra Pradesh, Himachal Pradesh, Karnataka, Assam, Gujarat, Kerala, Punjab, National Capital Territory of Delhi, and Haryana. Orissa was the first state to pass the ombudsman legislation in 1970 and also the first to abolish it in 1993.
<b>Procurement Laws</b>	Each state in India has its own procurement laws and regulations. The absence of a central law or state act on public procurement means that each ministry, department, and agency creates its own rules.

**Commissions:** This table includes permanent and ad hoc commissions created to propose reforms to administrative process or legislation to bolster anti-corruption efforts.

Name	Date	Brief Description
<b>Administrative Reforms Commission</b>	1966	In 1966 the Administrative Reforms Commission, headed by Morarji Desai, submitted a report entitled <i>Problems of Redressal of Citizen's Grievances</i> which recommended that states set up two special authorities to address citizen's grievances known as Lokpal and Lokayukta.
<b>Public Interest Disclosure and Protection of Informers – Law Commission of India's 179<sup>th</sup> Report</b>	2001	This law commission report recommended specific legislation to protect whistleblowers and led to the <i>Public Interest Disclosure and Protection of Persons Making the Disclosures Bill, 2010</i> .

**Tax Law:** According to the Central Vigilance Commission's National Anti-Corruption Strategy report a substantial portion of wealth created through corrupt means finds its way to bank accounts outside of India. As it stands tax evasion is not a criminal offense. The government has signalled its commitment to resolving this issue by being an active participant in agreements on exchange of information and renegotiation of double tax avoidance. India also has a comprehensive double taxation avoidance agreements with many countries.

Name	Brief Description
<b>Direct Taxes Code Bill, 2010 No. 110 of 2010</b>	This bill has not yet come into effect although it was tabled in the <i>Lok Sabha</i> in 2010. It is meant to consolidate the <i>Income Tax Act, 1961</i> and the <i>Wealth Tax Act, 1957</i> . Among other things this overhaul of tax law will address some of the major difficulties that India faces with tax evasion. <sup>62</sup>
<b>Income Tax Act, 1961 No. 43 of 1961</b>	Sections 90 and 91 provide specific remedies for taxpayers to avoid double taxation. Steps are currently being taken to update the <i>Income Tax Act, 1961</i> to enable the central government to enter into agreements even with non-sovereign jurisdictions for exchange of information and other purposes. This would go a long way towards preventing tax evasion especially with notorious secrecy jurisdictions.

<sup>i</sup> Tushar Dhara and Cherian Thomas, "In India, Tax Evasion is a National Sport" *Bloomberg Businessweek* (July 28 2011) online: <<http://www.businessweek.com/magazine/in-india-tax-evasion-is-a-national-sport-07282011.html>>.

**Bilateral Treaties on Double Taxation and/or Tax Information Exchange Agreements:** India has signed 90 double tax avoidance agreements with other countries and twelve tax information exchange agreements. For the most part, these agreements are up to the OECD standards on exchange of tax information which include exchange of information on request where it is foreseeably relevant to the administration and enforcement of the domestic tax laws of the requesting jurisdiction. Effective exchange of information requires that jurisdictions ensure information is available, that it can be obtained by the tax authorities, and that there are mechanisms in place allowing for the exchange of that information.<sup>i</sup>

Country	Treaty Signed	Date signed	Date entered into force
<b>United States</b>	Double Tax Agreement	September 12, 1989	January 1, 1991
<b>Canada</b>	Double Tax Agreement	October 5, 1995	May 5, 1997
<b>Brazil</b>	Double Tax Agreement	April 26, 1988	March 11, 1992
<b>China</b>	Double Tax Agreement	July 18, 1994	November 21, 1994
<b>Russian Federation</b>	Double Tax Agreement	March 25, 1997	April 11, 1998

<sup>i</sup> OECD, "India" *Exchange of Tax Information Portal* (2012) online <<http://www.eoi-tax.org/jurisdictions/CN#agreements>>.



Federal Anti-corruption Agencies		
Name	Relevant Legislation	Brief Description
<b>Central Vigilance Commission (CVC)</b>	<i>Central Vigilance Commission Act, 2003</i> No. 45 of 2003  <i>Prevention of Corruption Act, 1988</i> No. 49 of 1988	The CVC is an independent watchdog agency established in 1964 with a mandate to make inquiries and investigations of transactions of certain public servants. It has supervisory powers over the Central Bureau of Investigation. It can investigate complaints against officials suspected of having committed an offense under the <i>Prevention of Corruption Act, 1988</i> . It may only deal with public sector corruption in the federal government. In September 2010 it unveiled the Draft National Anti-Corruption Strategy. This strategy aims to create a legal and regulatory framework and strengthen existing institutions to effectively combat corruption. The <i>Global Integrity Report, 2011</i> suggested that this agency is not sufficiently independent. The CVC is authorized to protect whistleblowers and to act on their complaints by taking action against anyone who leaks the names of whistleblowers and witnesses.
<b>Central Bureau of Investigation (CBI)</b>	<i>Central Vigilance Commission Act, 2003</i> No. 45 of 2003  <i>Prevention of Corruption Act, 1988</i> No. 49 of 1988	This bureau functions under the Ministry of Personnel and is overseen by the Central Vigilance Commission. It has three divisions: the Anti-Corruption Division, the Special Crimes Division, and the Economic Offenses Division. These units have the power to investigate cases of alleged corruption in all branches of the central government, ministries, public sector entities and the Union Territories. The CBI does not have the power to investigate cases in the states without the permission of the respective state government. However, the Supreme and High Courts can instruct the CBI to conduct investigations. In 2008, the CBI launched a successful corruption awareness campaign via text message in collaboration with telecom service providers in Delhi and Mumbai. The CBI has a whistleblower/complaint mechanism on its website, where corruption can be reported.
<b>Directorate of Enforcement (ED)</b>	<i>Foreign Exchange Management Act, 1999</i> No. 42 of 1999  <i>Prevention of Money Laundering Act, 2002</i> No. 15 of 2003	The purpose of the directorate is to enforce the <i>Foreign Exchange Management Act, 1999</i> and <i>Prevention of Money Laundering Act, 2002</i> . The organization falls under the Ministry of Finance. It may conduct searches, seize incriminating materials, investigate suspected violations, confiscate properties, and arrest persons suspected of money laundering. <sup>ii</sup>
<b>Financial Intelligence Unit (FIU-IND)</b>	<i>Prevention of Money Laundering Act, 2002</i> No. 15 of 2003	Financial Intelligence Unit was set by the Government of India in November 2004 as the central national agency responsible for receiving, processing, analyzing, and disseminating information relating to suspect financial transactions. FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering. <sup>iii</sup> FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister. The Director of the FIU-IND has the exclusive and concurrent powers to implement provisions of the <i>Prevention of Money Laundering Act, 2002</i> .

<b>Office of the Comptroller &amp; Auditor General</b>	<i>Comptroller and Auditor General's Duties, Power, and Conditions of Service Act, 1971</i> No. 56 of 1971	This is India's supreme audit authority and has offices in all state headquarters. Auditor Generals are independent from state government and are accountable only to the Office. The Comptroller and Auditor General has revealed many financial irregularities in various branches of government, but governments frequently do not act on these findings. The Comptroller and Auditor General does not have the power to initiate investigations and must work with the Central Vigilance Commission. It publishes reports regularly and disseminates these to the public for free via its website.
<b>Chief Information Commission</b>	<i>Right to Information Act, 2005</i> No. 22 of 2005	This office was established in 2005. It gives practical shape to the <i>Right to Information Act, 2005</i> by giving government, courts, universities, police, development NGOs, and ministries instructions on how to share information with the public.
<b>Office of the Ombudsman</b>		There is no national ombudsman in India, although the <i>Lokpal and Lokayuktas Bill, 2011</i> was introduced many times to create one.
<b>India Government Tenders Information System</b>		This is the main source for government and public sector procurement. This digital portal has links to central and state tenders as well as tenders by public sector units.

<sup>i</sup> "Scorecard: India 2011," *Global Integrity Report* (Washington, DC: Global Integrity, 2011), 75b.  
<sup>ii</sup> India, Ministry of Finance, Department of Revenue Directorate of Enforcement (website) (2006), online: <<http://www.directorateofenforcement.gov.in/functions.html>>.  
<sup>iii</sup> India, Government of India, Ministry of Finance, Department of Revenue, Financial Intelligence Unit – India (FIU-IND) (website) (2011) online: <[http://dor.gov.in/fiu\\_pml](http://dor.gov.in/fiu_pml)>.

<b>Multilateral Agreements:</b> This table contains information on the treaties and multilateral frameworks that India is a member of on the subjects of corruption, organized crime, and tax agreements.		
Name	Date Signed/ Ratified	Notes
<b>United Nations Convention against Transnational Organized Crime (UNTOC)<sup>i</sup></b>	Signed December 12, 2002 Ratified May 5, 2011	India does not consider itself bound by the provision of the protocol relating to submission of disputes for arbitration or to the International Court of Justice. Furthermore where it has a bilateral Agreement with another country that agreement shall override the convention in cases of mutual legal assistance.
<b>UN Convention Against Corruption (UNCAC)<sup>ii</sup></b>	Signed December 9, 2005 Ratified May 9, 2011	The <i>Prevention of Bribery of Foreign Officials and Officials of Public International Organisations Bill, 2011</i> which is currently before the <i>Lok Sabha</i> is meant to bring India up to date with this convention.
<b>Financial Action Task Force<sup>iii</sup></b>	2010	India is a member
<b>South Asian Association for Regional Cooperation Multilateral Agreement on Avoidance of Double Taxation and Mutual Administrative Assistance in Tax Matters<sup>iv</sup></b>	April 1, 2011	Member states of the agreement are Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka.
<b>Convention on Mutual Administration in Tax Matters (Updated Protocol)<sup>v</sup></b>	Signed February 21, 2012 Entry into Force June 1, 2012	
<b>OECD Convention on Combating Bribery of Foreign Corrupt Officials in International Business Transactions</b>	N/A	The Indian government has not signed this convention.

<sup>i</sup> UN, Treaty Collection, "Status as at 24-04-2012 United Nations Convention against Transnational Organized Crime" online: <[http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtsg\\_no=XVIII-12&chapter=18&lang=en](http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtsg_no=XVIII-12&chapter=18&lang=en)>.

<sup>ii</sup> UN, United Nations Office on Drugs and Crime, "United Nations Convention Against Corruption: UNCAC Signature and Ratification Status as of 24 September 2012" (2012) online: <<http://www.unodc.org/unodc/en/treaties/CAC/signatories.html>>.

<sup>iii</sup> FATF, "FATF Members and Observers" FATF-GAFI (website) (2012) online: <<http://www.fatf-gafi.org/pages/aboutus/>>.

<sup>iv</sup> "India Ratifies Double Taxation Avoidance Pacts with SAARC" *The Economic Times* (February 5 2011) online: <[http://articles.economicstimes.indiatimes.com/2011-02-05/news/28427145\\_1\\_saarc-dtaa-black-money](http://articles.economicstimes.indiatimes.com/2011-02-05/news/28427145_1_saarc-dtaa-black-money)>.

<sup>v</sup> OECD, "Status of the Convention on Mutual Administration Assistance in Tax Matters and Amending Protocol – 30 August 2012" (August 30 2012) online: <<http://www.oecd.org/tax/Status%20of%20convention%2030%20August%202012.pdf>>.

## APPENDIX D – LAWS OF CHINA

### HIERARCHY OF LAWS:<sup>6</sup>

- Constitution, general principles of civil law, Criminal Code (1980), and Code of Civil Procedure
- Laws promulgated by the Standing Committee of the National People's Congress
- International Conventions and Treaties
- State Council Regulations, Orders, and Decisions
- Municipal People's Congresses

The legal framework for tackling corruption in China is contained mostly in the *Criminal Code of the People's Republic of China*. Unless otherwise indicated the sources of most of the information contained in this section on China comes from the *Business Anti-Corruption Portal*.<sup>7</sup> All of these charts are up to date as of September 21, 2012.

<sup>6</sup> *Foreign Law Guide* "China (People's Republic of China)" (2004) online: <<http://foreignlawguide.com/ip/flg/China%20Introduction.htm>>.

<sup>7</sup> Global Advice Network, "China Country Profile" *Business Anti-Corruption Portal* (Copenhagen, Denmark: 2011) online: <<http://www.business-anti-corruption.com/country-profiles/east-asia-the-pacific/china/?pageid=233>>.

**Criminal Code of the People's Republic of China:** This law came into force on January 1, 1980. It was revised and reformed by presidential decree of the People's Republic of China No. 83 of March 14, 1997. The types of bribery law in China may be divided into two categories: the first is official bribery and the second is commercial bribery.<sup>i</sup>

<b>Art 163</b>	This article creates the standard governing the criminal violation of commercial bribery for the <b>offeree</b> of a commercial bribe. The offeree need not be an employee of the state and the amount involved must be "relatively large" or "very large" before the parties may be prosecuted. <sup>ii</sup>
<b>Art 164 and Eighth Amendment</b>	This article prohibits commercial bribery and sets the standards for prosecution of the <b>offeror</b> of a commercial bribe. The article makes it unlawful for anyone to <b>offer</b> "money or property to the staff of a company or enterprise in order to make illegitimate benefits." The consequences of breaching this provision depend on the amount of money or property that is offered. The consequence may be a fixed-term imprisonment of no more than three years if the amount is found to be "relatively large." If the bribery involves "huge" amounts, the briber will be sentenced to a fixed-term imprisonment of "not less than three years but not more than 10 years" and may be fined as well. Natural and legal persons may both be found liable. <sup>iii</sup>  On May 1, 2011, the Eighth Amendment to the <i>Criminal Code</i> added a new paragraph to article 164 which prohibits giving any "property to any foreign official or official of an international public organization" to seek any "illegitimate commercial benefit." <sup>iv</sup> The law appears to be quite broad and applies to all Chinese citizens including those living abroad, as well as all persons physically in China. It has similar scope to the US <i>Foreign Corrupt Practices Act</i> of 1977.
<b>Arts 385 and 389</b>	These provisions deal with "official bribery" and makes it a criminal offense punishable by imprisonment. Art 385 makes it illegal for an "official" to take money or property. Art 389 makes it illegal for someone to give an "official" money or property. To constitute bribery there must be a <i>quid pro quo</i> benefit for both parties, but whether the offeror actually receives the benefit is irrelevant. <sup>v</sup> The consequences of being found guilty are fines and imprisonment relative to the value of the size of the bribe taken or given and the seriousness of the circumstances. The court may confiscate property from both individuals and entities. It is important to note that the term "official" or "state functionary" broadly encompasses anyone who performs public services pursuant to law. Since many major industries in China are state-owned or controlled this encompasses many people. <sup>vi</sup>
<b>Art 394 and "Gift Rules"</b>	A number of rules and regulations codify "gift rules" which sanction recipients of gifts (and not providers of gifts.) Art 394 of the <i>Criminal Code</i> provides that if the relevant personnel fails to turn over the gift to the state where the amount is "relatively large" he may be prosecuted for a criminal violation. <sup>vii</sup>

<sup>i</sup> Bing Ho and Hal Fiske, "Demystifying the PRC Bribery Law" *The American Chamber of Commerce: People's Republic of China* online: <<http://www.amcham-china.org.cn/amcham/show/content.php?id=140&menuid=04&submid=04>>.  
<sup>ii</sup> Ibid.  
<sup>iii</sup> Renee Mark and Peter Bullock, "From May 1st new China Anti-corruption Laws Follow Long Arm Jurisdiction Trend" *The Bribery Act* (website) (May 3 2011) online: <<http://thebriberyact.com/2011/05/30/from-may-1st-new-china-anti-corruption-laws-follow-long-arm-jurisdiction-trend/>>.  
<sup>iv</sup> Ibid.  
<sup>v</sup> Ho and Fiske, "Demystifying the PRC."  
<sup>vi</sup> "Expanding the Boundaries of China's Anti-Corruption Regime" *V&E Foreign Corrupt Practices Act Update* (October 5 2011) online: <<http://www.velaw.com/resources/ExpandingBoundariesChinasAnti-CorruptionRegime.aspx>>.  
<sup>vii</sup> Ho and Fiske, "Demystifying the PRC."

**Anti-Corruption Laws, Regulations, and Circulars:** This table includes non-criminal rules and regulations which govern official and commercial corruption (mostly bribery.)

Name of Law	Date	Brief Description
<b>Prevention of Bribery Ordinance – Hong Kong</b>	1971	This law deals specifically with corruption in the private sector and applies only in Hong Kong. It was enacted following several highly publicized corruption scandals in the 1970s and following a commission of inquiry into those scandals.
<b>"Income Tax Law"</b>	Promulgated by National People's Congress April 9 1991	Art 25 deals with tax evasion by concealment or deception or failure to pay tax. Criminal sanctions exist for extreme tax evasion including the death penalty for extreme cases. <sup>i</sup>
<b>"Anti-Unfair Competition Law"</b>	Promulgated by the National People's Congress, September 2, 1993	Arts 8 and 22 of this law prohibit commercial bribery. Art 8 provides a broad definition of commercial bribery stating that a bribe is made "by giving property or otherwise." It makes it a crime for business operators to give bribes by giving property or otherwise, for the purpose of selling or purchasing products. Those who violate this law may be investigated and held liable against those who have suffered as a result of the bribes made. <sup>ii</sup> Art 22 states that the consequences of commercial bribery are fines. <sup>iii</sup>
<b>"Interim Regulations of the State Administration for Industry and Commerce on Prohibition of Commercial Bribery"<sup>iv</sup></b>	Promulgated by the State Administration for Industry and Commerce, Effective November 15, 1996	These are regulations pursuant to the "Anti-Unfair Competition Law" cited above. They offer more detail about what constitutes a bribe or benefit.
<b>"Tender and Bidding Law"</b>	Promulgated August 30, 1999	This law covers all state-owned enterprise tenders, in particular large-scale infrastructure projects (such as construction, aviation, shipping, engineering, architecture, transportation, power and water), and large-scale, privately-invested projects for public interest (joint-ventures.) Unlike the "Government Procurement Law" there are no specific remedies procedures. <sup>v</sup>  To put this law into context, the Three Gorges Dam and construction for the 2008 Olympic games were undertaken by state-owned enterprises and would be subject to these rules. <sup>vi</sup>  This law is implemented by the National Development and Reform Commission and Local Development and Reform Commissions.

<p><b>“Government Procurement Law”</b></p>	<p>Promulgated by the National People’s Congress on June 29, 2002</p>	<p>This law covers central and sub-central government purchases. The law was enacted with the purpose of regulating government procurement activities, improving efficiency in the use of government procurement funds, and safeguarding the interests of the state and the public to promote honest and clean government.<sup>vii</sup> According to Art 3, the principles of openness and transparency, fair competition, impartiality, and good faith shall be adhered to in government procurement activities.<sup>viii</sup></p> <p>Chapter VIII concerns the legal liabilities that can be incurred for illegal bid-rigging and fraud. Art 72(2) states that where a procuring agency or its staff member in the course of procurement accepts bribes or obtains other illegitimate interests it shall be investigated for criminal responsibility, but if the offense is not serious enough to constitute a crime it shall be fined and the illegal gains shall be confiscated.<sup>ix</sup></p> <p>This law is implemented by the Ministry of Finance.</p>
<p><b>“Civil Servant Law”</b></p>	<p>January 1, 2006</p>	<p>This law defines the scope and basis of civil service administration. The law stipulates that civil servants should follow the principle of openness, equality, competition, and merit selection. The law covers all facets of civil servant employment. It also establishes a mechanism of supervision and restraint by providing nine obligations of civil servants as well as the punishments for violating those obligations.<sup>x</sup></p>
<p><b>“Anti-Money Laundering Law”</b></p>	<p>Promulgated by National People’s Congress on October 31, 2006</p>	<p>This law was enacted for the purpose of preventing money laundering and other related crimes and maintaining financial order. The primary target of anti-money laundering laws remains financial institutions who must implement certain measures to fulfill their anti-money laundering obligations (such as maintaining client identity systems, establishing internal control systems, and reporting suspicious transactions).</p> <p>In January 2007, the same year that China became a member of the Financial Action Task Force, the definition of money laundering was expanded to including corruption and bribe taking, violating financial management regulations, and financial fraud.<sup>xi</sup></p>

<p><b>“Regulations of the People’s Republic of China on Making Public Government Information”</b></p>	<p>April 24, 2007 Effective May 1, 2008</p>	<p>This regulation is like an access to information law. It provides the legal basis for China’s first nationwide government information disclosure system. It will apply not only to central government agencies but also extend downwards to provinces, counties, and townships.<sup>xii</sup></p>
<p><b>“Provisions on Public Reports issued by the Supreme People’s Procuratorate”</b></p>	<p>Promulgated April 23, 2009</p>	<p>These provisions are meant to encourage whistleblowers to report corruption activities of any government officials. They provide protection to whistleblowers and their relatives.<sup>xiii</sup></p>
<p><sup>i</sup> TCA Ramanujam “Tax Evasion as Criminal Offense” <i>The Hindu Times</i> (June 18 2011) online: &lt;<a href="http://www.thehindubusinessline.com/opinion/article2113261.ece">http://www.thehindubusinessline.com/opinion/article2113261.ece</a>&gt;.</p> <p><sup>ii</sup> Renee Mark and Peter Bullock, “From May 1st new China Anti-corruption Laws Follow Long Arm Jurisdiction Trend” <i>The Bribery Act</i> (website) (May 3 2011) online: &lt;<a href="http://thebriberyact.com/2011/05/30/from-may-1st-new-china-anti-corruption-laws-follow-long-arm-jurisdiction-trend/">http://thebriberyact.com/2011/05/30/from-may-1st-new-china-anti-corruption-laws-follow-long-arm-jurisdiction-trend/</a>&gt;.</p> <p><sup>iii</sup> China, “Anti Unfair Competition Law of the People’s Republic of China,” <i>The Supreme People’s Court of the People’s Republic of China</i> (website) (September 22 2003) online: &lt;<a href="http://en.chinacourt.org/public/detail.php?id=3306">http://en.chinacourt.org/public/detail.php?id=3306</a>&gt;.</p> <p><sup>iv</sup> “Expanding the Boundaries of China’s Anti-Corruption Regime” <i>V&amp;E Foreign Corrupt Practices Act Update</i> (October 5 2011) online: &lt;<a href="http://www.velaw.com/resources/ExpandingBoundariesChinasAnti-CorruptionRegime.aspx">http://www.velaw.com/resources/ExpandingBoundariesChinasAnti-CorruptionRegime.aspx</a>&gt;.</p> <p><sup>v</sup> “Public Procurement in China: European Business Experiences Competing for public Contracts in China” <i>European Union Chamber of Commerce</i> (2011) online: &lt;<a href="http://www.publictendering.com/pdf/PPStudyENFinal.pdf">http://www.publictendering.com/pdf/PPStudyENFinal.pdf</a>&gt;, 9.</p> <p><sup>vi</sup> <i>Ibid.</i></p> <p><sup>vii</sup> China, “The Government Procurement Law of the People’s Republic of China (Order of the President) no. 68,” <i>Chinese Government’s Official Web Portal</i> (2012) online: &lt;<a href="http://www.gov.cn/english/laws/2005-10/08/content_75023.htm">http://www.gov.cn/english/laws/2005-10/08/content_75023.htm</a>&gt;.</p> <p><sup>viii</sup> <i>Ibid.</i></p> <p><sup>ix</sup> <i>Ibid.</i></p> <p><sup>x</sup> China, “The Civil Servant Law of the People’s Republic of China,” <i>Asian LII</i> online: &lt;<a href="http://www.asianlii.org/cn/legis/cen/laws/tcslotproc462/">http://www.asianlii.org/cn/legis/cen/laws/tcslotproc462/</a>&gt;.</p> <p><sup>xi</sup> “China Adopts Anti-money Laundering Law” <i>China Daily</i> (31 October 2006) online: &lt;<a href="http://www.chinadaily.com.cn/china/2006-10/31/content_721316.htm">http://www.chinadaily.com.cn/china/2006-10/31/content_721316.htm</a>&gt;.</p> <p><sup>xii</sup> <i>Ibid.</i></p> <p><sup>xiii</sup> Jamie P Horsley, “China Adopts First Nationwide Open Government Information Regulations” <i>Yale China Law Center</i> (2009) online: &lt;<a href="http://www.law.yale.edu/documents/pdf/Intellectual_Life/Ch_China_Adopts_1st_OGI_Regulations.pdf">http://www.law.yale.edu/documents/pdf/Intellectual_Life/Ch_China_Adopts_1st_OGI_Regulations.pdf</a>&gt;.</p>		

<p><b>Agencies and Departments Responsible for Overseeing Anti-Corruption Initiatives:</b> This table lists the departments and bodies that oversee and sanction corrupt activities. The responsibility of enforcing anti-bribery regulations lies principally with the police and the People's Courts. The Communist Party's Discipline Inspection Committee is the body that, in practice, handles the majority of anti-corruption activity.</p>	
Name	Brief Description
<b>Communist Party's Discipline Inspection Committee</b>	<p>This committee is responsible for the vast majority of anti-corruption enforcement as it investigates cases of corruption amongst Party members. The committee only relies on the <i>Criminal Code</i> for reference and does not follow strict procedural rules. In 2010 it punished 146,517 members for corruption which led to 5,737 charges. The committee is directly under control of the Communist Party thus it is not able to pursue corruption investigations independently. This committee has been accused of being one of the most secret agencies in China.<sup>i</sup> Although it has launched crackdowns on high-level officials it has rarely provided specific details to the public on the nature of charges and alleged offences.<sup>ii</sup></p> <p>It has opened a hotline to collect people's reports and information regarding Party members, Party organizations, and other targets of administrative inspection who have violated Party discipline.</p>
<b>National Corruption Prevention Bureau<sup>iv</sup></b>	<p>This bureau was created on September 13, 2007. It is tasked with improving international cooperation against corruption and fulfill China's responsibilities under the <i>United Nations Convention Against Corruption</i>. The major responsibilities of the bureau are to organize and coordinate the national work of corruption prevention, make overall plans, formulate relevant policies. It also coordinates and directs the work of corruption prevention in enterprises, public institutions, social groups, intermediate organizations and other social organizations.<sup>v</sup> The agency is not autonomous, however. In 2007, it took over and consolidated the work of the Ministry of Supervision, the General Administration for Combating Embezzlement and Bribery, and the Department for the Prevention of Crimes by State Functionaries.</p>
<b>Ministry of Supervision</b>	<p>This ministry has provincial and local agencies throughout China and retains a significant role in enforcing anti-bribery measures, however, a lot of authority for anti-corruption enforcement and prevention was replaced by the National Corruption Prevention Bureau in 2007.</p>
<b>National and Local Administration of Commerce and Industry</b>	<p>These administrations are responsible for implementing the "Anti-Unfair Competition Law." It has the authority to start investigations into violations of the law at any time. Enforcement authority includes fines and disgorgement of improper benefits. It includes a 24-hour corruption hotline number for whistleblowers.</p>
<b>General Administration for Combating Embezzlement and Bribery</b>	<p>This body is part of the Supreme People's Procuratorate. It has provincial and local agencies throughout China and retains a significant role in enforcing anti-bribery measures, however, many of its powers were replaced by the National Corruption Prevention Bureau in 2007.</p>
<b>Department of the Prevention of Crimes by State Functionaries</b>	<p>This department is part of the Supreme People's Procuratorate. It has provincial and local agencies throughout China and retains a significant role in enforcing anti-bribery measures, however, authority for overseeing and enforcing anti-corruption was taken over by the National Corruption Prevention Bureau in 2007.</p>

<b>Anti-Money Laundering Bureau of the People's Bank of China</b>	<p>This bureau regularly conducts investigations and imposes fines on infringing financial institutions. It is the main institution in charge of enforcing anti-money laundering regulations and conducting investigations of financial institutions.</p>
<b>Independent Commission Against Corruption – Hong Kong</b>	<p>This commission was created in 1974. It is mandated to enforce anti-corruption law, prevent corruption, and engage in community education to fight corruption. This commission was set up following several highly publicized corruption scandals in Hong Kong in the 1970s and following a commission of inquiry into those scandals. In response to the recommendations of the commission of inquiry the government created this independent commission against corruption.<sup>vi</sup> This commission has been incredibly successful and is sometimes seen by commonwealth countries as a model for anti-corruption agencies.<sup>vii</sup></p>
<p><sup>i</sup> Jaime Florcruz, "Chinese Communist Chief Vows to Fight Corruption," <i>CNN World</i> (2011) online: &lt;<a href="http://articles.cnn.com/2011-07-01/world/china.hu.jintao_1_cpc-discipline-inspection-central-commission?_s=PM:WORLD">http://articles.cnn.com/2011-07-01/world/china.hu.jintao_1_cpc-discipline-inspection-central-commission?_s=PM:WORLD</a>&gt;.</p> <p><sup>ii</sup> Mcansh Law, "China's Anti-Corruption Body Secretive, Least Transparent," <i>The Indian Express</i> (2011) online: &lt;<a href="http://www.indianexpress.com/news/chinas-anti-corruption-body-secretive-least-transparent/754737/">http://www.indianexpress.com/news/chinas-anti-corruption-body-secretive-least-transparent/754737/</a>&gt;.</p> <p><sup>iii</sup> C. F. Bergsten, "Corruption in China : Crisis or Constant?," ed. C. F. Bergsten (Washington, DC: Peterson Institute for International Economics, 2008), 99.</p> <p><sup>iv</sup> UN, United Nations Working Group, "Brief Introduction to the Work on Corruption Prevention in China" (August 22 2011) online: &lt;<a href="http://www.unodc.org/documents/treaties/UNCAC/WorkingGroups/workinggroup4/2011-August-22-24/Replies_to_CU_2011_45/20110616_China_English.pdf">http://www.unodc.org/documents/treaties/UNCAC/WorkingGroups/workinggroup4/2011-August-22-24/Replies_to_CU_2011_45/20110616_China_English.pdf</a>&gt;.</p> <p><sup>v</sup> Ibid.</p> <p><sup>vi</sup> China, Hong-Kong, <i>Independent Commission Against Corruption</i> (website) online: &lt;<a href="http://www.icac.org.hk/en/home/index.html">http://www.icac.org.hk/en/home/index.html</a>&gt;.</p> <p><sup>vii</sup> Alan Doig, "Good Government and Sustainable Anti-Corruption Strategies: A Role for Independent Anti-corruption Agencies?" <i>Public Administration and Development</i> 15, no. 2 (1995).</p>	

**Bilateral Treaties on Double Taxation and/or Tax Information Exchange Agreements:** China has signed 100 double tax avoidance treaties with other countries and nine tax information exchange agreements. For the most part, these agreements are up to the OECD standards on exchange of tax information which include exchange of information on request where it is foreseeably relevant to the administration and enforcement of the domestic tax laws of the requesting jurisdiction. Effective exchange of information requires that jurisdictions ensure information is available, that it can be obtained by the tax authorities, and that there are mechanisms in place allowing for the exchange of that information.<sup>i</sup>

Country	Treaty Signed	Date signed	Date Entered Into Force
United States	Double Tax Agreement	April 30, 1994	October 22, 1986
Canada	Double Taxation Treaty	May 12, 1986	December 29, 1986
Brazil	Double Taxation Treaty	August 5, 1991	January 6, 1993
Russian Federation	Double Taxation Treaty	May 27, 1994	January 1, 1998
India	Double Taxation Treaty	June 18, 1994	November 21, 1994

<sup>i</sup> OECD, "China" *Exchange of Tax Information Portal* online: <<http://www.eoi-tax.org/jurisdictions/CN#agreements>>.

**Multilateral Agreements**

Agreement	Signed	Ratified
<i>United Nations Convention Against Corruption (UNCAC)</i> <sup>i</sup>	Signed December 10, 2003	Accession January 13, 2006
<i>United Nations Convention against Transnational Organized Crime (UNTOC)</i> <sup>ii</sup>	Signed December 12, 2000	Accession September 13, 2003
<i>Financial Action Task Force</i> <sup>iii</sup>	Member since 2007	
<i>Convention on Mutual Administrative Assistance in Tax Matters (Updated Protocol)</i> <sup>iv</sup>	Not signed	
<i>OECD Convention on Combating Bribery of Foreign Corrupt Officials in International Business Transactions</i>	Not signed	China does prohibit bribery of foreign officials under art 164 of its Criminal Code

<sup>i</sup> UN, United Nations Office on Drugs and Crime, "United Nations Convention Against Corruption: UNCAC Signature and Ratification Status as of 24 September 2012" (2012) online: <<http://www.unodc.org/unodc/en/treaties/CAC/signatories.html>>.  
<sup>ii</sup> UN, *Treaty Collection*, "Status as of 24-04-2012 United Nations Convention against Transnational Organized Crime" online: <[http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtsg\\_no=XVIII-12&chapter=18&lang=en](http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtsg_no=XVIII-12&chapter=18&lang=en)>.  
<sup>iii</sup> FATF, "FATF Members and Observers" *FATF-GAFI* (website) (2012) online: <<http://www.fatf-gafi.org/pages/aboutus/>>.  
<sup>iv</sup> OECD, "Status of the Convention on Mutual Administration Assistance in Tax Matters and Amending Protocol – 30 August 2012" (August 30 2012) online: <<http://www.oecd.org/tax/Status%20of%20convention%2030%20August%202012.pdf>>.

**APPENDIX E – INTERNATIONAL TREATIES AND CONVENTIONS**

**United Nations Convention Against Corruption (UNCAC):** This convention requires countries to establish criminal and other offenses to cover a wide range of acts of corruption, if these are not already crimes under domestic law. In some cases, states are legally obliged to establish offenses. In other cases, in order to take into account differences in domestic law, they are required to consider doing so. Countries agreed to cooperate with one another in every aspect of the fight against corruption, including prevention, investigation, and the prosecution of offenders. Countries are bound by the convention to render specific forms of mutual legal assistance in gathering and transferring evidence for use in court and to extradite offenders. Countries are also required to undertake measures which will support the tracing, freezing, seizure, and confiscation of the proceeds of corruption. Lastly, countries agreed on asset-recovery, which is stated explicitly as a fundamental principle of the convention. This is a particularly important issue for many developing countries which have been devastated by high-level corruption and where resources are badly needed for reconstruction and the rehabilitation of societies under new governments.<sup>i</sup>

Country	Signature	Ratification/ Approval	Enabling Statute/ Notes
United States	December 9, 2003	October 30, 2006	
Canada	May 21, 2004	October 2, 2007	
China	December 10, 2003	January 13, 2006	
Russian Federation	December 9, 2003	May 9, 2006	No. 274-FZ of December 25, 2008.  In enacting this statute Russia updated its <i>Criminal Code</i> and <i>Civil Code</i> and added Article 19.28 to its <i>Code of Administrative Offenses</i>
Brazil	December 9, 2003	June 15, 2005	Decree 5687/06 of January 31, 2006
India	December 9, 2003	May 1, 2011	The <i>Prevention of Bribery of Foreign Officials and Officials of Public International Organisations Bill, 2011</i> which is currently before the <i>Lok Sabha</i> is meant to implement this convention.

<sup>i</sup> UN, United Nations Office on Drugs and Crime, "United Nations Convention Against Corruption: UNCAC Signature and Ratification Status as of 24 September 2012" (2012) online: <<http://www.unodc.org/unodc/en/treaties/CAC/signatories.html>>.

World Trade Organization Membership			
Country	Status	Date of Membership	Concessions and Terms of Accession/Transitional Periods
United States	Member	January 1, 1995	
Canada	Member	January 1, 1995	
Brazil	Member	January 1, 1995	
India	Member	January 1, 1995	
China	Member	December 11, 2001	<p>China's accession agreement includes the "Transitional Product-Specific Safeguard Mechanism" (s. 16 of the agreement). This is a broad exception to the WTO's general rules on trade liberalization. It was created as a temporary safety valve to ease China's entry into the world economy and will last until 2013. This mechanism allows WTO members to restrict the import of any goods from China if they are perceived to create a market disruption to the member's local domestic market. Notably the mechanism has lowered the evidentiary threshold that another member must satisfy to demonstrate market disruption (s. 16.8).<sup>i</sup> One of the effects of 16.8 is that if one member country imposes a restriction on a Chinese product another country can impose the same restriction without having to show evidence that it has in fact caused an injury to their domestic market.</p> <p>China has also adopted "grey-area" measures and "voluntary" export restraints that had otherwise been banned by the WTO.<sup>ii</sup> For example, it voluntarily restrained exports of textiles and apparel to the US and EU in 2005.<sup>iii</sup></p> <p>Most of the countries that are resorting to this mechanism are developing countries.<sup>iv</sup></p>

Russian Federation	Member (since August 22, 2012)	Ratified July 10, 2012	<p>Russia has committed to fully apply all WTO provisions, with recourse to very few transitional periods.<sup>v</sup> Notably, Russia has agreed to implement the Trade Related Aspects of Intellectual Property Rights agreement without a transitional period.</p> <p>Transitional periods:</p> <p>a) Agricultural Subsidies: the total trade distorting agricultural support would not exceed US\$9 billion in 2012 and would be gradually reduced to US\$4.4 billion by 2018. The longest transition period is for pork farmers who will remain protected until 2020.</p> <p>b) Trade Related Investment Measures: all WTO-inconsistent investment measures, including preferential tariffs or tariff exemptions applied in relation to the existing automobile investment programs and any agreements concluded under them would be eliminated by July 1, 2018.</p> <p>c) The automotive, helicopters, and civil aircraft sectors are protected until 2018.</p>
<p><sup>i</sup> Chad P. Bown and Meredith A. Crowley, "China's Export Growth and the China Safeguard: Threats to the World Trading System?," <i>Canadian Journal of Economics/Revue canadienne d'économie</i> 43, no. 4 (2010), 1355-56.</p> <p><sup>ii</sup> Chad P. Bown, "China's WTO Entry: Antidumping, Safeguards, and Dispute Settlement" in <i>China's Growing Role in World Trade</i> ed. Robert C. Feenstra and Shang-jin Wei (University of Chicago Press, 2010), 18.</p> <p><sup>iii</sup> <i>Ibid.</i>, 21.</p> <p><sup>iv</sup> <i>Ibid.</i></p> <p><sup>v</sup> WTO, "Accessions: Working Party Seals the Deal on Russia's Membership Negotiations" (November 10 2011) online: &lt;<a href="http://www.wto.org/english/news_e/news11_e/acc_rus_10nov11_e.htm">http://www.wto.org/english/news_e/news11_e/acc_rus_10nov11_e.htm</a>&gt;.</p>			

**Plurilateral Agreement on Government Procurement (GPA):** To date this is the only legally binding agreement in the World Trade Organization focusing on the subject of government procurement. Not all members of the World Trade Organization are parties to the agreement, but those who are parties have rights and obligations under it. The GPA is based on the principles of openness, transparency, and non-discrimination. These principles apply to parties' procurement practices which are covered by the agreement and are to the benefit of the parties and their suppliers, goods, and services.<sup>i</sup>

Country	Status	Date of Membership	Additional Information
United States	Party	January 1, 1996	
Canada	Party	January 1, 1996	
Hong Kong, China	Party	June 19, 1997	
China	Observer	February 21, 2002	In December 2007 China submitted an offer to become a member but the offer was rejected as "deeply disappointing by its trading partners." On July 9, 2010 China submitted a revised offer.
Brazil	Neither Party nor Observer	N/A	Brazil has no intention of joining. <sup>ii</sup>
India	Observer	February 10, 2010	
Russia	Neither Party nor Observer	N/A	Following accession to the WTO Russia intends to join the GPA. Russia would become an observer to the GPA and would initiate negotiations for membership within four years of its accession.

<sup>i</sup> WTO, "The Plurilateral Agreement on Government Procurement (GPA)" online: <[http://www.wto.org/english/tratop\\_e/gproc\\_e/gp\\_gpa\\_e.htm](http://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm)>.  
<sup>ii</sup> Ping Wang, "China's Accession to the WTO Government Procurement Agreement – Challenges and The Way Forward," *Journal of International Economic Law* 12, no. 3 (2009), 663.  
<sup>iii</sup> Swiss Business Hub, "Public Procurement in Brazil" (São Paulo, September 2010) online: <<http://www.osec.ch/sites/default/files/PublicprocurementinBrazilREV.pdf>>, 2.

**OECD Convention on Combating Bribery of Foreign Corrupt Officials in International Business Transactions:** This convention establishes legally binding standards to criminalize bribery of foreign public officials in international business transactions and provides for a host of related measures that make this effective. It is the first and only international anti-corruption instrument focused on the "supply side" of the bribery transaction.<sup>i</sup>

Country	Deposit of Instrument of Ratification	Entry Into Force of the Convention	Entry Into Force of the Enabling Legislation	Enabling Statute/ Notes
United States	December 8, 1998	February 15, 1999	November 10, 1998	
Canada	December 17, 1998	February 15, 1999	February 14, 1999	
China	N/A	N/A	N/A	
Russian Federation	February 17, 2012	April 17, 2012	May 16, 2011	No. 97-FZ of May 4, 2011
Brazil	August 24, 2000	October 23, 2000	June 11, 2002	Decree 125/00 Decree 3,678 Law 10,467 Law 9,613
India	N/A	N/A		N/A

<sup>i</sup> OECD, Directorate for Financial and Enterprise Affairs, "OECD Convention on Combating Bribery of Foreign Public Officials in International Business: Ratification Status as of April 2012" online: <[http://www.oecd.org/document/21/0,3746,en\\_2649\\_34859\\_2017813\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/21/0,3746,en_2649_34859_2017813_1_1_1_1,00.html)>.



**United Nations Convention Against Transnational Organized Crime (UNTOC):** This convention was adopted by the UN General Assembly on November 15, 2000. It is the main international instrument in the fight against transnational organized crime. States that ratify this instrument commit themselves to taking a series of measures against transnational organized crime, including the creation of domestic criminal offenses such as participation in an organized criminal group, money laundering, corruption, and obstruction of justice; the adoption of new and sweeping frameworks for extradition, mutual legal assistance, and law enforcement cooperation; and the promotion of training and technical assistance for building or upgrading the necessary capacity of national authorities.<sup>i</sup>

Country	Signature	Accession	Exceptions
United States	December 13, 2000	November 3, 2005	The convention only applies to US federal criminal law and does not modify state criminal law. <sup>ii</sup>
Canada	December 14, 2000	May 13, 2002	None
China	December 12, 2000	September 13, 2003	None
Russian Federation	December 12, 2000	May 26, 2004	Russia accepted the convention with a few reservations. It retains jurisdiction over the offenses established in arts 4, 6, 8, and 23 of the convention. In addition it considers the convention as the basis for mutual law enforcement as long as cooperation does not include the conduct of investigatory or other procedural actions in the territory of Russia. <sup>iii</sup>
Brazil	December 12, 2000	January 29, 2004	None
India	December 12, 2002	May 5, 2011	India does not consider itself bound by the provision of the protocol relating to submission of disputes for arbitration or to the International Court of Justice. Furthermore, where it has a bilateral agreement with another country that agreement overrides the convention in cases of mutual legal assistance. <sup>iv</sup>

<sup>i</sup> UN, United Nations Office on Drugs and Crime, “United Nations Convention against Transnational Organized Crime and the Protocols Thereto” online <<http://www.unodc.org/unodc/en/treaties/CTOC/>>.  
<sup>ii</sup> UN, *Treaty Collection*, “Status as at 24-04-2012 United Nations Convention against Transnational Organized Crime” online: <[http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtidsg\\_no=XVIII-12&chapter=18&lang=en](http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtidsg_no=XVIII-12&chapter=18&lang=en)>.  
<sup>iii</sup> Ibid.  
<sup>iv</sup> Ibid.

**Group of States Against Corruption (GRECO):** this group was established in 1999 by the Council of Europe to monitor states’ compliance with the organization’s anti-corruption standards. Membership in GRECO, which is an enlarged agreement, is not limited to Council of Europe member states. Any state which took part in the elaboration of the enlarged partial agreement may join by notifying the Secretary General of the Council of Europe. Moreover, any state which becomes party to the *Criminal or Civil Law Conventions on Corruption* automatically accedes to GRECO and its evaluation procedures. Currently, GRECO comprises 49 member States (48 European states and the United States).<sup>i</sup>

Country	Status	Accession
United States	Member	September 20, 2000
Canada	N/A	N/A
China	N/A	N/A
Russian Federation	Member	February 1, 2007
Brazil	N/A	N/A
India	N/A	N/A

<sup>i</sup> Council of Europe, GRECO, “What is GRECO?” *Council of Europe* (website) online: <[http://www.coe.int/t/dghl/monitoring/greco/general/3.%20What%20is%20GRECO\\_en.asp](http://www.coe.int/t/dghl/monitoring/greco/general/3.%20What%20is%20GRECO_en.asp)>.

**The Financial Action Task Force (FATF):** this is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering, the financing of terrorism, and proliferation of weapons of mass destruction. The FATF is therefore a policy-making body that works to generate the necessary political will to bring about legislative and regulatory reforms in these areas. FATF has published recommendations in order to meet this objective. FATF is associated with the following groups:

**MONEYVAL:** Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism

**GAFISUD:** Financial Action Task Force on Money Laundering in South America

**EAG:** Eurasian Group

**ESAAMLG:** Eastern and Southern Africa Anti-Money Laundering Group

**APG:** Asia Pacific Group

Country	Status	Accession Year	Membership in an Associated Group
United States	Member	1990	US is an observer of MONEYVAL, GAFISUD, EAG, and ESAAMLG
Canada	Member	1990	Canada is an observer of MONEYVAL
China	Member	2007	China is also a member of EAG
Russian Federation	Member	2003	Russia is also a member of EAG and MONEYVAL
Brazil	Member	2000	Brazil is also a member of GAFISUD
India	Member	2010	India is also a member of APG

<sup>i</sup> FATF, "Who We Are" *FATF-GAFI* (website) (2012) online: <<http://www.fatf-gafi.org/pages/aboutus/>>; FATF, "FAFT Members and Observers" *FATF-GAFI* (website) (2012) online: <<http://www.fatf-gafi.org/pages/aboutus/>>.

## Other International Instruments, Conventions, or Guidelines

Name of Instrument	Brief Description
<b>OECD Guidelines for Multinational Enterprises</b>	These guidelines contain recommendations for responsible corporate behaviour and standards of conduct. These guidelines are based on voluntary commitment by companies. <sup>i</sup>
<b>UN Global Compact, Principle 10</b>	This is a policy initiative where businesses may voluntarily adopt strategies such as labour standards and human rights standards and integrate them into their business practices. Principle 10 states that "businesses should work against corruption in all its forms, including extortion and bribery." This principle appeals to a businesses' sense of the moral, legal, and economic risks of engaging in corruption. <sup>ii</sup>
<b>International Chamber of Commerce (ICC) Combating Extortion and Bribery: ICC Rules of Conduct and Recommendations</b>	According to the International Chamber of Commerce these rules are intended as a method of self-regulation by businesses against the background of applicable national laws. The rules are of a general nature and considered good business practice rather than having direct legal effect. They prohibit bribery and extortion and promote anti-corruption practices such as company-wide anti-corruption policies which apply to the company and to its agents. They also include guidelines and definitions of "gifts," "facility payments," and "hospitality." <sup>iii</sup>
<b>Integrity Clauses or Anti-Corruption Clauses</b>	Integrity clauses may be included in procurement or business contracts and may be used by businesses or governments. The Canadian government has started using "anti-corruption" clauses in all contracts signed by Public Works and the Canadian International Development Bank (CIDA). The former is the department charged with administering government procurement projects and the latter agency is charged with delivering aid to developing countries. CIDA's anti-corruption clause states "No offer, gift or payment, consideration or benefit of any kind, which constitutes an illegal or corrupt practice, has or will be made to anyone, either directly or indirectly, as an inducement or reward for the award or execution of this contract. Any such practice will be grounds for terminating this contract/ contribution agreement or taking any other corrective action as required." <sup>iv</sup> The major drawback of these types of clauses is that they are difficult to enforce.

<sup>i</sup> OECD, "Guidelines for Multinational Enterprises" *OECD* (website) online: <<http://www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/#>>.

<sup>ii</sup> UN, "United Nations Global Compact Against Corruption" online: <<http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/anti-corruption.html>>

<sup>iii</sup> ICC, "Combating Extortion and Bribery: ICC Rules of Conduct and Recommendations (2005 Revision)" (May 12 2005) online: <[http://www.unglobalcompact.org/docs/issues\\_doc/7.7/2005\\_ICC\\_Anti-Corruption\\_Rules\\_FINAL.pdf](http://www.unglobalcompact.org/docs/issues_doc/7.7/2005_ICC_Anti-Corruption_Rules_FINAL.pdf)>

<sup>iv</sup> Canada, "CIDA 101- General Conditions (Contracts)" (December 1 2003) online: <<http://www.acdi-cida.gc.ca/acdi-cida/acdi-cida.nsf/eng/REN-218124737-P7R#sec5>>.

**Convention on Mutual Administrative Assistance in Tax Matters:** this is a multilateral agreement developed jointly by the Council of Europe and the OECD and was open to all members of either organization on January 25, 1988. In June 2011 the Updated Convention was opened to all countries to make it easier for developing countries to secure the benefits of a cooperative tax environment. The convention facilitates international cooperation for a better operation of national tax laws. It provides for all possible forms of administrative cooperation between states in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. The OECD Global Forum on Transparency and Exchange of Information monitors and does peer reviews of the implementation this convention.<sup>i</sup>

Country	Signature of Convention/ Ratification	Signature of Updated Protocol	Ratification
United States	June 28, 1989 ratified January 30, 1991	May 27, 2010	Not yet ratified
Canada	April 28, 2004 Not ratified	November 3, 2011	Not yet ratified
China	Not signed	Not signed	N/A
Russian Federation	Not signed	November 3, 2011	Not yet ratified
Brazil	Not signed	November 3, 2011	Not yet ratified
India	Not signed	January 21, 2012	To enter into force on June 1, 2012

**Note 1:** each of these countries (including China) is also a member of the **Global Forum on Transparency and Exchange of Information**, which is a multilateral framework within which work on transparency and exchange of information is carried out by OECD and non-OECD countries. It has been around since 2000. Members and non-members monitor and peer-review each other's implementation of tax exchange treaties and the *Convention on Mutual Administrative Assistance in Tax Matters*. The Global Forum is the largest tax group in the World.<sup>ii</sup>

**Note 2:** India, Canada, South Africa, China, and the U S are all participants in the **OECD Forum on Tax Administration**. It was created in 2002 and is a forum where tax administrators can identify, discuss, and influence global trends and develop new ideas to enhance tax administration. It includes a sub-committee named the Offshore Compliance Network.

<sup>i</sup> OECD, Centre for Tax Policy and Administration, "Convention on Mutual Administrative Assistance in Tax Matters" (2012) online: <[http://www.oecd.org/document/14/0,3746,en\\_2649\\_33767\\_2489998\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/14/0,3746,en_2649_33767_2489998_1_1_1_1,00.html)>.  
<sup>ii</sup> Pascal Saint-Amans, "The Global Forum on Transparency Exchange of Information for Tax Purposes: Information Brief" (April 4 2012) online: <<http://www.oecd.org/dataoecd/32/45/43757434.pdf>>, 11.

**Foreign Account Tax Compliance Act (FATCA):** This is a piece of US legislation which was signed on March 28, 2010 as part of the *Hiring Incentives to Restore Employment (HIRE) Act*. We have included this legislation as it will have widespread repercussions internationally. It was enacted to prevent offshore tax abuses by US persons living or holding assets abroad. Among other things it will impose a 30 percent withholding tax on foreign financial institutions that refuse to disclose the identities of US persons, unless they reach an agreement with the Internal Revenue Service (IRS). The deadline for concluding such an agreement is June 30, 2013. FATCA challenges the US' current network of bilateral double tax avoidance treaties based on the *UN Model Tax Convention and the OECD Model Tax Convention* as well as tax information exchange agreements, because it imposes unilateral and coercive measures on foreign financial institutions to assist the IRS.<sup>i</sup> Following the "later in time principle" the FATCA treaty will override these bilateral treaties which can have a devastating consequence especially in developing countries (note that the US has never used tax sparing rules for developing countries). One of the most controversial pieces of the legislation is that it requires foreign financial institutions to obtain waivers of the US account holders' rights under the local banking secrecy laws.<sup>ii</sup>

Canada	Canada has been one of the most vigorous opponents of FATCA considering its financial institutions will be some of the most affected by the new rules as many Canadians have dual citizenship with the US. On September 16, 2011 Canada's federal Minister of Finance, Jim Flaherty, sent an open letter to the IRS stating his objections to the rules. Furthermore, it is quite likely that the waiver requirements will go against Ontario human rights legislation and banking secrecy legislation. <sup>iii</sup>
China	China plans to avoid the consequences of FATCA by passing all foreign currency transactions through state-owned banks, because state-owned banks are exempt from FATCA rules. <sup>iv</sup>

<sup>i</sup> Vokhidjon Urinov, "The US Foreign Tax Account Compliance Act: a Domestic Law with Global Scope" draft paper (2012), 3.  
<sup>ii</sup> Ibid.  
<sup>iii</sup> "FATCA will violate the Ontario Human Rights Code" *Righteous Investor* (November 28 2011) online: <<http://righteousinvestor.com/2011/11/28/fatca-will-violate-the-ontario-human-rights-code/>>.  
<sup>iv</sup> Jessica Meek "Chinese Banks Will Avoid FATCA, Observers Warn" *Risk.net* (December 13 2011) online: <<http://www.risk.net/operational-risk-and-regulation/news/2131127/chinese-banks-avoid-fatca-observers-warn>>.

