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The rule of law

> INTELLIGENT AID ESSAY COMPETITION

Intelligent Aid is an annual competition to find the best graduate talent for our London office. Students from across all UK Higher Education institutions and disciplines were challenged to write a 500 word essay on the rule of law. We received almost 500 entries and the writers of the best 40 essays were invited in for a two day workshop before presenting a case study to a number of partners. The top 20 have been offered a place on the Clifford Chance vacation scheme.

Here is a selection of some of the most interesting essays on the question:

“Is the Rule of Law essential in ensuring an economy’s success? Discuss with reference to one or more jurisdictions of your choice.”

Leo Colle is a second year law undergraduate at the University of Sussex

Surfing the wave of discontent following the financial crisis, American federal prosecutors have strained the bounds of their formidable power. Wielding broad criminal laws, U.S. Attorneys have exercised their virtually unchecked discretion to extract concessions and over \$100 billion from Wall Street. Their work is shrouded in a thick haze and culminates in secretive deals.

Banks are hectored into accepting opaque settlements in which no case is filed. A hefty fine is levied, the entity is required to implement structural reforms and to submit to supervision by a monitor. These deferred and non-prosecution agreements are designed to exclude the court system and – when they are not sealed – read like the transcripts of Maoist purge trials.

This brand of prosecutorial bravado cuts against the rule of law. But it has proved expedient for the economy at large.

For starters, it is a healthy compromise. It opens up the murky recesses of white-collar crime, inculcates the sort of significant reforms you might not get following a trial and conviction, yet shelters the economy's nerve-centre. Federal prosecutors' wide latitude to strong-arm financial institutions actually provides the latter with a lifeline. It sidesteps the uncertainty of a trial and the dire consequences of a criminal conviction. Arthur Andersen's collapse served as a lesson. The firm did not survive its trial. It was debarred; 28,000 jobs were destroyed in the U.S. and competition in the audit industry decreased. Preserving the



credibility of financial institutions avoids their failure and the ruinous impact on the wider economy [*cf.* Lehman].

Financial institutions have a range of strategic advantages over law enforcement. To be sure, Wall Street is a complex environment that can incentivise crime, magnify its consequences, and make it intractable. Banks' capacity to promote their collective interests and marshal resources enables them to skew the processes through which rules and market structures evolve. This can overwhelm prosecutors and regulators.

Targeting banks in the shadow of the law shields U.S. Attorneys from the influence of organised interest groups. The impenetrable, centralised criminal enforcement bureaucracy supplements captive civil regulatory agencies

“ The expansive mandate of prosecutors has been a force for positive change.”

and state attorneys. Its discretionary culture allows it to overcome limited resources and nurture skills crucial to the modern regulatory state. The expansive mandate of prosecutors has been a force for positive change. It has sought to improve corporate governance, foster discipline, and deter risk-rewarding cultures.

Marauding prosecutors may in fact have paved the way for the deconsolidation of Wall Street. Under the weight of compliance costs, red tape and fines the consensus has edged back toward boutique outfits. The market cues

are hard to miss. Family-run Rothschild has set the benchmark for revenues whilst small, publicly traded firms like Lazard trade at price multiples significantly higher than the mega-banks. Owing to regulatory headwind, Goldman Sachs analysts believe a partitioned JPMorgan could be worth 20% more than the current monolith.

Change is afoot. Behemoths, rife with conflicts of interest and posing serious systemic risks, are on the wane. U.S. capital markets are all the better for it.

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The influential legal philosopher, Lon Fuller, characterised the rule of law as rules that are general, public, prospective, clear, consistent, capable of being followed, stable, and enforced. This type of legal system has been strongly connected to economic growth. As *The Economist* has described it: ‘the rule of law has become the motherhood and apple pie of development economies.’

However, China seems to be the exception to the rule. In spite of having one of the largest, fastest-growing economies in the world, China’s legal system remains in its infancy. This is evidenced by the fact that people fear the judicial system. As a Chinese proverb says: ‘Do not visit the bureau when one is alive; do not visit hell when one is dead’. In other words, seeking resolution from the court is analogous to being put into hell after death.

However, whilst China does not have the rule of law in the western sense, it does have an informal ruling system. This is called *guanxi* and has been referred to a ‘rule of relationships’. *Guanxi* has been defined as a ‘friendship with implications of continued exchange of favours’. *Guanxi* constitutes a type of business merit that is built-up from previous dealings. One does not dare to go back on one’s word in a transaction because any breach of faith can be broadcasted on the *guanxi* network, alerting others of a bad business experience. It is like leaving negative feedback on someone’s eBay account. *Guanxi* has



fuelled economic growth and has been an engine of growth for SMEs.

However, it is clear that *guanxi* will be unable to support the continued success of China’s economy as businesses become more globalised. There are signs that the lack of a Rule of Law in China is already inhibiting economic growth. According to a recent joint report by the Hurun Report and Bank of China, 25% of China’s billionaires claim that the reason for not investing overseas was that they were concerned that the government officials may unjustly prosecute them. Foreign direct investment (FDI) is also under threat from a lack of the rule of law as there is a perception that China favours domestic businesses at the expense of foreign ones. This might explain

“Guanxi has been referred to as the rule of relationships.”

why, in the third-quarter of 2014, FDI fell to its lowest figure since July 2010. To those outside the *guanxi* system, only the rule of law can protect the legal rights of investors and support contractual arrangements.

Additionally, *guanxi* will not be able to ensure the sustainable growth China's economy. Currently, through the misuse of *guanxi*, factory owners can evade penalties when discharging waste that does not meet governmental

standards. According to the World Bank, environmental degradation is costing China 9% of its gross national income annually.

To conclude, whilst China's traditional value-based system has been successful for the country's initial economic growth, as businesses becomes increasingly more globalised, it is clear that only the rule of law will be able to ensure the sustainable development of China's economy.

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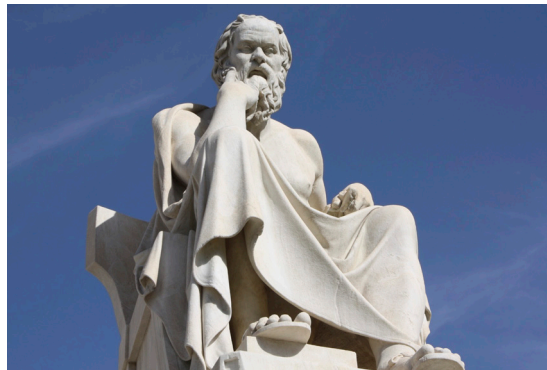
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As Mario Draghi espoused the rule of law during a speech on the economic convergence of post-recessionary Europe, the audience could be forgiven for forgetting that the concept's definition has been fiercely debated for more than two millennia. Yet, from Aristotle to Dicey and Bingham, common ground is found in the idea that those in power should be servants of the law. That all should be both bound by and entitled to publicly made laws is a key idea for all nations who associate themselves with the rule of law. It is surely this definition that Draghi, like so many others, had in mind when promoting the rule of law as essential to economic success. The degree to which this is true, however, is as uncertain as the concept's definition.

It is true that a correlation exists between secure, transparent legal systems and economic performance. In Classical Athens, for example, a clear legal system was supreme. Even Socrates' execution occurred within the context of public trial. This early bastion of democracy became the region's leading centre for trade. Likewise, the UK has become a 'legal island' to which individuals and companies flock in order to do business. And, in recent decades, the tackling of corruption and promotion of the rule of law in emerging markets have coincided with rapid economic growth. Possible reasons for this correlation immediately suggest themselves. A transparent legal system, not undermined by the whim of the ruling party, ensures a stable environment for economic activity. Companies and investors are much



more likely to do business in a legal jurisdiction where contracts can be enforced and property will remain secure. It is thus understandable that economic success should occur in countries underpinned by the rule of law.

Is this correlation, however, also a chain of causality? There are contradictions to the premise that the rule of law is a necessary precondition for economic success. In China, despite regular proclamations of the rule of law, the legal system is subordinate to the ruling party. Recent protests in Hong Kong reminded the wider world that proclamations of legal supremacy are dubious. Likewise, even developed nations like American and Britain have acted in ways that transgress the law. The invasion of Iraq and the actions of the NSA are exemplary of such

“Companies and investors are much more likely to do business in a legal jurisdiction where contracts can be enforced.”

transgression. Yet, despite such neglect of the rule of law, these nations experience continued economic joy. We must ask whether the rule of law can really be essential to economic success, when so many contradictions to the concept occur in prosperous countries.

The relationship between the rule of law and economic success is, then, a complex one. Certainly, the practical benefits of operating

within a stable legal framework are clear. This safeguard from the sudden removal of basic liberties attracts business. The application of rule of law in practice, however, is difficult. That prosperous countries can undermine the rule of law's supremacy suggests that, at the very least, the chain of causality is not unimpeachable.

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I come from a country that places third in the world for gross domestic product per capita¹, yet whose government cannot be regarded as truly democratic. A city-state which upholds equality of race, language and religion whilst continuing to criminalise homosexuality. An island nation whose students place in the top three globally for their performance in maths and science², yet cannot read newspapers borne of a free national press. It is by many accounts an authoritarian nanny-state, yet, curiously, also an indisputably prosperous one. This odd, miraculous, money-spinning web of contradictions is my Singapore.

Singapore defies the typical liberal values we associate with a high-income, developed nation. It imposes capital punishment for drug offences, and lacks an independent election commission. Freedom of speech and assembly are restricted: the government adopts a careful tactic of drowning opposition voices in slander suits, while the press does not serve as a “fourth estate”. Recently its Parliament enacted a bill³, prohibiting the sale and consumption of alcohol in defined “public areas”, which discriminates against low-income foreign workers by including their dormitories under its ambit. Most notoriously, Singapore’s Internal Security Act⁴ enables the detention without trial of those considered threats to national security, and includes an ouster clause



that limits the scope of judicial review⁵. Such laws have led commentators to assert that Singapore wasn’t founded on the rule of law so much as on rule *by* law.

However, it is only when we place such laws in context with Singapore’s unique circumstances that we can truly appreciate that, rather than govern according to a substantive, content-based conception of the rule of law, it really adheres to a “thin”, amoral interpretation. As a vulnerable entrepot devoid of national resources and bringing together a multi-ethnic populace, Singapore and its government are acutely aware

“The same stringent laws that deter crime also police the abuse of executive power.”

¹ World Economic Outlook Database, October 2014, International Monetary Fund.

² Organisation for Economic Cooperation and Development, Programme for International Student Assessment (PISA) Rankings, 2012, <<http://www.oecd.org/pisa/kevfindings/pisa-2012-results-overview.pdf>>, accessed 31 January 2015.

³ Singapore Liquor Control (Supply and Consumption) Bill, Bill No 1/2015 <http://www.parliament.gov.sg/sites/default/files/Liquor%20Control%20and%20Consumption%20Bill%201-2015.pdf>

⁴ Cap 143,1985 Rev Ed (Singapore)

⁵ Ibid, s8B

of the need to maintain order in the streets and project the nation as safe for business.

More importantly, the same stringent laws that deter crime also police the abuse of executive power, ensuring that Singapore ranks as the seventh-least corrupt in the world⁶. The effectiveness of the “Singapore Model” lies in the fact that while substantive laws have been adapted to fit its geopolitical constraints, their predictability and the robustness of its judicial system ensure a sufficient check on executive abuse against business interests⁷. It is little wonder, then, that Singapore has developed a burgeoning reputation as an arbitration hub.

In my view, Singapore stands testament to the idea that “the acid test of any legal system is not the greatness nor the grandeur of its ideal concepts, but whether in fact it is able to produce order and justice in the relationships”⁸ between man, society and the state. Legality, therefore, cannot entail accepting only a specific set of substantive moral values as noble at the cost of development. While the rule of law is indeed essential in all successful economies - Singapore included - our conception of what it is should be more adaptable.

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It has widely been argued that the rule of law is important in ensuring the success of a country's economy (Dam, 2006). However, this essay will examine a very different kind of economy, the Bitcoin economy. This is an economy that will arguably owe its success to the rule of law, and yet Bitcoin as a 'disruptive technology' presents fundamental challenges to regulators. Bitcoin is a cryptocurrency that is more than just a virtual commodity, its users have created a new and tangible economy that sees goods and services bought and traded across multiple jurisdictions.

Clearly, many transactions involving Bitcoin are already governed by an established legal framework. For example, buying a Dell computer or Microsoft software. As a report by The Bitcoin Foundation Canada highlights, "using Bitcoin does not render parties exempt from the application of the rule of law" for example, "transactions with Bitcoin are subject to contracts law in general". Therefore, countries with a strong rule of law have a clearer and more consistent existing legal framework within which trust and confidence can be established towards Bitcoin. This will provide some protection to consumers and businesses, which will allow the Bitcoin economy within those countries to mature.

According to Bingham (2010), one of the principles of the rule of law is that the law must "in so far as possible" be "clear". It can be argued that the success of a Bitcoin economy within a country will also depend on clear regulations being adopted to govern aspects of Bitcoin not already covered by existing law.



Supporting this argument, a study by the Montreal Economic Institute (MEI) has asserted that in order to "develop and grow", Bitcoin's legal status will need to be clarified. They emphasise that clear regulations will be needed to indicate how Bitcoin will be treated, for example in terms of taxation. This would help to reduce uncertainty for investors and create confidence and stability within the Bitcoin economy.

This can be demonstrated by looking at the strength of the Bitcoin economy in Germany, the first country where there was a partnership between a bank and a Bitcoin exchange. As the MEI study highlights, "Germany stands out from other countries by the clarity of its rules" relating to Bitcoin. Consequently, uncertainty within the German Bitcoin economy has been reduced and this has encouraged Bitcoin related business partnerships.

However, it must be recognised that regulations that prohibit or penalise Bitcoin's legitimate use will hinder the growth of the Bitcoin economy. For example, in Russia, the future of an open Bitcoin economy is looking unlikely because of a 2014 draft bill proposing monetary penalties for Bitcoin use and promotion.

Primarily, I would argue, it is the rule of law that will continue to determine the current and future success of the Bitcoin economy. Whilst it doesn't guarantee against misuse of this cryptocurrency,

as with any economy, it lays the foundations for the trust, confidence and protection that its legitimate users ultimately require.

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Taxation, competition and Antitrust laws, restrictions on the trade of certain goods -at first glance the rule of law appears not to ensure an economy's success, but rather limit it through the the restrictions it imposes upon the free market. However, my argument is that despite the seeming limitations of such restrictions, having a strong rule of law is nevertheless necessary for a nation state to maximise economic success – hereafter defined as GDP growth. The rule of law enables growth in two general ways: firstly, it ensures stability, which gives citizens the confidence to do business knowing that the safety of their person and possessions is secure, making it profitable for them to invest their time and money; secondly, it acts as an external and objective arbitrator that legitimises contractual agreements, and so provides a framework in which economic agents can trust and hence collaborate with one another. By creating stability and trust, the rule of law therefore incentivises business, which in turn leads to economic growth. In order to be said to represent a genuine rule of law, a nation's laws must fulfil three criteria: they must be clear and easily interpreted; they should apply to everyone equally (with certain established exceptions); and lastly, the laws must be enforceable in practice through a social infrastructure, for example courts.

The Russian Federation offers an example of the importance of the rule of law to economic success. Contemporary Russia's lack of a legitimate rule of law can be seen in a recent



description made by The Economist: “It is horribly corrupt, has weak institutions and no real property rights.” Nevertheless, Russia could be considered a contradiction to the proposition of this essay's title, since despite an inadequate rule of law it has seen a decade of impressive growth, so that we might instead conclude that it is rather natural resources that are essential to economic success. Yet this focus on exporting natural resources has come at the expense of other forms of growth, so that over half of the government's budget in 2015 derived from oil and gas revenues. Whilst a weak rule of law has hindered more sustainable forms of growth, businesses have simultaneously taken to using English law as the basis of transactions, not least because in the case of a legal dispute Russian businesses

“Despite an inadequate Rule of Law, Russia has seen a decade of impressive growth.”

would prefer to answer to English judges. Finally, the response of the international community to the Russian Federation's recent activities in eastern Ukraine — in the form of economic sanctions for example — could be interpreted as representing a supranational rule of law, adherence to which is similarly necessary to economic success.

To conclude then, we have seen that the rule of law is essential to economic success on multiple levels. The rule of law refers not only to a nation's laws and its infrastructural capacity to uphold them, but also to the international domain - to foreign legal systems that businesses agree to refer to, and to international agreements reinforced by consensus between nations.

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