

RULE *of* LAW,
ECONOMIC GROWTH
and PROSPERITY

Rule of Law, Economic Growth and Prosperity

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Report of the Rule of Law Working Group Sponsored by the
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FOREWORD

The rule of law is a key factor for stable, broad-based economic growth. It encourages investment, both domestic and foreign, along with entrepreneurship and business development. In addition, confidence in the law and its application creates jobs and helps build prosperity so critical to the hemisphere's long-term development.

Over the last decade, the rule of law has become one of the most discussed issues in both the Americas and across the globe. Increasingly, we recognize its significance for the private sector and for all citizens. Clear, transparent, widely understood, and equally applied laws benefit everybody from the small business owner to minority groups and consumers. Further, as the region increasingly competes with Asia to attract investment and to develop in the global economy, the rule of law becomes even more of a focal point.

With this in mind, the Americas Society and Council of the Americas established a Rule of Law Working Group to engage in a series of discussions about how to improve and strengthen the rule of law in the Americas for the benefit of all. Over the course of a year, we brought together private sector representatives, practicing lawyers, academics, and representatives of non-governmental organizations to look at four of the areas most critical to achieving far-reaching growth: the administration of justice; the regulatory framework for business and investment; the use of alternative dispute resolution methods and the enforcement of contracts (including the proper settlement of claims in bankruptcy); and the protection of tangible and intellectual property rights. We approached these topics with an eye towards the greater, society-wide implications of fostering a climate that respects the rule of law.

This working report is a framework of ideas and will serve as a launching point for further discussion throughout the hemisphere. It builds understanding of and support for a new, forward-looking agenda. Throughout the working report, we recognize that the rule of law in the Americas has improved, but in individual sectors rather

than systemically. For that reason, the hemisphere's many examples of positive reforms are noted along with potential areas for improvement. The Working Group suggests basic principles intended to guide the hemisphere's political, business and social leaders as they look to solidifying rules-based societies.

I am grateful to Antonia Stolper and Mark Walker for serving as the chairs of this important Working Group. Their leadership, vision and unparalleled experience in the region added substantial depth and insight to our discussions. I would also like to thank the many law firms that provided pro-bono assistance in researching and outlining many of the working report topics. The Working Group members dedicated substantial time and wisdom both in reviewing report drafts and participating in meetings in New York, Washington, São Paulo, and Mexico City. Their support and expert analysis is reflected in the pages of this report. Christopher Sabatini, AS/COA Senior Director of Policy, directed the Working Group along with Jason Marczak, Director of Policy. I would like to thank them and the entire team behind this initiative.

Susan Segal
President and CEO
Americas Society and Council of the Americas
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This report could not have been produced without the support of many individuals. For over a year, the working group members met a total of six times in New York, twice in Washington, once in São Paulo, and once in Mexico City. The two co-chairs, Antonia Stolper and Mark Walker, were essential in establishing the intellectual framework for the effort and, the commitment and active participation of the working group members provided the experience, analysis and knowledge that filled out the full report.

The working group enjoyed pro-bono assistance from Cleary Gottlieb Steen & Hamilton LLP and Shearman & Sterling LLP. In particular, Stephen Valdez of Cleary Gottlieb provided initial research for the “Administration of Justice” and “Contracts, Alternative Dispute Resolution and Bankruptcy” chapters. Kevin Brousseau and Christina Wilson of Shearman & Sterling wrote background memos for the “Regulatory Framework” and “Property Rights” chapters. And all of them read and commented on various drafts of the report as it unfolded.

The working group also counted on the assistance from a number of outstanding individuals, including Amanda Evansburg who served briefly as a consultant on the project and drafted the section on Intellectual Property Rights and edited and reviewed early drafts of the full report. Gonzalo Garcia Delatour, a visiting associate at Hughes Hubbard & Reed LLP, provided extensive background research on the Argentine bankruptcy reform, APE, described in the chapter “Contracts, Alternative Dispute Resolution and Bankruptcy.” Bradley Silver of Time Warner patiently walked us through the details of and differences between international property rights and pointed us in the direction of international treaties, agreements and research on aspects of the topic. Susan Schmidt of Manatt Jones Global Strategies, LLC read several drafts of the full report and provided extensive comments.

Last, but certainly not least, the outstanding staff of the Americas Society and Council of the Americas contributed in innumerable ways throughout. Eric Farnsworth, Vice President of the Council of the Americas, played a key role in launching the initiative and then provided detailed and thoughtful comments on a number of early drafts. Maria Lotito conducted the research and wrote the sections on e-commerce. Tyson Barker tirelessly researched examples for the “Regulatory Framework” chapter. There were other members of the Policy and Program teams at the AS/COA, who deserve mention, including but certainly not limited to, Juan Cruz Díaz, Talisa Anderson, Alana Tummino, Juan Matias Zaldua, Kelli Bissett, Juan Luis Serrano, Nataliya Binshteyn, Monica Guevara, Veronica Prado, and Eva Fernandez. Without their assistance in organizing the working groups in New York, São Paulo, Mexico City, and Washington, writing up the individual summaries and confirming citations this report would never have been possible.

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EXECUTIVE SUMMARY

Launched in March 2006, the Americas Society and Council of the Americas Rule of Law Working Group brought together private sector representatives, academics, practicing lawyers, and representatives of non-government organizations. Through meetings held in New York, Washington, Brazil, and Mexico we have engaged in a series of discussions about how to improve and strengthen the rule of law in the Americas. While we recognize that the rule of law is essential for the protection and defense of human and political rights, our discussions have focused on the rule of law as a fundamental pillar for achieving fair and broad-based growth and prosperity.

These discussions come at an important time, politically and economically, in the hemisphere. With the conclusion of the 2005-2006 elections, we are issuing this working report as new administrations set their agendas and goals for the next several years. Responding to the overwhelming message sent by voters will require governments to implement rule of law reforms that encourage entrepreneurship and business development, which in turn create jobs and broad-based prosperity. Moreover, as the region increasingly competes with Asia to attract investment and to develop in the global economy, adherence to the rule of law is essential.

Respect for the rule of law is a basic requirement for creating the conditions that foster business development. It provides the security that protects individuals' basic political and human rights. But the rule of law also provides entrepreneurs and small business owners the confidence they need to enter the formal economy and contribute to nationwide economic growth and development. Both these businesspeople and established corporations are more likely to thrive where the laws are clearly defined, known to the public, and applied neutrally and without prejudice across all members and classes of society.

The rule of law encompasses countless areas, but in this working report we concentrate on four of the areas most critical to achieving broad-based growth. These are:

- the administration of justice;
- the regulatory framework for business and investment;
- the use of alternative dispute resolution methods and the enforcement of contracts (including the proper settlement of claims in bankruptcy); and
- the protection of tangible and intellectual property rights.

Not intended to be an exhaustive analysis of each theme, the issues and reflections presented here will serve as an important launching point for working groups that the Americas Society and Council of the Americas will convene in countries throughout the region. The rule of law in the hemisphere has improved, albeit in individual sectors rather than systemically. For that reason, we highlight examples of successful reforms, while also noting some areas in need of improvement.

A fair and efficient system for the administration of justice, including the organization and operation of a country's judicial system, is a necessary pre-condition for the rule of law. As discussed in the working group, the substance of a country's laws matter little if the institutions set up to interpret and enforce those laws are inefficient, arbitrary or corrupt. Often times, susceptibility to abuse or misuse can be equally damaging to the integrity of the institution. Moreover, it has been shown that an independent and transparent judiciary facilitates economic growth by reducing perceived risks and creating a more welcoming environment for rising entrepreneurs. For these reasons, reforms in judicial processes and institutions—including the appointment and promotion of judges, the education and training of judicial personnel, the transparency of decision-making, and the accessibility of judicial proceedings and officials—are the lynchpins for a fair, open and efficient legal system.

In recent years, some Latin American countries have made considerable strides in this area. Mexico, for instance, has

strengthened the authority of the Federal Council of the Judiciary, the body that oversees most Mexican courts, with visible results. According to one report, the Council investigated 2,155 complaints against judicial personnel and issued 287 sanctions, promoting confidence in its ability to weed out incompetence and corruption. In Ecuador, the government's efforts to improve judicial efficiency are particularly noteworthy. Reforms instituted in six pilot courts have significantly streamlined procedures, reducing the time it takes to process cases by 85 percent.

We also analyzed the factors necessary for ensuring a sound regulatory framework for business and investment. Throughout the region, regulatory agencies and regulations have proliferated, often with overlapping functions, layers of bureaucracy and paperwork, and, at times, closely tied to political offices. This haphazard process of regulatory development has hurt the user and ultimately the government, creating complicated rules and procedures for running a business, investing, and managing the agencies' own decision-making processes. Cumbersome and costly regulations for operating a business place the greatest burden on small business owners and prevent entrepreneurs from entering the formal economy altogether. As seen by the working group, simplifying regulatory codes and reducing business start-up costs will foster economic development and ultimately increase public revenue for expanding social investment. A stable and straightforward regulatory scheme will also help attract sustainable foreign direct investment and bring added economic growth.

El Salvador and Honduras are prime examples of countries that have taken steps to facilitate business development. Both have simplified procedures for opening a business. In El Salvador, a 2005 law helped entrepreneurs speed up the process by 75 days. While in Honduras, the government has reduced business start-up costs by 12 percent.

For a society to achieve long-term growth, the rule of law must also encompass clear and consistent rules for the formation and enforcement of contracts and the settlement of commercial disputes, including claims arising from bankruptcy. Business cannot flourish in

the absence of legal assurances that private contracts will be honored. Small business owners and entrepreneurs are among the greatest beneficiaries of robust contract regimes; strong enforcement facilitates access to credit and promotes investment in and expansion of businesses. And when contract disputes arise, the rule of law is strengthened if private parties can take advantage of alternative dispute resolution methods, such as mediation and arbitration, to more efficiently enforce their contract rights. Alternatives to traditional court-based adjudication should be encouraged, as they are often not only faster but are also more easily accessible than litigation.

Bankruptcy laws are equally important to the rules governing opening and closing a business. They should be written and enforced in a way that promotes a streamlined and less burdensome process for all parties involved. By reducing the risk to banks for investing in start-ups and allowing businesses the opportunity to restructure, a fair and efficient bankruptcy system will promote entrepreneurship and job growth.

The use of specialized courts has become an increasingly popular means to resolve technical contract cases. By appointing to those courts judges who are specialists in contract law, Peru has reduced the time for resolving contract disputes. Trade agreements also provide an effective way to resolve disputes. From the North American Free Trade Agreement to the Central American-Dominican Republic-United States Free Trade Agreement and prospective agreements with Colombia, Peru and Panama, these agreements either strongly encourage or require that alternative dispute resolution methods be used to resolve international commercial disputes. Domestically, Brazil and Paraguay are among the countries that have passed laws to strengthen incentives to opt for arbitration. Nonetheless, arbitration is not a remedy for larger systemic concerns in the traditional and legal systems.

The final aspect of the rule of law addressed in our working report is the recognition and enforcement of property rights and intellectual property rights. Private ownership of property is one of the most

fundamental individual rights, yet many countries in the Americas still struggle with granting land titles and providing the security of property ownership. This is an important challenge since owning property is tied to full participation of individuals in the economy and expanding credit markets. The value of an individual's property can be leveraged to secure loans and make investments, allowing that individual to become a vested participant in the economy. Not only are property rights a recognized universal right, but they also provide a crucial step towards alleviating poverty and spurring economic growth in the region.

The enforcement of intellectual property rights is also important for economic development. Protection of intellectual property—namely patents, trademarks and copyrights—gives inventors and artists a legal incentive to create by granting them exclusive rights for a finite period of time. This allows innovators to recoup the costs put into creating the product. These guarantees are essential for creating and sustaining the modern, knowledge- and technology-based economies necessary to develop in today's global market. Consumers also benefit from the enforcement of intellectual property rights as these rights help ensure product safety and increase the likelihood of access to cutting-edge and innovative products and services.

We have seen great strides in the region with respect to tangible and intellectual property rights, but vast areas for improvement remain. Peru and Brazil are among the countries that have implemented successful land titling programs to grant property rights to landless individuals. Brazil has also attempted to clamp down on intellectual property abuses through a coordinated campaign that simultaneously stepped up enforcement while conducting a public education campaign to highlight the importance of intellectual property rights.

The Rule of Law Working Group sees this effort as an ongoing dialogue with counterparts throughout the hemisphere. Improving the rule of law requires a multi-faceted approach that is best achieved with broad-based commitment and support. To that end, our next step will be to share this working report in a number of countries in the hemisphere. We will convene local working groups comprising

local business counterparts, public officials, and local jurists, to analyze and expand on the ideas discussed here with an eye towards effecting positive and lasting change.

INTRODUCTION

What Do We Mean by the Rule of Law?

As attention on the subject has grown, the term rule of law has been stretched and used to describe a number of different processes and characteristics. For the purposes of the Rule of Law Working Group, we settled on a definition that applies broadly to laws, institutions, processes, and applications of the legal and judicial system. The term rule of law, as we use it in this report is:

A system in which the laws are public knowledge, clear in meaning, accessible to all, and apply equally to everyone; judges are impartial and independent and free from undue influence; central institutions of the legal system, including courts, regulatory agencies, prosecutors, and police are reasonably fair, competent, and efficient; government seeks to be law-abiding and its officials accept that the law will be applied to them; the making of laws is guided by transparent, stable, clear and general rules; and the laws themselves are prospective, known, clear, and relatively stable, and encompass critical areas.³

In this, the rule of law is essential not only for defending basic political and human rights, it is also a fundamental pillar for achieving fair and broad-based growth and prosperity.

Where laws are clear, widely known, and apply equally to everyone, all individuals—from the small business holder to minority groups and consumers—benefit from equal access to and treatment under the law. General public access to the law and trust in the legal and regulatory systems provide a stronger environment for the

³ This broad concept of the rule of law applies equally to the Spanish- and Portuguese-speaking countries in Central and South America whose legal systems are based on the Napoleonic Code and to the mostly English-speaking Caribbean countries whose legal system is based on the Anglo-Saxon tradition of common-law. Except where indicated, however, this report focuses primarily on the Spanish- and Portuguese-speaking countries and their civil-law system.

development and growth of formal enterprise and entrepreneurship. Throughout the world, the primary avenue for creating jobs and alleviating poverty has been entrepreneurship and small business growth.

Why the Rule of Law is Important for Economic Development

While the Washington Consensus of reforms that swept the hemisphere in the 1980s and 1990s sought to address policy and fiscal disequilibria and distortions necessary to restart economic growth and control inflation, they left untouched the larger institutional framework for broad-based sustainable growth. Included in this second generation of reforms is the rule of law. Although a much more difficult and long-term task than the initial policy-related reforms of the Washington Consensus, establishing the rule of law is essential for consolidating an accessible, more fair market economy that can generate stable economic growth and prosperity.

Among other things, the rule of law:

- ensures due process and predictability;
- protects entrepreneurship and small business development by establishing clear and objective rules for opening, operating and closing a business;
- imparts stability, certainty and clear legal boundaries for property rights;
- forces greater accountability of public officials;
- maintains the balance of power between the executive, legislative, judicial, and regulatory branches of government; and
- provides a check on the power of the state over individual citizens.

While many aspects of the rule of law are important for generating broad-based economic growth, certain areas—namely the administration of justice, the regulatory framework for business and investment, the use and enforcement of contracts and the protection of property rights and intellectual property rights—emerge as the

most fundamental challenges to be addressed if countries are to promote and facilitate small business development and attract direct domestic and foreign investment.

In a global economy, Latin America must increasingly compete with Asian countries for foreign investment. It is here that significant strides in the rule of law can bring huge benefits to the region. While Latin American countries may lack the market size of China or India—and therefore might offer fewer investment opportunities and possibly lower returns—improving the rule of law relative to other countries will substantially lower the risk for potential investors. This gives Latin American countries a comparative advantage in the global market that can help offset other limitations in the quest to attract high-end, technology investments.

The Rule of Law in the Americas

In the last twenty-five years there has been growing attention and activity regarding the rule of law throughout the Western Hemisphere. And while this activity has brought notable advances, reforming centuries of legal and institutional legacies has proven difficult.

The wave of reforms started with the political and economic transitions that the region experienced during the 1980s and 1990s. By the early 1990s, constitutionally based, democratically elected governments were established in every country in the region, except Cuba. For citizens and the newly elected governments, reform of the judiciary was seen as a particularly important priority to overcome impunity for past human rights abuses, better defend human rights and access to justice, limit government power, and improve the environment for economic growth. In the years that followed, a number of reforms and innovations were realized. These included the modernization of penal codes, the transition from inquisitorial to accusatorial trials, the construction of new institutions to house public prosecutors and defenders, and the creation of modern training facilities for judges and judicial personnel.

In the wake of this interest and change, new civil society and professional organizations dedicated to the rule of law sprang up, forming a new network of technical support and advocacy for reform. Groups such as the *Corporación Excelencia en la Justicia* in Colombia and the *Comisión Andina de Juristas* in Peru emerged and strengthened the popular demand and input for reforms. Regionally, a number of organizations and offices in multilateral organizations, such as the *Centro de Estudios de Justicia de las Américas* (CEJA), the Due Process of Law Foundation and the Organization of American States Unit for the Promotion of Democracy, improved the ability of in-country groups to network and share expertise.

Parallel to this, international and regional agreements and conventions have also fostered reforms in the region. A number of conventions, many of them mentioned in the following pages of the working report, have proposed regional standards for the enforcement of contracts, alternative methods of dispute resolution and human rights. In the area of human rights law, the region has made significant advances. Building off the Inter-American Convention of Human Rights, the Inter-American Commission on Human Rights and the Inter-American Court of Human Rights in Costa Rica have developed into a strong and effective avenue for the hearing and defense of human rights cases. The evolution of the Inter-American human rights system has created a body of precedent and has advanced human rights law in new and important ways.

The movement towards free trade, in the region and globally, also played a very powerful direct and indirect role in drawing attention to and improving the rule of law hemisphere-wide. The new crop of international trade agreements from the last decade has often included language requiring trade parties to uphold certain regulatory standards and principles of justice as conditions for membership. For example, the Central American-Dominican Republic-United States Free Trade Agreement (CAFTA-DR) requires participating countries to implement important domestic economic and legal reforms that foster competitive business development and investment, safeguard intellectual property rights, and promote transparency and the rule of law. The North American Free Trade

Agreement (NAFTA) and the Southern Common Market (MERCOSUR) contain similar requirements, including the promotion of alternative methods of dispute resolution and the enforcement of arbitration agreements and awards. The series of reforms required for participation in most free-trade agreements is a significant, and often overlooked, ancillary benefit of such agreements.

Globalization of the economy is another powerful, though indirect, force for the rule of law reform in the hemisphere. The need to compete with other nations for direct investment has compelled many Latin American countries to adopt critical reforms that range from increased transparency and predictability of judicial institutions to stronger enforcement of private contracts. Steadfast observance of the rule of law demonstrates a commitment to modernization and a readiness to compete in the global market.

All of these factors—democratization, the rise of reform groups, the proliferation of free trade and other international agreements, and economic globalization—have led to significant legal reform in the region. However, there is still much work to be done.

Recent Loss of Momentum

Despite the progress achieved in recent years, the lack of access to justice, judicial inefficiency and inconsistency in the application of the law remains an endemic, entrenched problem. Reforming the institutions and processes that contribute to these conditions is a task of years if not decades. Frustration over the lack of progress has generated concern that momentum for the rule of law may be waning. For many citizens, the two decades of attention to judicial reform have brought few tangible benefits; access to justice remains distant, government continues to intervene in minor and great ways in the judiciary, and well-documented cases of corruption against the powerful have gone untried. Within a number of countries, popular demands over more immediate concerns such as poverty and economic inequality have pushed the longer-term issue of institutional reform and justice lower on the political agenda.

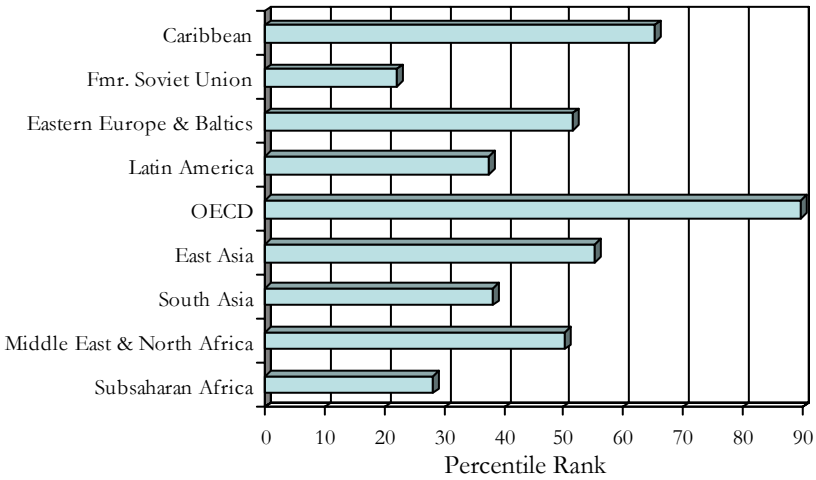
Internationally, some observers have also raised doubts about the efficacy of international efforts to promote the rule of law in Latin America.⁴

The fragility of gains in the judicial system was first evident in 1992 when Peruvian President Fujimori asserted executive control over judicial appointments and removals, violating the principle of separation of powers. More recently, a number of human rights groups have expressed concern over executive actions in Venezuela regarding the appointment of justices and expansion of the Supreme Court. In Venezuela and Bolivia, the desire for a sweeping reform of judicial systems seen as corrupt and as vestiges of the past needs to be balanced with an effort to avoid the perceived politicization of the institutions that could corrode broad respect for the law. In Guatemala, despite a near decade of sweeping changes detailed in the peace accords, the judicial system remains distant and slow, leading increasingly to extra-judicial killings by citizens to punish suspected criminals. And throughout the region, large portions of the population still lack access to judicial institutions.

According to international indices of the rule of law—themselves an outgrowth of the attention to the rule of law over the last two decades—Latin America remains behind the OECD, Eastern European, East Asian, and Middle Eastern countries.

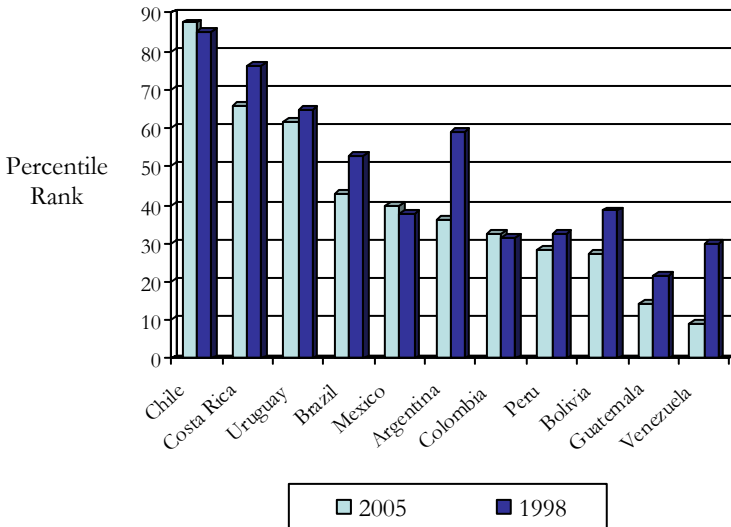
⁴ Thomas Carothers, ed., *Promoting the Rule of Law Abroad* (Washington, DC: Carnegie Endowment for International Peace, 2006), 11-12.

Rule of Law in the World (2005)



Within the region, progress towards greater rule of law varies between countries and from year to year in a given country.

Rule of Law in Latin America (2005, 1998)



Key: Percentile rank refers to the percentage of countries worldwide that rate below the selected country or region—higher values indicate better rule of law ratings. **Source (both graphs):** The World Bank, “Governance Matters V: Governance Indicators for 1996–2005,” The World Bank.

These examples reveal the difficulties in bringing broad change to such a complex institutional issue. True and lasting reform is not possible without the will of a country's own people and leaders, which comes from the recognition that security, growth and prosperity require adherence to the rule of law. It is this internal incentive—the desire to attain economic well-being and personal security for a country's own people—that will ultimately drive reform.

We believe that the international and business community can play a powerful role in engaging and helping strengthen the rule of law in the hemisphere. The rule of law is a broad public good that benefits individuals with common, everyday civil or family disputes as it benefits investors, large or small, in the commercial realm.

In the United States, in the 19th century, small and medium-size enterprises were instrumental in forging common interest with reformist politicians to secure broad judicial and legal reforms for the entire population. Progressive and civic-minded business can serve a similar function in the hemisphere today. Delivering the tangible benefits of the rule of law—personal security, access to a fair judicial system, speedy justice, protection of basic property, and economic prosperity—to citizens is a shared goal for all those who care about and work in the Americas.

This working report is divided into four chapters, each dealing with a specific issue within the rule of law. In each chapter, the working group provides a series of principles and examples related to effective implementation of the topic. The first chapter looks at the overall administration of justice and its various components, including the appointment and promotion processes for judges and judicial officials, the training and recruitment of judicial personnel, court efficiency, judicial resources and infrastructure, and transparency. In the second chapter, we analyze the regulatory framework for business and investment, with a specific focus on regulations governing the incorporation and operation of businesses, laws affecting regulated industries, and regulations affecting investment. The third chapter discusses contracts and their enforcement, alternative dispute

resolution and bankruptcy. In the last chapter, we look at property rights and the growing field of intellectual property rights.

ADMINISTRATION OF JUSTICE AND TRANSPARENCY

The administration of justice encompasses the organization and operation of the judiciary and the justice system. It includes: the appointment and promotion processes for judges; the division of powers as established in the constitution and in laws that determine the roles and functions of judges, prosecutors, councils of magistrates and other oversight committees (if they exist); the procedures for governing how cases are accepted, heard and decided upon; the rules for distributing cases to courts and for appeals; access to justice and the legal system for citizens and interested parties; and the budget allocation process for the bureaucracies related to justice. In short, it is everything that has to do with how the justice system actually functions as a branch of government and a bureaucracy. For the judiciary to work, it must work for all segments of the population regardless of socio-economic status or relative economic or political power.

How Is the Administration of Justice Related to the Rule of Law?

The administration of justice is at the core of the rule of law. If judicial institutions are ineffective, politicized, corrupt, or arbitrary the substance of the law makes little difference. Laws and processes for filling and staffing the courts and court procedures establish the framework for the fundamental independence of the justice system. Moreover, the fairness and efficiency of the institutions that constitute the justice system (courts, regulatory agencies,

According to the World Bank, the bulk of private investment in developing countries is domestic investment. Reforms to the rule of law that benefit private investors will provide the greatest benefits to domestic investors.

Source: The World Bank, "World Development Report 2005: A Better Investment Climate for Everyone," The World Bank,

<http://go.worldbank.org/WVDAOSZJ20>
(accessed April 30, 2006).

prosecutors, and police) depend on the manner in which the institutions are set up, the manner in which they operate, and the quality of their personnel. Without these basic criteria—an independent justice system and competent, objective and efficient courts and justice officials—the rule of law simply cannot exist.

Why Is Administration of Justice Important to Economic Growth and Prosperity?

The administration of justice plays a central role in providing the institutional and legal environment essential for economic growth and prosperity. An independent, efficient and accessible court system provides the essential guarantees that contracts will be enforced, conflicts will be resolved through a fair and predictable process, property will be protected as provided for under the law, and judicial decisions will be delivered quickly.

While the rule of law is for citizens and all levels of investment, the lack of predictability generated by the absence of the rule of law often has a greater relative impact on small businesses, the informal sector and start-ups. Informal sector entrepreneurs (i.e.,

individuals who work outside a country's regulated business environment in what is known as the "informal economy") and small businesses such as street vendors, store owners or small-time suppliers often lack the economic resources and political access of large ventures or international investors. As a result, they suffer disproportionately from inaccessible and inconsistent legal systems. Many of these individuals or firms face

Confidence in judicial interpretation of regulations and laws is weakest among informal social entrepreneurs. In ten countries surveyed, only 40 percent of informal social entrepreneurs believed that regulations would be interpreted consistently by officials, while 60 percent of large companies believed the same.

Source: The World Bank, "World Development Report 2005: A Better Investment Climate for Everyone," The World Bank,

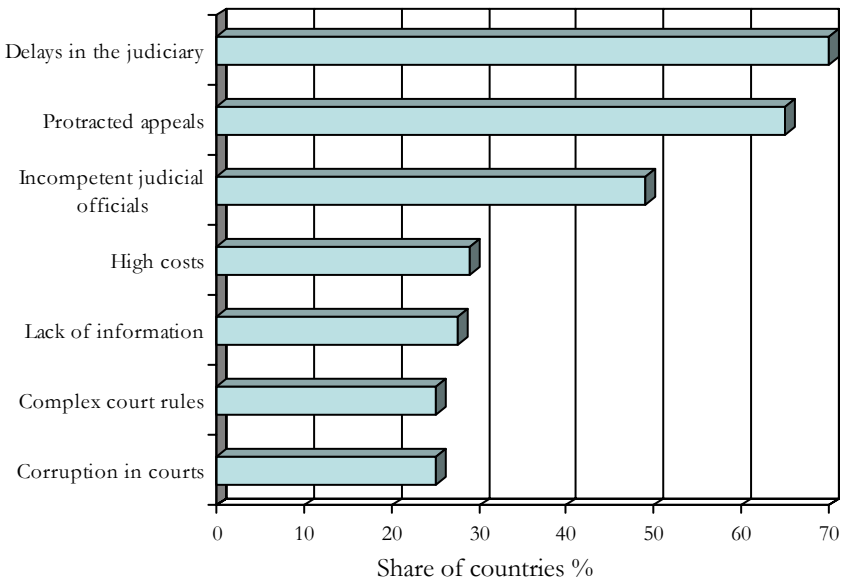
<http://go.worldbank.org/WVDAOSZJ20>
(accessed April 30, 2006).

issues of insecure property rights, delays in the resolution of court cases, unpredictability in the interpretation of laws, and limited access to judicial services. An environment in which the administration of justice is independent, fair, efficient, accessible, and transparent is more predictable and eases the constraints for expansion of these enterprises.

In sum, an effective system for the administration of justice, beyond the quality and content of individual laws, reduces risks for investors and opens the door for new entrepreneurs.

Recent research bears this out. In a global survey of entrepreneurs, the World Bank found that delays in the judiciary (70 percent), protracted appeals processes (65 percent), and incompetent judicial officials (just under 50 percent)—all aspects of the administration of justice—are the biggest obstacles to enforcing a contract.⁵

What is the Biggest Obstacle to Enforcing a Contract?



⁵ The World Bank, “World Development Report 2005: A Better Investment Climate for Everyone,” <http://go.worldbank.org/WVDAOSZJ20> (accessed April 30, 2006).

Studies in Argentina and Brazil that compare court efficiency across provincial courts have concluded that there is greater access to credit for entrepreneurs and established firms in states with better performing courts. Without credit, both established and aspiring businesses cannot enter or expand in the market. Similarly, research in Mexico has shown that “larger more efficient firms are found in states with better court systems,” leading to the conclusion that better courts “increase the firms’ willingness to invest more.”⁶

Effective court systems in Mexican states are correlated with more rapid growth of small firms.⁷

Conversely, too few justice officials and the absence of judicial offices in rural and peri-urban areas in the region have severely

Over 60 percent of the poor in developing countries list self-employment or starting their own business as the best path out of poverty.

Source: The World Bank, “World Development Report 2005: A Better Investment Climate for Everyone,” The World Bank, <http://go.worldbank.org/WVDAOSZJ20> (accessed April 30, 2006).

constrained the access to justice for informal and small businessmen and women.

These factors have contributed to declining public confidence in the judicial system throughout the hemisphere. According to the 2006 *Latinobarómetro* public opinion surveys conducted in 18 countries throughout the region, only 36 percent of citizens expressed “some” or “a lot” of trust in their judicial system.⁸

⁶ Kenneth Dam, “The Judiciary and Economic Development,” John M. Olin Law & Economics Working Paper No. 287 (2d Series), The Law School, University of Chicago March 2006, 2.

⁷ Roumeen Islam, “Institutional Reform and the Judiciary: Which Way Forward,” World Bank Policy Research Working Paper 3134 (September 2003, 7-8).

⁸ Latinobarómetro, “Latinobarómetro Report 2006,” December 2006, Latinobarómetro, http://www.latinobarometro.org/uploads/media/2006_02.pdf (accessed April 30, 2006).

Basic Principles

To achieve an independent and effective system for the administration of justice requires a basic framework of:

- independent, transparent means for judicial appointment, promotion and tenure;
- professional, competent judicial employees and public servants;
- efficiency of the court and judicial system in accepting and processing cases;
- physical accessibility of the courts; and
- transparency with regard to how cases are allocated and decisions are made.

Each of these criteria is discussed in detail in the sections below. In each section, the chapter first relates the criteria to the larger topic of the rule of law, and then outlines a series of normative principles for applying these criteria to further the rule of law. The section concludes with examples of practices and laws from around the world.

Appointment, Promotion, Tenure of Judges, Judicial Officials and Prosecutors

Equality for all before the law rests on an independent, professional judicial system that receives and decides cases without respect to economic or political status.

Securing the rule of law requires a judiciary that is, and is perceived to be, independent and impartial. Judicial integrity is preserved by allowing officers of the court to operate in an atmosphere relatively free from external pressure from other branches of government and private parties.

A transparent, non-political process for selecting, maintaining and promoting officials in the justice system is critical for finding well-trained legal professionals who are capable of defending and adjudicating claims based on the law. The rules regarding selection and promotion of judicial officials should encourage stability of tenure and freedom from external influence. These rules encompass systems for the appointment, tenure, promotion, and sanctioning of judicial officials.

Principles

a. Basis in the Law⁹

- Persons selected for judicial office should be individuals of integrity and ability with appropriate training or qualifications in the law. Any method of judicial selection should safeguard against judicial appointments for improper motives.

⁹ See United Nations, Office of the High Commissioner for Human Rights, “Basic Principles on the Independence of the Judiciary,” GA Resolution 40/32 (November 29, 1985), American Convention on Human Rights, International Covenant on Civil and Political Rights, United Nations, http://www.unhchr.ch/html/menu3/b/h_comp50.htm (accessed April 30, 2006).

- The system of appointment should be transparent and permit public review.
- Judicial terms should be set to minimize the potential for political or economic influence over judges due to shorter mandates. Judges, whether appointed or elected, should have guaranteed tenure until a mandatory retirement age or the conclusion of their term of office, where such exists.
- Judges by law should be subject to suspension or removal only for reasons of incapacity or behavior that renders them unfit to discharge their duties.

b. How Applied

- Appointment of judicial officials should permit the appointment of an adequate number of officials and not discourage recruitment of qualified individuals.¹⁰
- Socio-economic, racial, ethnic, religious, and gender diversity among judicial officials should be encouraged in order to achieve a variety of backgrounds and viewpoints, and to foster the perception that the judicial branch is representative of all segments of society.
- Promotion of judges should be based on objective factors, in particular, ability, integrity and experience.
- Rules for the appointment and promotion of judges should be strictly enforced. The use of provisional measures, even in limited circumstances, is extremely corrosive to maintaining judicial independence.
- Independent judicial disciplinary councils, or whatever body is responsible for discipline and judicial ethics, should be charged with the authority to investigate allegations of impropriety and if necessary independently sanction judges and officials.

¹⁰ See The Hon Justice Michael Kirby, "Independence of the Judiciary - Basic Principles, New Challenges," International Bar Association, Human Rights Institute, Hong Kong, 12 - 14 June 1998, http://www.lawfoundation.net.au/resources/kirby/papers/19980612_abahk.html (accessed April 30, 2006).

- Due process is essential prior to removing any officer of the court from office and all cases should be resolved expeditiously.
- All disciplinary, suspension or removal proceedings should be determined in accordance with established standards of judicial conduct.
- Judges should be held to the internal and disciplinary codes of their profession, but should be granted personal immunity from civil suits for monetary damages in accordance with national law for improper acts or omissions in the exercise of their judicial functions.

EXAMPLES

Judicial Appointment

Methods and requirements for the appointment of federal judges and prosecutors in Latin America vary. Generally, Mexico's federal nomination and appointment process is typical of the region. (See box on next page.) Argentina, Colombia, Panama, and Brazil, among others, vest the president with the authority to nominate appointees which congress then votes on.

Like Mexico, many countries have established special commissions that review credentials and nominate qualified lawyers to federal benches. The composition of these commissions varies according to the laws in each country, but they often include representatives from the judiciary and the bar, notable citizens and the executive. The commissions' mandates also vary. In some countries, such as Bolivia, Dominican Republic, El Salvador, Guatemala, and Paraguay, the commissions are charged with nominating justices who are then approved by the legislature. In Chile, the Supreme Court provides a list of nominees, the executive branch selects from those nominees, and the Senate must approve the selections. In Uruguay, the judicial school makes nominations to the Supreme Court. (For more on judicial schools, see page 32.)

Judicial commissions play an equally important role with respect to lower court appointments. Such commissions nominate lower court, federal judges in Argentina, and lower court justices in Bolivia, Costa Rica, Dominican Republic, and Paraguay. Typically, lower court nominees are then approved by the Supreme Court, except in Argentina where they are approved by the President. In Chile, the judicial academy recruits and recommends candidates who are then approved by the Ministry of Justice.

While most Latin American countries have structurally sound appointment procedures, the implementation of these procedures in certain countries has been subverted by provisional measures or corruption of the systems in place. For example, in 1992, former Peruvian President Fujimori effectively dismantled the *Consejo de la Magistratura*, rejecting its nominations, bypassing it for appointments, and instead appointing provisional justices throughout the court system.

Recent events in Venezuela have significantly weakened judicial institutions in that country, raising concerns among international human rights groups such as Human Rights Watch. Specifically, in 2004, under President Hugo Chávez, a law was passed that enlarged Venezuela's Supreme Court from twenty to thirty-two members. In a push to renew the judiciary, the Venezuelan

Appointments to the federal judiciary in Mexico are made by the President of the Republic, in the case of Supreme Court Justices, and by the Federal Judiciary Council in the case of lower court judges. Appointments to the Supreme Court also require the two-thirds consent of the Senate. The Federal Judiciary Council, with the supervision of the Supreme Court, appoints lower court judges, and determines the number and divisions of circuits, as well as the territorial competence of the District Courts and Courts of Appeal. The Federal Judiciary Council is composed of three members appointed by the Supreme Court from the Circuit Magistrates and District Court Judges, two members appointed by the Senate and one member appointed by the President.

government has taken steps to fill judicial posts with tenured officials. The only exception to this, as noted in the Inter-American Commission Human Rights annual report, was in the First and Second Courts for Contentious Administrative Matters.¹¹

The effect of subverting constitutional and legal procedures designed to ensure the independence of judicial officials is unarguably negative. Temporary judges who serve at the will of the executive provide enormous opportunities for political officials and other interested parties to exert influence over the judicial process. Moreover, the existence of provisional justices also adds an element of uncertainty to the decision-making process by opening up the possibility that a judge who renders a decision one week may simply not be employed shortly thereafter and a new one could overturn it.

Tenure

There are a variety of systems for judicial tenure throughout the world. Despite the variation, many of them, when upheld in practice, provide the basic job security essential to ensuring the independence of the judicial system. The essential dilemma is this: how to insulate judges sufficiently from political and economic pressures while still ensuring that they remain accountable and competent. In this sense, lifetime tenure brings some risks. Here is how countries in Latin America and throughout the world have addressed it.

- In Germany, there is a three-year probationary period for new judges. After the three-year period, judges can apply for lifetime tenure.
- In Argentina and Brazil, federal judges have life terms. A two-year probationary period exists for first-level federal judges in Brazil, after which they can be appointed for life. For the federal court system, there is a judicial career track with its own civil service. In both Argentina and Brazil,

¹¹ Annual Report of the Inter-American Commission on Human Rights 2006 (Washington, DC: Organization of American States, March 2007), <http://www.cidh.org/annualrep/2006eng/Chap.4e.htm> (accessed June 14, 2007).

federal judges can be removed by law on the basis of reputation and behavior.

- In Colombia tenure for all judges and magistrates is eight years with no reappointment. Prosecutors are appointed for four years likewise with no reappointment.

Judicial Accountability

Judicial accountability is a double-edged sword. While it is essential to ensuring a judicial system that meets objective standards of fairness, professionalism and ethical behavior, if applied improperly it can also be used as a tool for political influence to punish non-compliant judges. The central theme to consider is where the commission charged with oversight and monitoring is housed and how it is staffed. Judicial evaluations may be carried

A number of different examples of oversight committees exist in countries outside Latin America.

In Germany, a Court of Public Service, composed of sitting judges, is charged with oversight of member judges. In Belgium, the Supreme Court is responsible for sanctioning justices. Canada has a Judicial Council for monitoring federal judges. England, however, has no commission charged with overseeing magistrates.

out by the supreme court, another body charged by the court or a judicial council. Discipline and sanctioning of judges is often separate from evaluation of job performance. If organized and managed independently, these two functions—evaluation and discipline—can be effective means for ensuring greater judicial independence and professionalism. If these functions are politicized, however, they can become a tool for the improper use of influence and weakening of the rule of law.

In Latin America, judicial disciplinary systems exist but are often ignored.

- In Peru, the National Council of the Magistracy is charged with disciplinary duties. But, like other offices of its kind in the region, it has been a victim of executive intervention. In

1998, under President Alberto Fujimori, a series of actions limited the Council's authority to appoint and promote judges, causing its seven members to resign and temporarily disband the Council. The Council was later restored after Fujimori's resignation.

- In Mexico, the Federal Council of the Judiciary carries out disciplinary control of the judiciary, except with respect to the Federal Supreme Court and the Electoral Tribunals. In recent years, the Mexican judiciary has sought to strengthen the office, with notable success. A report in 2002 noted that the Council had strengthened administrative control and had investigated 2,155 complaints against judicial personnel, 287 of which resulted in sanctions.¹² In its recent "33 Propositions for Reforming the Judiciary in Mexico," the Federal Supreme Court emphasized the importance of mechanisms for the appointment, removal and confirmation of justices that guarantee the autonomy of justices in Federal and State supreme judicial courts and judicial councils.¹³
- In Brazil, the International Commission of Jurists has acknowledged the weakness in the federal judicial system's mechanisms for discipline and internal control. In a report in 2002, it concluded that the "disciplinary and sanctioning procedures instituted to deal with judges and prosecutors accused of misconduct while in discharge of their functions, or for ordinary crimes are lax and inadequate."¹⁴
- In Chile, the legislature has the power to bring "constitutional accusations" or impeachment proceedings against members of the Supreme Court for serious dereliction of duties. Five

¹² International Commission of Jurists, "Attacks on Justice 2002 – Mexico," International Commission of Jurists, August 27, 2002, http://www.icj.org/news.php3?id_article=2688&lang=en (accessed May 30, 2006).

¹³ "33 Propositions for Reforming the Judiciary in Mexico," Poder Judicial de la Federación, Suprema Corte de Justicia de la Nación, 27.

¹⁴ International Commission of Jurists, "Attacks on Justice 2002 – Brazil," International Commission of Jurists, August 26, 2002, http://www.icj.org/news.php3?id_article=2652&lang=en (accessed May 30, 2006).

impeachment proceedings have been held since 1989, with one of them removing a sitting justice.¹⁵

¹⁵ Margaret Popkin, “Efforts to Enhance Judicial Independence in Latin America: A Comparative Perspective,” Due Process of Law Foundation Working Paper (November 2001), 21.

Professional, Competent Officials

Small business owners often do not have the human or financial resources to navigate the judicial system. Their economic prosperity and well-being hinges upon an assurance that judges deciding their fate are fair and knowledgeable.

While not sufficient in and of itself, a professional, competent corps of public officials that staff the judiciary and related offices (justices, prosecutors, clerks¹⁶) is a necessary condition for an independent, effective and consistent judicial system. Professional, well-trained and well-remunerated judicial officials provide a greater probability that the justice system will be respected by those who work within it, reduce the potential for political influence in the judicial process, help ensure that cases will be tried and decided with regard for objectivity and regard for the technicalities of the law, and reduce the possibility that officials can be bribed. In this sense, the perceived and real prestige of the judicial system serves to promote greater professionalism and isolation from political and economic corruption.

A series of conditions must exist to ensure that judiciaries are able to attract and retain highly qualified, competent and respected professionals. The topic relates not just to the level of education or training of the personnel or their methods of appointment (discussed above) but also to the salaries paid to personnel that can attract quality professionals. As with every one of the issues confronting judicial integrity and efficiency, however, pay increases, while necessary, are not sufficient.

¹⁶ Although the principles discussed in this chapter apply to all court personnel, the chapter focuses on judicial professionals, specifically judges, rather than clerks and other administrative court employees.

Principles

- Apart from the formal appointment process (described above) minimum professional standards for judicial personnel, including but not limited to judges, should be set to ensure that appointees and functionaries have basic knowledge and technical skills in the law and—if necessary—in judicial management and administration.
- Salaries that guarantee a sufficiently high standard of living will attract and maintain respectable, qualified judges, court personnel and public litigators.
- Salaries that guarantee a sufficiently high standard of living will also discourage corruption for economic survival.
- Quality, modern university and graduate education in law and related judicial fields is essential in training professionals who will fill positions in all functions of the judicial system and thus establish the professional standard in country.
- Continuing legal education and training keeps justice officials current on technical aspects of the law, new legislation and emerging issues in law.
- Promotion of judicial personnel based on participation in training programs rewards professionalism and continuing education.

EXAMPLES

Standards

The standards for aspirants to assume the bench are important not just for guaranteeing a qualified cadre of judges but also for the intangible characteristic of the prestige of the organization. If justices feel that there is an element of exclusivity and merit in a judicial track, a career in the judiciary is more likely to attract educated individuals with a commitment to the profession and the law.

In a number of countries in the hemisphere, the qualifications required to become a judge are lower than in other parts of the world—a reflection, as we discuss below, linked in part to the quality of education. In some cases, the standards for formal education for appointees are quite minimal.

- To be named to a judgeship in a municipality in Chile a candidate needs only a law degree, two years of legal experience and must be at least 25 years old.¹⁷
- In Colombia, all judicial officers need only a professional law certificate and more than two years of legal experience, although this requirement varies depending on the position.
- To become a minister of the Supreme Court or a federal lower court judge in Mexico, the candidate must be at least 35 years old and have practiced law for at least ten years. As a check on the appointment of openly partisan judges, Mexican law also requires that the nominee not have served in select executive or elected positions in the last year. The recent Federal Supreme Court's white paper calls for "a strict application of existing regulations regarding judicial careers . . . to ensure that the selection, appointment, assignment, ratification, promotion and removal of members are the judiciary are in full compliance" with regulations.¹⁸
- At a state level in Mexico, the government in Chihuahua has taken great strides to dramatically overhaul the state judicial system. This has included deep and far-reaching institutional reform to improve efficiency as well as programs to improve the processes for recruitment, selection, training, and promotion of judges. One of the most sweeping reform initiatives in Mexico, the efforts in Chihuahua may well spark, by example, similar programs in other states and the federal system.
- Argentina's law establishes that Supreme Court justices must be lawyers with at least eight years of professional experience. It also sets a minimum annual income for appointees to

¹⁷ Chile, *Ley Orgánica*, Art. 252.

¹⁸ "33 Propositions for Reforming the Judiciary in Mexico," 29.

reduce the possibility of corruption of judges once on the bench.

A recent innovation in several countries has been the establishment of an examination for lower level justices to be overseen by the local magistrates' council or a similar body.

- In Peru, new judges who wish to be appointed must pass a public exam administered by the state (*concurso público*).
- Judges in Brazil must also pass a public examination to be admitted to the federal court system. Nevertheless, concerns have been raised about the requirements to take the exam. Federal judges who have passed the exam often enter the judiciary with little practical legal experience.
- In Argentina, aspiring federal judges must pass a written and oral exam that is graded by a jury of peers and evaluated by the federal council of magistrates.

Education

The issue of the quality of education and technical capacity of judicial officials starts with the law schools and extends to the opportunities for continuing legal education and training for judges and judicial officials once in the system. One of the basic areas of concern is the level of general education that law students receive in Latin American universities. Also of concern are the bar associations which have often underperformed as organizations to promote professional and ethical standards of members after law school.

According to a World Bank report, with the exception of Argentina, many countries in the region do not have consistent graduation standards for law students.¹⁹ Current law curricula offer little on niche or current issues in the law such as intellectual property rights, law and economics, securities transactions, finance, and accounting.

¹⁹ Maria Dakolias, "The Judicial Sector in Latin America and the Caribbean," World Bank Technical Paper Number 319 (June 1996), 55.

With the exception of Chilean universities, most do not have a practical requirement.

Studies have also demonstrated that poor salaries and low prestige has meant that a judicial career often fails to attract the best, most qualified graduates. According to judicial surveys conducted between 1985 and 1993 in Mexico, on average 93 percent of Mexico's federal judges and magistrates graduated from what are considered inferior quality law programs.²⁰

Compounding the problem, once out of law school only a handful of countries, such as Chile, have federal or state/provincial tests that lawyers must pass to practice laws. The absence of official federal or local bar exams in many Latin American countries means that there is no standard body of knowledge or skills that lawyers must possess before entering into practice. As a result, uneven law school education is not rectified by standard licensing examinations.

In Chile, to receive a license to practice law from the Supreme Court, lawyers must complete a six-month, non-paid internship with the legal aid office. There are similar efforts underway in Argentina to incorporate pro-bono practical requirements into law school programs.

Training and education continues after joining the judicial system and that training is essential in keeping judges up to date on emerging issues in the law. Judicial training institutions can be divided into two models: the judicial school and the peer group model. The former is more common under civil law systems and consists of a training institution under the ministry of justice that is charged with training all judicial officials, including prosecutors. This is the model that exists in almost all Latin American countries, including Ecuador, Argentina, Brazil, and Panama.

Concern has been voiced by a number of international agencies about the limitations of the judicial school model. One critique is that the

²⁰ Robert Kossick, "The Rule of Law and Development in Mexico," *Arizona Journal of International and Comparative Law* 21, no. 3 (2004), 742.

schools are designed for all judicial authorities and the curriculum tends to emphasize theory rather than the practical knowledge and skills required to preside over cases. Moreover, because the judicial school model is more didactic than the peer-based model, it offers fewer opportunities for interaction among judges on matters of law and legal interpretation.

One interesting model for judicial training has emerged in Chile, which set up an independent training academy that relies on a business-school curriculum and teaching method for judges. The academy also trains Court of Appeals judges in the area of court management and administration.

Salaries

Ensuring that judges and judicial officials receive adequate remuneration that is protected by law is an essential ingredient to attracting qualified jurists, building morale, preventing corruption of justice, and creating a sense of professionalism. But unfortunately, salaries for Latin American judges and judicial officials are often insufficient.

According to a World Bank report, throughout Latin America salaries of judicial officials are often much lower than average salaries for positions that require an equivalent level of education in the private sector and even in the public sector.²¹ Judges' salaries in Uruguay, Paraguay and Bolivia are roughly comparable to other public sector salaries, but still far below private sector salaries. One exception to this is Chile's Chief Justice who has a higher salary than even the President of the Republic.

The independence of the judicial system's capacity to set salaries is also crucial. In this matter, efforts by the Executive Branch to impose salary cuts on judges can seriously undermine the quality and independence of justice in a country. Efforts to unilaterally cut salaries may have a great populist appeal, but the inability to attract

²¹ Dakolias, "The Judicial Sector in Latin America and the Caribbean," 14-15.

and maintain skilled justice sector officials does long-term harm to the rule of law.

Efficiency

Slow justice is no justice

The rule of law depends on the speedy resolution of cases and pending conflicts across the justice system. Delays in the processing of cases serve as a serious drag on the ability of the state to administer justice. Even judicial systems with well-qualified personnel and fairly appointed judges will not be credible if they are inefficient. When cases are delayed, litigants are left in limbo. In economic terms the slow pace of justice, caused by judges deferring decisions or postponing the resolution of conflicts, can freeze up resources, prevent growth and serve as a disincentive for continued investment.

But delays in the judicial system also create opportunities for corruption. Litigants may be tempted to “buy” a speedier resolution to a case, undermining the integrity of both the decision at hand and the court system in general.

Principles

a. Basis in the Law

- Judicial decisions by courts should only be subject to revision by a higher court.
- Judicial administration should provide for speedy, clear resolution of cases.
- Administration procedures should be streamlined to permit an efficient use of judges’ time to be dedicated to adjudication.
- Weak limits or standards on conditions allowing for appeal can overload the court system and delay justice.
- Procedural codes for courts and relevant government ministries should provide a framework for the processing of cases and should set forth clear and enforceable mechanisms

with time limitations for the hearing and disposition of cases and for eligibility for appeal.

b. How Applied

- When they exist, procedural codes that set time limits and standards for the hearing and appeal of cases should be applied to ensure that cases are adjudicated quickly and fairly.

EXAMPLES

Throughout the region, judicial backlog remains a serious problem. For a case to take up to ten years to be adjudicated is not uncommon. The reasons for the backlogs are multiple and stem from the administrative burdens placed on judges, heightened litigation due to constitutional and legal guarantees of rights, weak standards for or limits on appeals, the inefficient allocation of cases and resources within the justice system, and the fact that for many governments and parties with economic interests there is little incentive to expedite judicial decisions. In the case of parties with economic interests, in many instances faster resolution of cases simply hastens their liabilities. Such a situation presents a collective action problem; those who would benefit most from a more efficient justice system are often those who are least organized or powerful.

Administrative Overload

In many countries in the region, judges do more than hear and decide cases: they also administrate. According to a World Bank survey conducted in the late 1990s, tasks such as managing lower courts, procuring materials for the courts, and allocating and overseeing budgets can take up to the majority of a judge's time. Often the judges and judicial personnel are not prepared to handle these basic issues of public administration. As a result, in Brazil, such duties can take 65 percent of the time of federal judges, in Peru up to 69 percent,²² and in Argentina up to 70 percent.²³

²² Edgardo Buscaglia, Maria Dakolias and William Ratliff, "Judicial Reform in Latin America" (Stanford: Hoover Institute, 1995)

Case Volume

Another drag on court efficiency are laws and procedures that permit a high volume of class action lawsuits and laws and norms that fail to establish clear guidelines and limits for appeals. Although these two issues represent distinct phenomena, they both contribute to court overload.

On one hand, while the right and capacity for filing class action suits can help to bundle a group of individual cases more efficiently than forcing the court to adjudicate each one individually, a low bar for the admission of such cases can flood the courts. For example, constitutional changes in Brazil that permitted citizens to file

One measure of case backlog is a court system's "clearance rate," defined as the ratio between the number of cases resolved in a given year and the number of cases filed in that year. According to countries' own judicial statistics, only a handful of countries' courts manage to dispose of cases at approximately the same rate at which they are filed. In 2003, the Argentine federal courts had a clearance rate of 91 percent; in Bolivia the rate was 64 percent, in Chile 79 percent, in Colombia 102 percent, in Costa Rica 97 percent, in Ecuador 16 percent, in El Salvador 113 percent, in Mexico 99 percent, in Nicaragua 19 percent and in Peru 79 percent.

Source: Justice Studies Center of the Americas, "Report on the Judicial Systems in the Americas 2004-2005," Justice Studies Center of the Americas, <http://www.cejamericas.org> (accessed April 30, 2006).

class action suits against the state for failing to uphold the extensive social and economic guarantees enumerated in the constitution resulted in a deluge of these types of claims, overwhelming even to the Supreme Court. According to one scholar, "unfettered access for everyone had produced, not surprisingly, access for no one."²⁴

On the other hand, while the appeals process permits higher court review of decisions, and thus facilitates uniformity in the

²³ Dam, 12.

²⁴ William Prillaman, *The Judiciary and Democratic Delay in Latin America: Declining Confidence in the Rule of Law* (Westport: Praeger Press, 2000), 6.

interpretation and application of the law, weak standards governing appeals have, in many Latin American countries, led to relentless appeals up the court hierarchy. This practice has prolonged the final resolution of cases and has burdened already over-taxed judicial systems. Although lenient appeals rules have the greatest impact on first level appellate courts, in some countries they have also affected the supreme court. For example, whereas the U.S. Supreme Court accepts about 200 cases a year, the Brazilian Supreme Court hears more than 100,000 cases a year.²⁵

Even where they exist, deadlines for judicial decisions and limitations on appeals are rarely enforced. According to a study by the World Bank, in 1996, 100 percent of cases sampled in Venezuela failed to meet required deadlines; in Argentina, time limits in the federal system were rarely imposed; and in Bolivia, sanctions against judges who failed to make deadlines were rarely applied. The Bolivian procedural process for first instance cases was supposed to take 42 days, but in the year of the study it took 519 days.²⁶

According to a survey of judges cited by the World Bank, 73 percent of federal judges in Brazil said that the high volume of appeals is the leading cause of delay in the judicial system.

Source: Maria Dakolias, "The Judicial Sector in Latin America and the Caribbean: Elements of Reform," World Bank Technical Paper (June 1999), 34.

Further adding to the problem of judicial delay is the uniquely Latin American judicial mechanism called the *amparo*.²⁷ This procedure, which allows a higher court to halt an unfair or legally questionable practice or ruling by a lower or state court, is beneficial because it promotes uniformity in civil court systems that lack a strong basis in precedent. However, the benefits of *amparos* come at a cost: severe delays in the judicial process. If the procedure or ruling in question is not resolved expeditiously and with finality, *amparos* can leave cases in legal limbo indefinitely.

²⁵ Dam, 15.

²⁶ Dakolias, "The Judicial Sector in Latin America," 35.

²⁷ An *amparo* is a motion that allows a court, a litigant, or in some cases a citizen, to enjoin the enforcement of a law, judicial proceeding or decision.

A number of countries are attempting creative solutions to address the issue of judicial delay:

- Sixteen of the nineteen Spanish speaking countries are currently undertaking or planning to implement a criminal procedure code reform that establishes an oral, accusatory trial system. These reforms have allowed for public trials that have helped to establish clear deadlines and make the system more transparent.
- In a series of constitutional and legal reforms, countries have expanded courts and their competencies with some success. Thirteen countries in the region have adopted reforms that grant the supreme court jurisdiction over constitutional matters, others have created special courts for family law disputes and others have introduced new technology to improve case management and therefore speed the processing of cases.
- In Ecuador, the government has launched a particularly successful effort in which, by streamlining procedures in six pilot courts, it reduced the time to process cases by 85 percent.
- A number of countries have also established procedures for arbitration that help remove cases from the courts, thereby alleviating congestion.
- In Brazil, the government approved constitutional amendment 45 with the goal of fostering greater judicial efficiency and public control over the administration of the federal judicial bureaucracy. To this end, the National Council of Justice, a 15-member external body, was established to develop and promote specific reforms to improve the Brazilian federal judicial system.
- In Mexico, the Federal Supreme Court of Mexico and the Mexican National Congress are proposing a reform of the *amparo* system. The reform seeks to reduce the effect of *amparos* on slowing down the resolution of cases, while consolidating the *amparo* as a mechanism for defending the constitution and protecting rights.

Resources and Infrastructure

To be able to benefit from an independent, professional justice system, aspiring entrepreneurs and small business owners need to have access to judicial offices and understand how the system

An effective and independent judiciary requires that the judicial system have a sufficient budget and resources to be able to maintain infrastructure, hire competent officials, train employees, and develop and sustain a physical presence throughout the country. An independent judiciary also requires budgetary autonomy from the executive and legislative branches.

But the matter of resources is more than just the absolute size of the budget; how the budget is allocated and spent is equally important. Ensuring effective use of financial resources depends on justice systems having adequate administrative and

Before 1939, the U.S. Department of Justice handled the federal judicial budget, personnel and audit issues. Today in the U.S. these responsibilities are handled by the Administrative Office of the U.S. Courts. The Chief Justice and the Judicial Conference appoint the director of this office. In Canada, the Ministry of Justice defends the courts' budget in the legislature.

fiscal expertise to be able to plan, allocate and administer their budgets effectively and efficiently. The allocation of resources within the judiciary is particularly important, as it touches on the need for judiciaries to have sufficient budgetary foresight and the means to ensure that poor and rural communities are served.

Not to be overlooked, the creation and maintenance of court facilities (or basic physical infrastructure) is critical to the rule of law. Basic elements such as office space, security, facilities for hearings, and file space are obvious features paramount to creating the basic conditions in which the rule of law can flourish. But in many judicial

facilities, particularly in rural and peri-urban areas, these simple features are lacking.

Principles

a. Basis in the Law

- A judicial system requires a budget adequate to support infrastructure, salaries and other costs.
- The amount of the judicial budget and its internal allocation should be determined and set independent of partisan or political interests or calculations.
- Broad access for citizens to the offices of an independent, efficient judicial system is the keystone to providing the basic security and protection essential to democracy and the rule of law.

b. How Applied

- The judicial budgets established in constitutions or laws should be respected in practice.
- Judicial systems must allocate budget resources rationally to take into account population, need, demand, fairness, and efficiency.

EXAMPLES

In recent years, the trend in the region has been to establish, either in the constitution or in statutory law, a fixed percentage of the federal budget to the federal justice system. The fixed allocations are intended to prevent political interference in the budget-setting process and to guarantee sufficient resources for the judiciary. The constitutions of Argentina, Costa Rica, El Salvador, Panama, Paraguay, Puerto Rico, and Venezuela establish that a certain percentage of the total fiscal budget shall be allocated to the Judicial Branch. The recent white paper issued by the Mexican Federal Supreme Court calls for a constitutional reform to ensure that the

“Judiciary and other agencies of justice administration receive an annual budget that is not lower, in real terms, than the budget for the preceding year” and is linked to “multi-year programs with defined objectives and transparent mechanisms of accountability.”²⁸

While the trend in the region has been for increasing resources being devoted to the judicial system, judicial budgets often do not track on a per capita basis. Below is a thumbnail comparison of the percent of budget dedicated to the judiciary and judicial budget per capita for 2004 and 2005:

	Judicial budget as % of federal budget	Federal judicial budget per capita 2004-2005 (in US dollars) ²⁹
Argentina	1.14% (2005)	26.4
Bolivia	1.01% (2004)	5.5
Brazil	.97% (2004)	27.8
Chile	5.3% (2005)	14.0
Colombia	1.04% (2004)	6.7
Peru	2.33% (2004)	6.2

While protecting the autonomy and stability of the budget from political influence is essential for an independent judiciary, simply increasing resources does not guarantee a more efficient and effective judiciary. A review comparing budget allocations and judicial efficiency in Latin America and the Caribbean found “no correlation between the overall level of resources and the time to disposition of cases.”³⁰

²⁸ “33 Propositions Reforming the Judiciary in Mexico” 29.

²⁹ Justice Studies Center of the Americas, “Report on the Judicial Systems of the Americas 2004-2005,” Justice Studies Center of the Americas, http://www.cejamericas.org/reporte/muestra_seccion.php?idioma=ingles&capitulo=ACJU-030&tiporeporte=REPORTE2&seccion=INSTPOJU (accessed April 30, 2006).

³⁰ Juan Carlos Botero, Rafael LaPorta, Florencio López-de-Silanes, Andrei Shleifer, and Alexander Volokh, “Judicial Reform,” World Bank Research Observer 18, no.1 (2003): 61-88.

If the goal is efficiency and access, the question is more how money is allocated and spent internally than the absolute budget numbers.

One such measure of efficient allocation, albeit imperfect, is the number of judges per capita. On the whole, across the region, the number of judges per capita is growing. In Chile, for example, from 2002 to 2004 the number of judges per 100,000 people increased by 7 percent; in Colombia, the number jumped by 40 percent between 2001 and 2004.

Nevertheless, the number of judges per capita, while it gives a gross indication of the access to justice for litigants and citizens and the potential obstacles to efficiency, does not reveal much about the efficiency of that allocation or the individual effectiveness of the judges. In large part this is because it tells us nothing about how well trained the judges are, their administrative or case burdens, or the distribution of judges across the country and among different jurisdictions. For example, Chile has the lowest number of judges per capita in the region but the third highest clearance rate. As a general rule, judiciaries must establish systematic means to allocate judges and resources throughout the country and in different courts (criminal, labor, commercial, etc.) based on clear objective criteria, including demand, need and population.

Number of Judges per 100,000 Inhabitants (2003)	
Costa Rica	16.9
Uruguay	14.4
Argentina	11.4
United States	11.0
Colombia	10.4
Bolivia	9.5
Brazil	7.7
Venezuela	6.8
Canada	6.6
Ecuador	6.1
Peru	6.1
Chile	5.0

Source: Justice Studies Center of the Americas, "Report on the Judicial Systems in the Americas 2004-2005," Justice Studies Center of the Americas, <http://www.cejamericas.org> (accessed April 30, 2006).

The best illustration is Brazil. Despite having the highest per capita federal judicial budget, just 31 percent of the population has access to judicial services. Here the issue is not just institutional presence of

the courts. For the poor it also includes access to legal counsel. According to a recent study, only 3,600 public defenders exist for the approximately 75 million poor. In a country with the third most lawyers in the world, the gap in public defense stems largely from the unequal allocation of justice across the court system and the public ministries charged with justice for the poor, clearly not with a lack of trained professionals.

Transparency

Citizens are more likely to use and have confidence in the judiciary if they know how it operates.

At its most basic, transparency means that the laws and their application must be public knowledge. Lack of transparency in the law can lead to arbitrary application and interpretation of laws and regulations. Those to whom the law will apply (citizens, organizations, firms) must be able to know what the law is and understand how it will be applied.

Transparency also refers to the organization and operation of the justice system as a bureaucracy. In matters pertaining to the appointment process for judges (including their qualifications and the deliberations surrounding their appointment), including the basic financial information of the judiciary (including the salaries of officials) and the means by which courts assign cases, transparency is essential for affected parties and the public to monitor judicial independence. This is also the case for judicial decisions; if the decisions, with the opinion of the judge, are made public, it allows affected parties and the public in general to understand and evaluate the basis for the decision. Such steps serve as a potential check on the arbitrary change of a decision by the executive or by another court outside the legal channels for appeal or adjudication.

The phenomenon of improper “criminalization” of civil disputes stems in large part from the lack of transparency of the justice system that allows officials to arbitrarily transfer cases from the civil courts to criminal courts. In such situations, defendants or litigants in a routine commercial dispute that would, by law, be treated as a civil case find themselves in criminal proceedings, which can sometimes result in a warrant for their arrest. According to one source, a case in Mexico in which a company had a civil case arbitrarily converted

into a criminal case resulted in the loss of over 200 million euros not being invested in the country.

While not unique to a particular legal system, criminalization of civil disputes is more common where the government has a greater role in and control over the investigation, as in civil law systems. Greater government involvement gives litigants a greater opportunity to ply corrupt officials.³¹ In these instances, transparency over judicial operations will discourage officials from bending to the demands of one litigant outside the bounds of the formal legal procedure.

With alarmingly low levels of public confidence in the judiciary, establishing and maintaining a minimum level of transparency over basic functions of the judicial system will help improve citizens' access to their judicial system and their confidence in it.

Transparency in the judicial sector cannot be taken as a catch-all approach to be implemented under all circumstances. In some judicial matters, professional secrecy is essential in protecting witnesses and preventing outside or improper influence over the assignment of a case.

Principles

a. Basis in the Law

- Laws and regulations should be public knowledge and clear in meaning.
- Basic administrative information including budgets, expenditures and salaries should, by law, be public information.
- Laws should ensure that judicial decisions and the opinions of deciding judges be public information and available on demand.

³¹ Susan Schmidt, "Evaluating an International Business Risk: Criminalization of Civil Disputes," *German American Trade* 17, no. 9 (2006): 17-19.

- The assignment of cases to judges with the court to which they belong is an internal matter of judicial administration. However, how and why those cases were assigned to courts or court systems should be public knowledge.
- Legal mechanisms should be in place to permit citizens to request copies of certain legal documents, including decisions and transcripts of proceedings.

b. How Applied

- Laws and regulations enforced by the judiciary and regulatory agencies need to be made available to the public in printed form.
- Information on court location, procedures, decisions, and information about judicial administration should be made readily available to citizens.
- The judiciary should be bound by professional secrecy with regard to its deliberations and to confidential information acquired in the course of their duties other than in public proceedings, and should not be compelled to testify on such matters.

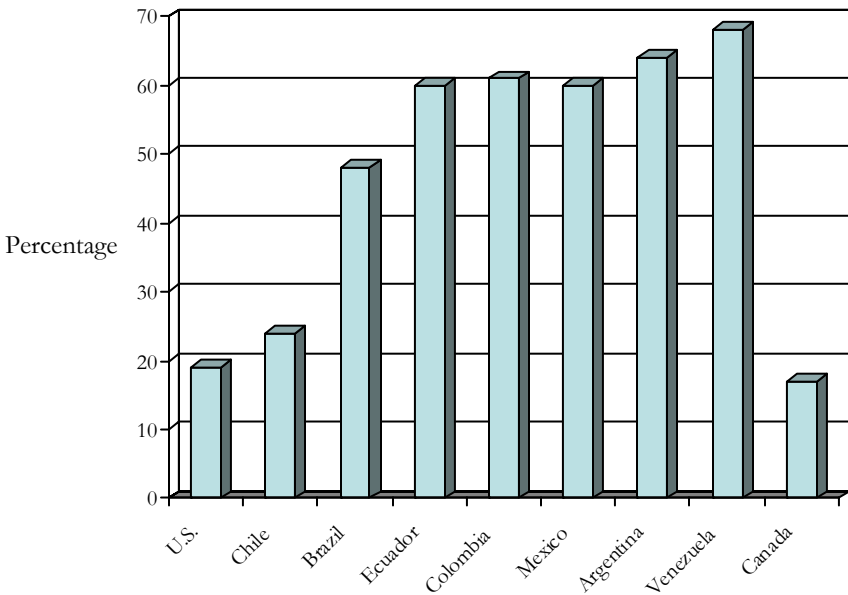
EXAMPLES

Knowledge of the Laws

An index developed by the Kurtzman Group measures the level of transparency of the law around the world. Called the Opacity Index, the scale measures the lack of clarity in the economic, normative and official structures in each country that may negatively affect investment and global commerce. Countries are compared on a scale of 0 to 100 with a lower number signifying a better overall score (greater transparency).³²

³² "The Opacity Index 2004," Kurtzman Group, <http://www.opacityindex.com> (accessed April 30, 2006).

Legal Opacity Index (2004)



- From 2001 to 2004, countries in Latin America improved their level of transparency, with the greatest improvements coming from Chile (25 percent improvement) and Brazil (23 percent improvement).
- Nevertheless, when compared to the rest of the developed world, Latin American legal and judicial systems were notably less transparent, with a fair degree of variety across the region.

Transparency of the Judicial System

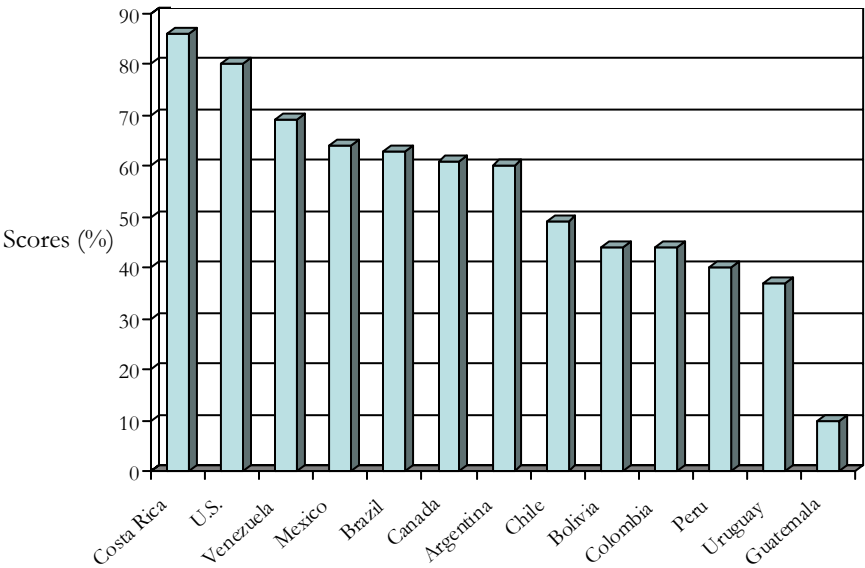
Countries throughout the region have made great strides in making basic information about their judicial system available to the public. For example, budgets and their allocation are now published. Information on the case load by court and case flow is also available in almost all countries, though less prevalent for the Caribbean

countries. However, often less clear are the standards for assigning cases and for allowing appeals.

One tool that is available to governments is the Internet. Increasingly, governments are putting online basic court information concerning cases entering the judicial system, the status of cases and the decisions. Granted, such a system is a less than perfect solution given the low levels of Internet penetration throughout the countries, but it does represent a quick and easy means of making information available to some citizens and interested groups, including lawyers and legal associations.

Even in this area, however, governments in the region have been slow to seize on this low-cost tool. According to a survey compiled by CEJA and available online, a large disparity exists between countries with respect to the availability of judicial information online. While several countries have taken great strides, a number have lagged far behind.

Index of Online Access to Information: The Courts



Source: Index of Online Access to Judicial Information, <http://www.cejamerica.org>.

REGULATORY FRAMEWORK FOR BUSINESS AND INVESTMENT

A regulatory framework brings together all the disparate pieces of the regulation process, from the development of a regulatory proposal to its promulgation and enforcement by regulatory agencies and the courts. While laws are written by the legislature, regulations come from executive branch agencies or ministries. It is this process that offers a great deal of opportunity for public discussion and input. Once in force, regulations also differ from laws in how they are applied and, consequently, the degree to which they can be challenged. Regulations written outside a specific statutory mandate can be more easily disputed by aggrieved parties. As a result, clarity of the law is essential for guaranteeing that regulations, as written, will be predictably enforced.

How is a Regulatory Framework for Business and Investment Related to the Rule of Law?

A regulatory framework is fundamental to the over-arching conditions necessary for the rule of law. Consumers, business and investment depend on a transparent, fair and predictable regulatory framework. A regulatory framework, if effectively and independently developed and enforced, limits the power of the state, protects against the arbitrary intervention of governments, ensures a level playing field for businesses, and prevents the abuse of power by economic interests, acting individually or in collusion.

Regulations are legal restrictions promulgated by a government agency that have the same binding effect as statutory law. The general purpose of a regulation is to implement a particular piece of legislation properly and to ensure compliance with the substance of the legislation.

At the same time, consumers, minority interests and others depend on regulations for their unique role in setting labor standards,

safeguarding consumer health and safety, and protecting environmental standards.

An effective regulatory process allows small businesses and other stakeholders to participate in the rule-making process ensuring greater accountability of the government and economic interests. These steps increase public understanding of the fair and consistent application of regulations and build confidence in the impartiality of a country's legal system.

Why is a Regulatory Framework for Business and Investment Important to Economic Growth and Prosperity?

A well-functioning regulatory framework can increase small business development and encourage firms to enter the formal economy. An increase in formal sector employers generates more jobs, lowering unemployment and increasing tax revenue for national programs. In a region plagued with 25 percent of its people living below the poverty line, citizens' ability to start and grow a business offers one of the best hopes for alleviating poverty and inequality.³³

In Latin America, the median country collects 4 percent less in tax revenue than would be expected given the level of development. In Argentina, that number increases to a whopping 12 percent.

Source: The World Bank, "Pro-Poor Growth in Latin America"

Excessively complex, burdensome and expensive procedures for the registration, licensing and functioning of a business will discourage entrepreneurs from entering the formal, legal economy. As Hernando de Soto has powerfully demonstrated, in Latin America the difficult barriers to entry into the formal economy have led to the

³³ The poverty line is defined here as living on less than US\$2 per day. In the Andean Community, the percentage of people living in poverty has increased 10 percent (to 34 percent) since the early 1990s. Source: Guillermo Perry, Omar Arias, J. Humberto López, William Maloney and Luis Sérvén, "Poverty Reduction and Growth: Virtuous and Vicious Circles" (Washington, DC: The World Bank, 2006), 23.

proliferation of economic activities on the margins, in what is known as the informal economy. The burden of a highly regulated environment is felt most acutely by small and medium firms that often lack the human and financial resources to navigate arcane, expensive bureaucratic procedures. Entrepreneurs hoping to establish small and medium businesses require a transparent regulatory framework with rules that are neither overly burdensome nor unduly complex.

Well-designed and implemented regulations can also improve service delivery in regulated industries. This is critical as many of these industries—water, electricity, telephone, and utilities—provide services essential to a country's basic infrastructure and citizens.

A stable, predictable and accountable regulatory environment also attracts international investment in regulated sectors, such as banking, telecommunications and resource extraction. Firms seeking to invest will search for a stable environment in which they can count on a fair, balanced environment that can offer high return possibilities and/or low investment risk.

In 2004, gross private capital flows (measured by percentage of GDP) in Latin America were 18 percent lower than world flows.

Source: International Monetary Fund, "World Economic Outlook," September 2006: Chapter 2 "Country and Regional Perspectives"

One other sector of the economy affected by the regulatory framework is the rapidly expanding world of electronic commerce or e-commerce.³⁴ In 2006, revenues from global e-commerce reached

³⁴ E-commerce is the abbreviation for electronic commerce: A way of doing real-time business transactions via telecommunications networks, when the customer and the merchant are in different geographical places. [Mattila] *Note:* Electronic commerce is a broad concept that includes virtual browsing of goods on sale, selection of goods to buy, and payment methods. Electronic commerce operates on a bona fide basis, without prior arrangements between customers and merchants and via the Internet using all or any combination of technologies designed to exchange data (such as EDI or e-mail), to access data (such as shared databases or electronic bulletin boards), and to capture data (through the use of bar coding and magnetic or optical character readers).

\$102.1 billion. The tremendous flows of investment and consumer spending online means access to unpenetrated markets for Latin American businesses. Yet, now that sales and investment transactions increasingly take place on the Internet, countries that struggle in establishing a credible regulatory framework with effective enforcement mechanisms will attract less capital inflow than those countries or regions that provide necessary protection and enforcement.

Basic Principles

To achieve a sound regulatory framework for business and investment requires a basic framework of:

- broad consultations with input from relevant stakeholders in the development and technical drafting of the regulation;
- access to proposed regulations and ample opportunities for comment and clarification during the pre-approval promulgation process;
- clarity and consistency in the issuance and decision-making processes behind regulations;
- transparency in the drafting, promulgation and application of regulations;
- regulations based on a foundation in the law;
- competent and responsive personnel with sufficient technology and the appropriate education and training;
- clear, streamlined regulations concerning the incorporation and operation of businesses;
- predictability in the agencies enforcing the regulations; and
- fairness in application of regulations according to the law across cases and subject matter.

These principles apply across the aspects of the regulatory framework as it concerns the economy and investment: regulations governing the incorporation of businesses; the tax regime; laws affecting regulated industries; and regulations affecting investment. Each of these criteria is discussed in detail in the sections below. In each

section, the chapter first relates the criteria to the larger topic of the rule of law, and then outlines a series of normative principles for applying each of these criteria to further the rule of law. The section concludes with examples of practices and laws from around the world with a focus on Latin America.

Regulations Governing the Incorporation and Operation of Businesses

An open and inclusive process for developing, promulgating and enforcing regulations will foster greater opportunities for emerging entrepreneurs

Business regulations include all monetary and administrative procedures that must be followed for an entrepreneur to operate legally. These regulations can be divided into two types—one for the start-up and the other for operation—with each presenting both monetary and indirect costs. As noted by Jansson and Chalmers, the specific procedures covered in each of these categories include:³⁵

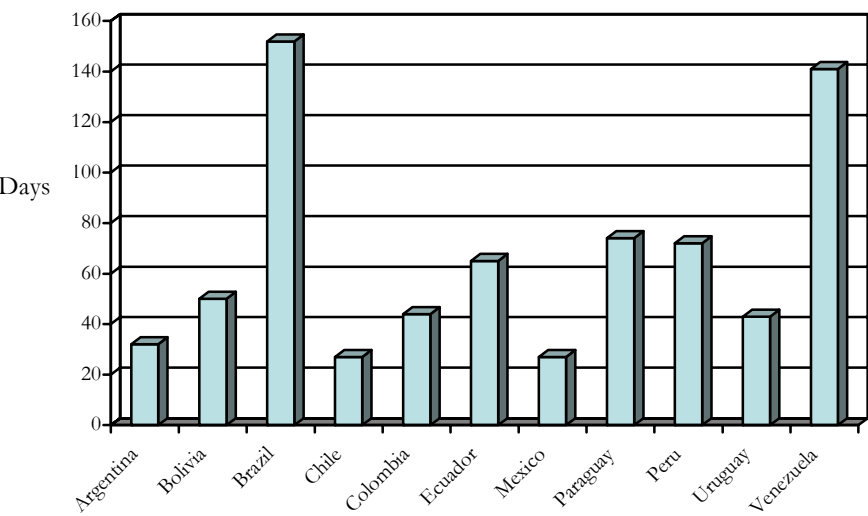
- initial monetary costs such as registration fees and other charges paid in the registration process;
- initial indirect costs including administrative expenses and revenue lost due to time spent on the registration process;
- ongoing monetary costs such as taxes and renewable permits; and
- ongoing indirect costs including administrative expenses related to compliance.

An analysis of Latin America's business regulatory environment shows that it is one of the most heavily regulated in the world. According to the World Bank's *Doing Business in 2006* report, the start-up time for a business in Latin America is less than one day shorter than in Sub-Saharan Africa, allowing it to just barely hold off the undesirable title of slowest region in the world to open a business. However, looking solely at administrative costs, Latin American regulations, on average, require an entrepreneur to jump

³⁵ Tor Jansson and Geoffrey Chalmers, "The case for business registration reform in Latin America" (Washington, DC: Inter-American Development Bank, July 2001), 3.

through more hoops and comply with more procedures than anywhere else. This poses both short and long-term monetary and administrative costs to a region that has the unfortunate distinction of being home to five of the ten countries that most regulate business start-up. The following graph provides a country by country comparison of the regional start-up time.³⁶

Number of Days to Start a Business (2006)



In Latin America, regulatory agencies should be mindful of the costs to society when business registration becomes overly complicated, decentralized or expensive. The first step in developing a more business-friendly environment is opening up the process for developing and debating regulations.

An open and inclusive process for the development and promulgation of regulations will allow a wider spectrum of stakeholders to have input. Greater discussion and participation ensures that

The cost of starting a business in Latin America is equivalent to 56 percent of per capita gross national income —13 percent higher than in East Asia and the Pacific.

Source: *Doing Business in 2006*

³⁶ *Doing Business in 2007* (Washington, DC: The International Bank for Reconstruction and Development / The World Bank, September 2006).

regulations will be technically appropriate for the target industry, enjoy greater buy-in from affected parties and reflect a spectrum of voices. The latter is particularly important for small and medium-size businesses, which in more closed discussions may lack the economic weight and political connections to ensure that regulations do not discriminate against smaller enterprises. Final regulations should reflect a broad range of interests.

For small and medium businesses, it is essential that one of the main reoccurring costs, taxation, is applied in a fair and non-discriminatory manner. An arbitrary and arcane tax structure will generate less government revenue by pushing entrepreneurs away from the formal economy. Conversely, clear and stable tax regulations applied equitably create a predictable environment for growth and can encourage greater tax compliance.

Employees operating in the informal economy often do not enjoy guaranteed worker rights, safe working conditions or health and social security benefits. In turn, consumers cannot be certain that products are in line with national health and safety standards. Informal operation also deprives government of much-needed tax revenue. For businesses, informality limits access to credit, thus dampening the potential for growth.

At the same time, the creation of a transparent and understandable tax framework, along with the institutions necessary for ensuring collection and management, can be an important factor in generating confidence in the tax system. Reducing corruption can also help increase citizens' willingness to pay taxes. In the end, the right mix is one that guarantees the objectives of regulations with the need to encourage compliance.

Principles

a. Basis in the Law

- Regulations should be developed through an announced, clear and accessible public process that elicits stakeholder input.
- Process for review should seek to guarantee that rules are technically practical and comply with their stated purpose.
- All information regarding registration requirements and procedures should be made widely available and accessible to the public.
- Filing rules and procedures should be simple and clear to ease market entry for small and medium-size businesses.
- Changes in fixed fees or administrative complexity should be minimized, as such actions affect the more sensitive and vulnerable small businesses more than larger ones.
- Registration costs should be fixed, clear and low enough as not to discourage small entrepreneurs.
- Policy coordination should exist between central and local/regional governments.

Tax regulations

- Tax burdens for start-up businesses should be maintained at a level that encourages their entry into the formal economy.
- Tax agencies should be free from political influence or meddling while remaining accountable and professional.
- Tax agencies should maintain an incentive structure that encourages uniform tax collection consistent with the law.
- Greater streamlining of tax regulations, along with communication among taxing authorities, should be prioritized to ease the administrative burden on small businesses.
- Mechanisms to promote transparency should decrease perceived or real opportunities for corruption.

b. How Applied

- Company registration should be an administrative, not judicial, process.
- A feedback loop should be maintained in which businesses can provide input into reforming the registration process.
- Registration requests should be handled expeditiously.
- Rural populations should benefit from equal access to and understanding of the regulatory process.
- Government agencies responsible for business incorporation should be independent of political influence.

Tax regulations

- Payments for taxes and renewable permits should be simplified and consolidated to promote greater ease of compliance.
- Tax collection agencies should collect according to the law and in a non-arbitrary fashion.
- Mechanisms, including judicial review, should be put in place to redress abuses of power and other wrong-doing by tax collection agencies and resolution of such matters should be swift.

Mexico currently has one of Latin America's lowest tax takes—under 15 percent of GDP. By bringing more businesses out of the informal sector and reforming its tax collection strategy the government can significantly increase fiscal revenue.
Source: Economist Intelligence Unit

EXAMPLES

In both Latin America and beyond, numerous positive examples can be cited from countries that adopted public comment processes, reduced start-up time, streamlined procedures, implemented clear and transparent guidelines, and/or decreased administrative hurdles. These advances can be seen in the ease with which business complies with initial and/or ongoing costs.

- Working with a local non-governmental organization (NGO), the Institute for Liberty and Democracy, the Peruvian government launched a campaign to decrease the excessive paperwork and bureaucratic hurdles faced by both businesses and individual citizens. After two years of public hearings, numerous reforms were implemented including the establishment, in 1990, of a Unified Business Registry for incorporating small businesses.³⁷
- A common concern cited by small and medium-size businesses in Canada was the amount of time spent on federal, provincial and municipal paperwork. In response, the Canadian government launched the “Paperwork Burden Reduction” to significantly reduce the time and quantity of paperwork faced by entrepreneurs.
- In 2005, El Salvador, implemented a new "Law on Uniform Procedures" which simplified applications to register a new company with the government. As a result, the process for opening a new business is 75 days shorter than in 2003.
- Honduras has attempted to generate new business opportunities by cutting start-up costs in half. As a result, total start-up costs fell by 12 percent; costs would have dropped more if not for the notary fees, which account for the bulk of expenses.³⁸

Serbia and Montenegro (separate states as of June 3, 2006) have significantly sped-up the waiting time for approval of business registration documents. An approval rule has been implemented that grants businesses freedom to start-up if the government has not responded to their application in five days. Serbia and Montenegro also cut the minimum capital requirement for business start-up from 5,000 euros to 500.

Source: *Doing Business in 2006*

³⁷ Institute for Liberty and Democracy, “Administrative Simplification,” Institute for Liberty and Democracy, <http://www.ild.org.pe/eng/history25.htm> (accessed May 30, 2006).

³⁸ *Doing Business in 2006*, 10.

Looking at ongoing monetary costs, small enterprises often lack the economies of scale and the technical capacity to assess and thus fulfill their tax liabilities under the conventional system. Recognizing this, several countries in the region have introduced simplified taxation schemes for small firms to reduce compliance costs.

- In Chile, electronic invoicing, introduced gradually from 2003, is expected to decrease the administrative burden of filing taxes while halving tax evasion by 2008. Estimates are that e-invoicing will add some US\$2billion, or nearly three percent of Chile's GDP, to annual fiscal revenues.³⁹
- Argentina, Bolivia, Brazil, and Peru have replaced several of their major taxes with a single tax. In 1998, Argentina introduced Monotributo, a single gross revenue federal tax for small businesses that eased the burden of compliance imposed on small firms. Brazil, a country rarely lauded for its tax policies, introduced a tax called *Simples* in 1996 to replace several taxes at the federal level. According to a study by Brazil's tax agency, a sample group of firms that opted for *Simples* in 1996 and 1997 saw a significant reduction in the costs for receiving and processing tax files. These same firms created 500,000 new formal sector jobs.⁴⁰ Despite this reform, however, tax rates in Brazil are still very high, often prohibiting small business growth.

Autonomous agencies are better protected from political interference and can generate greater credibility. In Latin America, tax agencies granted autonomy, when balanced with public and private accountability, were

In Argentina, the total tax rate is equivalent to 117 percent of a medium-size firm's profit in its second year. Only Uzbekistan, Belarus, Central African Republic, Democratic Republic of Congo, Sierra Leone, Burundi, and Gambia have higher commercial tax rates.

Source: *Doing Business in 2006*

³⁹ *Economist Intelligence Unit*. "Chile Country Finance Report," September 19, 2005.

⁴⁰ Aaron Schneider, Victor Lledo and Mike Moore. "Social Contracts, Fiscal Pacts and Tax Reform in Latin America" (Washington, DC: Inter-American Development Bank, 7 February 2004), 10.

the most successful in increasing efficiency, compliance and quality of service. Hence, there is always a balance to be struck between an agency that is free from the corrupting influences of politics and economic interests and one that is accountable internally and before the law.

- In Mexico, the autonomous tax agency balances independence and accountability by having to present to Congress a performance report three times a year.

Laws Affecting Regulated Industries

Sound regulatory policies for utilities and other basic industries benefit consumers and investors alike.

Banking, insurance, utilities and other sectors crucial to overall economic well-being are often subject to closer government scrutiny and oversight, as their health is fundamentally tied to national prosperity and citizens' well being. The effectiveness and stability of the banking system rest on regulations that guarantee the deposits of citizens and firms. Without security in the banks, people do not invest in formal, domestic channels for savings and foreign investors are less likely to keep their savings in the country. Moreover, without deposits, banks lack the funds to reinvest in their own economies through loans and similar measures that fuel growth.

In theory, regulation should yield greater price fairness and stability for consumers, service expansion to marginalized sectors of the population and—in capital-intensive industries—greater security of recapturing up-front investment. Looking specifically at utilities, regulation seeks to promote efficiency and competition. A good regulatory policy will protect consumers against monopolistic practices and investors against opportunistic government actions. In the end, industry regulation works best when the sector in question is confident that its investments and ongoing practices will be treated according to agreed upon basic principles.

In short, consumers, investors and infrastructure development depend on fair, clear and forward-looking regulations, the implementation of which is overseen by a qualified and autonomous regulatory agency.

Principles

a. Basis in the Law

- A transparent process should exist for the drafting and review of proposed regulations.
- Technical staff in the rule-making ministry should have the tools to fully evaluate the implications of new and existing regulations.
- Text and decision-making should be clear, transparent and unambiguous.
- Regulations should be based on cost-benefit calculations that balance stakeholder interests.
- Governments should issue credible, long-term commitments to encourage investment in capital intensive projects.
- Regulations should be based on a foundation in the law.
- Regulations should be fair and not favor one group of interested stakeholders over another.

b. How Applied

- Equal application should prevail both in respect to the treatment of incumbent industries and the conditions of entry for new businesses.
- Regulatory agencies and their employee, while maintaining their statutory independence, should be open to input from the industries they regulate, to benefit from these companies experiences in other regulated jurisdictions.
- Regulatory agencies should be free from political pressure and their information and staff expertise should be adequate for their jobs to be done effectively.
- Review of decisions by regulatory agencies should follow clear, predictable and transparent processes.

EXAMPLES

In several cases, Brazil has led the way in establishing open, participatory processes in the development, drafting and

implementation of regulations. Following the deregulation of telecommunications industries in 1997, Brazil created the National Agency of Telecommunications (ANATEL) to draft, monitor, and enforce laws, rules and regulations over the industry. Since its inception, ANATEL has placed particular emphasis on assuring that the process of drafting regulations is open to consumers as well as to regulated businesses. In 2006 ANATEL expanded public consultation in the drafting process to include number portability, which will allow users to switch from one operator to the other without changing phone numbers. However, ANATEL faces a number of economic and political constraints, including a 40 percent reduction in its planned budget and loss of power to the non-independent Ministry of Communications.

Reliable and stable infrastructure is key to economic growth and development. Throughout most of the region, public sector regulation and privatization were tackled in the wrong sequence.

Instead of first developing effective regulatory agencies and then privatizing, a wave of privatizations swept through the region before the

ANEEL, Brazil's electricity regulatory agency, allows stakeholders to contribute suggestions for the revision of regulations, including taxation. From 2003 to 2006, ANEEL compiled recommendations from consumers, unions, companies, concessionaires, as well as public and private institutions. On June 7, 2006, ANEEL, as in previous years, opened up the electricity tariff revision process for stakeholder input on proposed changes in service, distribution and pricing.

proper mechanisms for oversight could be established. As a result, regulatory agencies were forced to respond to the industry as opposed to the industry responding to the regulations. By privatizing without regulatory oversight, some state-owned industries sometimes became private monopolies, exaggerating existing distortions in the market and missing out on an opportunity to create broader-based ownership.

Nevertheless, examples can be highlighted of countries that implemented an effective system for determining the prices of regulated services.

- Jamaica, in 1995, introduced a new office of utility regulation and instituted a mechanism for providing specific pricing and other commitments to investors through contracts.
- Chile's method of regulation for the distribution (wires) process of electricity is based on a combination of yardstick regulation, price caps, and replacement cost accounting and has become a model for many other countries in the region including Ecuador, Guatemala, Peru, and El Salvador.⁴¹

Legal certainty and consistency is critical to industry growth. Investors reinvest and maintain a presence in industries in which they see continued long-term stability.

- In Peru, a high degree of legal certainty, consistent treatment of investors and an efficient and effective regulatory body have contributed to the growth of the hydrocarbons sector. The General Hydrocarbons Bureau oversees the natural gas industry, from production to distribution, and participates in contract negotiations.
- In the Dominican Republic, Law 153 of 1998 has contributed to a flourishing telecommunications industry. The sector's development is under the control of the Dominica Telecommunications Institute (Indotel), a decentralized and autonomous regulatory body.

⁴¹ Council of the Americas. "Energy in the Americas - Building a Lasting Partnership for Security and Prosperity (October 2005)," The Americas Society and Council of the Americas <http://www.as-coa.org> (accessed May 30, 2006).

Regulations Affecting Investment

Investment is one of the main drivers for job creation.

The degree to which a country can attract and retain investment, both foreign and domestic, is one of the most significant factors in determining its development path. Only with investment in new and existing industries can advancements be made in areas ranging from technological innovation to infrastructure modernization. In an increasingly globalized world, competitiveness and job creation hinge on creating conditions necessary for small and large businesses to flourish.

Investment decisions are based on both real and perceived factors. Naturally, investors, both domestic and foreign, gravitate to countries and sectors that offer a low risk with a high possible rate of return. Latin America cannot compete with Asia and many other emerging economies in its medium-term investment reward potential, but it can rapidly take a series of concrete steps that can reduce investor risk. With countless investment destinations, capital will naturally flow to countries where it is secure under the law, both in theory and practice, and where all investors are subject to the same open rules regardless of country of origin.

Regulation in today's high-tech consumer and investment markets must also address non-cash transactions. Investors and business owners are increasingly shopping and setting-up shop online, cashing in on the enormously promising e-commerce market. The burgeoning field presents new opportunities for Latin American economies and new challenges for law makers who must establish credible regulatory frameworks.

By the year 2010, Latin America's e-commerce sector will generate sales of \$23.12 billion, compared with \$4.3 billion in 2005. This would mean a 40 percent average annual growth during the period from 2006-2010.

Source: *América Economía*, Market Survey, October 25, 2006. Cited by Valor Online, October 25, 2006, www.valoronline.com.br

The number of Latin Americans with Internet access has grown 350 percent since 2000, and consumer and investor confidence in regulatory frameworks with recourse for grievances will determine how many of these potential consumers invest online.⁴² To ensure that emerging market economies realize the benefits of e-commerce, governments, financial institutions and businesses must pro-actively establish effective fraud management and data security mechanisms.

Principles

a. Basis in the Law

- Investment laws and regulations should be consistent so that they are more easily understood.
- Investment loopholes should be eliminated so that emerging entrepreneurs can more easily make informed decisions.
- Governments should ensure that new policy or regulatory proposals do not undermine the investment climate by introducing unjustified burdens or other distortions.
- Regulations on investment should be expanded to include electronic payments and contracts, and be coordinated with other national governments inviting input and support from financial institutions and business owners.

b. How Applied

- Foreign and domestic investors should be subject to fair, predictable treatment under existing law.
- Enforcement of investment regulations should be carried out as prescribed by the law.
- Investment disputes should be resolved fairly and efficiently and with appropriate access to international arbitration.
- All citizens should have an equal opportunity to challenge investments that do not comply with the law.

⁴² Data obtained from www.exitoexportador.com based on published results from Nielsen//Net Ratings, the International Telecommunications Union, Internet World States and other reliable sources.

- Governments should mandate the official registration and establishment of top-level domains for websites engaging in e-commerce, and establish standards for consumer authentication programming and data storage and disposal.
- Governments should invest in the necessary infrastructure and training to ensure that agencies charged with enforcing e-commerce laws have the capacity to keep up with the fluid nature of the field.

EXAMPLES

The biggest headway in creating safe and inviting climates for investment has been achieved in North America and Western Europe. For example, in the Organization for Economic Cooperation and Development (OECD), proposed laws and regulations are subjected to a quantitative impact assessment.⁴³ Information on costs and benefits is made available to legislators and other policymakers to help ensure that proposals reflect an economy-wide perspective and provide an additional check on rent seeking.

In Latin America, both Nicaragua and Uruguay introduced new laws to support sharing credit information, making it easier for lenders to quickly evaluate creditworthiness. In Chile, all investment instruments are available to foreign companies on the same terms that apply to domestic firms.

The United Nations paved the way for e-commerce regulation beginning in 1996 by passing the UNICITRAL Model Law on Electronic Commerce, further bolstered in 2005 by the UN Convention on the Use of Electronic Communications in International Contracts. Mexico has amended its Commercial Code

⁴³ The OECD is a grouping of 30 member countries that share a commitment to democratic government and the market economy. In the Americas, members include: Canada, Mexico and the United States.

to include provisions recommended by the UNICITRAL Model Law, making particular strides in e-commerce security.⁴⁴

In 1999, Colombia established regulations on e-commerce that formally recognize the legality of electronic signatures, regulate online commerce and accept the legality of real-time online contracts and contracts presented verbally over the telephone. Also, the government has outlined guidelines for secure and authenticated sending and receipt of e-mail, along with methods of verifying dates of receipt and authorship.⁴⁵

⁴⁴ Luz E. Nagle, "E-Commerce in Latin America: Legal and Business Challenges for Developing Enterprise" *American University Law Review* 50, no.4 (April 2001): 920.

⁴⁵ Nagle, 920.

CONTRACTS, ALTERNATIVE DISPUTE RESOLUTION AND BANKRUPTCY

Contracts, alternative dispute resolution (ADR) and mechanisms for balanced and predictable outcomes in case of bankruptcy and insolvency are important components of the broader system of rule of law. The effective and fair legal basis and application of each of these components guarantees fairness for parties to commercial transactions and litigants in commercial disputes, regardless of economic or social status.

If fairly and effectively drafted and enforced, contracts protect individual rights. The guarantees established in contracts, along with the enforcement and predictable resolution of disputes, provide an essential bulwark against arbitrary state intervention while promoting individual rights.

Alternative dispute resolution can also serve as an important tool for fostering the rule of law. By providing both an alternative to overburdened and inefficient judicial tribunals and a new, transparent channel for the resolution of disputes, ADR can increase the access to justice as well as its fair administration. Local arbitration and mediation provide communities with a faster and less daunting alternative to traditional methods of litigation.

Bankruptcy law squarely fits into any discussion on contracts and ADR. Insolvency and re-organization present a unique set of circumstances under which certain contracts may legitimately go unenforced (through pre-established rules) for the sake of salvaging an ailing business or liquidating a failed one. If properly implemented, bankruptcy law ensures a fair and transparent manner for both creditors and debtors to resolve financial disputes. Combined with evenhanded contract enforcement and ADR judgments, the quick resolution of bankruptcy cases contributes to predictability and security in one's rights.

Efficient, fair and predictable rules governing all three of these areas are fundamental to property, investment and personal rights.

Why are Contracts, Alternative Dispute Resolution and Bankruptcy Important to Economic Growth and Prosperity?

A stable environment that encourages the formation of new enterprises and the growth of existing ones hinges on the expectation that agreements (in the form of contracts) will be respected and disputes over their enforcement will be quickly resolved. Similarly, contract security and a fair and effective system for resolving insolvency disputes increase the availability of capital for investment. ADR contributes to contract security by allowing for the resolution of disputes through an impartial and more expeditious forum.

Well-performing economies have a high number of long-term contracts. The absence of reliable, low-cost contract enforcement in many developing countries has been cited as one of the primary causes of economic stagnation and underdevelopment.

Source: Paul Holden, "Promoting Change: Small Business Reform and the Multilateral Investment Fund" (Washington, DC: The Inter-American Development Bank, January 2001).

Fair, effective bankruptcy procedures also encourage entrepreneurship. Studies of economic development and business formation have observed that the "economies in which businesses are easily started are also those in which they fail in the largest numbers."⁴⁶ The goal is not just to establish a framework that eases the creation of business, but also one that provides more options to creditors and debtors in resolving bankruptcy. For creditors the cost of potential bankruptcy of a debtor should not be so high as to increase risk to the point where lending for start-ups is dramatically reduced. For entrepreneurs, bankruptcy laws and procedures should not overly penalize insolvent businesses so as to discourage reasonable risk taking in the future.

⁴⁶ Paul Holden, "Promoting Change: Small Business Reform and the Multilateral Investment Fund" (Washington, DC.: The InterAmerican Development Bank, January 2001), 9-10.

Basic Principles

To achieve a well-functioning system for contracts, alternative dispute resolution and bankruptcy requires a basic framework of:

- a system that allows parties to mutually agree on how to conduct business relations within a set of generally accepted principles and rules;
- transparency in the drafting and predictability in the enforcement of contracts;
- efficiency and fairness in the resolution of contract and bankruptcy disputes;
- judicial and ADR systems that are affordable and accessible;
- recognition of agreed-upon international conventions and instruments; and
- equal treatment for all investors.

Each of the three subjects is discussed in detail in the sections below. In each section, the chapter first relates the subject to the larger topic of the rule of law, and then outlines a series of normative principles that propose how each of these subjects can contribute to the rule of law. The section concludes with examples of practices and laws from around the world with a focus on Latin America.

Contracts

Fair and consistent contract enforcement is vital to the creation of a thriving economy.

Contracts form the backbone of any private or commercial deal and are critical to the functioning of a rules-based society. From agreements on the rendering of services to the supply of goods or the protection or transfer of property rights, certainty in the drafting and enforcement of the promises in a contract is an essential foundation for growth and prosperity.

In Brazil, 57 percent of small firms have confidence in the legal system to enforce contract/property rights disputes—a full 16 percent less than large firms.

Source: 2003 Brazil Investment Climate Survey, World Bank.

Among all sectors of the population, small business owners and emerging entrepreneurs are some of the greatest beneficiaries of a system that respects and enforces contracts. Widespread certainty that contracts will be honored provides the basis to initiate business endeavors with new (and lesser known) clients outside the businessperson's established network of trusted partners. With the confidence that contract rights will be protected, small business owners can be more assured of equal treatment with regard to other enterprises, creating a business environment that not only fosters but also promotes entrepreneurship. Greater contractual security allows for increased access to credit and promotes investment and business expansion, both of which are fundamental to creating new sources of employment.

Certainty in the enforcement of contracts leads to greater society-wide respect for and trust in the rule of law. The consistent and unbiased application of agreements between parties fosters greater confidence that the legal system will safeguard other individual and social rights and can be trusted. For small businesses and other potential users of the legal system, delays or unfair contract

enforcement push people away from the judicial process and diminishes expectations for fair and effective protection.

In Latin America, one of the principal challenges to contract law resides with the enforcement of impartial judgments. Filing parties often contend with overwhelmed court systems where adjudication is constrained by judicial capacity, and authorities are unable or unwilling to execute court decisions. Judgments often lack finality, leaving grievances unresolved. The International Foundation for Electoral Systems (IFES) demonstrates that in countries such as Argentina, Peru and Mexico the situation is further complicated by a process where judges address each stage of enforcement separately rather than as a single, streamlined procedure.⁴⁷

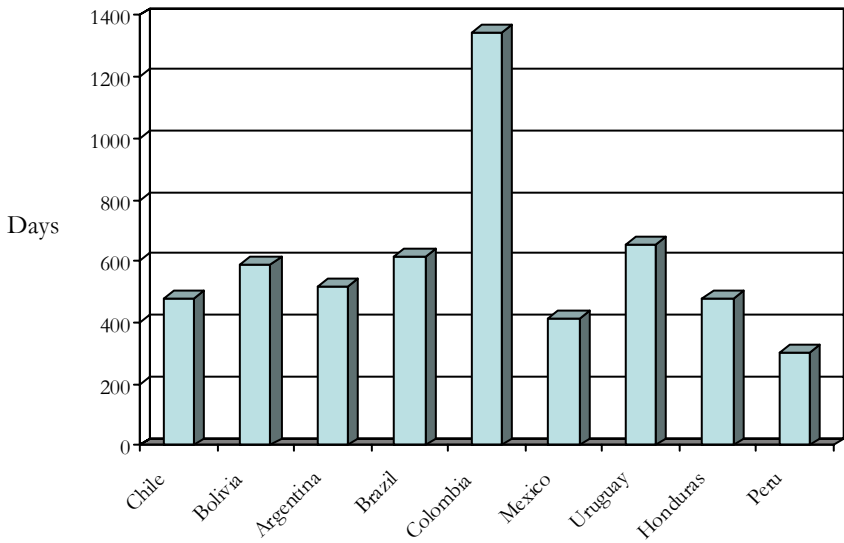
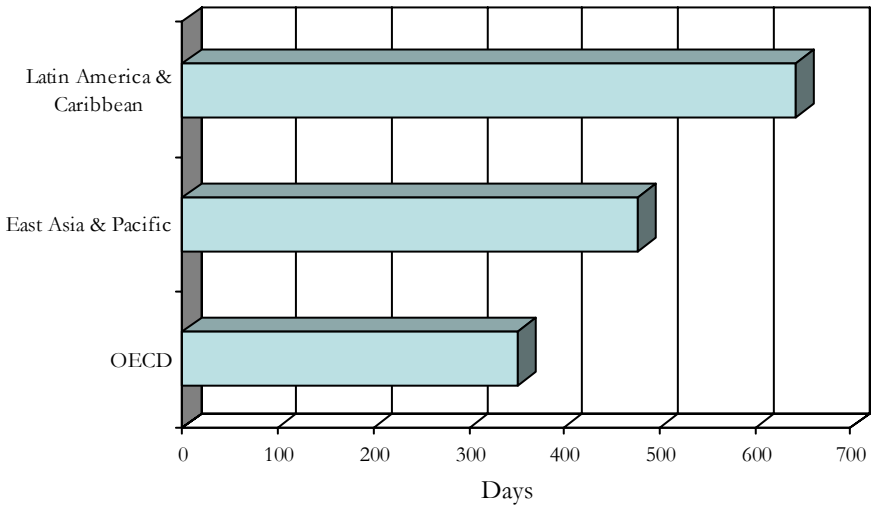
From a global perspective, Latin America ranks near the bottom in regard to both the length of time and number of procedures that a firm must undergo for resolution of a commercial dispute. Not only does inefficient contract enforcement impede domestic entrepreneurship but it also increases the risks faced by foreign investors.

The graphs on the next page illustrate how long it takes to resolve a dispute in court both from a cross-regional perspective and within Latin America.⁴⁸

⁴⁷ Keith Henderson, Angana Shah, Sandra Elena, and Violaine Autheman, “Regional Best Practices: Enforcement of Court Judgments Lessons Learned from Latin America” (Washington, DC: International Foundation for Electoral Systems, April 2004), 6-7.

⁴⁸ Data was gathered with the assumptions that the case represents a lawful transaction in the country’s most populous city, the plaintiff has fully complied with the contract, each side presents one witness, judgment is in favor of the plaintiff and is not appealed, and the debt is eventually collected through asset sale at a public auction. Time is counted from the moment the lawsuit is filed until payment.

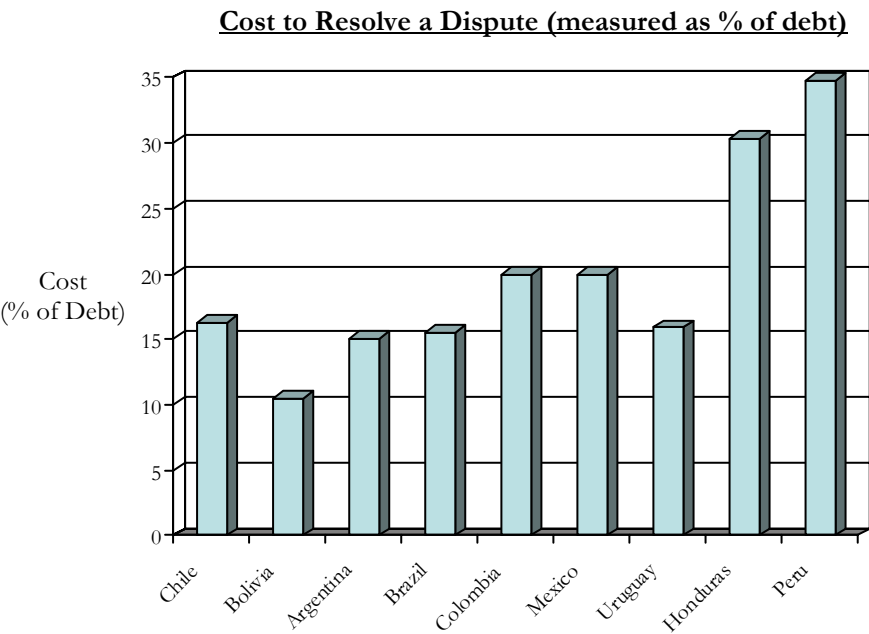
Time to Resolve a Dispute



Source (both graphs): *Doing Business in 2007* (Washington, DC: International Finance Corporation / The World Bank, September 2006).

No country stands out as a model for timely dispute resolution, but Colombia's inefficiency far exceeds that of its neighbors. Despite recent reforms that shift the burden of court filing notification from the public to private sector, contract enforcement in Colombia remains one of the slowest processes in the world. Another factor affecting the slow pace of the legal system is the court inefficiency that stems from case backlogs, lengthy appeals processes and understaffed courts described in the earlier chapter on the administration of justice. For example, in Brazil 88 percent of commercial cases are appealed.⁴⁹

Sometimes the costs of enforcing a contract through the court system approach the original value of the contract. The graph below measures the legal costs, including court costs and average attorney fees, for enforcing a contract as a percentage of the total claim.



Source: *Doing Business in 2007*, IFC/World Bank

⁴⁹ *Doing Business in Brazil* (Washington, DC: The World Bank, 2006), 11.

Many firms often decide to simply write off a contract if the expected cost of enforcement through the courts approaches the original value of the contract. But while this may be a cost-effective option for larger firms, for small or informal sector business it is a luxury they often cannot afford.

Principles

a. Basis in the Law

- Contract rights should be guaranteed and transparent to all.
- Basic contract rules should be simple and easily discernable, making the benefits of entering into legally enforceable contracts accessible to parties from all socio-economic backgrounds.⁵⁰
- Freedom of contract should be limited only by unconscionability and being contrary to established law.
- New rules applicable to contracts should take into account extra-territorial advances in contract law and regional instruments adopted by international law-formulating agencies.

b. How Applied

- Contract obligations should be enforced efficiently, quickly, transparently, and fairly across economic, geographic and social groups.
- Proceedings for routine contract enforcement should be relatively quick and affordable.
- Fair limits on time and avenues for appeals should apply to provide for timely resolution of disputes.
- Efficient mechanisms should be in place to allow for the enforcement of contracts.

⁵⁰ See Posner discussing how legal institutions in the developing world lack the expertise, resources, and political will to adopt the “standards” based system of contract enforcement prevalent in countries like the U.S. He advocates instead starting with the basic clear-cut rules that are easily discernible to parties and judges.

EXAMPLES

To increase the efficiency and expertise in resolving specific issues, many countries route more technical cases through specialized courts. Judges in these courts are specialists in the fields within their court's jurisdiction. In Latin America, Peru has recently improved the process for resolving commercial disputes with the introduction of specialized courts (*juzgados*) and corresponding appeals courts. With the increased expertise of specialized judges presiding over these new courts, the time to resolve a contract dispute has decreased from 441 days in 2004 to 300 days in 2006, according to World Bank statistics.⁵¹ Originally, seven specialized courts and one appeals court began operations in April 2005; by May 2006, 22 specialized courts and two appeals courts were on pace to begin operations.

In a survey of small and medium-sized enterprises, 92 percent in Argentina, 71 percent in Mexico and 93 percent in Peru believe that the time required for enforcing a judgment creates a disincentive for using the court system.

Source: Keith Henderson, Angana Shah, Sandra Elena, and Violaine Autheman, "Regional Best Practices: Enforcement of Court Judgments: Lessons Learned from Latin America" (Washington, DC: International Foundation for Electoral Systems, April 2004).

On a multilateral level, the Hague Conference on Private International Law, an intergovernmental organization with 64 member countries from Latin America and the rest of the world, concluded discussions on the Convention on Choice of Court Agreements in June 2005. Negotiations originally centered around a proposed Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Cases, but in 2002, ten years after talks began, delegates scaled back the draft convention to focus on a less controversial set of topics. The Convention applies only in cases where the parties have specified in the contract a court to resolve disputes that arise under the contract. In those circumstances, parties would be able to enforce designated court judgments within their

⁵¹ *Doing Business in 2007* (Washington, DC: International Finance Corporation / The World Bank, September 2006).

national borders even if the court is located abroad. Currently, no country has signed the Convention.

The European Union offers positive examples of mechanisms that can increase contract enforcement efficiency.

- In July 2001, the Commission on European contract law launched a process to reduce distinctions between national contract laws in the European Union (EU). Its action plan calls for increasing the consistency among all EU law in the area of contracts, promoting EU-wide general contract terms, and further examining whether problems in European contract law may require nonsector-specific solutions.
- Slovakia and Macedonia, along with other transitional Eastern European countries, have implemented alternatives to the traditional court enforcement mechanisms. Following the French and Belgian model, independent agents are now used to enforce collateral pledges and mortgages, resulting in a more efficient and effective process for case closure. Separation of judicial and enforcement functions has proved quite worthwhile, and, despite its strong differences with the Latin American model, it could significantly help to expedite case closure.

More closely connected to Latin America is the Inter-American Convention on the Law Applicable to International Contracts signed in Mexico City in 1994, which allows parties to choose the law governing all or parts of a binding international contract. The Contracts Convention allows choice of law clauses to be modified at any time and also includes rules for resolving commercial disputes. Mexico and Venezuela are party to the treaty, and Bolivia, Brazil and Uruguay are signatories.

Alternative Dispute Resolution

ADR is often faster, cheaper and more easily accessible than the court system, providing a good alternative for small businesses and entrepreneurs.

First implemented in the 1970s, alternative dispute resolution (ADR) has spread from the United States to now include much of the developing and developed world. ADR initiatives have become a popular choice for those wishing to resolve oral or written contractual disputes in a more flexible and often more conciliatory manner.⁵²

ADR is unique in that it encompasses a wide range of processes for resolving disputes, and can be tailored to the needs of the particular parties involved, whether they are multinational corporations, small business owners or local villages. The techniques that constitute ADR are very diverse and bear little in common to one another except that they are all alternatives to traditional court-based adjudication.

In Peru, 64 percent of people surveyed stated they were satisfied with their local *jueces de paz*, while 66 percent found them to be honest—a far cry from the majority who distrust formal judges.

Source: Roberto Gargarella, “‘Too Far Removed from the People’: Access to Justice for the Poor: The Case of Latin America” (Buenos Aires: Universidad Torcuato di Tella, June 28, 2004).

Community-based ADR offers locals an alternative to the formal court system, which for many is distant or expensive. In Latin America, the concept of *juzgados de paz*—courts created to offer the local population a quicker, less costly means to resolve minor disputes—has regained popularity throughout the Andean region. The head of these courts (*juez de paz*) has the legal authority to make binding decisions. Colombia, for example, has seen an emergence of

⁵² Without empirical studies from developing countries, many questions remain regarding the actual success of ADR in increasing efficiency and in providing broader access to justice. For more information, see the World Bank’s Law and Justice Institutions project, <http://www.worldbank.org/>.

such legal officers in remote villages where they are chosen by community groups and then elected by popular vote.

The two most common forms of ADR are arbitration and mediation. Arbitration more closely resembles traditional litigation in that a neutral third party hears the arguments from each side and imposes a final and binding decision that is enforceable by the courts. ADR is distinct from formal judicial litigation in that the parties have generally agreed to the use of arbitration before the dispute arose, the

actual proceedings are less formal than in a court, and the right to appeal the decision is limited.⁵³ Mediation is the fastest growing ADR method and, unlike litigation, provides a

According to CPR Institute for Dispute Resolution, 56 percent of US federal judges favor ADR, 97 percent of corporate executives prefer ADR, and 55 percent of ABA litigators commonly advise clients on the use of ADR.

Source: www.cpradr.org

forum in which parties can resolve their own disputes with the help of a neutral third party. The mediator never imposes a decision upon the parties; instead, he or she works to keep the parties talking to mutually agree on a solution. Mediation depends upon the commitment of the disputants to solve their own problems—an important consideration since mediation is often non-binding. Parties that are unable to agree upon a mediated resolution to a dispute may then resort to formal legal proceedings to resolve it.

Originally conceived as an informal substitute to traditional court proceedings, ADR has become increasingly popular and its use has grown to encompass

In certain countries, arbitration may face some of the same problems as formal litigation, including high costs, long delays, and great complexity. Bolivian arbitration is hindered by the requirements that arbitrators must be lawyers and the courts can review arbitration findings.

⁵³ For more information, see Heywood W. Fleisig and Nuria de la Peña, “Law, Legal Institutions, and Development: Lessons of the 1990s for Property Rights, Secured Transactions, Business Registration, and Contract Enforcement.” Prepared for the World Bank, October 2003.

all types of disputes, making its effective implementation equally critical to the rule of law as case resolution through the court system. Therefore, when considering the basic principles that should be applied to ADR, many of the arguments discussed in the chapter on Administration of Justice also apply. For example, arbitrators and mediators should be held to the same standards as judges and court officials in regard to their independence and impartiality, competence and training. Likewise, transparent and non-discriminatory proceedings are critical to ensuring that everyone from the small to large business owner has an equal chance at having a dispute heard and resolved on the merits of the claim.

With local judges often increasingly issuing verdicts influenced by personal interests, commercial disputes are increasingly being referred to international arbitration. The decisions in international arbitration are easier to enforce than local judgments if the country is party to the relevant international convention on arbitration. Of note, Brazil and Argentina both accept international arbitration.

Principles

a. Basis in the Law

- Dispute resolution mechanisms should be efficient and neutral for all parties.
- Formal legal systems should recognize and give full force to resolutions reached through officially sanctioned alternative dispute resolution (ADR).
- ADR should be available for firms of all sizes and accessible for all socioeconomic groups.
- For individual and small scale disputes, whether ADR is mandatory or voluntary should depend on context.
- Special emphasis should be placed on effective access to ADR for the poor and those for whom litigation is expensive or otherwise inaccessible.
- Any mandatory ADR must meet minimum standards of due process.

- Commercial arbitration should conform to regional and international standards.
- ADR should be context specific.
- ADR rules and procedures should be congruent with international accords.

b. How Applied

- All socio-economic classes should receive similar treatment during ADR procedures and in decision enforcement.
- ADR procedures should be transparent to all parties.
- Both the courts and the state should recognize and enforce disputes resolved through ADR.
- When the established ADR process incorporates the use of traditional social norms to resolve disputes, it should ensure a non-discriminatory impact on women and minorities.
- ADR should minimize pre-existing power disparities during the decision-making process.
- Courts enforcing international arbitration agreements should adhere to a narrow interpretation of exceptions such as those written into the New York Convention.

Examples of International ADR Accords

- 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention)
- 1975 Inter-American Convention on International Commercial Arbitration (Panama Convention)
- 1985 UNCITRAL Model Law on International Commercial Arbitration
- International Commercial Arbitration Agreement of Mercosur

EXAMPLES

Throughout Latin America, alternative dispute resolution procedures, both voluntary and mandatory, have increasingly been adopted as a substitute for court litigation. In the last ten years, many countries

have passed new or updated arbitration laws that expand the instrument's effectiveness.

- In Brazil, the 1996 Arbitration Act eliminated the practical obstacles to the use of arbitration, making pre-dispute arbitration agreements valid and enforceable without additional requirements. It expressly calls for “equal treatment of the parties, impartiality of the arbitrator and freedom of decision.” Because the Act’s constitutionality was disputed by a Supreme Court judge for five years, its enforcement did not actually come into effect until 2001.⁵⁴
- The Peruvian General Arbitration Law (GAL) of 1996 provides comprehensive and flexible procedural guidelines for how ADR can be pursued and enforced. The GAL guarantees respect for international arbitration law including multilateral and bilateral international agreements. In Peru, lower costs and voluntary compliance with ADR decisions have made it a reliable means of resolving debt-related disputes. In addition, parties are free to choose the specific procedure for resolving a dispute and are provided with a default procedure when one cannot be agreed upon. Arbitrators can decide on their jurisdiction and grant interim measures; awards may be subject to review by a state court or by another arbitral tribunal.
- In Mexico the white paper published by the Mexican Federal Supreme Court calls for increased use of alternative dispute resolution mechanisms in the court system, including a

In 2002, Paraguay enacted a new arbitration act that is modeled after the UNCITRAL Model Law and applies to both national and international arbitral procedures. Under the act, like modern arbitration standards, the arbitration tribunal has the power to decide on its own jurisdiction and to issue interim measures.

⁵⁴ For more information, see Pucci, Adriana Noemi. “Arbitration in Brazil: Foreign Investment and the New Brazilian Approach to Arbitration” *Dispute Resolution Journal* (February-April 2005.)

thorough review of their effectiveness and the creation of laws and procedures that facilitate the expansion and development of alternative justice systems.

Many sub-regional trade agreements also require the use of ADR to resolve business disputes.

- Article 2022 of the North American Free Trade Agreement (NAFTA) requires that each party facilitate the use of arbitration and other means of ADR for the settlement of international commercial disputes between private parties. Signatories must implement procedures that ensure observance of arbitration agreements and enforcement of arbitral awards. NAFTA Article 707 likewise acknowledges the importance of ADR in resolving disputes for agricultural goods. Since these items are perishable, speedy judgments are particularly important.
- The Mercosur Treaty stipulates that conflicts between the government members or between a resident of one of these countries and the government of another shall be settled first by direct negotiations between the parties and then through a Special Administrative Group. If these methods do not succeed, the treaty encourages the use of arbitration.

Prospective free trade agreements between the United States and Peru, Colombia and Panama also strongly encourage the use of ADR mechanisms to streamline the resolution of commercial disputes between private parties.
- Article 20.22 of the Central American-Dominican Republic-United States Free Trade Agreement (CAFTA-DR) requires that parties, “to the maximum extent possible,” facilitate and encourage the use of arbitration and other ADR methods for the settlement of private international commercial disputes in the free trade area.

The promotion of alternative dispute resolution is an important ancillary benefit of free trade agreements because arbitration

and other forms of ADR can minimize the disruption in the free flow of goods and services that can result from lengthy litigation proceedings. The inclusion of ADR provisions in trade agreements and, even more fundamentally, the extension of regional trade agreements themselves should be encouraged as a means to promote prompt and efficient conflict resolution and to facilitate the flow of business.

Bankruptcy

*Some of the most successful entrepreneurs often fail at first.
Fair and comprehensive bankruptcy laws can encourage
repeated attempts at business innovation.*

Equally important to the operation and sustainability of a business are bankruptcy laws—i.e. laws governing the procedures for dealing with insolvent or potentially insolvent businesses. By declaring bankruptcy, a business is discharged of most of its financial obligations and shielded from extra-bankruptcy litigation by individual creditors.

Bankruptcy laws protect troubled businesses by allowing viable companies to sustain themselves during short-term financial crises and by helping failed companies to liquidate quickly and efficiently.

Bankruptcy claimants (creditors, tax authorities and employees) should expect to receive less than 13 cents on the dollar from insolvent firms in Brazil, Ecuador, Venezuela and the Dominican Republic—a stark contrast with 81 cents in South Korea.

Source: *Doing Business in 2006*.

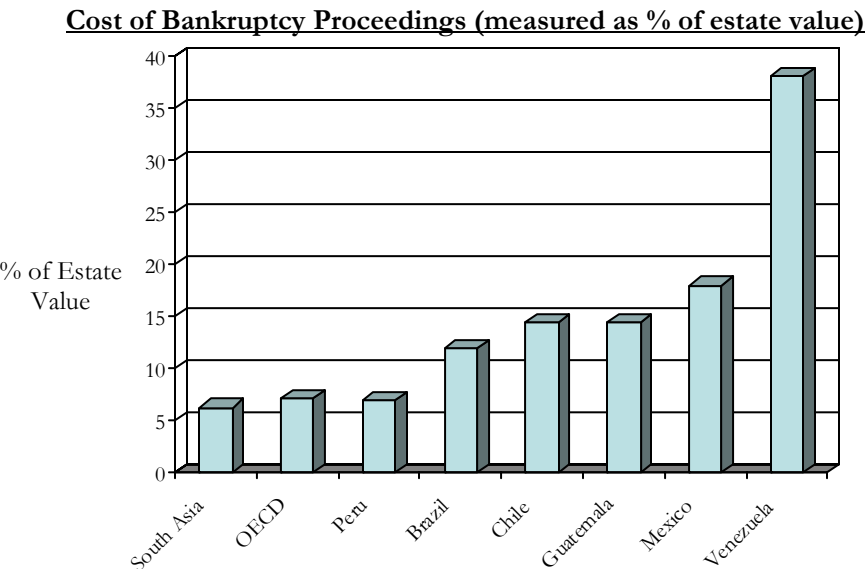
Well-written and fairly and efficiently enforced bankruptcy laws generate greater investor confidence, leading to more investment and the resulting spillover effects—economic growth, job creation and greater prosperity. But long delays in the bankruptcy process end up decreasing the potential amount of recovery and deterring investment. The associated legal costs of years of litigation also serve as a strong deterrent for both investors and business owners. In that same light, businesses that could potentially ride out financial crises suffer since their restructuring process is held at bay during the bankruptcy process.

Emerging entrepreneurs, along with the overall workforce, have the most to lose from weak bankruptcy law and/or poor enforcement.

Drawn out bankruptcy processes disproportionately punish small firms that lack the human and financial resources to remain engaged in long legal battles. All domestic firms risk reduced investment, as potential creditors are wary of investing in climates characterized by low post-bankruptcy recovery rates.

The effects of poor bankruptcy laws reverberate throughout society—reduced investment leads to slower firm growth, fewer jobs and fewer opportunities for increasing individual prosperity. In the end, prohibitively cumbersome procedures governing the closure or restructuring of businesses will negatively affect the will of both creditors and debtors to engage in investment activities.

So, how do Latin America’s bankruptcy proceedings stack up to those in the rest of the world? In regard to the time it takes to resolve a bankruptcy case, the region’s efficiency ranks with Sub-Saharan Africa. The *Doing Business in 2006* report also points out that in Ecuador, it takes, on average, eight years for a domestically owned firm located in Guayaquil to complete a bankruptcy—almost five and a half years more than the regional average. In the OECD, bankruptcy completion lasts an average of 1.4 years.



Source: *Doing Business in 2007*, IFC/World Bank

Principles

a. Basis in the Law

- Laws should provide for adequate balance between liquidation and reorganization in a way that maximizes the societal value of the assets.
- In the case of reorganization, laws should strive for an efficient process that minimizes the bureaucratic burden placed on the debtor.
- Laws should allow for the efficient and orderly liquidation of assets and payment of creditors.
- Preference of claims payment should be based on non-discriminatory criteria.
- Laws should recognize and enforce creditors' rights.
- Laws must adequately preserve priority of claims.
- Security interests should be recognized and enforced.

b. How Applied

- Courts should interpret and apply the laws in a way that is fair and transparent to all similarly situated creditors. There should be no prejudice against size or status of parties or foreign creditors vis-à-vis domestic creditors.
- Rulings should balance the rights of creditors with those of debtors.
- The laws and procedures should allow for efficient, quick resolution and exit from the system.
- Judges, lawyers, and court officials should be adequately trained to interpret and apply bankruptcy laws. Independent and competent agencies should exist for their enforcement.

EXAMPLES

Addressing the ramifications of Argentina's economic crisis, the Out-of-Court Reorganization

Proceeding (*Acuerdo Preventivo Extrajudicial*-APE) was passed by the Argentine legislature in May 2002. It has created an efficient and less costly tool for companies to restructure liabilities. Under APE,

The APE process has both roots and spillover effects throughout the hemisphere. It is based on the Chapter 11 bankruptcy reorganization process in the United States and parts of the law have been adopted by Brazil.

debtors in insolvency situations or in general economic or financial distress can begin restructuring negotiations with all or some of its creditors. Discussions are conducted outside the scope of the judicial system and the courts are only involved to obtain approval of the accord reached. To obtain final court approval of the agreements, a majority of the unsecured creditors—representing at least two-thirds of the total unsecured liability—must have achieved a consensus over the final decision. Once ratified, compliance with the final deal is obligatory for all creditors, including those who did not participate in the agreement.⁵⁵

In 2005, Brazil's New Law of Corporate Bankruptcy and Restructuring (*Nova Lei de Falências e Recuperação de Empresas*) represents a significant step forward for the rehabilitation of troubled businesses. It provides a detailed framework for both out-of-court and in-court restructurings, and allows a debtor to attempt an out-of-court restructuring with all of its creditors, certain classes of creditors or only select creditors.

As a result, the expected time to go through bankruptcy in Brazil has been halved to five years. According to a June

The Brazilian preventive reorganization process requires debtors to deposit fixed amounts with the court. This money can then be used to pay off parts of debts as the debt becomes due or for payment of court fees.

⁵⁵ We would like to thank Gonzalo Garcia Delatour, a visiting associate at Hughes Hubbard & Reed LLP for his research on this point.

2005 article in Brazil's *Gazeta Mercantil*, the new law could pump 204 billion *reais* into the economy in six years. This law gives creditors increased priority; previously, labor-related debts were paid first followed by taxes, loans, credit lines, and suppliers. The law also gives companies 180 days to restructure before filing for bankruptcy.

Mexico's Business and Reorganization Act, which went into effect in May 2000, has significantly altered bankruptcy procedures. Prior to the reforms, insolvency proceedings in Mexico took from two to five years or more to complete. Under the Business and Reorganization Act, once a company is declared in *concurso mercantil* (or insolvent), it must work out a plan of reorganization with its creditors within one year. If the debtor company and its creditors are unable to reach an agreement within this time frame, the debtor company is automatically declared bankrupt, and a *sindico* (or trustee) is appointed to sell its assets.

The Business and Reorganization Act has already been invoked by at least one troubled Mexican company to positive effect. In May 2002, following a year of failed negotiations with its unsecured creditors, Corporación Durango, S.A. de C.V., Mexico's largest paper products company, filed an application for reorganization under the Business and Reorganization Act. Durango continued to negotiate with its unsecured creditors after the filing, and, in August 2004, the company reached an agreement with 68 percent of its unsecured creditors on a plan of reorganization. In February 2005, the Mexican court approved the plan, and within a few weeks, Durango had successfully completed its reorganization. Whether other Mexican companies will follow Durango's example in undertaking to restructure their financial obligations is yet to be seen.⁵⁶

Bankruptcy reforms in Colombia also stand out for their positive effects. In 1989, Colombia introduced a bankruptcy reform that

⁵⁶ Richard Cooper and Dalmua Garcia, "The Durango Restructuring: A New Beginning in Mexican Restructurings?," August 22, 2005, Cleary Gottlieb Steen & Hamilton, LLP, http://www.cgsh.com/files/tbl_s5096AlertMemoranda/FileUpload5741/281/56-2005.pdf (accessed July 30, 2006).

shifted procedures from the traditional judicial system to an administrative agency. With this quicker and more flexible approach, Colombia saw the number of procedures required to resolve a bankruptcy case drop by over 80 percent for disputes initiated in the two years after passage.⁵⁷

The European Union's strong desire to promote cross-border investment among member states has led it to the forefront of resolving international bankruptcy proceedings. In 2002, a Regulation on Insolvency Proceeding came into force, which, among other things, ensures that all parties involved in a bankruptcy proceeding do not have an incentive to transfer their assets or court proceedings to other member states to obtain more favorable treatment. Balancing sovereignty with the need to create intra-EU standardization, the regulation stipulates that the primary bankruptcy proceeding must originate in the member state where the claimant has the greatest amount of assets; secondary proceedings can be filed in other states in which the bankruptcy filer has assets.

More relevant to Latin America are the efforts undertaken by the United Nations Commission on International Trade Law (UNCITRAL), which has adopted a Legislative Guide on Insolvency Law (2004) promoting best practices and a Model Law on Cross Border Insolvency (1997). The Model Law respects national procedures while seeking to sort out insolvency proceedings in which the assets of the bankrupt debtor are scattered in different countries or the creditors of the debtor are located

Brazil's insolvency regime has been modernized from a focus on liquidation to reorganization, reflecting the current consensus among the international legal community. However, the new law has not been easily enforced in the bankruptcy cases involving Brazil's largest national air carrier, Varig, and the Parmalat Brazilian subsidiary. In the case of Varig, the courts ordered the company's auction despite attempts to maintain control of its finances and property.

⁵⁷ See "Bankruptcy Reform—Breaking the Court Logjam in Colombia" (Washington, DC: The World Bank, September 1995).

abroad. In 2005, Mexico became the first Latin American country to adopt legislation based on the UNCITRAL Model Law.

PROPERTY RIGHTS AND INTELLECTUAL PROPERTY RIGHTS

Broad-based rights to acquire and protect property are fundamental to individual rights. The Universal Declaration of Human Rights—unanimously ratified by the United Nations General Assembly in 1948—specifically highlights the importance of property rights in Article 17. The article states: “Everyone has the right to own property alone as well as in association with others. No one shall be arbitrarily deprived of his property.” As an internationally recognized human right, the right to own property is of unique importance to the overall rule of law.

In Brazil, an entrepreneur in a large urban center will have to go through an average of 14 procedures to register property—the third most in a survey of 175 economies.

Source: *Doing Business in 2005*, (Washington, DC: International Finance Corporation / The World Bank, September 2004).

Respect for property rights is the lynchpin of individual liberty, the restriction of the power of the state and the guarantee of individual rights to accumulate and trade wealth. Moreover, protecting the right of citizens to own property vests them in the political-legal system. This economic and political citizenship improves the rule of law by reinforcing citizens’ desire to safeguard and strengthen the institutions responsible for ensuring property protection.

We must also consider the importance of intellectual property rights (IPR) for protecting the products of technological innovation and creative expression. Laws designed to protect intellectual property usually give the creator a limited exclusive right to use and sell his or her creation for

Intellectual property rights are far-reaching but generally focus on protecting novel inventions and processes, literary and artistic works, and symbols, names, images, and designs used in commerce.

a finite period.⁵⁸ Widespread knowledge of how intellectual property rights arise and how such rights are enforced, along with broad-based access to these processes, is increasingly important for promoting a rules-based system.

It is critical that the courts and agencies responsible for enforcing intellectual property rights do so in a fair, efficient and transparent manner.

Why are Property Rights and Intellectual Property Rights Important to Economic Growth and Prosperity?

For emerging entrepreneurs, secure ownership of property can offer collateral in economic transactions and expand access to credit for mortgages, start-up capital and other business ventures. The ability to obtain a title and confidence in its enforceability also motivates individuals to invest in their property. For example, in Peru, households in which residents owned title to the land invested in home construction at three times the rate of those without title.⁵⁹ Legitimate and enforceable land title, along with stable, defined ownership of property, improves market economies and development prospects.

But, throughout the developing world, this basic right does not exist. In Peru, studies have shown that 53 percent of urban residents and 81 percent of rural residents live on untitled land. While in the Philippines, 57 percent of urban residents and 67 percent of rural residents live on untitled land. In Mexico, despite a number of well-publicized land titling drives, legal protection and insurance for titles provided to citizens remain weak.

⁵⁸ This definition of intellectual property rights is a combination of those used by the World Trade Organization and the World Intellectual Property Organization.

⁵⁹ Erica Field, "Entitled to Work: Informal Enterprise in Urban Peru," *Development Outreach*, The World Bank Institute (March 2005), <http://www1.worldbank.org/devoutreach/mar05/article.asp?id=284>, (Accessed July 30, 2006).

In total, the global estimated value of untitled real estate stands at \$3.9 trillion.⁶⁰ If ownership rights were granted, the value of this land could be used as collateral for loans and investments. In fact, as a result of Peru's massive land titling efforts in the late 1990s, mortgages grew from \$66 million in 2000 to \$136 million in 2003. At the same time, formal credit increased from \$249 to \$367 million.⁶¹

By the same token, protection of intellectual property rights can also foster individual prosperity and long-term economic growth. From the perspective of an innovator, guarantees of effective

Patents: Rights granted to an inventor to exclude others from commercially exploiting the invention for a limited time.

Trademarks: Any sign that individualizes a good and distinguishes it from competitors' products.

Copyright: Rights given to creators in their literary, scientific and artistic works.

protection encourage ingenuity and investment in turning an idea into an actual product.⁶² Only with reasonable guarantees of patent enforcement can innovators have a fair chance of achieving a commercial return on their inventions. This is necessary for paying back the cost of development and funding additional innovation. Patents disclosure can also act as a catalyst for future inventions. Widespread dissemination of new products allows inventors to focus on other efforts and avoid unnecessary duplication of research.

Small businesses and other domestic firms have a particular stake in the protection of intellectual property rights. For small firms, innovation (and its protection) is a good source of development as it may require only minimal capital investment. These same firms also benefit from cross-border technology sharing, investment and joint

⁶⁰ Hernando De Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000).

⁶¹ *The Economist*, "The Mystery of Capital Deepens," August 26, 2006.

⁶² While IP protection is important for providing incentives for innovation and research, it is not sufficient on its own. Protection for ideas and knowledge-based products needs to be coupled with investment in education and technology to spur sustained high technology development.

ventures with global companies when protection of invention is assured.

Consumers are among the greatest beneficiaries of intellectual property protection. For example, where IPR laws are adequate and enforced, consumers can be more assured of product safety and quality. This is especially important in areas such as medicine where copycat drugs can have disastrous health consequences. Respect for IPR also encourages domestic release of the newest products, giving citizens and local companies access to cutting-edge developments.

For example, copyright—a type of intellectual property applicable in the arts and technology—is

important in encouraging social and cultural development. By protecting authors and other creators, copyright can support the

In 2005, an estimated \$3.7 billion was lost in trade throughout the Americas due to copyright piracy. With 98 percent of records and music pirated in Peru and 99 percent in Paraguay, these countries are the worst infringers in the hemisphere.

Source: International Intellectual Property Alliance, 18 September 2006.

creation of new works that often reflect national heritage, while supporting the growth of national industries. Of course, while artistic creativity and innovation hardly depend on such legal guarantees, they provide a powerful protection for artists and creators.

Basic Principles

Achieving a well-functioning system for property rights and intellectual property rights requires a basic framework of:

- ease of access for the nonpolitical registration of property claims;
- transparency in the issuance of property and intellectual property protections;

- speedy and efficient enforcement against persons violating these rights;
- strong institutions to ensure that individual rights are upheld;
- cooperation among domestic and international authorities responsible for safeguarding property;
- recognition of agreed-upon international conventions and instruments; and
- equal treatment for all property and intellectual property rights holders.

Both property rights and intellectual property rights are discussed in detail in the sections below. Similar to other chapters, we first relate the protection of these rights to the larger topic of rule of law, and then outline a series of normative principles that propose how each of these rights can contribute to the rule of law. The section concludes with examples of practices and laws from around the world with a focus on Latin America.

Property Rights

Granting and enforcing property rights stimulates participation in local economies and can contribute to the alleviation of poverty.

Security of property is one of the most basic and essential rights protected by the state and its agencies. Property rights are the bundle of rights that together provide for the legal protection of ownership. These rights provide for the control, use or

John Locke: “Every man has a property in his own person...Whatsoever then he removes out of the State that Nature hath provided, and left it in, he hath mixed Labour with, and joined to it something that is his own, and thereby makes it his Property.”

transfer of assets, and are embedded in all aspects of the legal system. Central to providing property security are the titles and laws that spell out the rules governing ownership and the procedures that allow for government enforcement. Where respect for property rights prevails, entrepreneurs can further promote development by buying and trading assets such as stocks and titles.

From individual dwellings to business investments, property rights not only allow for security from takeover or expropriation, but also provide individuals with a necessary tangible asset. This need for adequate and efficient titling procedures has increased with the wave of urban migration throughout the region. As cities have developed and attracted new residents, inefficient titling processes have led to the ballooning of settlements where families live without title to their land. This has stymied development in local communities and effectively shut out of the formal economy many of those who have come to cities seeking to improve their lives. Internationally established human rights also insist that each individual and family be

secure in their property and protected from arbitrary repossession by the state or a third party.

Small and large businesses also require adequate property protection and reliability of enforcement. An emerging entrepreneur is unlikely to risk the human and financial investments to start a business if the legal system is unable to guarantee its ownership. And inability to list property as an asset severely constrains any business in its access to capital needed to grow.

Principles

a. Basis in the Law

- Laws should provide a standardized, integrated means of identifying and defining property.
- To facilitate access to property, rules and processes for gaining title should be streamlined, with low barriers for formal approval/recognition.
- Rules for granting title to and protection of property should reflect established social norms while remaining independent from political influence.
- Clear and simple procedures are essential for writing and interpreting statements confirming ownership and facilitating the transferability of assets.
- The use of property as collateral—with the implied risk—should be permitted.
- Protections of property should be clearly stated in the law.

b. How Applied

- Courts and procedures for resolving small property disputes should be physically and financially accessible.
- Programs for granting land titles should draw from existing social and informal relationships and norms.
- Judicial interpretation of laws protecting the rights of ownership, use and transfer should be clear and consistent.

- In analyzing laws concerning property as collateral, neither party should be unduly favored.

EXAMPLES

The granting of property ownership continues to gain importance around the world as governments recognize the intrinsic links between alleviating poverty and giving individuals legal rights to their land. For example, land-titling programs are underway in Colombia, Mexico, Honduras, Paraguay, Ghana, Egypt, South Africa, Turkey, and the Philippines. Within the Americas some notable examples are listed below.⁶³

- Nearly 1.2 million Peruvians became property owners within five years after the government issued reforms to promote formal property ownership. Created in 1996, the Committee for the Formalization of Private Property (COFOPRI) converted unregistered property into titled land through a low-cost, speedy process. The process was managed through a network of local offices that allowed the committee to reach out to most of the informal neighborhoods in eight cities. Qualifying for a title required merely proving residence on eligible land prior to the start of the program.⁶⁴
- In Brazil, 272,000 *favela*-dwelling families have received property titles since 2003, while another 450,000 families are expected to receive titles.⁶⁵ The government maps individual *favelas* and then grants titles to families that can prove they have lived on the land for at least five years. In Rio de Janeiro, the government announced in September 2006 that it will begin the program in two more *favelas* to the benefit of an estimated 5,000 families.⁶⁶

⁶³ Sebastian Galiani and Ernesto Schargrodsky. "Property Rights for the Poor: Effects of Land Titling." August 2005.

⁶⁴ Erica Field, "Entitled to Work: Informal Enterprise in Urban Peru," *Development Outreach*, The World Bank Institute (March 2005), <http://www1.worldbank.org/devoutreach/mar05/article.asp?id=284>, (Accessed July 30, 2006).

⁶⁶ *Brazil Magazine*, "Favela Residents in Brazil Get Deed to Their Shacks," September 26, 2006.

- In 1984, the government of the province of Buenos Aires, Argentina, sought to resolve the untenable land situation for the estimated 1,800 families living without a land title on the outskirts of the city of Buenos Aires. In a law passed that year, the government offered the formal landowners compensation so that the people actually living on the land could enjoy ownership rights. Half of these landowners accepted the offer and the others continue to fight the decision in court. Nonetheless, hundreds of families now own their land.
- Property ownership in Peru substantially improved access to credit in just three years time. With property as collateral, Peru's massive land titling program helped increase formal credit by over \$100 million.
- In Mexico despite a number of land-titling programs initiated by the government, private ownership of land remains shallow. Legal restrictions on the number of notary publics in Mexico have created a bottleneck for new landholders wishing to officially register their title under the law. According to one source, there are only 245 notary publics in Mexico City, an urban area with a population of over 11 million.

Intellectual Property Rights

The enforcement of intellectual property rights stimulates domestic industry and protects national creativity.

In an increasingly globalized, technology-dependent world, the protection of intellectual property rights has emerged as a key factor for economic growth and development. An adequate and effective intellectual property rights regime creates jobs, generates taxable income for the government and facilitates foreign and domestic investment by assuring protection for the investors' intellectual property. Although much of the discussion about IPR enforcement has focused on the interests of foreign companies operating in the developing world, observance of intellectual property rights equally benefits national stakeholders. It stimulates domestic industry while preserving national culture and creativity. In addition to providing economic incentives to domestic and foreign innovators, intellectual property laws and their enforcement also protect consumers by reducing the possibility that counterfeit products that do not meet health, safety or quality standards can reach the market. In countries where intellectual property rights are clear, codified and actively enforced, business and consumers both thrive.

Intellectual property is typically divided into two categories: industrial property, which refers to trademarks, patents and the like, and copyright, which refers to rights given to creators in their literary, scientific and artistic works.⁶⁷ A patent typically protects a device, method or process that is new, inventive and useful. It gives the

The World Health Organization estimates that 25 percent of medicines sold in developing countries are counterfeit.

⁶⁷ Industrial property can also refer to service marks, utility models, industrial designs, layout-designs of integrated circuits, commercial names and designations, geographic indications, and protection against unfair competition. These sub-categories are not covered in this report.

inventor the right to exclude others from making, using or selling the invention for a limited period of time. A trademark provides a product with a unique mark that identifies and distinguishes it from competitors' products and assures consumers that they are buying the product they intend to buy. Copyright protects the unique expression of an idea or information for a limited period of time and can be applied to traditional artistic works (i.e., literary works, movies and musical compositions) as well as protect computer software, databases and other technical materials.

Over the last 20 years, economists and academics have increasingly turned their attention to intellectual property rights and their impact on economic development.

Numerous studies have shown that enforceable IPR regimes increase overall economic welfare in less developed countries. Although

Firms patent an estimated 50 to 80 percent of inventions.

Source: Edwin Mansfield, 1986

many of these studies have focused primarily on patents, protection of copyright, with typically lower entry costs and greater domestic creation (when compared to patented products), have also been found to promote economic well-being.⁶⁸ In fact, copyright industries already make a significant contribution to the local economies of many Latin American countries. In Mexico, for example, in 1998 the copyright industries accounted for 6.7 percent of the GDP and employed about 1.5 million people, representing 3.7 percent of the total Mexican workforce that year.⁶⁹ The percentages for Argentina, Brazil and Uruguay are roughly the same.

While the economic benefits of strong IPR enforcement are evident, so are the disadvantages of weak IPR regimes. For one thing, the lack of intellectual property protection can reduce the incentives for businesses and inventors to invest time and money in developing new

⁶⁸ International Intellectual Property Alliance, *Initial Survey of the Contribution of the Copyright Industries to Economic Development*, International Intellectual Property Alliance (April 2005), http://www.iipa.com/pdf/2005_Apr27_Economic_Development_Survey.pdf (accessed July 30, 2006).

⁶⁹ International Intellectual Property Alliance, 10.

products, which impedes progress and prevents the transition from the informal to the formal economy. Failure to protect IP rights also affects the rights that artists have over their own creations. Furthermore, foreign companies are unlikely to introduce new and innovative products into countries where soon products will be vulnerable to competition from imitations. As a result, citizens of countries that lack strong IPR protection miss out on important technological advances enjoyed by those in countries with more developed IPR regimes. Export markets likewise suffer because many countries are more hesitant to import goods from places that turn a blind eye to violations of IPR rights. Importers cannot be as assured of product quality or authenticity.

Agreements to open markets such as the Colombia and Peru Trade Promotion Agreements provide clear rules and guidelines for establishing fair and enforceable IPR protection.

Understanding the importance of intellectual property rights for development, the international community has come together to promote protection at both the national and international levels. International conventions and agreements, along with efforts in cross-border cooperation and the sharing of best practices, have improved the environment for IPR protection. Below are some examples:

- In 1994, the World Trade Organization Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) was established as the first multilateral trade-related intellectual property agreement. The most comprehensive international IP accord, TRIPS governs copyright and related rights, geographical indications, patents, trademarks, trade dress, and

In the Patent Cooperation Treaty—a 1970 accord detailing procedural issues—developing countries accounted for fewer than 2 percent of applications from 1999 to 2001. Of these applications, over 95 percent came from China, India, South Africa, Brazil, and Mexico.

Source: UK Commission on Intellectual Property Rights

undisclosed or confidential information, and specifies enforcement and dispute resolution procedures.

- The most important treaty governing patent and trademark issues dates back to the Paris Convention for the Protection of Industrial Property (1883). More recently, trademarks are also addressed in the Trademark Law Treaty (1994) and the recently adopted Singapore Treaty on the Law of Trademarks (2006).
- Copyright and related rights are protected in the Berne Convention for the Protection of Literary and Artistic Works (1886), the Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations (1961), the WIPO Copyright Treaty (1996), and the WIPO Performances and Phonograms Treaty (1996).

The Business Software Alliance estimates that 35 percent of currently used software is pirated. In Latin America, that number jumps to 68 percent.

Source: *Third Annual BSA and IDC Global Software Piracy Study*, May 2006.

Principles

a. Basis in the Law

Intellectual Property-General

- Local law should be consistent with international conventions.
- Local law should give foreign nationals the same protection as they provide to their own citizens.
- Equal treatment should be granted for all innovators in cases of patent infringement, trademark piracy and counterfeiting.

Brazil's National Institute of Industrial Property is said to have a backlog of 60,000 applications and an 8-10 year wait before issuing decisions.

Source: Michael Ryan, 2006

- All actors in the supply chain should be held accountable for knowingly engaging in the sale of products that violate patent, trademark and copyright protections.

Copyright

- Access to the system must be open to large and small holders of copyrights.

b. How Applied

Intellectual Property-General

- Injunctive relief should be available as a remedy for the infringement of intellectual property rights.
- Counterfeit goods and materials used in their manufacture should be immediately destroyed except in exceptional circumstances.
- Action should be taken against intellectual property infringers to discourage further infringement while facilitating the recovery of losses.
- Investigation procedures coupled with ex-officio powers by law enforcement and stiff penalties can serve as deterrents to counterfeiting and piracy.
- Government authorities in free-trade zones and border areas should have the authority and initiative to strictly and consistently enforce intellectual property rights.
- Both in-country and cross-border cooperation should exist among customs, judiciary, police and other authorities to maximize collective action against infringers.
- Judges charged with adjudication of intellectual property rights disputes should possess adequate technical training and experience.
- Proceedings to suspend the release of counterfeit or confusingly similar trademarked goods should require sufficient evidence from the rights-holder, while ensuring that obligations are not overly cumbersome so as to deter small and medium-size businesses from initiating proceedings.
- Disputes should be fairly and expeditiously resolved.

Industrial Property (Patents/Trademarks)

- Access and information on how patents and trademarks are determined and enforced should be made widely available.
- Government programs and materials should be available to assist individual inventors and small businesses obtain protection for inventions and/or brands.
- Notice of an invention and the granting of a patent should be broadly disseminated.
- Consistent criteria and transparent processes should be used for determining whether an invention is in fact novel and non-obvious (inventive step).
- Criteria for the rejection and acceptance of trademark and patent applications should be applied consistently.
- Patent infringement case resolutions should take into account the short and long-term damage suffered by the patent owner.

EXAMPLES

Within the Western Hemisphere, several countries have taken positive steps forward to address intellectual property rights. However, IP protection remains a serious concern in most countries, with these examples only serving to highlight a small number of encouraging actions.

- In Paraguay, a patent law entered into force in January 2005. Originally promulgated in November 2000, the new law provides for the granting of product patents for pharmaceutical compositions. The law also addresses patent infringement and provides recourse through civil and criminal action and a

Brazil's *Clube Atlético Paranaense* has successfully reduced illegal product sales by street vendors through the creation of lower cost apparel and other products that are distributed by vendors. Not only does this boost the team's sales but it also brings new actors into the formal economy.

specific provision that sets out terms for calculating damages and losses.

- Brazil established the National Council for Fighting Piracy and Crimes Against Intellectual Property in October 2004. Although Brazil has made some strides in recent years to fight piracy, the Council represents a significant achievement. Various ministries, the legislative branch, police, and industry representatives worked together to develop a national plan to combat piracy through increased education, enforcement, institutional collaboration, and new economic policies. In 2005, much attention was placed on enforcement with several operations conducted at points where pirated goods enter the country; action was also taken at some of the more important locations for pirated goods sales.
- In Colombia, Resolution 603, enacted in July 2000, requires businesses to report compliance with copyright laws in annual tax reports. The legislation specifically highlights software piracy, and, in treating it as a form of tax evasion, allows the tax agency to inspect software licenses during tax inspections. The Resolution addresses a key IP issue in Colombia where software piracy is widespread. However, since the tax authority is permitted, but not obligated to ensure compliance, the provision has yet to make any significant inroads in combating software piracy.

Outside the Americas, the European Union boasts many model provisions that provide a good direction for ways to enhance IP guarantees.

- In Germany, a reliable, fast and cost effective court system has allowed it to become the preferred European jurisdiction for patent litigation. Professional judges with academic training in science or engineering preside over patent disputes, reducing the time and cost for resolving cases by eliminating the use of external experts.
- Italy, in the 1990s, changed the treatment of pirates to link their actions to tax infringement—a charge that carries greater penalties.

- A Community Trade Mark (CTM) allows a European trademark holder's registration to be valid in all European Union member states. By avoiding separate filings, a CTM simplifies procedures and reduces fees for the applicant.

Looking at other developing countries, India has gained momentum as a hub for research and innovation through the adoption of stricter IP laws. In March 2005, the Indian parliament approved

Argentina, Brazil, and Chile have yet to provide adequate protection against unfair commercial use of undisclosed test and other data submitted by pharmaceutical companies seeking marketing approval for their products. In the case of Chile, significant amendments are needed to IPR legislation to bring it in line with international and bilateral agreements.

Source: 2006 Special 301 Report

legislation that brought the country into compliance with the TRIPS agreement. With strong pharmaceutical and biotechnology industries and the world's fourth largest drug market by volume, the legislature in India believed that domestic drug producers had more to gain if the government brought patent protections in line with international law. The previous patent law only required patents to be granted to the chemical processes that produced a drug—not the drug itself—allowing for the creation of a large generic industry that had kept many foreign companies from investing in India.

CONCLUSION

We convened this working group and are issuing this working report at a time of important transition for Latin America. Over the course of a year, as our members analyzed how to improve the rule of law in the Americas, Latin Americans in 12 countries were going to the polls to select new governments. The period from November 2005 to the end of 2006 saw the election or re-election of presidents from Brazil to Peru and Mexico, each with his or her own vision and direction for the future. This historical series of elections in the hemisphere provides a unique opportunity for these new governments to address citizens' demands for security and prosperity by effectively improving the rule of law.

Throughout this report, we have pointed out the numerous positive developments that governments have implemented to make the rule of law more accessible, fair, transparent, and efficient. But these reforms, while critical, have not produced systemic change. Rather, what we are witnessing are isolated examples of success. As we have argued throughout this report, the rule of law is a seamless web stretching from the individual to the corporation. Promoting the sort of broad-based reform that can touch on all these factors and the principles outlined in this report requires systemic thorough change.

Among the various principles and proposals, the working group would like to highlight three important ideas woven throughout our discussions. First, the rule of law is important for the livelihood of all in a society. Every individual needs to be certain that the law, from its drafting to its enforcement, is part of a legal system that is open, prospective and equal. Second, the people that make up a country's economy, from aspiring entrepreneurs to business owners and consumers, must have confidence in the rule of law to maximize their potential economic contributions. Economies can thrive without it, but achieving sustainable economic growth and reaching new levels of prosperity hinge on a well-functioning legal system. Third, the concern and collective commitment of the private sector in matters related to the rule of law is a general public good. An environment

conducive to entrepreneurship is tied hand-in-hand to one where all individuals are equal beneficiaries of a sound legal framework.

As the Americas Society and Council of the Americas continue this work, we hope that others will remain engaged in strengthening the rule of law in our hemisphere. There are many ways that the international community and domestic actors can help facilitate positive change. One step is to support governments that are seeking to or have implemented necessary reforms. Improving the rule of law demands a multi-pronged approach that is best achieved with broad-based commitment and support. For this, in-country dialogue and debate is essential for ensuring that a range of opinions, analyses and prescriptions are incorporated into any modifications of the legal system.

In the next phase of this working group we will be doing exactly that. This working report will be used as the discussion report to convene working groups in a number of countries in the hemisphere. These working groups will bring together a cross-section of the local community. Not only will these discussions shape an even more comprehensive conversation, but together, the private sector, non-governmental organizations, multilateral institutions, legal practitioners and others can lay the groundwork for real, positive change.

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William Irwin is Manager of International Government Affairs at the Washington office of the **Chevron Corporation**. Mr. Irwin coordinates activities in support of the company's international businesses as they relate to the U.S. Government, the diplomatic corps, the United Nations, and U.S. trade associations. He has worked in engineering, strategic planning and business development positions across the globe. Mr. Irwin is an officer of the US-Venezuela Business Council and sits on the board of the US-Colombia Business partnership.

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Luiz A. Sette is Associate General Counsel and leads the Legal and Corporate Affairs practice in Latin America and Caribbean for **Microsoft Corporation**. He provides legal support and strategic advice to 21 subsidiaries in the region and its business leaders, and creates ties with governments, industry and community organizations. Mr. Sette has been an active representative of Microsoft in external forums. Prior to Microsoft, he was a partner of Azevedo Sette Advogados in Brazil and worked as Foreign Associate with Simpson Thacher & Bartlett.

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Susan Segal was elected President and CEO of the **Americas Society** and **Council of the Americas** in August 2003 after working in the private sector with Latin America and other emerging markets for over 25 years. Prior to her current position, she was a founding partner of her own investment and advisory group focused primarily on Latin America and the U.S. Hispanic Sector. Previously, Ms. Segal was a Partner and Latin American Group Head at JPMorgan Partners/Chase Capital Partners where she invested across sectors and countries in addition to pioneering early stage investing in Latin America. Before joining CCP, she was a Senior Managing Director focused on Emerging Markets Investment Banking and Capital Markets at MHT/Chemical/Chase Banks.

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Rule of Law, Economic Growth and Prosperity

A working report of the Americas Society and Council of the Americas
Rule of Law Working Group

Respect for the rule of law is a basic requirement for fostering business development and generating stable, broad-based economic growth. It provides entrepreneurs and small business owners with confidence to enter the formal economy and is essential to nationwide development.

For that reason, the Americas Society and Council of the Americas convened private sector representatives, practicing lawyers, academics, and representatives of non-governmental organizations over the past year to discuss reforms and next steps for improving the rule of law throughout the hemisphere. Meeting in New York, Washington, São Paulo, and Mexico City, the working group looked at four of aspects of the rule of law most critical to achieving far-reaching growth:

- the administration of justice;
- the regulatory framework for business and investment;
- the use of alternative dispute resolution methods and the enforcement of contracts (including the proper settlement of claims in bankruptcy); and
- the protection of tangible and intellectual property rights.

Chaired by Antonia Stolper and Mark Walker—both Latin American legal experts—this initiative and the working report serve as an ongoing dialogue with counterparts across the Americas. Improving the rule of law requires a multi-faceted approach that is best achieved with broad-based commitment and support.