

**Radical Reform: Transitions to Liberal Democracy  
and the Rule of Law**

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It's an honor to be here. As Chris said, I attend many AEI events. AEI is for me one of the great joys of living in Washington.

My topic is reform, and I think any talk on reform should note what Macauley had to say on the subject. "Reform," he said, "Don't speak to me of reform, sir. Things are bad enough as they are."

A word about the background of my interest. I was brought up in a good cold warrior family, and we saw the Russians as Communism's first and in some ways principal victims. So when the Soviet Union fell, I was a natural enthusiast for programs to promote the "rule-of-law" in Russia. And the process has forced me to think a great deal more about the problem.

Most of my examples are drawn from Russia or other parts of the former Soviet Union, but I think the principles are applicable to other countries that lack fully fledged liberal democracy.

The key features of liberal democracy (or what I may sometimes call "market democracy") are these: the enactment of laws through representative bodies; free speech; private property; the resolution of most resource allocation issues by individuals and firms operating in free markets.

For the rule of law, the core is the idea that as against the government a citizen or firm can get a hearing in court, before a (largely) disinterested judge, on whether the statute or rule invoked against him by the executive branch really applies, and what it really means. Citizens must also have recourse to impartial courts for resolution of disputes among themselves over property, contract, and corporate relations. Laws must have some minimal level of clarity so that people can rely on them in deciding on their conduct and as a (partial) limit on selective enforcement. Finally, judgments must be enforced--a problem Americans normally needn't think of, but which is critical in much of the world.

Two caveats: First, I'm agnostic on the power of courts to overrule legislatures on the ground of Constitutional violations. England, after all, has no such relationship between court and legislature, yet surely enjoys the rule of law. Second, I want to mention one thing the rule of law is NOT: a society in which most or lots of issues are resolved by

“law,” i.e., rules created and enforced by the state, or by agencies using the power of the state. One can see how the phrase “rule of law” might be taken to have that meaning, but that is not my intention--nor the intention of most people using the phrase.

For purposes of this talk I'll put aside the interesting question whether liberal democracy and the rule of law are suitable for all nations. Fukuyama argues that liberal democracy has unique advantages for fulfilling universal human needs. Above all, it's able to channel the human yearning for distinction into productive activity, rather than into fighting over distribution of a fixed pie. The argument seems strong to me. But even if the appeal of liberal democracy is not universal, the issue of transitions is still worthwhile. It's clear that some people in non-liberal countries prefer liberal democracy and the rule of law enough to work for it from within--so it's interesting to see the world through their eyes and think of the problems they face. And it's surely in our interest that as many countries as possible move in that direction. The move may not be inevitable, as Fukuyama argues, but it surely is desirable.

Finally by way of background, I want to acknowledge that I'll talk as if liberal democracy were a finished, established thing, although we know that's not true. It's constantly reworking itself, getting worse in some ways, better in others. But however deep the need for reform may be here, for example, the move to liberal democracy for a country that has never had it--the case calling for the “radical reform” of my title--still seems distinctively different.

The impediments to countries' rapid evolution into liberal democracies seem to me of three basic types: (1) interest groups, (2) collective action problems, and (3) culture:

1. Interest groups that benefit from the status quo.

On the government side are officials who either control state resources directly (think of government oil and gas monopolies, for example), or who have lucrative relationships with nominally private firms. On the nominally private side are firms that benefit from sweetheart arrangements with officials.

The sweetheart deals arise out of a whole range of government decisions that are vital to whether a business will flourish or be stamped out: contracting, licensing, taxation, criminal law enforcement, etc.

A recent example is the role played by Lukoil, a nominally private firm owning a minority share in TV-6, which is, legally at least, the most independent TV station in Moscow. Lukoil invoked a provision of Russian bankruptcy law that allowed a minority shareholder to put a firm into bankruptcy when it failed to meet certain financial criteria. The odd thing was that TV-6 had been in considerably worse financial shape before, yet Lukoil had not invoked this provision. Why do so now, with the channel seemingly on the mend financially? The answer, as one commentator put it, appears to be that any dividends that Lukoil could expect from TV-6 were dwarfed by the benefits it could expect from pleasing the government.

So for those who benefit now from the process of decision-making on the basis of either outright graft or patrimonial connections, a change to the rule of law will be harmful.

Of course that somewhat oversimplifies. For the bureaucrats, one can easily imagine that some or even all might end up better off, if the end of this sort of manipulation meant (a) higher salaries for those continued on the government payroll, and (b) more lucrative jobs in private industry--thanks to economic improvement--than were available before. For the firms, the existing system involves the costs both of (1) making the pay-offs and (2) being subject to the risks of similar treatment at the hands of bureaucrats bought by their competitors; so you might expect even apparent "beneficiary" firms to embrace change. Put another way, the removal of deadweight loss has the potential to make everyone better off.

But my earlier oversimplification is basically justified. First, the gains to any particular participant are iffy, even if the resulting economic growth is ample to provide them. Second, the current participants have a kind of human capital built up in the existing relationships (and perhaps even in their manipulative skills), and radical reform would impair the value of those relationships and skills.

## 2. Collective action problems.

Here I'm talking of the hazards of being a pioneer in a nation's move to rule of law, at a time when it is far from clear how many others will move in that direction, and how fast and how far. An important part of what drives a person are his actual expectations about how others will behave--particularly people he might transact business with (or embark on a civic project with), or officials who wield government authority and are supposed keep the peace, protect property, or collect taxes.

If dishonesty and corruption have been widespread, even the most honest person--perhaps especially the most honest person--will still be reluctant to enter transactions that depend either on honesty of others, or on courts to sanction the dishonest.

If courts and officials are often used--through bribes or connections--to stamp out new competition, then people will be slow to invest in creating productive resources, and certainly slow to give up practices that work in a corrupt system.

A related example is what William Easterly calls "matches"--the proposition that the return on a particular skill or endeavor increases when there are productive complements at hand.[1] A doctor can be more productive in a society where he or she can readily obtain complementary inputs (nurses, hospitals, equipment, drugs). Two sad consequences follow: First, in a society with a generally low skill level there is less incentive to invest in human capital. Second, those who do so may well be tempted to emigrate to places where the return is greater because a good supply of complementary skills is already present; the result is brain drain.

### 3. Culture.

Alternatively I'll sometimes call this "habits of mind." (For some, culture conjures up such things as preferred types of theater.) I think of habits of mind as having two aspects. The first is normative: how I evaluate certain kinds of behavior, my own and others'. The second relates more to practice. Thinking independently, seeking to engage others in common enterprises, being able to engage in the articulation and compromise that are necessary for effective association--these are all practices. It isn't enough to think well of them (the normative issue); it's necessary to be able to do them. And doing them requires practice.

Unfortunately, habits of mind adaptive for one situation may not be adaptive for another; some of the habits that work where the society as a whole isn't a liberal democracy, or in a subculture whose members are generally excluded from the benefits of a surrounding liberal regime (or at least a relatively liberal one), may not work in a liberal regime.

First, take instances where incentives for purely individual effort, such as hard work, ingenuity, and risk-taking, are deadened. Consider, for example, Russian peasants living in the "commune" that prevailed between nominal Emancipation in 1861 and (loosely) 1906. Given that much of the fruits of such efforts would be socialized, a peasant of that era might well take a generally dim view of people who did well. One scholar of the peasants says they commonly believed that "successful peasants more than likely achieved their wealth through usurious and unfair practices." [2]

Similarly, if as was true in the Jim Crow South the KKK singles you out for harassment because you have managed to acquire an education, and government won't protect you, you may come to think less well of investment in your own, or your children's, human capital.

Second, and almost surely a greater problem, are conditions that do not reward--or even penalize--the sort of relationships that are valuable (even essential) in a liberal market.

If you live in a totalitarian system where assembling for any independent purpose is regarded as evidence of treason, you won't have much of the experience of organizing into voluntary associations--and therefore not much capacity to do so. Contrast this with tendency to spontaneous association that Tocqueville found so extraordinary among Americans. Incidentally, I was delighted reading Morris's new volume on Teddy Roosevelt over the weekend to learn that before he became president at 42 he found time to start three associations--a finance club, a stockmen's association, and a hunting-conservation society.

Even in states where spontaneous association has not been a crime, social capital is warped. In the patrimonial state success is heavily dependent on having a good relationship with one or a few higher-ups. You get benefits if you're in a favor-exchanging relationship with some "boss" or his subordinate. Sicily, at least as portrayed

by Robert Putnam and others, is a classic example. In such a state there's no premium--indeed, probably quite a discount--on ability to organize independently of the hierarchy.

I'm not saying there is no social capital in a totalitarian or patrimonial state. But it's going to be largely built up in vertical relationships. A story from Russia under Stalin illustrates the mechanism. The occupant of an apartment installed a flower-box in his window; the occupant a flight below objected. Each side took its claim up through the informal chains of officials, until at last the dispute was settled by Kalinin, the President of the USSR. Of course, as he was only a figurehead the dispute cannot be said to have diverted him from important work, but it shows the verticality of the ties.

Besides this sort of vertical relationship, there may be social capital in rather narrow horizontal relationships; there's evidence of very close bonding, for example, in rather narrow clusters of workers in the Soviet Union. But the horizontal linkages don't add up to the sort of relationships that fit a liberal democracy, because they're not suitable for actually accomplishing things beyond their own boundaries.

Further, in the Soviet Union, much of the networking activity that might be called social capital was devoted to zero-sum activities: deciding who will get the limited supply of goods in a store, or who will get a plum job. Little was devoted to bringing new resources to a task, or organizing existing resources better.

Consider the following view of the rule of law. In an interview with NPR, the Russian translator of the Harry Potter books said of the second volume that it carries the message that rulers should not follow the law. "Russia wouldn't be here if people followed the law." True--the planned economy would have produced disaster earlier if there had not been devices for getting around the plan.

In speaking of "culture," I'm risking the wrath of social scientists, many of whom--perhaps most--deny that it has any role worthy of investigation. So far as I can make out, one argument is that culture, or these habits of mind, are hard to define and measure, therefore they can't be taken seriously. I'd offer three answers:

1. The difficulty of measurement in itself tells us nothing about the reality or importance of a phenomenon.
2. Common sense suggests that culture--in the form of specific habits of mind--is very important. To take an obvious example, if you are brought up speaking Japanese and have no occasion to distinguish between Ls and Rs, your mouth doesn't acquire the capacity to utter the distinction or your ears to detect it. If true for speech, why not for social aptitudes? Compare Aristotle--you learn to do good by doing good.
3. The habits of mind that interest me are susceptible to measurement, if only imperfectly, and indeed have been measured exhaustively.

In any event, I don't want to overdo the extent to which history has created habits of mind that make a transition to liberal democracy hard. There's evidence (from study of case files of local litigation) that in many contexts perfectly ordinary Russian peasants subscribed to attitudes associated with bourgeois individualism. And in the early years after the October Revolution, Russian peasants, to the extent that the government left them alone, seemed to be moving forward quite briskly in their ideas about property rights.[3]

Even for a subculture within a liberal democracy, these habits of mind obviously play a role. This is the story of immigrants to the U.S. Even though often coming from societies where the rewards to exercises of ability, ingenuity, and cooperation were dangerous or at least didn't take a socially productive form, they've picked it up within a generation or two.[4] And as Michael Barone argues (indeed argued from this podium in his Bradley Lecture), the same is likely to prove true for Afro-Americans, viewed as fairly recent immigrants from the Jim Crow South.

But the radical reform of a whole nation presents a much tougher case. I'll approach it in terms of the sources of the change. These seem to be threefold: (1) From above in the "nation," (2) from below in the nation, (3) from the exterior.

#### 1. Reform from above within the nation.

Our media tend to treat reform from above as virtually the only source of reform, or the only interesting source. Reform at the top is obviously helpful (it's better to have a Yeltsin than a Brezhnev in charge), but alone is likely to be inadequate. Reforms are likely to be thwarted altogether or distorted in practice.

Interest groups that benefit from status quo will resist the reforming leader, and at a minimum will try to extract concessions. The concessions in turn will distort the reforms and perhaps cost political support in the broader population. This is essentially the story of "nomenklatura privatization" in Russia.

You may be tempted to wish the opposition away. But if your "reformer" president or prime minister could proceed by decree, you wouldn't have "liberal democracy." Of course where legislative and executive candidates run on an explicit platform of drastic reform, and win, you have what is presumably the ideal: this would be reform from above driven by pressure from below. But even then:

Formal legal change will not yield the hoped for results--or at least not all of them--unless there are solutions to the collective action issue and to the culture problem. Actors need assurance that a new pay-off system is really in place; people must internalize new norms and move toward practical action based on those norms.

Let me here take a partial detour to the subject of corruption in general and in relation to the judiciary. Corruption is plainly one of the negations of the rule of law. Part of what can be done about it is a police work issue, on which I can't offer anything. But part

relates to opportunities for corruption. Obviously government policy can spawn these, by proliferating permit requirements and other regulatory obstacles, especially ones that fly in the face of human--or at least market--nature, such as binding ceilings on interest rates. So reducing these must be part of any reform program--though one obviously sure to attract strong resistance.

Much of the criticism of Russian reform in the last decade depicts the process as one of free-market zeal run amuck, recklessly doing away with--or failing to establish--what are loosely called regulatory protections. If that refers to failure to assure the honest enforcement of basic rules of contract and property rights, and basic prevention of fraud, the criticism is sound. But before the critic convinces you that the reformers were frauds and charlatans, you ought to get him to explain just how he would have provided this assurance. And so far as gross levels of regulation are concerned, rest assured that Russia has not been suffering a drought. Recently Putin gave a speech eloquently denouncing current permitting processes, a series of checkpoints for bribe delivery that he called "legalized extortion."

Another policy issue, not so obviously related, is foreign trade. Openness to foreign competition reduces the pay-off from bribes to officials who, in exchange for favors from local firms, throw obstacles in the way of local competitors. If setting goons on your local competition still leaves you exposed to strong foreign competition, there's much less advantage to it. And of course genuinely free trade implies few bureaucratic obstacles to the imports themselves. I don't mean to suggest that this point disposes of all issues relating to a reforming country's trade policy, but it is a plus for liberalization that is rarely mentioned.

Now, corruption and the judiciary. Clearly liberal democracy requires getting the right balance between judicial independence and judicial accountability. Widespread corruption suggests there is not enough accountability. But if the only solution is less judicial independence, then you lose--or at least impair--a useful building block for the liberal state.

Here, judges are seriously constrained by norms that they bring to the job and that are enforced almost exclusively by informal means. This makes it possible (at least we like to think it does) to afford a pretty high level of judicial independence--the wonderful protections of Article 3--without too great a risk of irresponsibility. But internalization of such norms can't happen overnight.

Further, to connect this with my earlier remarks on social capital, there is evidence that independent citizen monitoring is very helpful here, but forceful monitoring is in turn heavily dependent on a healthy civil society.[5] Again, while reform from above is perhaps necessary, it plainly isn't sufficient.

So would-be reformers better be alert to the difficulties. Interest groups can be fought, or bought off, but all of that will cost political capital and blunt the reforms. The local culture is a deeper problem even than interest groups, precisely because it cannot be

bought off. Reforms that assume a different culture (1) won't work as expected and (2) are likely to raise undue expectations. This takes us to the need for reform from below.

## 2. Reform from below within the nation.

As you know, evolution in nature works one-by-one; a mutation prevails if but only if it enhances the survival prospects of an individual (specifically, the individual as a vehicle for transmission of genes). I don't mean to suggest that the evolution of human norms and behavior patterns proceeds in exactly the same way as physical evolution in nature, but I think you have to ask what will persuade an individual to change his outlook and behavior.

Suppose you believe that transparency in corporate organization is good (your ethical position), and that offering a relatively transparent form of corporate organization might give you a competitive advantage in attracting capital (because minority shareholders will be protected from looting by management). But (1) the tradition of corrupt courts makes it hard to make a binding promise in the corporate charter; and (2) transparency will likely make the firm a target of corrupt tax officials. So the innovation is riskier than it ought to be.

The good news is that even in the face of defective surrounding institutions, some will take the plunge. Michael Khodorkovsky, the major shareholder of Yukos Oil, took steps to increase transparency and protect minority shareholders, and the firm's stock has risen 100-fold.

You might react to that by saying, Why is he worrying about incentives? Look how Khodorkovsky was rewarded! But remember, at least dozens had the opportunity to pioneer in this way, but until Khodorkovsky, no one did.

More generally, there are two phenomena that support optimism--norm entrepreneurs and cascades. "Norm entrepreneurs" are people ready to take what for others would be unacceptable risks in deviating from prevailing practice. They may have natural leadership skills, or extra insight into the benefits of new norms, or they may be uniquely situated to exploit an innovation. Clearly Khodorkovsky had something that persuaded him to do what other oligarchs would not.

Closely related is the concept of cascades. This turns on the idea that a lot of people don't think for themselves much (especially on topics where they don't think their thoughts will have much impact), so they tend to follow the crowd. But people's readiness to "follow-the-crowd" varies a lot. Some will pursue a new norm alone (the norm entrepreneur); some, if they harbor doubts of the old norm, will act on those doubts if they see 5% of the relevant group change, some 10%, and so on. The result may be a very swift evolution once a cascade gets under way. (Think of East Germans risking exit via Hungary in 1989.)

So the obstacles presented by collective action problems and ill-suited habits of mind are not insuperable. The current liberal democracies, or their parent cultures, after all, somehow achieved this transformation.

### 3. Remedies from outside.

First, a key tenet: A “reform” that the recipient country hasn’t adopted on its own, with support by relevant interest groups, is not likely to last, and it is likely to be evaded or thwarted. In the jargon of the field, such a reform isn’t “owned” by the recipient country. You know the riddle, “How many psychiatrists does it take to change a light bulb?” “Just one--but the light bulb has to really want to change.”

I see these as fitting into three categories (I apologize for what may seem excess trinitarianism; it’s not deliberate): government-to-government aid; government aid to the private sector; and a grab-bag called other (which in my view comes out on top).

A. Government-to-government “democracy” aid. AID has funded projects aimed at supporting democracy through judicial reform. (1) Some of this has been highly technical, such as sharing our lore on case-processing methods--the flow of cases. This is surely helpful, but hardly transformative.

(2) Some has taken the form of increasing the judiciary’s budget, renovating buildings and other physical infrastructure. But plainly the rule of law isn’t greatly advanced if judges use spandy new offices and computers to reach decisions based on bribes or political influence.

(3) There has also been aid on issues of judicial selection and “judicial career laws,” i.e., efforts to balance responsibility with independence. Now you’re getting to the core of judicial behavior, but you’re likely to run into strongly vested interests--at least on the “responsibility” side of the balance. When proposals surfaced to expose the Russian judiciary to even a rather softened version of ordinary laws, elements of the judiciary broke out into an uproar--and, oddly, the uproar was listened to. In the government’s fight to put those reforms through, U.S. AID could help the government with technical advice, perhaps, but that would be of little weight in the political struggle. In other words, the most important aspects of any change are very largely beyond our direct influence (and rightly so, I would add).

B. Government aid to private parties. In the 1990s AID (and international donors) got the idea of trying to nurture civil society. They began to give aid to select organizations, usually located in capital cities, and usually ones devoted to advocacy of what was considered in the public interest. Here is Thomas Carothers’s list: “election monitoring, civic education, parliamentary transparency, human rights, anticorruption, the environment, women’s rights, and indigenous people’s rights.”[6]

These are all fine, but the whole group seems a pale shadow of the range of organizations that Tocqueville found in America in the 1830s; or that Putnam described in his study of

Northern Italy. The organizations seem heavily weighted to lobbying, and seem to largely exclude associations that might spring up for other purposes--such as associations that business firms use to mediate or arbitrate disputes, or to set standards, or that people use for credit or mutual insurance, to organize irrigation, or to carry out broader civic projects. Think of the associations formed by Teddy Roosevelt alone!

But I think there's a more fundamental defect in this type of aid. It gives these select organizations a louder voice--but one that is recognizable as not independent or indigenous. Surely this is an extreme case of a "reform" not being "owned" by the donee country.

C. My grab bag--other ways. Here two approaches seem to me to stand out, each summarized in a slogan of the Eisenhower administration: "people to people" and "trade not aid."

"People to people": Here I'm speaking of real relationships between Americans and individuals in these countries (whether general, such as students too young to have specialized, or "expert"). I'd concentrate them on the young. Senator Bradley's idea of making it possible for 100,000 Russians to study here strikes me as a great example.

Trade: First, this seems to be an avenue for direct transmission of modes of relating--contract, trust, transparency--in a market democracy. So long as the U.S. parties are not subsidized by government, they'll negotiate realistically--they'll have to. And it should expose economic agents in the reforming country to the sorts of provisions and informal institutions that are helpful in keeping parties honest. Second, for the reforming country, lower trade barriers means fewer profitable opportunities for corrupt rent-seeking practices. And finally it should increase the economic opportunities of people in the reforming country.

Are there cases where trade has a downside, or at least where we should have doubts? Obviously trade in the products of slave labor is completely counterproductive; the trouble is that except in extreme cases it may be hard to monitor.

Also, when firms in the liberal democracies buy raw materials--the products of extractive enterprises--my guess is that there will be relatively little beneficent transfer of sound practice. Because of the large rents typically involved in such fields, they tend to attract corruption, and I'm less confident there that our higher standards will come out on top.

Post-9/11, one inevitably asks what its implications are for a subject like this. First, of course, it clearly raises the stakes, or more precisely exposes how high the stakes have been all along. A country without the rule of law--or at least a certain type of country without the rule of law--is at risk of becoming a harbor for terrorists, and so is more than just a nuisance or a remote threat.

Can U.S. activities fostering the rule of law be relevant? I've focused here on methods that can operate (if at all) only over the long pull. That's because, except for relatively minor technical matters, these seem to me the ones most likely to succeed.

Are there effective short-run methods? I doubt it. Although an external power can control a country that is deficient in the rule of law, that very control is likely to stifle development of healthy indigenous institutions. Rule of law by decree is an oxymoron.

I think we tend to draw unduly optimistic inferences from our occupations of Germany and Japan after World War II: First, the occupations followed the total defeat of those countries' ruling elites, and thus their complete delegitimation. Second, it may be that we underestimate the comparatively healthy elements that existed in those societies before their eras of Holocaust and rampage.

But in terms of 9/11-type hazards, the exigencies may be such that the long term is too long. Then other policies will be in order, but they will relate only very obliquely to the rule of law.

Finally, 9/11 raised for us the question why there is such a correlation between Muslim countries and countries bereft of rule of law or liberal democracy. Here I'll hazard a guess based on a confessedly incomplete reading of what Bernard Lewis has had to say (a guess that, in what I've read, he never actually endorses). What may be critical is that Islam originated as a combined church and state, and on the whole retained that character for centuries. As a result those areas have missed a linchpin in the healthy dispersion of power in Western societies--the existence of two powerful institutions making competing claims to authority.

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If my overall message seems a bit gloomy, I urge you to remember the norm entrepreneurs and the cascades, not to mention the history of existing liberal democracies--they too weren't built in a day, but they did get built.

[1] William Easterly, *The Elusive Quest for Growth* 155-61 (2001).

[2] Christine Worobec, *Peasant Russia: Family and Community in the Post-Emancipation Period* 41 (1995).

[3] Orlando Figes, *Peasant Russia Civil War: The Volga Countryside in Revolution 1917-21*.

[4] Mancur Olson, Jr., "Big Bills Left on the Sidewalk: Why Some Nations Are Rich and Others Poor," *J. of Econ. Perspectives*, vol. 10, number 2, pp. 3-24.

[5] World Bank, *World Development Report 2002: Building Institutions for Markets* 125-27, 129.

[6] Thomas Carothers, *Aiding Democracy Abroad* 210 (1999).