Rewarding Corruption?

The Perverse Effects of Judicial Corruption on Foreign Direct Investment

in Latin America

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Abstract: The traditional view that inter-branch judicial independence is a necessary condition for high levels of foreign direct investment is flawed because it neglects to consider the significance of the autonomy of judges from societal actors as a distinct factor. Separating these two aspects of judicial independence and then interacting them produces four "judicial regime types": the Liberal, Partisan, Clandestine Control, and Dependent judicial regimes. Using data from the World Economic Forum's Global Competitiveness Reports, this study examines the influence of judicial regime type on levels of foreign direct investment in Latin America. Case studies drawn from Central America demonstrate that Dependent judicial regimes may have advantages over even the highly independent and autonomous Liberal regimes.

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Judicial independence is widely recognized by scholars and practitioners alike as an important component of a functioning polity. It is widely believed to be important for many goods, such as respect for human rights, political accountability, transparency, and promoting a good investment climate, all of which can be grouped under the nebulous concept of the rule of law. Herein, I focus on the effect of the judiciary on foreign investment in Latin America. Whereas the usual argument is that an independent, non-corrupt judiciary is necessary for the attraction of foreign investment and overall economic growth, evidence from Latin America suggests that systems with corrupt judiciaries, perversely, may also provide fertile investment climates. Section one introduces the concepts of judicial regime types, constructed by overlaying the concepts of inter-branch judicial independence and judicial autonomy from societal actors. Section two examines these two concepts and of judicial regime types on foreign direct investment in Latin America. Section three then delves into five case studies from Central America to examine the dynamics of both political and petty corruption on investment climate.

I. Judicial Independence and Autonomy

The rule of law, defined as a system in which "legal rules are applied fairly, consistently, and predictably across equivalent cases, irrespective of the class, status, or power of the subject of the rules,"[1] has been a central part of democracy-promotion efforts (as "rule of law reform") as well as efforts to understand democratic development since the so-called "third wave" of democratization in the 1980s.[2] The rule of law was considered necessary for governments to

[1] Larry Diamond, *Developing Democracy: Toward Consolidation* (Baltimore, MD: The Johns Hopkins University Press, 1999) at 11.
[2] Thomas Carothers, "The Rule of Law Revival," *Foreign Affairs* 77 (1998): 95–106; Thomas Carothers, *Promoting the Rule of Law Abroad: In Search of Knowledge* (Washington, DC: Carnegie Endowment for International Peace,

make “credible commitments” to citizens, political rivals, and investors alike.[3] The rule of law, which defies measurement or even uniformly accepted conceptualization, has fallen out of favor. Judicial independence – in itself not easy to measure[4] – has taken its place in political economy research.[5] The recent work of Biglaiser and Staats,[6] based on a survey of United States firms doing business in Latin America highlights the significance of judicial independence in particular as an important consideration for foreign investmors. Judicial independence is important primarily in its relationship to property rights protections.

This research has not, however, taken into account a newer line of research on the surprising benefits of “rule by law” with judicial independence or semi-dependence in

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2006); Domingo, Pilar and Rachel Sieder, *Rule of Law in Latin America: The International Promotion of Judicial Reform* (London: Institute of Latin American Studies, 2001); Juan J. Linz and Alfred Stepan, *Problems of Democratic Transition and Consolidation: Southern Europe, South America, and Post-Communist Europe* (Baltimore, MD: Johns Hopkins University Press, 1996); Samuel Huntington, *The Third Wave: Democratization in the Late Twentieth Century*, Julian J. Rothbaum Distinguished Lecture Series (Norman, OK: University of Oklahoma Press, 1993); Margaret Popkin, *Peace Without Justice : Obstacles to Building the Rule of Law in El Salvador* (University Park, Pa.: Pennsylvania State University Press, 2000).

[3] Douglass North, John Joseph Wallis, and Barry R. Weingast, *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History* (Cambridge, UK: Cambridge University Press, 2009); D. C. North and B. R. Weingast, “Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-century England,” *The Journal of Economic History* 49, no. 04 (1989): 803–832.

[4] Indeed, a cottage industry of statistical measures of judicial independence has developed. Analysis of these measures in Latin America, however, has found them to not even correlate well with each other, leading to significant questions about their usefulness. Julio Ríos Figueroa and Jeffrey K. Staton, *Unpacking the Rule of Law: A Review of Judicial Independence Measures*, Political Concepts (Committee on Concepts and Methods, International Political Science Association, September 2008).

[5] Yi Feng, “Political Freedom, Political Instability, and Political Uncertainty: A Study of Political Institutions and Private Investment in Developing Countries,” *International Studies Quarterly* 45 (2001): 271–294; Steven Globerman and Daniel Shapiro, “Global Foreign Direct Investment Flows: The Role of Governance Infrastructure,” *World Development* 30 (2002): 1899–1919; Robert Grosse, “Foreign Direct Investment in Latin America,” in *Generating Savings for Latin American Development* (Coral Gables, FL: North-South Center Press, University of Miami, 1997), 135–53; John P. Truman and Craig F. Emmert, “The Political Economy of Foreign Direct of U.S. Foreign Direct Investment in Latin America: A Reappraisal,” *Latin American Research Review* 39 (2004): 9–28.

[6] Glen Biglaiser and Joseph L. Staats, “Do Political Institutions Affect Foreign Direct Investment? A Survey of U.S. Corporations in Latin America,” *Political Research Quarterly* 63, no. 3 (2010): 508–522; Joseph L. Staats and Glen Biglaiser, “Foreign Direct Investment in Latin America: The Importance of Judicial Strength and the Rule of Law,” *International Studies Quarterly* 56 (2012): 193–202.

authoritarian and hybrid regimes.[7] These studies, which focus primarily on hybrid regimes outside of Latin America, have highlighted that both independent and dependent judiciaries may be quite functional for governments for a long time. With the pressures to grant independence to judiciaries, especially in the area of constitutional law, governments may create the appearance of an independent constitutional arbiter without actually allowing that body to effectively check the government on the important issues by such means as withholding certain areas from its jurisdiction.[8] Unfortunately, many such studies focus primarily on the highest courts and constitutional arbiters, which may not be the most significant actors in the protection of thelegal interests of investors.[9] Thus, while it widely believed that an independent judiciary is necessary to attract investment, few studies have established adequately that it is a necessary condition. I argue that the root of this problem lies in our current conceptualization of judicial independence.

[7] Tom Ginsburg and Tamir Moustafa, *Rule by Law: The Politics of Courts in Authoritarian Regimes* (Cambridge: Cambridge University Press, 2008); Tamir Moustafa, "Law Versus the State: The Judicialization of Politics in Egypt," *Law and Social Inquiry* 28 (2003): 883–928; Nathan J. Brown, *The Rule of Law in the Arab World: Courts in Egypt and the Gulf* (Cambridge, UK: Cambridge University Press, 1997).

[8] This phenomenon is common in Latin America as well and was especially true during periods of authoritarian rule and transition, although it continues in a number of weak democracies and semi-democracies. Daniel M. Brinks, "'Faithful Servants of the Regime': The Brazilian Constitutional Court's Role Under the 1988 Constitution," in *Courts in Latin America*, ed. Gretchen Helmke and Julio Ríos Figueroa (Cambridge, UK: Cambridge University Press, 2011), 128–153; Anthony W. Pereira, *Political (in)justice : Authoritarianism and the Rule of Law in Brazil, Chile, and Argentina*, Pitt Latin American Series (Pittsburgh, Pa.: University of Pittsburgh Press, 2005). In contrast to arguments from Israel and Taiwan, among other polities, the creation of such bodies need not allow these bodies to take on a life of their own. Juo-Juo Chu, "Global Constitutionalism and Judicial Activism in Taiwan," *Journal of Contemporary Asia* 38, no. 4 (2008): 515–534; Yoav Dotan and M. Hofnung, "Legal Defeats - Political Wins. Why Do Elected Representatives Go to Court?," *Comparative Political Studies* 38, no. 1 (2005): 75–103; Menachem Hofnung, "The Unintended Consequences of Unplanned Constitutional Reform: Constitutional Politics in Israel," *American Journal of Comparative Law* 44 (1996): 585–604; Gary J. Jacobsohn, "Judicial Activism in Israel," in *Judicial Activism in Comparative Perspective*, ed. Kenneth M. Holland (New York: St. Martin's Press, 1991), 90–116.

[9] Elena Martinez Barahona, *Seeking the Political Role of the Third Government Branch: A Comparative Approach to High Courts in Central America* (Saarbrücken: VDM Verlag, 2009); Diana Kapiszewski, "Power Broker, Policy Maker, or Rights Protector? The Brazilian Supreme Tribunal Federal in Transition," in *Courts in Latin America*, ed. Gretchen Helmke and Julio Ríos Figueroa (Cambridge, UK: Cambridge University Press, 2011), 154–186; Matthew M. Taylor, *Judging Policy: Courts and Policy Reform in Democratic Brazil* (Stanford, CA: Stanford University Press, 2008); Jodi Finkel, *Judicial Reform as Political Insurance: Argentina, Peru, and Mexico in the 1990s* (Notre Dame, IN: University of Norte Dame Press, 2008); Silvia Inclán Oseguera, "Judicial Reform in Mexico: Political Insurance or the Search for Political Legitimacy?," *Political Research Quarterly* 62, no. 4 (2009): 753–766.

Judicial independence is generally defined as the ability of judges to rule without interference from the political branches of government. It is typically demonstrated by guaranteed (sufficient) budgets, clear appointment processes, and the absence of court-packing or "court-sacking" (politicized removal) schemes. It is not clear, however, that elected politicians are the primary threats (or threats at all) to investors. In the absence of widespread nationalizations of industries and firms, other societal actors – firms, elites, activists, and especially criminals – may pose greater threats to investors than do politicians. What I call *judicial autonomy* better captures the position of judges and litigants vis-à-vis these threats. Judicial autonomy has not been widely discussed in the literature.[10] I define judicial autonomy as the ability of judges to rule without interference from societal actors. It can be seen primarily through signs of its absence: threats against judges, bribery and other forms of judicial corruption, abuses of disciplinary processes, and short, nonrenewable judicial tenures. Where a lack of judicial autonomy is paired with a thriving criminal sector, the consequences for judges, litigants, and criminal defendants can be disastrous. Perversely, the lack of judicial autonomy may also provide opportunities for litigants willing to make use of money, force, or influence to obtain desired judicial outcomes.

Parsing these two concepts allows us to consider how they interact with each other to produce four judicial regime types. A Liberal judicial regime with both high independence and high autonomy is generally the goal of rule of law reforms. Liberal systems typically have the

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[10] There are some exceptions, however autonomy is neither fully developed nor given prominence in these works. Javier A. Couso, "The Politics of Judicial Review in Chile in an Era of Democratic Trasition, 1990-2002," in *Democratization and the Judiciary: The Accountability Function of Courts in New Democracies*, ed. Gloppen, Siri, Roberto Gargarella and Elin Skaar (London: Frank Cass, 2004), 70–91; Pilar Domingo, "Judicialization of Politics: The Changing Political Role of the Judiciary in Mexico," in *The Judicialization of Politics in Latin America*, ed. Rachel Sieder, Line Schjolden, and Alan Angell (New York: Palgrave MacMillan, 2005), 21–46; Daniel M. Brinks, *The Judicial Response to Police Killings in Latin America: Inequality and the Rule of Law* (Cambridge, UK: Cambridge University Press, 2008); Brinks, "'Faithful Servants of the Regime': The Brazilian Constitutional Court's Role Under the 1988 Constitution."

constitution as the final arbiter and some measure to provide for access to justice for all. Partisan Control regimes have low independence but high autonomy and are typified by judiciaries that will not use the constitution to check the elected branches, but may be protected in their personal security. Clandestine Control regimes are typified by high independence but low autonomy. In such regimes, judges may be free from partisan control and may even exercise constitutional review, but may also be subject to a variety of corrupting social influences such that justice becomes available only to those with the wealth or power to command it. The absence of both independence and autonomy is often associated with authoritarianism and is termed a Dependent judicial regime. Such systems, wherein a deeply dependent judiciary treats friends and enemies of the regime quite differently, are decreasingly the norm in Latin America and the developing world more generally.[11]

If the conventional wisdom is correct, judicial independence should be more important than judicial autonomy. The conventional wisdom would thus make no distinction between Liberal and Clandestine Constrol regimes, nor between Partisan and Dependent regimes. This ordering assumes that the primary fear of investors is a seizure of investments by a hostile government. I suggest that in today's climate in Latin America – and perhaps globally – government seizure is less a threat than are land invasions, lawsuits, protests, and criminality. Dealing with these phenomena can dramatically increase the cost of doing business and thus profitability. In some cases, such as a hotel or resort developer that has to stop work due to a

[11] Indeed, international pressures have caused many countries – both democracies and hybrid regimes – to create or empower constitutional tribunals. Victor Ferreres Comella, "The Consequences of Centralizing Constitutional Review in a Special Court: Some Thoughts on Judicial Activism," *Texas Law Review* 82, no. 7 (2004): 1705–36; Bruce M. Wilson, "Changing Dynamics: The Political Impact of Costa Rica's Constitutional Court," in *The Judicialization of Politics in Latin America*, ed. Sieder, Rachel, Line Schjolden and Alan Angell (New York: Palgrave MacMillan, 2005), 47–65; Bruce M. Wilson, "Institutional Reform and Rights Revolutions in Latin America: The Cases of Costa Rica and Colombia," *Journal of Politics in Latin America* 1, no. 2 (2009): 59–85.

drawn-out title challenge, they may be able to shut down business altogether for extended periods of time. Investors in this climate must operate with a more nuanced view of property protections. For many, an independent but inefficient judiciary may provide less security than one that can be easily bought and sold, leading to the perverse outcome that a lack of judicial autonomy and independence may become desirable. Corruption may increase the cost of doing business less than transparency in an unstable environment.

A savvy investor considering entering a market in an unstable environment may find it wise to consider the relationships that are available to him more than the arms-length protections. Popular protest and public interest litigation, which are frequently aimed at foreign firms in Latin America, may take years to go through the judicial system. However, these delays may be largely cleared up when a partial judiciary dismisses these lawsuits. Issues such as kidnapping, extortion, or threats from narcotrafficking gangs may also require the hiring of private security as the police are often compromised. However, the same corruption that allows gangs to evade the law may also allow a multinational corporation or its local subsidiaries to evade the law on labor issues. As such, I suggest that, assuming equal distribution of natural resources, market size, and openness to trade, foreign investors may in practice favor Dependent and Clandestine Control systems above Liberal and Partisan systems. Put differently, many investors will be willing to proceed without credible commitments given sufficient opportunities to guarantee desirable outcomes through corruption.

II. Independence and Autonomy in Latin America

I turn now to a statistical examination of the influences of judicial independence and autonomy on foreign direct investment in Latin America. In this section, I examine several dimensions of judicial independence and autonomy in terms of how they correlate with levels of foreign direct investment to draw inferences about the influence of the two concepts. This analysis is followed by a discussion of how the different judicial regime types, as found in Latin America, relate to varying levels of foreign direct investment. While the highly independent and autonomous Liberal judicial regimes are associated with higher levels of foreign direct investment, levels of judicial autonomy are shown to be associated with variation in levels of foreign investment as well.

Given the difficult in finding reliable statistical measures of judicial independence, it should be no surprise that it is even more difficult to find adequate measures of judicial autonomy. Most measures are based on surveys of either public or expert opinion; it is not typically possible to discern on which dimensions of judicial independence or autonomy the raters may have focused. The World Economic Forum's *Global Competitiveness Report,* published annually, is based primarily on a survey of international business executives about their perceptions of a large number of primarily domestic factors related to economic competitiveness. This report provides a number of measures of potential interest for understanding the independence, autonomy, and activities of the judiciary as they relate to the economy.

Their "judicial independence" measure is problematic because it bundles, as does most available data, independence from government officials with independence from societal actors (here, citizens and firms). This bundling makes it impossible to separate out those independent influences. As such, I choose to focus instead on a variety of other measures that indirectly measure the issues of judicial independence and autonomy. The primary measure that I use as a proxy for judicial independence is "Efficacy of Legal Framework in Challenging Regulations," as this measure comes most closely to directly addressing the relationship between the judiciary and the government. Judicial autonomy poses a somewhat more complex data problem. The WEF identifies asks several potentially pertinent questions, including "Irregular Payments and Bribes," and "Ethical Behavior of Firms." However, these data are closely correlated. Due to the question having been asked for more years, the remainder of this analysis focuses on the "Ethical Behavior of Firms." In the discussion that follows, I also take account of another measure, "Business Costs of Crime and Violence," which helps to provide nuance to the judicial autonomy dimension.

Although a robust regression analysis is inadvisable due to the small number of cases available (72 country-years in which the relevant questions were asked), this analysis attempts to discern the relationships between these two proxy variables and the level of Foreign Direct Investment (Balance of Payment Inflows), as reported by the World Bank. I also look at Market Size, as reported by WEF, and a WEF measure of the level of the "Prevalence of Foreign Ownership." As demonstrated in Table 1, the umbrella measure of Judicial Independence is correlated with FDI, but also with every other proxy measure. It is not, however, correlated with foreign ownership. Foreign ownership is correlated only with the ethical behavior of firms, my proxy for judicial autonomy. Not surprisingly, Foreign Direct Investment is correlated most strongly with the measures of economic power, GDP per capita and market size. However, of the proxy variables I have identified, FDI is correlated with the ethical behavior of firms and irregular payments and bribes, *but not with the efficiency of the legal system in challenging regulations, my proxy for inter-branch judicial independence.*[12]

[Insert Table 1]

While one does not want to draw causal inference from correlations, this result suggests that, at the least, levels of Foreign Direct Investment are unlikely to be the product of perceptions of inter-branch judicial independence as defined here. The correlation between the ethical behavior of firms (as well as irregular payments and bribes) and Foreign Direct Investment begs further examination of this relationship. I proceed with this examination by using these proxy measures to categorize the economies of Latin America according to the typology of judicial regime types introduced above. Table 2 reflects this categorization, for which I have transformed these proxy variables simply into high and low groups.

[Insert Table 2]

The countries grouped within the Liberal Judicial Regime are not surprising. With the exception of the perceived improving judicial independence in Honduras in the 2012 survey, all of the other countries in the region are perceived to have low judicial independence, based on the efficiency of challenges to regulations. In addition, those countries with poor ratings on Business Costs of Crime and Violence could be understood as having somewhat lower autonomy than what registers in this table. Again, there are no surprises amongst the high crime countries; Colombia, El Salvador, Guatemala, Mexico, and even Honduras are notorious for the activities

[12] Note that the WEF also reports a question regarding the "Efficiency of the Legal System in Settling Disputes," which covers a much broader array of disputes and is a theoretically good proxy for judicial autonomy. However, it is extremely closely correlated with the measure of the efficiency in challenging regulations, rendering it meaningless as an alternative. I hypothesize that this correspondence owes to the tendency of survey respondents to conflate these two issues in their minds and also to conflate all levels of the judiciary from the lowest trial courts to the Supreme Courts.

of organized crime and street gangs in those countries. Understanding that there may be some variation within each category, let us turn now to the consequences of these judicial regime classifications for foreign investment. Table 3 reports the averages within each regime type for Foreign Direct Investment. In addition to the raw figure reported by the World Bank, this table reports two additional calculations: FDI per capita to control for the size of the market and FDI per capita as a percentage of the GDP per capita in order to control for the overall wealth of the economy.

[Insert Table 3]

Countries with Liberal judicial regimes enjoy substantially higher levels of foreign direct investment by any method of calculation. However, there are also notable differences between the Partisan Control and the Government Control judicial regimes.[13] Countries with higher levels of judicial autonomy have higher levels of foreign investment, especially when considered on a per capita basis, than those with lower levels of judicial autonomy, even when both experience low levels of inter-branch judicial independence. Countries that have high crime rates, especially very high crime rates, which should be understood to have especially compromised judicial autonomy, have the lowest rates of foreign investment of all. Compared with simple explanations of judicial independence as inter-branch independence, including differing levels of judicial autonomy from society demonstrates an important further dimension in understanding the dynamics of foreign investment. Understanding this dynamic is especially important in Latin America, a region in which fostering inter-branch judicial independence continues to be a major challenge for reformers.

[13] With Honduras in the 2012 report being the only country to fall into the Clandestine Control cell according to this data and 2012 FDI figures not yet having been reported by the World Bank, that cell cannot be calculated.

III. Investigating Independence and Autonomy in Central America

This section examines the issues of judicial independence and judicial autonomy through the experiences of five Central American countries.[14] Costa Rica enjoys a Liberal judicial regime as well as relatively high levels of foreign direct investment. Nicaragua was rated as a Dependent regime until 2012, which should suggest very low levels of foreign direct investment. However, recent years have seen its rate of foreign direct investment, when controlled for the size of the economy, rise considerably above even Costa Rica's. El Salvador, Guatemala, and Honduras are all classified as Partisan Control regimes above; El Salvador and Guatemala also have very high rates of crime, further depressing the autonomy of judges. Of the three, Honduras has the highest rate of foreign direct investment, which nearly equals Costa Rica's.

[Insert Figure 1]

Figure 1 charts the variation in the rate of foreign direct investment (calculated as foreign direct investment per capita divided by gross domestic product per capita) in these five countries. Although all five countries experienced a substantial dip during the recent global recession, all have largely recovered by the end of 2011. In addition to having the highest overall rate of foreign investment, Nicaragua also experienced the best recovery, as the only country whose 2011 rate surpassed its 2009 level. I argue that Nicaragua's success in attracting investment, which contradicts the predictions of the conventional wisdom, can be explained by the high levels of judicial corruption available in that country. In other words, it is precisely the lack of

[14] The sections on Costa Rica, Nicaragua, and Guatemala are based on extensive field research carried out since 2002. Discussion of El Salvador and Honduras are based on secondary reports. All interviews were guaranteed confidentiality and are not named.

judicial independence that perversely encourages investors to enter that market at even greater levels than richer Guatemala and El Salvador or more competitive Costa Rica.

Costa Rica

In the typological terms laid out in the first section, I characterize Costa Rica as a Liberal judicial regime. Judges are generally quite independent, have excellent prospects for lengthy careers within the judiciary, and enjoy a variety of protections from societal influence. There is little reason to believe that business commitments would not be credible. As such, conventional wisdom would expect it to be highly attractive to investors. In general, the climate for investment in Costa Rica is considered competitive; the World Economic Forum consistently ranks it as more competitive than the other Central American countries. They have joined a variety of free trade agreements with the United States, their Central American neighbors, and their Latin American cousins.

A Liberal judicial regime is defined as one in which there is both high judicial independence and high judicial autonomy. When asked about threats or others pressure from politicians, several Costa Rican judges indicated that they had heard rumors of some judges receiving threats, but neither had experienced it themselves nor known any personally who had. The only judge interviewed who indicated that she had felt unprotected by the judicial administration was in a city distant from San José and riddled with crime associated with drug trafficking. Judges and lawyers reported similar insulation from societal actors, although several were concerned that the judgment of the press could be too quick and too harsh. Even that, however, was the subject of disagreement among interviewed judges. At the same time, Supreme Court magistrates enjoy essentially – although not officially – lifetime tenure and ordinary judges are subject only to the discipline of the judiciary itself. Both groups have access to judicial police and bodyguards. Judges faced with disciplinary proceedings enjoy procedural guarantees and a robust judges' association advocates for them.

This independence of the judiciary and opening to trade has been rewarded with generally high levels of foreign investment. Intel famously located a manufacturing plant outside of San José in 1997, where it currently employs 2800 people. Its large agricultural sector is typical of the isthmus but is matched by a wildly successful tourism sector. However, while the tourism industry is a magnet for foreign investment, particularly in the area of hotel and resort development, the openness of the legal process has made it possible for activists and other societal actors to hold up major international projects. With the technically lenient constitutional chamber of the supreme court (Sala IV) allowing petitions quite broadly, developers frequently find their legal bills skyrocketing even if they are eventually vindicated and allowed to proceed.

El Salvador

El Salvador is classified here as a partisan regime with a very high crime rate. El Salvador enjoys a relatively stable party system, dominated by two major parties. While the judiciary has been the subject of a dramatically intensive judicial reform program for two decades,[15] initial growth in judicial independence in the 1990s was reversed through the appointment processes that played out in the National Assembly.[16] The politicization of the appointment process, especially for the Supreme Court, has produced a court that, at least at times, appears to engage in what Helmke has called "strategic defection" by trying to anticipate

[15] Popkin, *Peace Without Justice : Obstacles to Building the Rule of Law in El Salvador*; Margaret Popkin et al., *Justice Delayed : the Slow Pace of Judicial Reform in El Salvador* (Cambridge, MA Washington, D.C.: Hemisphere Initiatives ; Washington Office on Latin America, 1994).
[16] Borja Díaz Rivillas and Sebastián Linares Lejarraga, "Fortalecimiento De La Independencia Judicial En Centroamérica: Un Balance Tras Veinte Años De Reformas," *América Latina Hoy* 39 (2005): 47–96.

the changes in the political winds so that they can rule with the winners.[17] Formally, the courts have more independence than Guatemala's, Nicaragua's, or Honduras', given that judges enjoy lengthier tenures (9 years) and the judiciary is more institutionally independent of the executive and legislative branches. Nonetheless, the perception is clearly of a judiciary that is not independent of political influence.

El Salvador is also subject to some of the highest rates of violent crime in the region, with San Salvador frequently listed among the top ten most dangerous cities in the world. Several street gangs have achieved prominence, including the *Mara Salvatrucha*, which also has ties in cities with Salvadoran immigrant populations throughout the United States. Street gang violence in El Salvador has provoked a *mano dura* ("hard hand") response from successive Salvadoran governments. It does not appear that these extreme legal measures have done much to curb the violence and they may have increased the incentives to engage in corruption to avoid conviction in the criminal courts.[18]

El Salvador's very low rate of investment may be the product of this type of corruption. El Salvador's judiciary shows frequent signs of being dependent on the political parties, which may require potential investors to develop relationships with one or the other of the intensely divided Salvadoran parties. At the same time, the criminality and criminally-associated corruption poses special difficulties. Potential investors may find that they need to develop complex networks of corruption including politicians, judges, and possible criminals. This may

[17] Gretchen Helmke, "Checks and Balances By Other Means: Strategic Defection and Argentina's Supreme Court in the 1990s," *Comparative Politics* 35, no. 2 (2002): 213–230; Gretchen Helmke, "The Logic of Strategic Defection: Court-Executive Relations in Argentina Under Dictatorship and Democracy," *American Political Science Review* 96, no. 2 (2002): 291–303; Brinks, "'Faithful Servants of the Regime': The Brazilian Constitutional Court's Role Under the 1988 Constitution."

[18] Pierre Frühling, *Maras and Youth Gangs, Community and Police in Central America* (Swedish International Development Agency, 2008), www.Sida.se/publications.

be more difficult than it is in Guatemala, where judges have shorter tenures and may consequently be much more open to individual corruption or influence. In addition, investors who come to San Salvador are at high risk of finding themselves the object of violent crime. Together, these factors make El Salvador an extremely unattractive environment for investment.

Guatemala

Guatemala is another partisan regime with a very high crime rate. From a societal level, it is similar to El Salvador in many ways. The major cities are plagued by violence from street gangs and much of the countryside must contend with organized crime around drug trafficking. In Guatemala City, “fully occupied” but largely empty high rises reflect widespread money laundering endeavors. Judges and other legal officials are frequently invited to engage in corruption, sometimes by force. Attacks on judges, including killings, are not unheard of. Impunity frequently reigns for those with the funds, force, or friends to influence verdicts to their liking. Unlike El Salvador, Guatemala’s party system is highly fractured. Many parties are personalist vehicles for presidential candidates or represent frequently-shifting coalitions. While corruption is widespread, it is far less predictable than in a more stable party system. Typically, relationships of influence must be forged on a case-by-case basis, reducing predictability for investors.

A partisan judicial regime is one in which there is judicial autonomy but little judicial independence. The primary difficulty for judicial independence in Guatemala lies with the highly permeable appointment processes. The Constitutional Court is appointed for five years by the president, the Supreme Court, the Congress, the San Carlos University, and the bar association. The Supreme Court and the Court of Appeals are appointed through a highly permeable selection committee that includes representation from the law schools, the other courts, and the bar association. While efforts were made in the most recent round of appointments to ensure the transparency of this process, the very structure of it provides multiple entry points for corruption. Ordinary judges are appointed through a bureaucratic judicial school, but have little prospects for advancement outside of the path described above. For judges at all levels, the pressing need to secure a future after this job produces a potential to submit their autonomy to patrons who could supply that future.

Despite its openness to trade and participation in a large number of free trade agreements, Guatemala's high levels of crime should make it among the least attractive places in Latin America to do business. Private security is a must for foreigners, especially those who are unable to keep a low profile. Travelers and businessmen find themselves subject to kidnapping rings, highway robbery, and other violent crime. The crime itself likely deters investors, but the ability to buy protection may make it worthwhile to the adventurous to invest in a country with a large and rapidly urbanizing population. When asked about corrupting influences on the courts, several lawyers who work with international firms indicated that there are many corrupt lawyers who will work with smugglers and other organized crime in addition to legitimate businesses. While those lawyers who agreed to be interviewed expressed concern about widespread corruption in the legal system – with one expressing concern for his safety – none admitted to participating in it themselves. With a labyrinthine system and almost intimate networks of corruption, Guatemala poses, like El Salvador, the worst case scenario for foreign investment.

<u>Honduras</u>

Honduras is the last of the Partisan regimes discussed here. Like El Salvador, it has a stable party system, but crime and violence are merely a high concern for businesses, rather than a very high one. That Honduras enjoys a higher rate of investment than either Guatemala or El Salvador would thus seem unsurprising. However, Honduras began the study period with a 2009 *coup d'etat* against President Manuel Zelaya that saw many countries consider sanctions and produced a year of political uncertainty that did not completely dissipate with the election of President Porfirio ("Pepe") Lobo. This coup presents an interesting theoretical challenge to the question of judicial independence and foreign investment in that the Supreme Court played a central role in allowing the coup to go forward and validating the subsequent assumption of the presidency by Roberto Micheletti. Micheletti had been president of the Congress, which had quite recently completed a round of appointing the Supreme Court, suggesting the possibility of a *quid pro quo* or perhaps sincere loyalty.

As with Salvadoran judges, Honduran judges are closely associated with the political parties. The Congress has the primary authority to appoint the Supreme Court (which, in turn, governs the rest of the judiciary) and, in practice, those appointments are the product of partisan negotiations. These negotiations are facilitated by the Honduran practice of appointing a full slate of Supreme Court Magistrates at one time, allowing the two major parties to simply split the slate according to their partisan power. While the magistrates have slightly longer tenures (7 years) than their Guatemalan counterparts, they are nonetheless heavily influenced by their political allies. These ties provide investors with a relative easy path to find corrupt influence to protect their legal interests. These networks do not need to be as complex nor as intimate as in Guatemala or El Salvador. I argue that it is this dynamic of corruption that makes Honduras a relatively attractive locale for investors.

This situation may be in flux, however, in terms of both inter-branch judicial independence and judicial autonomy. There continues to be increasing crime in Honduras, however, especially in the area of street gangs and in the drug trafficking that occurs primarily on the Caribbean Coast. At the same time, the long-term aftermath of the coup has changed the atmosphere for judicial independence. The political atmosphere under President Zelaya had become highly polarized and that may now be changing, which may lower the stakes for politicians in cementing their control over judges. It may be in reflection of these changing dynamics that the WEF scores shifted sufficiently by 2012 to move Honduras into the "Clandestine Control" category, which includes high independence and low autonomy. Unfortunately, it is too soon to see the effects of this shift on foreign investment.

Nicaragua

Nicaragua has an extremely dependent judiciary, with the two main political parties dividing the spoils of the appointment process through pacts since 2000.[19] This dependent judiciary on several prominent occasions has done the direct bidding of the president in contravention of the law and the constitution, including the 2009 release from prison of convicted former president Arnoldo Alemán, called in 2004 one of the ten most corrupt world leaders in recent history by Transparency International. The Supreme Court also freed President Daniel Ortega of constitutional term limits so that he could go on to win a third term in 2011. However, Nicaragua also enjoys a very low crime rate and most of the country is not frequently

[19] Indeed, the roots of this pact-making back to the democratic transition in 1990, in which the incoming Liberal Party administration or President Chamorro made allowances for a number of *Sandinista* officials to stay on.

visited by drug trafficking,[20] making it a considerably more pleasant environment in which to do business than its three neighbors to the North.

Nicaragua is, however, a poor country with a relatively small population and few natural resources. It has made efforts to foster a tourism industry, but has not approached the level of development found in Costa Rica. It is not immediately clear why investors would be attracted to Nicaragua. Under Ortega, it has been more closely aligned with Venezuelan President Hugo Chavez and his Bolivarian Alternative than he has with hemispheric free trade initiatives. Why should the country with the most dependent judiciary in Central America enjoy better rates of investment than the country with the most independent? I argue that Nicaragua's judicial corruption, in the context of a relatively stable and hierarchical party system, actually provides more predictability for investors than an independent and autonomous judiciary would. Indeed, investors who take advantage of that corruption may find that they are afforded not just predictability, but predictable judicial successes – even if the law may not favor them.

IV. Moving Beyond the Case Studies

These case studies shed light on some of the factors that may affect the decisions of foreign investors to move into a market. In Central America since 2009, the flow of foreign investment runs contrary to the assumptions. While quite a bit pours into Liberal Costa Rica, even more flows into highly dependent Nicaragua. Probing of the judicial politics of these five countries suggests two things: first, corruption may actually be a boon to investment. Stable

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Pierre Frühling, *Maras and Youth Gangs, Community and Police in Central America* (Swedish International Development Agency, 2008), www.Sida.se/publications.

[20] As with Costa Rica and Honduras, Nicaragua's Caribbean Coast has been penetrated by the drug traffickers who take advantage of the weak presence of the state in that region.

networks of corruption may provide more predictability and higher returns than a stable, fair, and independent legal system. Second, while violent criminality is extremely damaging to investment, the extent of its impact varies with the particular patterns of available corruption.

However, the experiences of Central America do not closely follow the trends demonstrated in the rest of Latin America. If we rank the Central American judicial regimes in terms of rate of foreign direct investment, we find that the best performer is the Dependent regime, followed by the Liberal regime and the Partisan regime. This ranking would suggest that having a combination of petty and political corruption is a very significant attractant for investors. However, based on the averages for the region as a whole, the best performing regime type in Latin America is the Liberal regime, followed by the Dependent and then the Partisan regimes. This would suggest that a judiciary independent of political influence and general corruption is especially attractive for foreign investors more often than not, and that having access to petty corruption is preferable to simply having access to political corruption.

More research is needed to discern the reasons for this difference in outcomes. One problem with this data is a relatively low amount of variation within the region. As such, it could be helpful to analyze the World Economic Forum's data on a global basis. This would provide both the necessary additional variation and a much larger sample, allowing for more robust statistical analysis. A global study would also help to test whether these results are simply reflecting particularities of the Latin American (or Central American) region.

Central America, with its typical instability, generally high crime and corruption, and violent history, is often treated as unique within the region of Latin America. However, violent criminality notwithstanding, much of this uniqueness may have grown less significant with the normalization of politics and increasing diversification and opening of their economies. What, then, explains the anomalous results in Central America? Especially if we exclude Costa Rica, Central America remains more impoverished, more unequal, more corrupt, and more violent than most of South America and indeed most of the world. However, the nature of that corruption and violence is no longer the military repression that typified the 1980s and prior decades. Corruption and violence in Central America has diversified and become highly privatized. The impact of this reality on economic development needs to be better understood as creating a unique set of opportunities even as it forecloses others. We need to determine the drivers of these differences and whether they hold true for all or most systems or whether there are thresholds – be they economic, political, or criminal – below which investment perversely rewards corruption and above which investors seek an honest, Liberal judiciary.

An avenue for further research would be the influence of criminal money in the system. A great deal of economic activity in Guatemala, especially, but most of Central America as well as Colombia, includes drug trafficking and money laundering. These two activities distort the regular markets for investment, as suggested by the empty high rise developments in Guatemala City. In Guatemala, criminal organizations have penetrated many sectors of political society as well as particularly strategic parts of the countryside. Guatemala's president Otto Pérez has considered legalizing the drug trade in his country. If this happens, this illicit money would likely emerge into the formal economy. How this would affect the investment climate, the levels of corruption of the levels of violence is unclear, but Pérez is hoping that this move would improve all three.

V. Conclusion

The conventional wisdom about judicial independence has been that a judiciary independent of political influences from the elected branches of government will provide the necessary stability and predictability for a strong investment climate. Investors, it is theorized, seek to minimize the risk of losing their investments to political changes that might involve nationalizations of industries or other arbitrary seizures. This research suggests that this theory is incomplete because it leaves out the autonomy of judges from societal actors, who may pose equally grave and more frequent threats than those threats posed by political actors. At the least, the trends in the entire Latin American region suggest that the introduction of judicial autonomy to analyses can explain differences in levels of foreign direct investment between countries without politically independent judiciaries. The closer examination of Central America turns the predictions of the conventional wisdom on their head; Nicaragua, with a dependent judiciary, attracts a higher rate of foreign investment, when controlling for population and wealth, than does liberal Costa Rica.

Based on these results, I argue that we need to reconsider some of our assumptions about what investors seek in a host government, as well as what kinds of governing institutions can actually provide the return on investment that foreign investors are seeking. In Central America, at least, it appears that political corruption may be attracting more investors than honesty. Inter-branch judicial independence is not sufficient to explain investor behavior. Indeed, inter-branch independence is not even a necessary condition for foreign investment. Introducing judicial autonomy provides an important addition to our understanding of legal investment climates. More research is needed, however, to better understand the ways in which patterns of petty corruption may inhibit or catalyze investment.

The typology of judicial regimes presented here can provide new insight into why countries may be reluctant to adopt Liberal policies in their legal systems. While it is obvious that the winners in the current system would be reluctant to change a system that makes them winners, this data reveals that outside interests such as investors may also have an interest in maintaining a corrupt *status quo*. The tendency of countries to get "stuck" in a midway stage between authoritarianism and liberalism has frustrated reformers. This study reveals one reason why the pull of that stickiness is so strong. There may be a point of liberalization at which foreign investors are willing to put their money into a country even though it is far from fully liberalized. If that point is prior to the strengthening of judicial independence and autonomy, perverse incentives may come into play to actually encourage corruption rather than building further judicial independence and autonomy. Understanding judicial autonomy may help to better promote strong judiciaries and the strong polities and economies that may accompany them.

Table 1: Correlations (Kendall's tau_b)

		0.03 GDP per capita (US$)	1.06 Judicial independence, 1-7 (best)	1.11 Efficiency of legal framework in challenging regs., 1-7 (best)	1.15 Business costs of crime and violence, 1-7 (best)	1.05 Irregular payments and bribes, 1-7 (best)	1.18 Ethical behavior of firms, 1-7 (best)	FDI	10th pillar: Market size, 1-7 (best)	6.11 Prevalence of foreign ownership, 1-7 (best)
0.03 GDP per capita (US$)	Correlation Coefficient	1.000	.345**	.346**	.042	.284*	.200*	.428**	.388**	.099
	Sig. (2-tailed)	.	.000	.000	.630	.012	.022	.000	.000	.256
	N	90	90	72	90	54	90	65	90	90
1.06 Judicial independence, 1-7 (best)	Correlation Coefficient	.345**	1.000	.862**	.185*	.555**	.446**	.387**	.069	.097
	Sig. (2-tailed)	.000	.	.000	.038	.000	.000	.000	.441	.279
	N	90	126	72	126	54	126	101	126	126
1.11 Efficiency of legal framework in challenging regs., 1-7 (best)	Correlation Coefficient	.346**	.862**	1.000	.329**	.504**	.426**	.187	-.179	.090
	Sig. (2-tailed)	.000	.000	.	.006	.000	.000	.123	.132	.446
	N	72	72	72	72	54	72	47	72	72
1.15 Business costs of crime and violence, 1-7 (best)	Correlation Coefficient	.042	.185*	.329**	1.000	.017	-.032	.020	-.285**	-.086
	Sig. (2-tailed)	.630	.038	.006	.	.903	.720	.806	.001	.336
	N	90	126	72	126	54	126	101	126	126
1.05 Irregular payments and bribes, 1-7 (best)	Correlation Coefficient	.284*	.555**	.504**	.017	1.000	.892**	.334*	-.008	.154
	Sig. (2-tailed)	.012	.000	.000	.903	.	.000	.034	.952	.264
	N	54	54	54	54	54	54	29	54	54

1.18 Ethical behavior of firms, 1-7 (best)	Correlation Coefficient	.200*	.446**	.426**	-.032	.892**	1.000	.292**	-.027	.217*
	Sig. (2-tailed)	.022	.000	.000	.720	.000	.	.000	.760	.015
	N	90	126	72	126	54	126	101	126	126
FDI	Correlation Coefficient	.428**	.387**	.187	.020	.334*	.292**	1.000	.483**	.094
	Sig. (2-tailed)	.000	.000	.123	.806	.034	.000	.	.000	.254
	N	65	101	47	101	29	101	101	101	101
10th pillar: Market size, 1-7 (best)	Correlation Coefficient	.388**	.069	-.179	-.285**	-.008	-.027	.483**	1.000	.057
	Sig. (2-tailed)	.000	.441	.132	.001	.952	.760	.000	.	.524
	N	90	126	72	126	54	126	101	126	126
6.11 Prevalence of foreign ownership, 1-7 (best)	Correlation Coefficient	.099	.097	.090	-.086	.154	.217*	.094	.057	1.000
	Sig. (2-tailed)	.256	.279	.446	.336	.264	.015	.254	.524	.
	N	90	126	72	126	54	126	101	126	126

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Table 2: Judicial Regimes in Latin America 2009-2012

	High Independence	Low Independence
High Autonomy	**Liberal** Brazil 2011-2012* Chile Costa Rica Honduras 2011 Uruguay	**Partisan** Brazil 2009-2010* *Colombia** Dominican Republic 2012 *El Salvador** *Guatemala** Honduras 2009-2010 *Mexico** Nicaragua 2012 Panama
Low Autonomy	**Clandestine** *Honduras 2012**	**Government Control** Argentina Bolivia Colombia 2012 Dominican Republic 2009-2011* Ecuador* Nicaragua 2009-2011 Paraguay Peru *Venezuela**

*Countries that received poor ratings for Business Costs of Crime and Violence. Italics indicate very poor ratings.

Table 3: Average FDI by Judicial Regime & Criminality

	FDI	FDI per capita	FDI per capita/ GDP per capita
Liberal	11494260620	450.4135	0.056473
Dependent	2178515135	103.0977	0.034678
Partisan Control	9186308496	164.9267	0.030109
High crime	9509808985	118.1795	0.023534
Very High Crime	6001164912	100.0811	0.017531
Very High Crime (excluding Venezuela)[21]	7164039473	113.6511	0.020725

[21] Levels of foreign direct investment have been highly volatile in Venezuela in the period under study. Particularly given one year with a very large net outflow of investment, I think it is worthwhile to exclude it from this calculation.

Figure 1: Foreign Investment in Central America, 2009-2011