Rule of Law – Hidden Wealth of Nations

"I'd like to live as a poor man with lots of money." – Pablo Picasso

Depending on the time of day, there are about 192 member countries in UN. Among them, it is hard to find two countries that are exactly alike. No two countries have identical lists of aspirations either.

Even so, at least one common aspiration cuts across all countries – regardless of history, geography, culture, ethnic mixture or any other such characteristics. That aspiration and the consequent quest are for more wealth – to be more prosperous.

Such quests nonetheless have resulted in huge disparities in wealth. Some countries are hugely wealthy while some are miserably poor. Of course Economists worldwide study such differences; and to some, such differences are their sole area of expertise. Perhaps one may focus on an area hitherto considered too anecdotal and is being described below.

(The issue of wealth vs. poverty is of interest not to economists alone; it should interest us mortals – the author being one of them – as well.)

On would of course wonder about the causes behind such disparities. There can be many causes. Some countries are endowed with natural wealth such as oil and consequently can be wealthy. Then again there are countries lacking significant natural wealth and yet are very prosperous! Why is it so? Could there be one factor that stands out as a dominating root cause?

".... the code is more what you'd call guidelines than actual rules." – Captain Barbossa in *Pirates of the Caribbean*

If one travels around the world, one would find that disciplined societies are more prosperous. However, how can one display the relationship, instead of relying merely on anecdotal evidence?

Discipline or Rule of Law is manifested in many ways. Whether it is following traffic rules, waiting in a queue for any service, trains running on time, etc., all such situations occur more or less with ease and predictably in a society that accepts the Rule of Law. On the other hand, in a society that lacks Rule of Law, such situations occur typically with an extra effort, if they occur at all.

Even so, how does one measure adherence of Rule of Law? It is rather difficult to obtain data by standing at a large number of traffic intersections in various countries to obtain data on the extent to which those countries follow traffic rules (a measure of Rule of Law).

"There are three kinds of lies: Lies, damned lies, and statistics" – Benjamin Disraeli

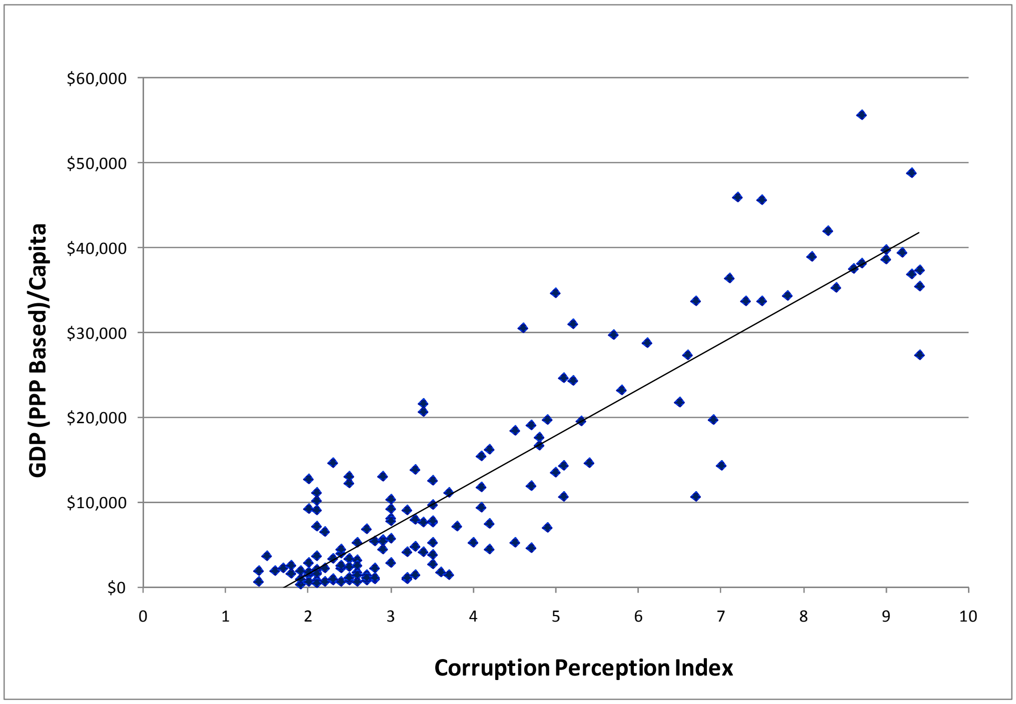
Perhaps one measure for Rule of Law can be the ***Corruption Perceptions Index*** (CPI) published by Transparency International (http://www.transparency.org/). They publish the annual CPI by ranking 180 countries in a scale of 1 (lowest) to 10 (highest) by their perceived levels of corruption, as determined by expert assessments and opinion surveys.

Wealth is a relatively easier measure. One measure for the wealth of a nation is its ***GDP per Capita*** adjusted by ***Purchasing Power Parity***. This data is easily available at the Central Intelligence Agency web site (https://www.cia.gov/).

Sukumar Roy **http://www.ioptsyn.com**
Email: sroy91@yahoo.com

When GDP per Capita is plotted against CPI using 2007 data for both (shown below), the correlation coefficient is an astounding 79.6%! It also means that only 20.4% of the correlation is due to other factors.

(Data for both CPI and GDP per Capita was available for 153 countries. Equatorial Guinea, Kuwait, United Arab Emirates and Qatar were ignored because of their obvious oil wealth and very small populations. Luxembourg (which also has a very small population) was ignored for being an outlier.)



"The cause is hidden, but the result is known" – Ovid in *Metamorphoses*

Correlation, however, does not automatically mean ***Causal*** relation. For example, if one plots data of sale of air conditioners and soft drinks, the results will likely show a high degree of correlation – though it is obvious that there is no causal relation. Sale of more soft drinks will not cause sale of more air conditioners and vice-versa. The root cause for both is the season in a year – in this case sales of both will likely go up in summer.

To show causal relationship requires analysis of other data. Though the data here is limited, the following shows a causal link between GDP per Capita and CPI. Countries such as Singapore perhaps prove that the GDP per Capita" is the causal "effect" after all. Former Prime Minister of Singapore Lee Kuan Yew enacted strict codes for the Rule of Law at first. The increase in their per Capita GDP came later. Strict enforcements of Singaporean laws (to detractors they may be draconian) also helped. Superior governance requires strict enforcement – and not just enactment of laws.

The GDP per Capita of Equatorial Guinea shot up from $2700 in 2002 to $50,200 in 2005 (according to CIA data and due to oil) and yet their Corruption Perceptions Index stayed low – still at 1.9 in 2007(corresponding GDP per Capita is $44,100). The increase in wealth did not lead to increased transparency.

One may also to put forward the following argument. If a thief becomes wealthy through crooked means (and remains free), it is highly unlikely that he/she becomes honest as a consequence.

Chances are that a wealthy thief becomes bolder and becomes an even bigger thief. The only factor that can counteract is the fear of getting caught and imprisoned – by enforceable and transparent Rule of Law (hence increased transparency). Rule of Law enshrined by its strict enforcement clearly is a causal factor to thwart criminal activities.

(The author certainly does not imply in the above that the country Equatorial Guinea, collectively, is therefore a thief.)

The Singapore example tends to establish a causal relationship between wealth ("GDP per Capita") as the effect and Rule of Law ("Corruption Perception Index") as the cause. The Equatorial Guinea example shows that increase in wealth does not improve Rule of Law. Hence Rule of Law is ***not*** an effect – it is the ***cause***.

Lesser Rule of Law also manifests in other damaging ways. For example, according to a 2005 report from the International Labor Organization (ILO), Italy had an annual workplace fatality rate of 6.9 per 100,000 workers when its Corruption Perceptions Index (CPI) in 2005 was rated at 5. During the same year, the workplace fatality rates for France and UK were 3.0 (7.5 CPI) and 0.8 (8.6 CPI), respectively. This also shows a relationship, albeit for a very small sample size.

It is also interesting to note that workplace fatality will have a deleterious effect on worker productivity and hence will negatively impact the GDP per capita. Here too, CPI seems to play a part as a root cause in affecting GDP per Capita.

"In matters of conscience, the law of majority has no place." – Mahatma Gandhi

Rule of Law, transparency and democracy are related. Only Rule of Law leads to transparency which is also possible only under democracy. Deficiencies in Rule of Law seemingly results in less wealth – aka poverty. This is in line with the relation between poverty and lack of democracy espoused by Prof. Amartya Sen, Nobel Laureate.

The above begs a question. Should certain elements of democracy be suspended temporarily – while maintaining its core values – along with a strict enforcement such as in Singapore, until a country has achieved a certain state of discipline? Perhaps a domineering force in the form of a ***benevolent dictatorship*** is needed to enforce discipline, if it is still possible to invoke such an oxymoron!

Even otherwise – there should not be any doubt regarding the role Rule of Law plays in creating wealth in a society. Any improvement in Rule of Law is therefore desirable. Any stricter enforcement of existing and meaningful laws will improve transparency and hence should increase wealth and reduce poverty.

Once discipline is established, chances are that Rule of Law will be on autopilot – with less need for enforcement and will push to further improve transparency. This increasing trend of transparency can then lead to a truer democracy and less poverty.

(The author is fully aware that a measure such as CPI is somewhat inexact due to its basis on a perceptions survey. However, for comparison purposes at "macro" levels, the use of such a measure should be considered valid.)

Sukumar Roy

http://www.ioptsyn.com
Email: sroy91@yahoo.com