

RIGHTS AS SIGNALS

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ABSTRACT

Because rights operate as trumps over normal governmental interests, they have an inherent cost. Consequently, by entrenching protection for human rights, governments can signal a willingness to give up power in the short term to obtain long-term benefits. Investors can infer from this that the government has a low discount rate and is less likely to pose a threat of expropriation. Similarly, when courts vigorously enforce human rights, they dramatize their judicial independence, which is valuable to investors, who themselves may have no interest in human rights. Thus, human rights enforcement may help encourage investment and thereby indirectly foster economic growth.

I. INTRODUCTION

CAN developing countries afford human rights and the rule of law? Perhaps not, according to Richard Posner. Posner advises poorer countries against “creating a first-class judiciary or an extensive system of civil liberties.”¹ Although he is by no means opposed to judicial independence and human rights, he argues that they should largely await economic growth.² From this point of view, the dramatic recent expansion of constitutionalism is a bit perplexing, if not a mistake.

Posner’s argument can be challenged on several grounds. Although he minimizes the importance of an independent judiciary to development,³ the current consensus among economists is apparently to the contrary.⁴ Some

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¹ Richard A. Posner, *Creating a Legal Framework for Economic Development*, 13 *World Bank Research Observer* 1, 9 (1998). Posner suggests that “democracy may not do much for the economy,” and he is especially skeptical about providing legal rights to criminals, which may undermine protection of property in countries that cannot afford sophisticated methods of policing. *Id.* at 11. See also *id.* at 8–9 about democracy.

² See *id.* at 3.

³ *Id.* at 7.

⁴ See Robert D. Cooter, *The Strategic Constitution* 196 (2000). For an excellent review of the literature, see Michael J. Trebilcock, *What Makes Poor Countries Poor: The Role of Institutional Capital in Economic Developments*, in *The Law and Economics of Development* 40–44 (Edward Buscaglia, William Ratliff, & Robert Cooter eds. 1997). For suggestions about some possible limitations to this thesis, see Amanda Perry, *Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence*, 49 *Int’l & Comp. L. Q.* 779 (2000).

economists also would argue that democracy is indeed directly conducive to development.⁵ More fundamentally, many people would reject on moral grounds the view that protection of human rights should bow to economic considerations.⁶ Indeed, according to Ronald Dworkin, the ability of a claim to triumph despite having a net social cost is exactly what makes that claim a right—it is for this reason that he famously refers to “rights as trumps.”⁷

Even Dworkin’s view of rights, however, indirectly supports part of Posner’s argument by affirming that rights are socially costly. Thus, Posner’s concern about the potentially high cost of rights seems well founded.⁸ It also creates a puzzle about the political dynamics of constitutionalism.

Constitutionalism limits the power of the dominant political coalition. Yet, constitutional rights and the rule of law are most useful to those who are least able to protect themselves through political or judicial influence. By definition, these are the less powerful groups in society, which are consequently in no position to create these institutions on their own. In the meantime, the dominant political coalition seems to pay an immediate price. What motivates the dominant coalition to agree to such a loss of power?

Another remark by Posner himself suggests a possible answer.⁹ He observes that “effective legal reform depends ultimately on a political will to reform, which in turn is likely to depend on a political will to implement economic reform”; if the dominant political group does “not want economic reform, the will to adopt legal reform is likely to be absent.”¹⁰ What this means, however, is that legal reform is a good signal of being truly committed to economic reform.¹¹ The critical point is that the legal reform does not itself

⁵ The relationship between democracy and development is the central focus of two recent important works by eminent economists, Amartya Sen, *Development as Freedom* (1999), and Mancur Olson, *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships* (2000). On the somewhat ambiguous empirical evidence about whether democracy fosters economic growth, see Adam Przeworski & Fernando Limongi, *Political Regimes and Economic Growth*, 7 *J. Econ. Persp.* 51 (1993).

⁶ See Cooter, *supra* note 4, at 257–58 (explaining the argument that “liberty trumps wealth”).

⁷ Ronald Dworkin, *Rights as Trumps*, in *Theories of Rights* 15–68 (Jeremy Waldron ed. 1984).

⁸ This is the theme of Stephen Holmes & Cass R. Sunstein, *The Cost of Rights: Why Liberty Depends on Taxes* (1999).

⁹ Another possibility, highlighted in a recent article by Ran Hirschl, is that the dominant elite is about to lose political control in the legislature and executive branch but has a stronger foothold in the judiciary. See Ran Hirschl, *The Political Origins of Judicial Empowerment through Constitutionalization: Lessons from Four Constitutional Revolutions*, 25 *L. & Soc. Inquiry* 91 (2000). Thus, it wants to transfer power from the legislature and executive to the judiciary. This may or may not hold true in certain circumstances, such as the four case studies offered by Hirschl. But Hirschl himself notes that major constitutional reforms have occurred in over 40 countries since 1970, *id.* at 92 n.1, and it seems unlikely that the special circumstances cited by Hirschl were present throughout this category.

¹⁰ Posner, *supra* note 1.

¹¹ A similar model, in which employers view marital status as an indicator of “steadiness,” is presented in Richard A. Posner & Eric B. Rasmusen, *Creating and Enforcing Norms, with Special Reference to Sanctions*, 19 *Int’l Rev. L. & Econ.* 369, 375–76 (1999).

need to involve the interests of investors, who can also obtain a useful signal from enforcement of human rights generally.¹²

The signaling hypothesis is based on a premise that some readers may find dubious: that investors have an interest in the rule of law. As Section IIIB explains, there is solid support for this premise among economists. Nevertheless, it conflicts with the widespread notion that foreign investors would ideally prefer to deal with authoritarian regimes, where they can use corruption and other informal methods to protect themselves, while ignoring the interests of the local population. No doubt such arrangements have existed in various times and places, particularly with respect to extractive industries requiring low investments in technology. But, all things being equal, it appears that investors do find the rule of law and an independent judiciary attractive.¹³ Regimes that wish to capitalize on this appeal may find protection of human rights an important signal of their long-term commitment to this strategy.

Section II reviews signaling theory and shows how constitutionalism and judicial activism can provide valuable signals to investors. The perspective on rights presented here fits comfortably within a broader set of theories about how people use “principled” actions to signal that they are reliable contracting partners. The implications of the signaling hypothesis are explored more thoroughly in Section III, followed by some brief concluding remarks. Whether by coincidence or otherwise, the signaling hypothesis fits well with some of the basic trends in constitutionalism, including its frequent association with economic liberalization.

II. A SIGNALING PERSPECTIVE ON RIGHTS

We can imagine two separate stages in constitutionalism. The first is the adoption of a constitution that purports to limit governmental power, protect human rights, and provide some mechanism for enforcement. The second is the actual implementation of these limits when a court holds unconstitutional some significant executive or legislative acts.

Apart from its direct purposes, each step communicates a message. To the extent it is initially credible, the first step communicates that the dominant coalition is sufficiently aware of the long-term benefits of liberalization to give up some of its own potential power. This is a message of interest to investors who are concerned about the regime’s long-term commitment to economic liberalization. Thus, adoption of a constitution may send a useful signal of the dominant coalition’s intentions. The methods used to ratify

¹² A somewhat similar signaling theory, involving compliance with International Monetary Fund (IMF) rules, is presented in Beth A. Simmons, *Money and the Law: Why Comply with the Public International Law of Money?* 25 *Yale J. Int’l L.* 323 (2000).

¹³ For a recent review of the theoretical and empirical literature on this point, see Tom Ginsburg, *Does Law Matter for Economic Development?* 34 *L. & Soc. Rev.* 829 (2000).

constitutions may strengthen the signal. Ratification by a legislative supermajority or through a national referendum communicates to foreign investors that a large portion of the population is “on board” and would resist unconstitutional government actions. Even without enforcement mechanisms, the political signal sent by ratification may be credible to investors.¹⁴

By agreeing to constitutional reforms, the dominant coalition does provide itself with a degree of insurance from the fallout resulting from a future loss of influence. As we will see, it also stands to benefit from the significant long-term impact of the rule of law on economic development. The point, however, is that the costs are likely to be relatively immediate, while the benefits extend over a longer period of time. This trade-off makes the most sense when the dominant group has a low discount rate.¹⁵

Of course, there may be other reasons for adopting constitutionalism unrelated to the government’s discount rate. The dominant coalition may have an ideological commitment to the rule of law and human rights. Alternatively, it may be facing an imminent loss of power in other branches of government, motivating it to strengthen the hand of the judiciary by entrenching basic rights. In some circumstances, investors may find these alternative explanations plausible, so that constitutionalism does not serve as a useful signal of a long-term commitment to economic reform. But in other circumstances, as we will see, the signal can be clear.

Successful judicial enforcement of the constitution strengthens the signal to investors. The second step communicates that the judiciary is sufficiently independent to successfully oppose the other branches of government. Even if the rulings in question relate to human rights such as free speech or due process, they tell investors that the judiciary is also in a position to enforce any constitutional provisions dealing with expropriation. Perhaps more importantly, such decisions may also show that the judiciary can operate free from outside influence in deciding ordinary legal issues of contract and property law. Such a showing of judicial independence can be encouraging to investors even if they themselves have no interest in human rights.¹⁶

¹⁴ A word of clarification about terminology may be in order. Speaking of a signal to “investors” suggests that the recipients are multinationals or foreign banks. Capital from these sources may indeed be important for development. As outsiders who lack intimate knowledge of local politics and legal culture, foreign firms may find signals particularly salient. But other sources of capital are also important for development. Local citizens may also be more willing to make domestic investments if they do not fear expropriation and feel confident about the presence of the rule of law. Such reassurance may also affect the willingness of citizens to invest in their own human capital or to make this investment domestically (for instance, by returning home after receiving a foreign education).

¹⁵ On the significance of time horizons for secure protection of property rights and judicial independence even when the ruler is an autocrat, see Olson, *supra* note 5, at 25–34.

¹⁶ It may be helpful to clarify the nature of the rights in question. We are most interested in those rights that most clearly signal judicial independence. In general, positive rights—such as entitlements to work or health care—are likely to have broad political appeal and hence do not test the courts’ ability to resist political pressure. Issues about the division of power also

Information about judicial independence is important to investors for several reasons. Most obviously, it suggests that the judiciary has the necessary strength to enforce constitutional prohibitions against expropriation. But legislative expropriation is not the only risk facing foreign enterprises, nor is it even the most important.¹⁷ Investors may also have to contend with corrupt or abusive executive officials, whose actions may be subject to judicial control. They may also need assurance that the courts will be free from outside influence in deciding ordinary litigation. Because enforcing human rights is a politically costly way of exercising judicial independence, it provides a credible signal that the courts will respect the rights of investors.

This paper builds on recent applications of signaling models to explain behaviors when the costs of these behaviors seemingly outweigh direct benefits. In a recent book, Eric Posner uses signaling models to explain a wide range of human behavior.¹⁸ In his basic model, there are two types of people. The good type of person has a low discount rate and takes a long-term perspective; these people are better contract partners because they are willing to forego the short-term benefits of exploiting their partners in exchange for the long-term benefits of cooperation. The bad type has a lower discount rate and is therefore a less reliable contract partner. As Posner explains, “because a good type is a person who values future returns more than a bad type does, one signal is to incur large, observable costs prior to entering a relationship.”¹⁹ For instance, Posner explains voting as an up-front investment used as a signal by good types—although voting costs both good and bad types the same in terms of time and effort, good types can recover the investment over more extended rounds of cooperation with others.²⁰ Posner’s model can be useful even if we assume that behavior like voting springs primarily from other motivations. As others have observed, reputations “can arise for non-strategic reasons and yet be just as powerful in achieving credibility.”²¹

Signaling models may also be useful in international law.²² Notably, Beth

provide a poor test of judicial independence. If a court rules in favor of the legislature in a dispute with the executive, for example, it is difficult for outsiders to know whether the court is making a principled stand or merely siding with the more powerful branch. In contrast, decisions that favor unpopular religions, ethnic minorities, or political dissidents are a stronger test of the courts’ willingness and ability to resist political pressure.

¹⁷ See Susan Rose-Ackerman & Jim Rossi, *Disentangling Deregulatory Takings*, 86 Va. L. Rev. 1435, 1472 (2000).

¹⁸ See Eric A. Posner, *Law and Social Norms* (2000).

¹⁹ *Id.* at 19.

²⁰ *Id.* at 123. Similarly, people signal that they are cooperators by obeying the law even when breaking the law would produce gains greater than the risk of punishment. *Id.* at 111.

²¹ Avinash Dixit & Barry Nalebuff, *Autocracy, Democracy, and Prosperity*, in *Strategy and Choice* 165 (Richard J. Zeckhauser ed. 1991).

²² Posner, along with Jack Goldsmith, discusses the possibility that states sometimes have an interest in being known as reliable partners rather than rogues. States may consequently “pay lip service” to customary international law in the hope of being classified as civilized by other states and reaping the benefits of that perception. See Jack L. Goldsmith & Eric A.

Simmons suggests that states commit to formal International Monetary Fund obligations as a “signaling device to convince private market actors as well as other governments of a serious intent to eschew the proscribed behavior,” thereby improving trade, capital flows, and “other benefits of good standing in the international economic community.”²³ She points out that pooling equilibria are also possible: “as more countries commit themselves to a rule, noncommitment sends a strong negative signal about a government’s willingness to comply, which explains the ‘snowballing’ or ‘momentum’ effects observed with respect to international commitments in a number of issue areas.”²⁴ Thus, she says, “[g]overnments comply with their legal commitments largely to preserve their reputation for providing a stable framework for the protection of property rights and to enjoy future economic benefits on favorable terms.”²⁵

Essentially, this paper proposes a similar hypothesis about constitutionalism and the rule of law. A signaling model has four requirements: (1) identification of the signal, (2) identification of the characteristic that is being signaled, (3) explanation of why signaling the characteristic is desirable, and (4) a showing of why the signal is credible. The general thrust of the argument should be obvious by this point, but some of the details are spelled out in the next two subsections.

A. *Constitutionalism as a Signal*

It is now widely believed that economic growth requires private investment, which in turn is fostered by assurances of a stable legal regime. Otherwise, potential investors will be wary of proceeding for fear that their investments will be expropriated, either directly or through future redistributive taxes or regulations.²⁶ This is an issue that Mancur Olson in particular stressed. Even an autocrat, Olson argued, has an incentive to foster investment by providing assurances against expropriation, and if the autocrat has a long time horizon (perhaps as founder of a dynasty), he will also have an incentive to fulfill those assurances.²⁷ But, of course, the temptation always exists of announcing a policy against expropriation, waiting for the resulting investments, and then confiscating them anyway. How does a regime, particularly a new regime with no track record, provide credible assurances that it will

Posner, A Theory of Customary International Law, 66 U. Chi. L. Rev. 1113, 1137 (1999). This point is further elaborated in Jack L. Goldsmith & Eric A. Posner, *Moral and Legal Rhetoric in International Relations: A Rational Choice Perspective* (Olin Working Paper No. 108) (<http://papers.ssrn.com>, accessed August 13, 2001).

²³ Simmons, *supra* note 12, at 324.

²⁴ *Id.* at 324–25.

²⁵ *Id.* at 325.

²⁶ See John M. Litwack, *Legality and Market Reform in Soviet-Type Economies*, 5 J. Econ. Persp. 77 (1991).

²⁷ See Olson, *supra* note 5, at 6–10, 25–28, & 40–43.

carry out its promise to respect the rights of investors? One possibility is to adopt constitutional guarantees of human rights and the rule of law, which can be a useful signal provided the government would find violation costly.

Consider a world with two types of dominant coalitions. The good type has low discount rates and correspondingly long time horizons; it is willing to give up the immediate gains of expropriation for the longer-term gains of growth. The bad type, having higher discount rates, is prone to expropriate both foreign and domestic assets. We saw in the previous subsection that any up-front expenditure to some extent signals a low discount rate. Better signals have the characteristic of initially costing good types less than bad types.

Constitutionalism, in the sense of a legal guarantee of democracy and individual rights, can provide such a signal. First, constitutionalism involves an immediate sacrifice of social control, and such up-front expenditures always help signal low discount rates. The government must put up immediately with a good deal of annoying dissent and irritating limits on its enforcement powers in the hope of reaping future benefits. Dominant coalitions that hope to renege on their promises and squeeze all available rents out of society are less likely to agree to hinder themselves in this way. Indeed, as we saw earlier, the nature of rights requires that the government eschew some actions that would in fact be socially beneficial (or at least, beneficial to the dominant coalition). The government is not only acknowledging that it considers freedom of speech, individual privacy, and freedom of religion to be valuable. To a greater or lesser extent, depending on the strength of the constitutional guarantees, it is also agreeing to treat these rights as trumps, with the potential to stymie the pursuit of other social interests. Thus, agreeing to respect rights is an inherently costly (and therefore credible) signal.

Second, economic liberalization involves a willingness to give up tools that are conducive to expropriation. Although the point is most obvious with regard to direct economic guarantees like takings restrictions, it applies to a broader range of rights. By limiting the government's available enforcement mechanism (through due process guarantees), its political controls (through guarantees of free speech), and its ability to selectively expropriate (through equality guarantees), constitutionalism makes direct or indirect expropriation harder to accomplish. Restrictions on enforcement methods may be particularly significant. As Olson points out, bad economic policies designed to collect rents for the government generally "prescribe outcomes that all or almost all private parties have an incentive to avoid, and no one in the private sector has an incentive to report violations to the authorities."²⁸ Restrictions on abusive investigation techniques make it much harder to enforce such regulations; restrictions on the severity of punishment make it difficult to obtain compliance without having a high detection rate for violations. Thus,

²⁸ *Id.* at 107.

although not directly aimed at economic reform, limits on enforcement actually discourage rent-seeking economic regulation. Good types will be more willing than bad types to put themselves in a position where they will find it costly to extract rents in the future.

Third, one of the important ways that a dominant coalition can extract rents from society is by imposing its social norms on dissident groups and individuals. A coalition that limits its power to extract such rents signals that it is less oriented toward rent seeking in general. For example, by giving up its power to engage in the satisfying practice of suppressing minority religions, the coalition shows that it is willing to give up short-term rents for longer-term benefits. A similar signal may be sent by a surrender of the power to legally enforce traditional gender roles.

In short, political liberalization can be a good indicator of a commitment to economic liberalization. Constitutionalism strengthens the signal by making political liberalization less readily reversible and therefore a more serious up-front commitment. Note that the foregoing argument holds even if the constitution does not provide any explicit protection against economic expropriation. It also holds even if there is some possibility that the constitution will later be rescinded or that the government will flout judicial decrees; both actions are costly because they publicize the government's breach of its commitments to potential investors and other audiences.

A striking example of this signaling method is provided by Hong Kong. Hong Kong investors rationally feared expropriation after the 1997 turnover. Moreover, it was clear that following the turnover, the Chinese government would have the raw physical power to do whatever it liked. Nevertheless, by committing to the 1990 Basic Law, including elements of democracy and the rule of law, the Chinese were able to provide investors with a seemingly credible signal of its future intentions.²⁹ The government understood that respect for human rights would be the "touchstone by which Hong Kong's fragile autonomy within Communist China is measured."³⁰ By increasing the political cost of expropriation, the Basic Law provided some direct assurance to investors, inasmuch as the Chinese government would have the embarrassment of violating its commitment in a way that would offend the international community.³¹ But more importantly, the signal came with a more immediate political cost. By agreeing to an arrangement so much at odds with its own governing ideology, the Chinese government signaled that it

²⁹ See Owen Fiss, *Hong Kong Democracy*, 36 *Colum. J. Transnat'l L.* 493 (1998) (explaining quasi-constitutional nature of the Basic Law and democratic elements in the post-1997 regime). For further discussion, see text accompanying notes 42–48, *infra*.

³⁰ *Hong Kong—For Whom the Gong Tolls*, *The Economist*, February 17, 2001, at 45.

³¹ Protecting basic rights also limited the likelihood that rights-protective foreign governments might impose trade restrictions on Hong Kong.

well understood the long-term financial gains that come from respecting the rights of Hong Kong investors.³²

The significance of the signaling model depends in part on the plausibility of alternative explanations for constitutionalism. The Hong Kong case is particularly strong because of the weakness of alternative explanations. The rulers of mainland China clearly were not pursuing their own ideological agenda when they supported the adoption of the Basic Law—quite the contrary. Nor is self-protection a plausible explanation, since the mainland rulers are not even residents of Hong Kong and have no reason to expect the Hong Kong courts to protect their interests against a hostile future legislature. Thus, in this case, the signal was particularly clear.

B. Signaling Judicial Independence

Markets are common in even the most underdeveloped countries, indeed, even where they are illegal. Olson tellingly refers to these as “irrepressible markets.”³³ But these markets usually involve on-the-spot exchanges where enforcement is not a problem. Long-term contracting is a different matter. Contracts for future performance are an important part of a capitalist economy; as Olson explains, “To realize all the gains from trade, then, there has to be a legal system and political order that enforces contracts, protects property rights, carries out mortgage agreements, provides for limited liability corporations, and facilitates a lasting and widely used capital market that makes the investments and loans more liquid than they would otherwise be. These arrangements must also be expected to last for some time.”³⁴

In particular, financial, futures, and insurance contracts are difficult without a credible enforcement mechanism.³⁵ For this reason, “the absence of an independent, professionally competent, and well-respected judiciary represents a serious deficiency in a country’s social and economic capital and is likely to be a significant impediment to economic development.”³⁶ Judicial

³² See Ted Hagelin, *Reflections on the Economic Future of Hong Kong*, 30 *Vand. J. Transnat’l L.* 701, 713–20 (1997). One political cost is the encouragement given to mainland Chinese who may favor political reform. Another is the psychic cost to officials of agreeing to an ideologically unpalatable institutional arrangement.

³³ “Those who live in low-income economies know that there are shops and market days in the villages, bazaars in the town, and peddlers hawking their wares on the street. The number of shops and peddlers in a large, poor city such as Calcutta is almost uncountable. The largest number of markets that I have ever seen in one place was in far from prosperous Moscow in early 1992, where there were people buying and selling at almost every metro stop and street corner.” Olson, *supra* note 5, at 173.

³⁴ *Id.* at 185.

³⁵ *Id.* at 186–87. See also Thomas Carothers, *Aiding Democracy Abroad: The Learning Curve* 164 (1999).

³⁶ Trebilcock, *supra* note 4, at 43. This is not to say that an independent judiciary is absolutely indispensable to growth, China and Vietnam being familiar counterexamples. See Posner, *supra* note 1, at 2; Holmes & Sunstein, *supra* note 8, at 75. On the other hand, the long-term viability

independence is particularly important in newly liberalized economies in which the state is likely to own important enterprises and therefore has a direct financial stake in the outcome of litigation involving those enterprises.³⁷

Richard Posner aptly summarizes the legal machinery that ideally accompanies modern capitalism: "In its ideal form (an important qualification), the machinery consists of competent, ethical, and well-paid professional judges. . . . The judges are insulated from interference by the legislative and executive branches of government. They are advised by competent, ethical, and well-paid lawyers. Their decrees are dependably enforced by sheriffs, bailiffs, police, or other functionaries."³⁸ As is common knowledge, much of this machinery is typically absent in less developed countries when first they attempt to liberalize their economies.³⁹

Judicial independence serves an additional purpose when linked to constitutionalism. We have seen that constitutionalism is a costly and therefore credible signal that the dominant coalition has a low discount rate and is willing to trade present social control for long-term growth. Judicial review is not the only safeguard for constitutional rights, but it is an important one, so the presence of an independent judiciary strengthens the significance of constitutionalism.⁴⁰ The formality of legal action also increases its visibility and thus the ease of detecting and interpreting the signal.

For a country to reap the benefits of an independent judiciary and the rule of law, the judiciary must not only be independent and effective, it must also be seen as independent and effective. But it is not easy for outsiders to observe the day-to-day conduct of the whole judicial system. Conspicuous enforcement of constitutional rights is a particularly credible signal of judicial independence, for several reasons.

First, to reiterate a point made earlier, to the extent rights operate as trumps, rights enforcement is inherently costly to the government in the short run. By honoring the trump, the government is throwing away what would otherwise be a winning card in the regulatory game. Its willingness to comply with a costly judicial decree is a sign of the effectiveness of the judicial

of this "Asian values" approach has been questioned in countries like Korea. See Seung Wha Chang, *The Role of Law in Economic Development and Adjustment Process: The Case of Korea*, 34 *Int'l Lawyer* 267 (2000). For an extensive collection of comparative material regarding judicial independence, see *Global Constitutionalism: Criminal Procedure/Courts and Politics V-1 to V-74* (Paul D. Gewirtz, Karen Johnson, & Jacob Katz eds. 2000).

³⁷ See Trebilcock, *supra* note 36, at 43. See also *id.* at 44 (discussing application of this principle to eastern Europe).

³⁸ Posner, *supra* note 1, at 2.

³⁹ See Carothers, *supra* note 35, at 170–76 (detailing weaknesses of judicial systems even after foreign efforts at reform). A particularly telling anecdote about the difficulty of reform is found in *id.* at 157, recounting a conversation with a Haitian judge.

⁴⁰ For empirical evidence about the significance of an independent judiciary in protecting human rights, see Frank B. Cross, *The Relevance of Law in Human Rights Protection*, 19 *Int'l Rev. L. & Econ.* 87 (1999).

system. Obeying a decree that had a positive cost-benefit ratio would be a less serious signal, since the government might be obeying such a decree because of the economic benefits of the decree rather than because of a norm of respect for judicial independence.

Second, when judges enforce constitutional rights against the government, they necessarily signal that they themselves believe they have sufficient independence to risk government disapproval. Judges are in a much better position than outsiders to know their own vulnerabilities, so their willingness to take on the government in what are often high-profile cases is a good indicator of their independence. Like most signals, this one is less than completely reliable—the judges might be either mistaken or unusually courageous and principled. But judges on the whole are not professionally inclined to recklessness, so their willingness to oppose the government is likely to mean that they can do so safely.

Third, rights-enforcing decisions are to a certain extent self-inflicted wounds. Someone had to appoint these independent-minded judges or allow them to continue in office. Sometimes political hacks may surprise their sponsors by behaving independently on the bench, but independent action is more likely if the judges are principled and professionally competent. The government's willingness to appoint such judges or tolerate their continuance in office is an indication that the government is attentive to the long-run benefits of the rule of law. Making such appointments risks costly rights-enforcement decisions; the presence of these decisions is correspondingly a signal of the quality of appointments and thereby of the government's commitment to the rule of law.

As Richard McAdams points out, passing up the short-term gains of opportunism may indicate an ability to hold to commitments in the face of changing impulses as much as it indicates a low discount rate.⁴¹ By honoring adverse judicial decisions in controversial cases, the governing coalition also shows that it has the self-control to maintain a long-term strategy of adherence to the rule of law even under political pressure.

In short, judicial activism in enforcing rights provides useful information to investors about a country's general commitment to the rule of law.⁴² Again,

⁴¹ See Richard H. McAdams, Signaling Discount Rates: Law, Norms, and Economic Methodology, 110 *Yale L. J.* 625, 657–58 (2001).

⁴² The signal is strongest where the ordinary courts that enforce ordinary contract and property rights also have the power of judicial review. Nevertheless, even where constitutional issues are relegated to a special court, conspicuous activism by that court sends a more general message about the regime's general commitment to the rule of law. Moreover, where a constitution does provide explicit protection of economic rights, the ability of a constitutional tribunal to aggressively protect other rights may also signal its willingness to protect economic rights as well. But judicial activism over human rights is a significant signal to investors even in the absence of entrenched economic rights.

Hong Kong provides a useful illustration.⁴³ Not long after China assumed control, the new local government issued a regulation restricting immigration from the mainland by children of Hong Kong residents. The effect of the regulation was to block the immigration of over 1 million people from the mainland to Hong Kong, which otherwise could have been a severe strain on Hong Kong's resources. The Court of Final Appeal held the regulation to be a violation of the Basic Law provision governing right of abode, but waffled on the extent to which final interpretative authority over the provision rested with the central government. The central government then issued an official contrary interpretation of the Basic Law, based on its reading of the original legislative intent and stressing that the immigration provision involved matters that were the particular domain of the central government. Maneuvering followed over whether the mainland government had the final authority to interpret the agreement.⁴⁴

This episode was less than a clear-cut victory for judicial independence in protecting individual rights—but it was also less than a clear-cut defeat. Judicial review remained largely intact in Hong Kong.⁴⁵ The central government seemed to be at great pains to handle the situation without imposing sanctions on the Court of Final Appeal or appearing to eviscerate the court's authority over violation of the Basic Law by the local government.⁴⁶ This sense of caution surely did not derive from any idealistic attachment to human rights or the rule of law. Rather, it must have stemmed from an appreciation that openly flouting the independence of the Court of Final Appeal sent a bad signal.⁴⁷ Indeed, as it was, the affair was considered a sign of "continued political risk" for investors.⁴⁸

III. IMPLICATIONS AND EXTENSIONS

Now that we have laid out the basic hypothesis, it is time to explore its broader implications. We begin by discussing some empirical questions about the hypothesis. Then we turn to considering other ways the constitutionalism might act as a signal.

⁴³ For the basic background, see Lin Feng, *The Constitutional Crisis in Hong Kong—Is It Over?* 9 Pac. Rim L. & Pol'y J. 281, 284–88 (2000). For discussion of the legal issues, see Albert Chen, *The Constitutional Crisis in Hong Kong*, 33 Int'l L. 1025 (1999).

⁴⁴ Indeed, the import of the central government's ruling on other abode cases remains unclear. See Hong Kong iMail, 2000 WL 2321657 (September 26, 2000).

⁴⁵ See Tahirih V. Lee, "Apres Moi le Deluge"? Judicial Review in Hong Kong since Britain Relinquished Sovereignty, 11 *Indiana Int'l & Comp. L. J.* (forthcoming 2001).

⁴⁶ See Frank Chinjo, *The Hong Kong SAR and Right of Abode*, June–July 1999 (www.csis.org.asia.hkupdate, accessed October 12, 2000).

⁴⁷ The central government insisted that it would intervene with its own official interpretations only when necessary to preserve Hong Kong's prosperity. See Maria Estanislao, *Right of Final Adjudication in Hong Kong: Establishing Procedures of Constitutional Interpretation*, *Asian Pac. L. & Poly J.* 10, 21 (2000).

⁴⁸ Economist Intelligence Unit Country Report: Hong Kong (August 2000 update).

A. *Empirical Issues*

The evolution of constitutionalism in each country is a complex and unique story. Corresponding to these different lines of development are varying mixes of costs and benefits. The most that one can hope for, in the way of an explanatory theory, is to explain some of the overall trends. Although it may be to some degree speculative, the signaling hypothesis does seem to fit with some overall trends.

First, if constitutionalism functions as a signal to investors, we would expect to see constitutionalism associated with moves toward market liberalization. In the former Soviet bloc, constitutionalism clearly accompanied a shift toward a market economy.⁴⁹ In Canada, New Zealand, and Israel, which already enjoyed forms of capitalism and democracy, rights entrenchment accompanied a major move toward market liberalization at the expense of government economic control.⁵⁰ Entrenchment may also result when a radical change in regime throws in doubt the previously liberal economic scheme, as we saw in the case of Hong Kong. Similarly, in South Africa the black majority supported entrenchment of rights to prevent the flight of human and financial capital held by the white minority.⁵¹

Second, new regimes have the strongest need to signal their future intentions. A country like Britain has several centuries of experience with an independent judiciary and enforcement of contract and property rights. Thus, it has little need to send any special signal about these conditions, and the move toward entrenching human rights has been correspondingly slow and halting.⁵² New regimes, like those in eastern Europe, have no track record and therefore a much stronger need to establish their credibility—thus, their quick rush toward constitutionalism.

Third, signals are most needed by outsiders. If there is a firm dominant coalition, the members do not need additional signs to provide reassurance

⁴⁹ See Hirschl, *supra* note 9, at 93.

⁵⁰ See *id.* at 114 (support for Israeli basic law on individual rights came from supporters of “neoliberal” economic policies); *id.* at 127 (entrenchment of civil liberties in Canada “strongly supported by influential coalitions of neoliberal economic forces”); *id.* at 131–32 (New Zealand bill of rights associated with transition from “what had probably been the most protected, regulated, and state-dominated system of any capitalist democracy to an extreme position at the open, neoliberal, free-market end of the spectrum”). Hirschl’s view of the Israeli case is further explained in Ran Hirschl, Israel’s “Constitutional Revolution”: The Legal Interpretation of Entrenched Civil Liberties in an Emerging Neo-Liberal Economic Order, 46 *Amer. J. Comp. L.* 427 (1998).

⁵¹ See Hirschl, *supra* note 9, at 137 (African National Congress supported entrenched bill of rights because otherwise “the new regime in South Africa would have been unable to reassure domestic and international economic elites that, despite the big changes, their predictability interest would remain secure.”).

⁵² See David Feldman, The Human Rights Act 1998 and Constitutional Principles, 19 *Legal Stud.* 165 (1999) (discussing the very recent British experiment with a modest form of judicial review).

about the safety of their investments; they know perfectly well whether their property and economic rights are secure. Thus, we would not expect to find active judicial review in a country like Japan, where the political situation has been very stable and investment has been through informal domestic networks. Under these circumstances, neither expropriation nor the independence of the judiciary is a pressing concern. Although not a complete pawn of the government, the Japanese judiciary is notoriously quiescent.⁵³

Finally, the collective surge by countries toward constitutionalism in regions like eastern Europe is also explainable on the basis of signaling. If no one else has adopted constitutionalism, failure to do so may not be particularly meaningful. When everyone else in a region is adopting constitutionalism, however, failure to do so becomes a sharp negative signal. This signal is particularly important because other countries in the same region are likely to be in competition for the same sources of financial and human capital. Thus, being a holdout against a regional trend can be expensive, and as a result an entire region may shift suddenly into the constitutionalist column once a tipping point is reached.⁵⁴

The conformity of the signaling hypothesis with these empirical regularities suggests that it may indeed have some explanatory power. Undoubtedly, there are many reasons to adopt constitutional protections for human rights. Whether conscious signaling is an important factor in most cases is unclear. Where it is present, it may take the form of an ill-defined desire to “send a message” about the adoption of a modern liberal regime, rather than a well-articulated intent to influence investors. But even were it not a decisive motivation, the potential benefits of signaling could at least make it easier for advocates of constitutionalism to win support in close cases. An awareness of signaling effects may also help cushion tribunals that vigorously enforce human rights from retaliation, for fear that this would “send the wrong message” to outsiders. Obviously, more rigorous empirical study is called for, but the evidence at least seems suggestive.

Another interesting question, deserving of further exploration, is why regimes use constitutionalism rather than relying on other methods to signal low discount rates and determination to respect the rights of investors. Clearly, other potential mechanisms do exist, such as paying off old debt, maintaining government assets abroad that investors could reach in litigation, currency policies that render the economy susceptible to capital flight, or international agreements protecting investors. In practice, one might expect any given

⁵³ See J. Mark Ramseyer & Eric B. Rasmusen, *Why the Japanese Taxpayer Always Loses*, 72 S. Cal. L. Rev. 571 (1999).

⁵⁴ Simmons found statistical evidence of a similar phenomenon with respect to adherence to IMF obligations by nations in a given region. See Simmons, *supra* note 12, at 353–57. Consistent with the thesis of this paper, Simmons also found evidence suggesting that investors may view compliance with rule-of-law obligations as indivisible, rather than distinguishing between different kinds of legal obligations. See *id.* at 360.

country to use a mix of these signaling methods. Constitutionalism might be expected to play the largest role when the others are less feasible or when it has incidental benefits such as obtaining foreign assistance. As noted earlier, constitutionalism could also benefit from a cascade effect, leading countries to adopt this signal when others in their region do so. But without more intensive empirical investigation, these explanations necessarily remain speculative.

B. Possible Extensions

Besides investors, constitutionalism may operate as a signal to other potential audiences. One audience in democratic countries is the median voter. As Akhil Amar points out, even in democracies, citizens face an “agency problem,” since it is hard for them to monitor the conduct of their governments in order to prevent abuses.⁵⁵ Opponents of the U.S. Constitution, who had come very close to prevailing and retained considerable political influence, viewed the national government as aristocratic, remote from the people, and apt to expand its power indefinitely at the expense of the states—in short, as a Leviathan in the making.⁵⁶ The Bill of Rights seems to have had at least some success in overcoming these concerns. Yet it hardly dealt with them directly. The First Amendment did limit federal power over speech, and the Tenth Amendment hinted at federalism-based limits to federal power. The remainder of the amendments were largely concerned with restricting the government’s ability to implement its policies, by requiring the use of local juries, limiting police searches, and guaranteeing various rights in criminal trials. These implementation restrictions placed some direct restraint on the potential Leviathan’s strength. But they may also have operated as a signal: the very willingness of the Constitution’s supporters to agree to these shackles on federal enforcement tended to suggest that they were not, after all, embarked on a campaign to establish autocracy. For swing voters who had supported the Constitution only with trepidation, this signal may have been useful in cementing their support—not to mention in helping to obtain the support of former opponents of the Constitution. Refusal to adopt a Bill of Rights, in contrast, might have sent a strong negative message.

Another potentially important audience consists of ethnic or racial minorities, who often have reason to be suspicious of the good faith of the majority. Like investors, they may take some reassurance from direct constitutional protections, in this case, guarantees of religious freedom or antidiscrimination clauses. But also like investors, they may be reassured by visible evidence that the courts are sufficiently independent to enforce such

⁵⁵ See Akhil Reed Amar, *The Bill of Rights as a Constitution*, 100 *Yale L. J.* 1131, 1152, 1182, & 1205 (1991).

⁵⁶ See Daniel A. Farber & Suzanna Sherry, *A History of the American Constitution 175–215* (1989).

provisions vigorously, as well as by indications that the legislature has deliberately limited its power to inflict damage on them. Again, beyond the direct benefits of these government actions, they also carry a message about the majority's good faith. One possible example might be found in the Warren Court, whose decisions to stand firm on civil rights despite heavy public pressure and to vigorously enforce the rights of criminal defendants may have been intended to send a signal to increasingly disaffected members of the black minority. Or, in what is nearly the reverse situation, the provisions of the South African constitution may have been intended to reassure white voters regarding the good intentions of the newly empowered black majority.⁵⁷

In conclusion, the basic idea underlying this paper is that protecting human rights is costly to governments, so the willingness of a government to do so sends a valuable message about its commitments. In particular, by adopting entrenched legal protection for human rights, countries communicate that they are willing to sacrifice short-term advantages to obtain long-term benefits such as economic growth. Investors can infer from this that the government is less likely to pose a threat of opportunistic behavior such as expropriation. Similarly, a strong indication of judicial independence is presented when courts vigorously enforce human rights against their governments. An independent judiciary is valuable to investors who themselves have no interest in human rights whatsoever.

Thus, the signaling model suggests that human rights enforcement can help encourage investment and thereby indirectly foster economic growth. This effect may bolster the motivation for protecting human rights or at least help counter the fear that human rights protection is too much of a luxury for poorer countries.

⁵⁷ Signaling may also operate on the retail level. It is unclear, for instance, whether the express message of the Miranda warnings actually makes much difference to defendants. But the ritual of giving the warnings might nevertheless be important. It is psychologically less costly for police officers to comply with the requirement if they are well trained (so they know the warnings and the rules for using them well) and if they are inclined to obey rules and regulations. In short, administering the warnings conveys a signal about the officer's professionalism. This is significant (and presumably reassuring) information for the accused. To take another example of retail-level signaling, affirmative action plans may be useful in part because they signal that the employer or school is unlikely to engage in racial discrimination against minorities. This may provide reassurance to minorities who are already within the institution as well as encouraging applications by others. (Note, however, that the signal as usual works best if it is costly—that is, if the affirmative action program interferes with institutional efficiency or exposes the institution to the threat of outside sanctions of some kind.)