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Law and Principal-Agent Interaction

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ABSTRACT

Politicians or statesmen are often accused of overstepping the boundaries of their contract with the people. Taking themselves liberties not granted by law, they push their advantages too much. The principal-agent model from game theory of contracting high-lightens the role of law and court independence for constraining political elites from engaging in rent-seeking and political looting, like various forms of corrupt practices or sex crimes.

Keywords: *Law, Principal-Agent Model, Montesquieu, Legal Systems, Schools Of Jurisprudence.*

INTRODUCTION

Whether a country has an authoritarian or democratic political regime, law and the legal system plays a most fundamental role, structuring interaction between political elites and the people. A country may practice *rule by law* or *rule of law.*

The transition from a regime of rule by law to a regime of rule by law is of utmost importance for ordinary people in a country, because it entails that law become a mechanism of constraints upon the government and its bureaucracy. Law, as statute law or customary law, is basically a set of constraints upon human interaction. This fundamental feature applies to both public law and private law. Here, I deal with public law, as restraining the principal-agent interaction, typical of all politics.

Due to transaction cost reasons, political agents emerge to provide a population with a set of public goods and other services. The costs of the agents, including remuneration, are covered by taxes and user fees, while the delivery of public sector services provides citizens with value. The crucial question of *quid pro quo* arises arises between costs and value.1)

POLITICAL CONTRACTS HAVE OPAQUE CONSIDERATIONS

Political agents, whether in political parties or as charismatic leaders, interact with the electorate on the basis of promises in exchange for votes or support. Given opportunistic behavior with guile, political agents want a *rent* from their policy efforts, the size of which is difficult to specify in a contract. Rent-seeking behavior on the part of political agents is facilitated by asymmetric information, favoring the agents.

Political interaction is a zero sum game, where one may hope that conflicts are resolved by peaceful means, for instance voting. The political contestants employ information as a key tool in the struggle for power, including lying and false accusations.

Law is one of the key mechanisms for restraining opportunistic behavior, like bribery, favoritism and embezzlement or patronage, as well as constraining the employment of asymmetric information. When there is rule by law, arbitrary government is restrained and political authority is regulated by the publicans of general commands. When there is rule of law, a set of legal institutions eliminate authoritarian rule. Political contracting between people and government agents is based upon promises about performance and outputs of goods and services, but will they be kept? To reduce rent-seeking or political looting by agents, law is necessary. The law and the legal system embody basic institutions of the political regime.

LEGAL SYSTEMS

Max Weber in Economy and Society (1978) pointed out there are in reality only a few legal systems or traditions. Today we have:

- Common Law
- Civil Law
- Sharia Law
- Socialist Law.

The independence of courts is only possible in the first two types of law, because the remaining two kinds have each a goal that restricts legal integrity and validity.

In Koranic Law, the precepts of religion are ultimately guiding, leaving much discretion the Kadis and Muftis – what Weber called "*Kadi-justiz*". In Socialist Law, the interests of the nation or of the Proletariat guide law making and law adjudication at the end of the day.

Independence of courts is essential for a workable principal-agent model, where law really restrains the political agents. To understand the fundamental importance of law for politics, one may first consider what rule by law, endorsing legality, excludes, namely case by case examination, i.e. arbitrariness, or case by case discretion:

- Decretism
- Rule by ordinances or regulations
- Military rule
- Emergency law giving power
- Executive orders
- Habeas Corpus violations
- Impossibility of appeal
- No complaints procedures
- Dependency of judges
- Fakes trials.
- Arbitrary arrests and prison sentences.
- Restrictions on defense of accused.

Rule of law, secondly, whether combined with any form of democracy-referendum type, parliamentary type, or presidential dispensation, promotes:

Predictability

Public law when properly implemented makes it possible for people to increase the rationality of behavior. They know what rules apply, how they read as well as how they are applied consistently. This is very important for the making of strategies over a set of alternatives of action.

Transparency

Societies operate on the basis of norms prohibiting, obligating or permitting certain actions in specific situations. Rule of law entails that these norms are common knowledge as well as that they are not sidestepped by other implicit or tacit norms, known only to certain actors.

Due Process of Law

When conflicts occur either between individuals or between persons and the state, then certain procedures are to be followed concerning the prosecution, litigation and sentencing/incarceration. Thus, the police forces and the army are strictly regulated under the supervision of courts with rules about investigations, seizure, detainment and prison sentencing. No one person or agency can take the law into their own hands.

Fairness

Rule of law establishes a number of mechanisms that promote not only the legal order, or the law, but also justice. For ordinary citizens, the principle of complaint and redress is vital, providing them with an avenue to test each and every decision by government, in both high and low politics. Here one may emphasize the existence of the *Ombudsman*, as the access to fairness for simple people.

China has recently moved towards rule by law, but the country is far from rule of law, practiced for instance in India. Singapore has rule by law but not fully rule of law, i.e. only rule of law I. Many Asian countries have to change to introduce rule by law, as government tends to be arbitrary and corrupt. Muslim nations do not cherish rule of law. Legal culture and legal system matter for the choice between rule by law and rule of law. The United Nations recommends good governance, which is either rule of law I or rule of law II.

Good Governance

Rule of law principles offer mechanisms that restrain behavior in politics. One may distinguish between rule of law in a narrow sense – RULE OF LAW I – and in a broad sense – RULE OF LAW II. Some countries practice only rule of law I, whereas other countries harbor both mechanisms. Rule of Law II is tapped by voice and accountability, whereas Rule of Law I is tapped by legality and judicial autonomy in the *World Bank Governance Project* data. 2)

In continental political theory, rule of law tends to be equated with the German conception of a Rechtsstaat in its classical interpretation by Kant. 3) It signifies government under the laws, i.e. legality, lex superior and judicial autonomy (rule of law I). In Anglo-Saxon political thought, however, rule of law takes on a wider meaning, encompassing in addition also no

judicial institutions such as political representation, separation of powers and accountability (rule of law II). In general, the occurrence of rule of law II is a sufficient condition for the existence of rule of law I. But rule of law I – legality and judicial independence - is only a necessary condition for rule of law II – constitutionalism as voice and accountability.

Rule of Law I

Legality and Judicial Independence According to the narrow conception of rule of law, it is merely the principle of legality that matters. Government is in accordance with rule of law when it is conducted by means of law, enforced by independent courts. The law does not need to contain all the institutional paraphernalia of the democratic regime like separation of powers and a bill of rights. However, whatever the nature of the legal order may be, the principle of legality restricts governments and forces it to accept the verdicts of autonomous judges.

Countries that lack the narrow conception of rule of law tend to have judges who adjudicate on the basis of short-tern political considerations, twisting the letter of the law to please the rulers. Thus, law does not restrain the political agents of the country, employing the principal-agent perspective upon politics (Besley, 2006). Whatever protection the law offers in writing for citizens or foreigners visiting a country becomes negotiable, when a case is handled by the police. Even if a country does not possess a real constitution with protection of a set of inalienable rights, it still makes a huge difference whether the courts constitute an independent arm of government. Thus, also in countries with semi-democracy or with dictatorship, matters become much worse when judges cannot enforce whatever restrictions are laid down in law upon the political elite.

The independence of courts is a heavily institutionalized aspect of a mechanism that takes years to put in place. Judges are paid by the state by means of taxation, but the formula of “He who pays the piper calls the tune” does not hold. In order to secure judicial independence from politics and the rulers an elaborate system of appeal has to be erected, meaning that the behaviour of lower court judges will be checked by higher court judges. The standard institutional solution is the three tripartite division of the legal system with a supreme court at the apex. However, countries may have one than one hierarchy of courts making the judicial system complex. An independent judiciary secures a fair trial under the laws. From the point of view of politics this is important in order to avoid that accusation for any kind of wrong doing is used for political purposes.

When there is autonomous legal machinery in a country, then also politicians or bureaucrats may be held accountable for their actions or non-actions – under the law. This is of vital importance for restricting corrupt practices of various kinds.

Rule of Law Ii

Constitutional Democracy. Broad rule of law involves much more than government under the laws, as it calls for inter alia: separation of powers, elections, representation and decentralization of some sort. In the WB governance project the broad conception of rule of law is measured by means of the indicator”voice and accountability”. Since rule of law II regimes are invariably rule of law I regimes, but not the other way around, countries that score high on voice (of the principal) and accountability (of the agents) can be designated as constitutional states. A constitutional state affords two kinds of mechanisms that enhance stability in political decision-making, one creating so-called immunities or rights that cannot be changed and the other introducing inertia in the decision-making processes.

Immunities and so-called veto players would reduce the consequences of cycling, strategic voting and log-rolling. The critical question in relation to the constitutional state is not whether immunities and veto players per se are acceptable, but how much of these two entities are recommendable? Given the extent to which a state entrenches immunities and veto players, one may distinguish between thin constitutionalisms versus thick constitutionalism.

WHAT IS LAW?

By "legal norm", one may refer to a paragraph in law, or an institution in society' legal functioning system. When norms or rules are obeyed or backed by sanctions, one speaks about "institutions", or "institutionalization". A reasonable definition of "law" is that it refers to ordered couples of norm sentences and behaviour regularities, i.e. <*norm*, *enforcement*>. The legal system would comprise:

- Written constitution, the text and supplements;
- The rulings of the constitutional court, i.e. the application and interpretation of its judges;
- The extent to which the norms or rules are met with compliance.

In the various schools of law, the emphasis is put differently on the essential properties of law. 4)

Law Is Not Morality

The natural law scholars claim that there is a set of norms laid down in reason somehow. *Right reason* offers the law of humanity, transcending so-called positive law, i.e. country or national law. What is natural law that has become so popular in the new moralist in the social sciences? The natural law scholars claim that there is a set of norms laid down in reason somehow. Right reason offers the law of humanity, transcending so-called positive law, i.e. country or national law. 5)

Dworkin rejuvenated the natural law school by developing an OUGHT- jurisprudence, clustering upon two moral concepts, namely: A) rights; B) law's integrity. 6) 7) The term "right" is much disputed in jurisprudence and political theory. It can be employed in both IS-jurisprudence and OUGHT-jurisprudence. Dworkin looks upon the key terms like "justice", "rights" and "entitlements" from the point of view of normative jurisprudence. As a matter of fact, law and morals are inseparable: "law's integrity". Thus, rights always constitute normative trumps, i.e. what people can rightfully claim from government.

Typical of what Dworkin has written is the confusion of IS and OUGHT. What is the foundation of what law? Which morals? Whose morals? To most legal scholars, natural law teachings are too open ended. Law must somehow be separated from morals.

Law Is Evolutionary and Ambiguous

Kelsen developed a so called *pure theory of law*, eliminating all OUGHT-jurisprudence, approaching law as a logically coherent system of norm propositions, starting from a *Basic Norm*, giving *normatively* to all law and its set of norms, favoring statute law. 8)

Hart looked upon law as rules, separating between primary and secondary rules. Primary rules are imperatives, prohibitions and recommendations. While secondary rules cover several *rules of recognition* for eliminating merely moral rules. "A rule of recognition" stands for the various markers of law as legality: Parliament, courts, public boards or agencies, etc. 9) Legal positivism was developed rather differently by Kelsen and Hart. The Hart framework is more flexible than Kelsen's. It makes no assumption of logical coherence and closeness. Kelsen argued famously that legal validity is not only objective but also logical as to its nature. 10) Thus, from the Basic Law at the constitutional top of government to the most elementary regulation at the bottom of the state there is a logical string of necessity, tying the system together. 11) Hart never such exaggerated claims for the logicality of the legal norms, but was perhaps content with subjective normativity with the judges and police, i.e. the applications of the primary rules are considered valid by the officials. Legal positivism and its ideal of logic normativity hardly stand up to Posner's view of law and jurisprudence. Posner examines existing law or legal order from the point of view of IS jurisprudence. 12), 13). He emphasizes the following features in his polemic against both Dworkin's natural law theory and various legal positivisms:

- Change and evolution;
- Inconsistencies;
- Lacunae;
- Conflicting interpretation;
- Biases.

Law is not a closed system of norms but always changing, adapting not always coherently.

Law Is Basically the Enforcement of Norms

To the legal realists, law is real regularities in the behavior of state officials, comprising the "legal machinery". In their Is-jurisprudence concerning law as<norm, regularity>, the legal realists in Scandinavia did not focus upon validity, which to them meant merely the application and not any form of normativity, objective or subjective (Haegerstroem, 14), Ross, 15), Eckhoff, 16). Jurisprudence is the study of behavior regularities (Hedenius, 17) or simply facts (Olivecrona, 18).

Law as Theoretical Systems of Rights

"Rights" may be employed as key theoretical term for systematically analysing existing legal order, for instance using Hohfeld's elegant conceptual scheme. Consider the Hohfeld scheme and how it can be used to describe the existing legal order, i.e. existing rights, duties,

competencies, etc. 19). The general theory of rights was offered by Hohfeld in the early 20th century - see Diagram 1 and Diagram 2 for the variety of rights, their opposites and correlatives.

Diagram1. *Legal Opposites*

Right	Privilege	Power	Immunity
No-right	Duty	Disability	Liability

Note: *Privilege is the opposite of duty; no-right is the opposite of right. Disability is the opposite of power; immunity is the opposite of liability*.

Diagram2. *Legal Correlatives*

Right	Privilege	Power	Immunity
Duty	No-right	Liability	Disability

Note: *A right implies that someone else has a duty. A privilege means that someone else has no-right. A power entails that someone else has a liability. An immunity implies that someone else has a disability.*

The Hohfeld distinctions are very helpful in analysing the rights that people *actually* possess in the legal order of a country, like e.g. India and China. The variety of right concepts may also be employed to state recommendations about urgent legal reforms to improve upon peoples' right – the normative perspective.

PRINCIPALS, AGENTS AND MONTESQUIEU

Montesquieu's theory of judicial independence under the regime of the separation of powers helps to understand why liberty is low in Central Asia and East Asia, from St Petersburg to Shanghai, as well as in the Koranic world with both Sunnis and Shias. Taking out India with its British legacy, this is actually the same world that was called "*Oriental Despotism*" by the French Enlightenment. His Arias *Politics* offers also a moral tool for reforming several countries in the world, where judicial independence is compromised.20) 21)

The theory of three different state competences antedates democratic theory, but has been integrated into it in the form of constitutional democracy. All viable constitutions - formal or informal - adhere to the Montesquieu distinctions as long as they respect law and deliver rule of law. The independence of courts is necessary for legal integrity and the respect of law.

CONCLUSION

Principal-agent interaction arises whenever a small group of people act on behalf of a larger group of people over a long time, providing services against remuneration. The relationship involves power and prestige, based on the asymmetric information advantage of the small group – the agents. Restraining the agents from taking advantage of the principal, the population, there must be law and the independence of judges.

The tendency of political agents to self-seeking behaviour must be controlled and openly investigated. And any break of the rules of the contract on the part of political elites must be disclosed openly and punished as well as corrected. The law informs about the duties, time limits, remuneration and rights of political offices.

The law also binds the principal to obligations as well as protects his/her rights. Without rule by law or rule of law, there political anarchy and arbitrariness. Rule of law constrains the political elites and government much more than rule by law.

Even if law is sometimes not crystal clear, it remains the necessary tool for regulating principal-agent interaction. It protects people through both public and private law against abuses by government and its bureaucracy.

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