



European Economic  
and Social Committee

**ECO/511**  
**The rule of law and its impact on economic growth**

## **OPINION**

European Economic and Social Committee

**The rule of law and its impact on economic growth**  
[Own-initiative opinion]

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## 1. **Conclusions and recommendations**

- 1.1 The rule of law has come under pressure recently both within the EU and outside it. This development is worrisome as it has the potential to undermine respect for fundamental rights – as well as the other values set out in Article 2 TEU.
- 1.2 The weakening of the rule of law will affect the functioning of society, fundamental rights, civil society, as well as the economy. The question therefore is where this kind of backsliding could lead the EU and the European economic and social model.
- 1.3 To function well, the single market needs to rely on a transparent and stable legal framework that also covers the enforcement of common rules, as national courts must trust that courts in other Member States are equally committed to upholding the values on which the EU is founded.
- 1.4 The separation of powers, and in particular an independent judiciary that has the power to review government behaviour, is key to investment and economic growth.
- 1.5 The EESC calls on the European Commission to make efforts to measure the economic impact of the rule of law. This includes developing a solid system of measurement that takes the substantive part of the rule of law as well as the procedural part explicitly into account.
- 1.6 Many countries have laws that are perfectly compatible with the rule of law but are imperfectly enforced. It is therefore important to focus on proper implementation.
- 1.7 The EESC welcomes the efforts of the European Commission and other institutions to develop appropriate tools to defend EU values and promote a rule of law culture. However, the EESC considers that the effectiveness of existing tools, such as Article 7 TEU and the rule of law framework and infringement procedure, the annual EU Justice Scoreboard and the new Rule of Law Mechanism, could still be improved and should be complemented by measures focused on the rule of law, but geared more effectively towards economic considerations.
- 1.8 In the European Semester, the Commission should accelerate highlighting the relevance of the rule of law as one of the key elements underpinning a competitive and sustainable economy. The EESC recommends that national follow-up review processes be created, which include representatives from civil society and the social partners, and that the overall involvement of CSOs and the social partners be increased throughout the Semester process.
- 1.9 The EU's annual rule of law review process should be made as open as possible to civil society. The findings and recommendations of the European Commission should be discussed publicly both at the national and the European level, and followed up by specific measures to address incidents and negative trends, including for the economy. Civil society, including the social partners, should be involved more closely and also be involved in the follow-up. The EESC has proposed an annual forum of civil society organisations, which would contribute to the review cycle with its diverse representation.

- 1.10 Civil society organisations as well as the media play a crucial role in countries where governments are moving away from the rule of law. They enable the checks and balances that hold governments accountable. The EESC calls for increased financial and substantive support for organisations involved in defending and promoting the rule of law and fundamental rights.
- 1.11 Membership of the EU is very valuable for all members *as long as non-compliance with the basic rules is sanctioned*. If no sanctions apply, the value of membership for all complying members is reduced.
- 1.12 It seems that awareness regarding the crucial importance of the rule of law both as a fundamental value but also as being instrumental to economic growth is lacking among the public in many Member States. Therefore, the EESC calls for a permanent awareness-raising strategy to alert EU citizens to just how crucial the rule of law is.

## 2. Introduction

- 2.1 The rule of law is one of the values on which the European Union is built (Article 2 TEU) and is a precondition for achieving the other values that the Union aims to promote<sup>1</sup>.
- 2.2 However, the rule of law has come under pressure recently both within the Union and outside. This development is troublesome as it might mean less respect for the other values named in Article 2.
- 2.3 This pressure has an impact on the functioning of and trust in the judiciary. Further implications are felt by civil society with the threat of the judiciary losing its role as a bulwark and guardian of fundamental rights.
- 2.4 As the EESC noted in its opinion<sup>2</sup>, "Respect for the rule of law also ensures legal certainty and a level playing field for business initiatives, innovation, investments and fair competition across the internal market for the benefit of consumers and citizens."
- 2.5 The question therefore is where this kind of backsliding could take the European economic and social model. The weakening of the rule of law might impact the functioning of society, fundamental rights, civil society and the economy.
- 2.6 If not stopped, the threats to the rule of law and the overall deterioration of fundamental rights are likely to negatively affect the mutual trust that underpins the internal market and hence economic growth in the EU.
- 2.7 In the Communication<sup>3</sup> on "Strengthening the rule of law within the Union", the Commission refers to the work of the OECD on the importance of the rule of law to development and the

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<sup>1</sup> The position is shared by the Commission and explicitly stated in its rule of law framework (IP/14/237).

<sup>2</sup> [OJ C 62, 15.2.2019, p. 173.](#)

<sup>3</sup> [COM\(2019\) 343 final.](#)

overall business and investment climate. In this connection, the EESC has likewise underlined the need to give more consideration to economic aspects of the rule of law.

- 2.8 Disregard for the rule of law hampers balanced economic and social development in line with the Sustainable Development Goals (SDGs), and the pursuit of the Union's overarching goal "to promote peace, its values and the well-being of its peoples" (Article 3 TEU). Promoting the rule of law is one of the targets of SDG 16.
- 2.9 When dealing with rule of law deficiencies in the EU, the impact on economic growth has received less attention. Research focuses on the impact of state and public governance at large on economic growth, especially in developing countries. This opinion, therefore, focuses on the economic impact on the rule of law in the EU.
- 2.10 The aim of this opinion is to help stakeholders understand that the European values enshrined in Article 2 TEU, in addition to their intrinsic value, also represent an economic value.

### 3. **Defining the rule of law**

- 3.1 At European level, the rule of law is a well-established principle enshrined in the Treaties and based on the case law of the Court of Justice of the European Union (CJEU), the European Court of Human Rights (ECHR), and the Council of Europe, as well as on the relevant work of the Venice Commission. The rule of law requires that all public powers act within the constraints laid down by law, in accordance with the values of democracy and fundamental rights, and under the control of independent and impartial courts<sup>4</sup>.
- 3.2 By specifying the individual components of the rule of law, substantive components can be separated from procedural ones. The most basic and central component of the rule of law is equality before the law, i.e. the notion that the law treats everybody the same and refers to the substance of the law.
- 3.3 Procedural equality before the law is a necessary condition for achieving a high level of rule of law. Nevertheless, it is not sufficient as both substantive and procedural equality are needed. A number of procedural components are needed to make sure that the letter of the law is implemented. The separation of powers is key as it helps to ensure that the government also remains within the confines of the law. The judiciary will only be able to keep the executive power in check if both judges and prosecutors are independent from the other two branches of government.
- 3.4 Moreover, a number of minimum standards in law enforcement need to be safeguarded: everybody has to enjoy fundamental rights, have the right to a fair trial, etc. Finally, law enforcement needs to be impartial, meaning that nobody is discriminated against and that the

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<sup>4</sup> Academic literature often differentiates between "thick" and "thin" varieties. Møller, J. (2018). *The advantages of a thin view in Handbook on the Rule of Law*, Edward Elgar Publishing, pp. 21-33 and Bedner, A. (2018) *The promise of a thick view in Handbook on the Rule of Law*, Edward Elgar Publishing, pp. 34-47.

judiciary is free of corruption<sup>5</sup>. According to Article 2 TEU, the rule of law and democracy go hand in hand as founding values.

#### 4. **Why the rule of law is conducive to sustainable economic growth**

- 4.1 Sustainable economic growth is considered to be one of the most important indicators of the health of an economy. Increasing economic growth is associated with the increasing wealth of a country and its population. Moreover, a market economy is unable to function without basic rules and procedures, including rules regarding private ownership and the voluntary transfer of ownership (i.e. contract law). More generally speaking, a market economy will only thrive on the basis of stable and predictable rules, as exemplified by the internal market and the economic and monetary union (EMU) as the engines of the European economy.
- 4.2 Economic growth implies that more goods and services become available on a per capita basis over time. The only means to achieve that is to increase productivity. This, in turn, presupposes investment in both capital and education (also called "human capital"). To establish a connection between the rule of law and economic growth, we thus need to ask how the rule of law can affect the general propensity to invest.
- 4.3 Investment, in particular long-term investment, will only take place if potential investors expect the investment environment to remain predictable and favourable over many years. The rule of law plays a crucial role in a government's ability to offer such a stable environment.
- 4.4 An executive power that is not constrained by the other two branches of government – the legislative and the judiciary – could make many promises to potential investors regarding their freedom to set prices at will, not to be taxed highly (or at all), to transfer profits back to their country of origin, etc.
- 4.5 However, an unconstrained government is incapable of making binding promises, i.e. entering into credible commitments. The separation of powers, and in particular an independent judiciary that has the power to review government behaviour and uphold private contracts is key to investment and economic growth.
- 4.6 As well as the independence of the judiciary, its impartiality is also key. If judges can be bribed, i.e. they are not impartial, then, rather than being based on the principles of the rule of law, cases are decided in favour of the party that is able (and/or willing) to pay the higher bribe. Thus, corruption is incompatible with the rule of law.
- 4.7 If judges discriminate against certain groups, then the law is not applied equally. Any kind of partiality will make the legal environment less certain, which is not only expected to lead to lower overall investment levels but also to fewer transactions. Partial courts will therefore slow down economic growth.

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<sup>5</sup> Voigt, S. (2012) *How to measure the rule of law*, *Kyklos*, 65(2), pp. 262-284.

4.8 The accessibility of courts is another key factor. If it takes years to reach a court decision, this might have a number of detrimental effects on the economy: contracting partners in breach of contract might use the court strategically if it is commonly known that a court decision will take a long time. Delayed justice – whether this involves delayed decision-making or late implementation – makes contracting less attractive, leading to fewer transactions and exactly the same effects as those caused by the lack of an independent judiciary, as described above.

## 5. **How to measure the rule of law**

5.1 To ascertain the rule of law's effects on economic growth, it first needs to be measurable. However, this is not easy as it is a multidimensional concept and various difficult coding decisions need to be made, such as whether all dimensions should be given the same weight.

5.2 Some of the early measures were driven by data availability rather than theoretically derived conjectures. Although there is a very high correlation between the substantial and procedural aspects of the rule of law<sup>6</sup>, the substantive component, equality-before-the-law, does not figure in most of the better-known indicators of the rule of law. A solid system of measurement that takes the substantive part of the rule of law as well as the procedural part explicitly into account should therefore be developed by the Commission.

5.3 Another important issue regarding measurement is the question of whether *de jure* provisions or their actual implementation are measured. Many countries have laws that are perfectly compatible with the rule of law but ineffective enforcement. It is therefore important to focus on implementation.

5.4 The question of how best to use available measures is also important. On the one hand, aggregate measures can be useful for getting a first impression of what is going on in a particular country. On the other hand, if "actionable" advice is sought, i.e. analyses that can have direct policy implications, aggregate measures are not very helpful.

5.5 Despite the difficulty involved, the EESC recommends that the European Commission explore the possibility of measuring the economic impact of the rule of law both in the Member States and in the candidate countries, and possibly link this to the rule of law review cycle.

## 6. **What do the existing data say?**

6.1 Cross-country studies analysing the effects of the rule of law on economic growth have shown that, on average, countries adhering more to the rule of law grow faster than countries adhering less<sup>7</sup>. This does not mean that individual non-rule-of-law-abiding countries cannot achieve high levels of economic growth. These are called "outliers" by economists. Such cases are possible and do occur but will not occur with high frequency.

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<sup>6</sup> Gutmann, J., & Voigt, S. (2018) *The rule of law: Measurement and deep roots*, European Journal of Political Economy, 54, pp. 68-82.

<sup>7</sup> This causal relationship is one of the central points of a subdiscipline called Institutional Economics. An advanced textbook treatment is Acemoglu, D. (2008) *Introduction to Modern Economic Growth*, Princeton University Press; a textbook catering to the non-specialist is Voigt, S. (2019) *Institutional Economics – An Introduction*, Cambridge University Press.

- 6.2 In estimating the effects of the rule of law on economic growth, the respective income levels also need to be taken into consideration. All other things being equal, countries already enjoying a high per capita income level tend to find it more challenging to achieve high growth rates than countries starting from a lower level. This is an indication of the so-called "convergence effect".
- 6.3 Aggregate measures of the rule of law are not very helpful for identifying specific transmission channels through which it could affect economic growth. This is why the focus here is on a limited number of the core components of the rule of law in this section.
- 6.4 It was already shown above that an independent judiciary seems to be crucial for ensuring that governments remain within their constitutionally defined constraints.
- 6.5 Analysing the effects of *de jure* and *de facto* indicators of judicial independence separately, it turns out that *de jure* provisions do not have any effect on economic growth. *De facto* provisions, on the other hand, are strongly correlated with faster economic growth<sup>8</sup>. Improving *de facto* levels of judicial independence has an economic payoff: countries that have done so have received an extra dividend, i.e. they have experienced faster growth<sup>9</sup>.
- 6.6 It has been shown that judicial independence and judicial accountability are complementary, rather than competing with each other<sup>10</sup>. A number of judicial guarantees, such as the right to counsel, limit the discretionary leeway of judges. As such, they can be interpreted as ensuring judicial accountability. Interestingly, it has been shown that some such guarantees are not only conducive to judicial accountability and, in turn, the rule of law, but also to economic growth. This is the case with regard to the timeliness of court decisions, with written – as opposed to oral – procedures and with the right to counsel<sup>11</sup>.
- 6.7 Corruption is not only a crime, it is also incompatible with the rule of law. However, measuring corruption is fraught with difficulties. Since the payer and the recipient of the bribe usually have no incentive to signal that a bribe was involved, objective data are impossible to gather. Most literature has relied on so-called "corruption perceptions", i.e. the subjective evaluation of how widespread corruption is in a particular country or in a specific public service.
- 6.8 Although proving that corruption is detrimental to economic growth remains difficult, by now a host of studies point in that direction. For instance, it has been shown that it reduces investment<sup>12</sup>. Corruption also has other distortive effects: for example, it could lead to higher

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<sup>8</sup> Feld, L. P., & Voigt, S. (2003) *Economic growth and judicial independence: cross-country evidence using a new set of indicators*, European Journal of Political Economy, 19(3), pp. 497-527.

<sup>9</sup> Voigt, S., Gutmann, J., & Feld, L. P. (2015) *Economic growth and judicial independence, a dozen years on: Cross-country evidence using an updated set of indicators*, European Journal of Political Economy, 38, pp. 197-211.

<sup>10</sup> Voigt, S. (2008) *The economic effects of judicial accountability: cross-country evidence*, European Journal of Law and Economics, 25(2), pp. 95-123.

<sup>11</sup> Hayo, B., & Voigt, S. (2014) *The relevance of judicial procedure for economic growth*, CESifo Economic Studies, 60(3), pp. 490-524.

<sup>12</sup> Mauro, P. (1995) *Corruption and growth*, The quarterly journal of economics, 110(3), pp. 681-712.



military budgets<sup>13</sup>. It also affects the structure of public spending, with the focus moving away from important public services such as health and education towards less productive activities<sup>14</sup>. The OECD summarises a recent study as: "... it is clear that corruption has a direct impact on the cost of a project both for the private and public sectors. Its indirect effects include damaging public institutions, impairing citizens' trust in their government thereby lowering incentives for innovation, and increasing social inequality. But they also increase the cost of doing business, a tax on economic activities, that then is translated to the ultimate users or consumers of the projects."<sup>15</sup>

- 6.9 Prosecutors that are both independent and accountable are conducive to high rule of law levels because crimes will be prosecuted independently from political pressure, the particular identity of a criminal suspect and other similar factors. It has been shown that prosecutors that are actually independent are associated with lower corruption levels<sup>16</sup>. Given that corruption is detrimental to growth this can, therefore, be interpreted as indirect evidence that independent prosecutors – as one component of the rule of law – are conducive to economic growth.
- 6.10 Finally, let us look at judicial efficiency, remembering the oft-quoted saying that justice delayed is justice denied. One of the most impressive studies in the area focuses on India<sup>17</sup>. Differences in court delays are regressed on measures of output in agriculture, industry and the service sector. It shows that judicial delays have a negative effect on output growth in all three sectors of the economy.

## 7. Possible policy implications

### *Existing EU tools*

- 7.1 The EESC has called for the tools at the EU's disposal to be enhanced to counter backsliding with regard to fundamental EU values<sup>18</sup>. The EESC welcomes the efforts of the European Commission and other institutions to develop appropriate tools to defend EU values and promote a rule of law culture. However, the EESC considers that the existing tools, such as Article 7 TEU and the Rule of Law Framework, the infringement procedure, the annual EU Justice Scoreboard and the new Rule of Law Mechanism could still be improved and should be complemented by measures focused on the rule of law but geared more effectively towards economic considerations.

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13 Gupta, S., De Mello, L., & Sharan, R. (2001) *Corruption and military spending*, European journal of political economy, 17(4), pp. 749-777.

14 Mauro, P. (1998) *Corruption and the composition of government expenditure*, Journal of Public economics, 69(2), pp. 263-279.

15 Organisation for Economic Co-operation and Development (2015) *Consequences of Corruption at the Sector Level and Implications for Economic Growth and Development*, Paris: OECD Publishing.

16 Van Aaken, A., Feld, L. P., & Voigt, S. (2010) *Do independent prosecutors deter political corruption? An empirical evaluation across seventy-eight countries*, American Law and Economics Review, 12(1), pp. 204-244.

17 Chemin, Matthieu (2009) *Do judiciaries matter for development? Evidence from India*, Journal of Comparative Economics 37: pp. 230-250.

18 [OJ C 282, 20.8.2019, p. 39.](#)

- 7.2 In the European Semester, the European Commission considered the relevance of the rule of law to the business environment in its drive to promote growth-enhancing structural reforms in areas such as effective justice systems and the fight against corruption. Currently, input to the EU Justice Scoreboard originates mainly from those supplying justice services such as the ministries of justice, associations of judges, judicial councils, etc. Curiously absent are those demanding judicial services who might offer valuable suggestions on how to improve the various justice systems. Civil society organisations (CSOs), as well as the social partners, could assume an important role in mediating information. The EESC urges the Commission to accelerate highlighting the relevance of the rule of law as one of the key elements underpinning a competitive and sustainable economy. Rule of law indicators should be incorporated in a more visible way and include issues such as legal certainty and access to remedies for businesses and workers. Efforts should be made to improve the follow-up procedure with a view to better implementation of recommendations. The EESC recommends that national follow-up review processes be created, including representatives from civil society and the social partners, and that the overall involvement of CSOs and the social partners be increased throughout the Semester process.
- 7.3 The EU's annual rule of law review process should be made as open as possible to ensure that the findings and recommendations of the European Commission are discussed publicly both at the national and the European level, and followed up by specific measures to address incidents and negative trends. The European Commission should increase involvement of CSOs as they are often the first to suffer when the rule of law is threatened and can therefore serve as a fire alarm<sup>19</sup>. The European Commission should also take measures regarding reprisals against civil society organisations due to participation in the process. The EESC has proposed an annual forum of civil society organisations which would contribute to the review cycle. It stands ready to contribute to this process and to ensure broad representation of civil society organisations, including those representing socio-economic interests such as the social partners.
- 7.4 The EESC already welcomed the Commission's proposal to protect the Union's budget in case of generalised deficiencies as regards the rule of law in the Member States. In this regard, the EESC supported the proposal to make receipt of EU funds by the Member States conditional upon respect for the principle of the rule of law and thought that this conditionality could be extended to the other principles linked to the rule of law set out in the EU Treaties<sup>20</sup>.

### ***Possible further policy responses***

- 7.5 Given that a high level of rule of law is a fundamental value of the EU and in addition has positive effects on economic growth, it is imperative that the EU take measures to safeguard the rule of law.
- 7.6 The Court of Justice of the European Union (CJEU) has issued a number of landmark decisions in defence of judicial independence lately. As well as the legal reasons given by the court, there

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<sup>19</sup> The comparison between police patrolling and fire alarms in monitoring agents was proposed in McCubbins, M. D., & Schwartz, T. (1984) *Congressional oversight overlooked: Police patrols versus fire alarms*, American journal of political science, pp. 165-179.

<sup>20</sup> [OJ C 440, 6.12.2018, p. 106.](#)

are also economic justifications as to why action by the EU institutions is warranted. To function well, the single market needs to rely on a transparent and stable legal framework that also covers the enforcement of common rules, as national courts must trust that courts from other Member States are equally committed to upholding the values on which the EU is founded.

- 7.7 The concept of a single European judicial area is important for business as it allows court decisions made in one Member State to be applied in another. For this project to succeed, it is crucial that all courts within the European Union be independent. If that cannot be guaranteed anymore, the single European judicial area will not only remain incomplete but will also be in decline. The Commission needs to ensure that the principle of judicial independence is upheld in all Member States in order to make the idea of a single European judicial area and free movement of judicial decisions a reality.
- 7.8 Every nation state wants to be credible and investor-friendly, offering credible commitments to potential investors. EU membership provides clear benefits to all Member States as it enables all Member States, irrespective of their economic or political history, to make commitments that are more credible. In that sense, membership of the EU can be very valuable for all members *as long as non-compliance with the basic rules is sanctioned*. Without sanctions, the value of membership for all complying members will be reduced.
- 7.9 In other words, non-complying Member States create negative externalities for complying Member States. This is because every time a Member State government does not deliver according to the promises it made by joining the EU and such non-compliance remains unsanctioned, the credibility of EU law will suffer in all Member States. Hence, the value of being a Member State of the EU would be reduced, as in time it would no longer be a signal of credibility. Insistence on compliance with the basic values of the EU is, therefore, fully justified.
- 7.10 Many decisions are directly relevant for all citizens of EU Member States. If the voting rights of Member States that are governed by would-be autocrats systematically breaching the principle of the rule of law are not suspended, then these would-be autocrats will be allowed to participate in decision-making that directly affects all EU citizens. This has aptly been called Europe's "other democratic deficit"<sup>21</sup>.
- 7.11 In other words, another justification for intervention by the EU is negative externalities created by would-be autocratic governments that extend not only beyond their nation state's borders, but impact every citizen of EU Member States. In sum, interventions with the aim of upholding or re-establishing respect for the rule of law are fully justified.
- 7.12 One means of supporting and promoting the rule of law is to support civil society organisations and the media. The ability of citizens to create associations, meet and express themselves freely, as well as media freedom, are key elements of the rule of law as part of the checks and balances to hold governments accountable. A shrinking civic space also impacts the ability of companies

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<sup>21</sup> Kelemen, R. D. (2017) *Europe's other democratic deficit: National authoritarianism in Europe's Democratic Union. Government and opposition*, 52(2), pp. 211-238.

and workers to establish themselves, associate freely, and innovate. Civil society organisations are also an important economic player, contributing to almost a third of employment in the EU<sup>22</sup>, and providing services that are fundamental to economic growth, such as in the field of education, health and social protection. The EESC reiterates its call for active EU support of the social partners and civil society organisations in the EU, and notably the development of an EU fund offering financial support for litigation cases relating to violations of democracy, the rule of law and fundamental rights, targeted at civil society organisations<sup>23</sup>.

- 7.13 There are many reasons why the rule of law should be defended, both from within Member States and by the EU institutions. It seems that the general public in many Member States needs to be made more aware of the crucial importance of the rule of law as both a fundamental value and a vital ingredient to economic growth. One indirect way to defend the rule of law could therefore be to raise awareness of just how crucial it is among the general public in the various Member States. The EESC has already called for an awareness-raising campaign in the form of a deliberate communication strategy<sup>24</sup>. The EU needs to invest in information campaigns to promote the rule of law and urgently take measures to support free media.

Brussels, 18 September 2020

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The president of the European Economic and Social Committee

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<sup>22</sup> [Working paper No 13/2016 \*The Size and Scope of the European Third Sector\*](#), p. 8.

<sup>23</sup> [OJ C 62, 15.2.2019, p. 178.](#)

<sup>24</sup> [OJ C 282, 20.8.2019, p. 39](#), recommendations 1.11.