

# The rule of law and the enforcement of contracts

The rule of law is one of the most important institutions for economic development. For Friedrich von Hayek, Nobel prize winner in economics, the rule of law meant that “government in all its actions is bound by rules fixed beforehand — rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances and to plan one’s individual affairs on the basis of this knowledge.” In recent years several economists have sought to quantify the effects of this institution on economic growth. In general terms, these efforts attempt to measure the extent to which property rights are protected and how perceptions on the incidence of crime, the effectiveness of the judiciary, and the enforceability of contracts affect economic growth rates.

Unfortunately, Puerto Rico does not rank high on most quantitative measures of the rule of law. According to the Global Competitiveness Index constructed by the World Economic Forum, out of 131 countries Puerto Rico ranks 44th in judicial independence, 57th in favoritism in decisions of public officials, and 71st in transparency of government policymaking. With respect to the enforceability of contracts, Puerto Rico’s performance is even worse: we rank 97th out of 181 countries, behind economic powerhouses such as Haiti and Albania, in the Doing Business 2009 survey conducted by the World Bank.

It is in this context that we need to analyze recently enacted legislation that suspends the effectiveness of certain government collective bargaining agreements for two years. Whether we like it or not, collective bargaining agreements are legal contracts, and laborers and capitalists have the same need to know with certainty how government “will use its coercive powers in given circumstances” and the same right to plan their affairs on the basis of this knowledge.

In our legal system, legislative meddling with contracts is generally limited by the U.S. constitution, which asserts that no state shall pass any law impairing the obligation of contracts; and by the Puerto Rico constitution, which states in its bill of rights that no laws impairing contractual obligations shall be enacted. The leading modern federal case on contractual impairment is *Home Building & Loan Association v. Blaisdell* (1934), where the U.S. Supreme Court upheld a Min-

nesota law enacted during the Great Depression that authorized state courts, for the duration of the economic emergency declared to exist by the state legislature, to suspend mortgage foreclosures on homes and farms.

At first glance, the Blaisdell decision would appear to support the recent actions of the Puerto Rico legislature. However, the 1977 case of *United States Trust Co. of New York v. New Jersey* limits the applicability of Blaisdell. In the U.S. Trust case, the Supreme Court invalidated a state law as violating the contracts clause for the first time in nearly 40 years. Justice Blackmun, writing for the majority, suggested that a law impairing the state’s own obligations was subject to less deference than legislation interfering with private contracts. Cases where the government’s own obligations are being impaired are to be subject to something approaching “strict scrutiny,” according to Blackmun such laws must be “reasonable and necessary to serve an important public purpose” in order to pass muster under the contracts clause. However, in applying this standard, “complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State’s self-interest is at stake.” So, is the wholesale suspension of collective bargaining agreements (not only the economic clauses) reasonable and necessary to achieve the current administration’s purposes? The answer to that question, I will leave to the courts.

At the local level, it appears a contracts clause was included in the Puerto Rico constitution as an afterthought. José Trias Monge, in the third volume of his constitutional history of Puerto Rico, states that the clause was included despite of its “scant judicial value” because (1) it was deemed to have a positive psychological effect on the investment climate in the island; (2) its elimination would require “providing complicated explanations to Congress”; and (3) the “minorities” participating in the convention had repeatedly and strongly insisted



Sergio M. Marxuach

on its inclusion. Thus, according to Trias, “it was decided, as in many other occasions, to choose the less risky alternative and include a clause whose true utility it is difficult to discern, but which in unskilled hands had the potential for inflicting damage on social justice programs.”

Ironically, Trias was concerned that a strict interpretation of the contracts clause would be used by local conservative partisans — just like conservative courts did in the U.S. during the 19th and early 20th centuries — to protect narrow private interests and to derail big welfare state programs enacted for “the greater good.” It did not occur to Trias that a future administration could use his lax interpretation of the contracts clause and his argument that the greater social good justifies the means precisely to weaken one of the biggest achievements in the field of social justice, namely, collective bargaining agreements. Notice also the other ironies of the current situation: we have a Republican governor justifying his policies with a traditionally Democratic argument for government intervention in the economy, while unions are in the unusual position of defending the inviolability of contracts, one of the core principles of the capitalist canon.

While we agree that Puerto Rico is facing a fiscal crisis, we also worry about the precedents being set by the current administration. What will stop a future administration from arbitrarily canceling or suspending a 30-year Public-Private Partnership Agreement? All it has to do is have the legislature declare an “emergency” according to its own subjective criteria, and presto. Our policymakers should bear in mind a scene from *A Man for All Seasons*, where William Roper argues he would cut down every law to go after the Devil and Sir Thomas More replies, “and when the last law was down and the Devil turned around on you — where would you hide, Roper, all the laws being flat? This country is planted thick with laws from coast to coast and if you cut them down, do you really think you could stand upright in the winds that would blow then? Yes, I’d give the Devil the benefit of the law for my own safety’s sake.” So would I.

*The author is Director for Policy Development at the Center for the New Economy, a Puerto Rico-based think tank. [www.grupocne.org](http://www.grupocne.org)*