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### POLICY ANALYSIS

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## Economic Aspects of the Weak Rule of Law in Slovenia

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The rule of law has a significant impact on economic growth, international trade, foreign direct investment, fragmentation of production processes, and in general on trust among individuals in a society – trust being an essential component of social capital. Within the time frame analyzed, the rule of law has weakened in Slovenia both in comparative and absolute terms. The lack of a satisfactory strengthening of the rule of law in Slovenia has resulted in a number of anomalies with regard to the public's trust in the rule of law, entrepreneurship and markets, as well as overall trust among people in general. The importance of the last-mentioned issue is significant in the context of the historical fact that the unprecedented increase in prosperity from year 1800 to today is not rooted solely on three R's of Revolution, Reformation, and Renaissance, but rather particularly on the expansion of ideas that liberated and ensured the dignity of the middle class. These same ideas are at present under great threat in Slovenia mainly due to the weak rule of law. This article tries to move from criticism to a

constructive debate about the causes and possible solutions of problems in the Slovenian justice system. It highlights proposals for an organizational and ethical transformation of the Slovenian judiciary toward a stronger rule of law — not rule of men — which would maintain or even increase freedom for Slovenian citizens as well as their protection from abuses by the state.

### The importance of institutions

Economists have long ago recognized the impact of institutions on economic activity within a society. Institutions provide the formal and informal rules of the game in a society. New institutional economics analyzes various aspects of the institutional framework of a society — property rights, management models, social norms, ideology, mechanisms of control and enforcement, and contractual relations. The International Society for New Institutional Economics, which was created in 1997, is proud to have recipients of the Nobel Prize for Economics among its members (Ronald Coase, Joseph Stiglitz, Douglass North,

Elinor Ostrom, Oliver E. Williamson). The representatives of the new institutional economics school have explored questions with regard to the development of the legal institutions of a country as well as the influence these institutions have on economic activity. As an example, Hoff and Stiglitz<sup>1</sup> show that strengthening the rule of law during times of transition stalls when low expectations about the quality of legal institutions, i.e., rule of law, serve to increase an expected return on the use, in a sense abuse, of public property. As such, special interest groups then become in favor of weakening the rule of law. In their research, Caselli and Gennaioli outline the workings of various social groups that are in favour of or against the implementation of the rule of law, and deregulation and at the same time show that reforming the legal system can significantly increase social groups' support for further deregulation of the economy.<sup>2</sup> In an empirical analysis, Rigobon and Rodrik demonstrate that the rule of law and democracy have a positive impact on the economic development of a country, while the economic openness of a country is positively correlated with the quality of the functioning of the legal institutions.<sup>3</sup> Because of the explosion of fragmentation and decentralization of business processes, the rule of law and general trust in society are correlated with the growth of productivity in an economy,<sup>4</sup> these two factors also being keys to economic growth in the last few decades.<sup>5</sup> The same conclusions were drawn by Knack and Keefer<sup>6</sup> and La Porta et al.<sup>7</sup> Trust, which is addressed later in the paper, is positively correlated with foreign direct investment and international trade.<sup>8</sup> Alfaro et al. also show that the quality of legal institutions has a significant impact on the ability to attract foreign direct investment

into a country – a factor particularly relevant to Slovenia, which is experiencing a slowdown in real economic convergence due – at least in part – to a dismal inflow of foreign know-how and capital.<sup>9</sup> An annual survey among the foreign investors in Slovenia, which was conducted by the Centre of International Relations, University of Ljubljana, confirms that weak rule of law is among the most important determinates of the extent of their investment.<sup>10</sup>

Let's now look at an overview of the findings of selected studies measuring the quality of legal institutions and comparing the performance of the rule of law in Slovenia to other countries. The World Justice Project The Rule of Law Index 2014 measures the legal institutional environment in 99 countries, representing over 90 percent of world population.<sup>11</sup> Slovenia's rank per category is: Constraints on Government Power (30th place), Absence of Corruption (32nd place), Open Government (23rd place), Fundamental Rights (13th place), Order and Security (17th place), Regulatory Enforcement (28th place), Civil Justice (29th place), and Criminal Justice (27th place). In the first area, Constraints on Government Powers, Slovenia significantly negatively deviates on sanctions for official misconduct (0.52; on a scale 0-1, where 0 is the worst) and limits by judiciary (0.54). Regarding the second category, Absence of Corruption, Slovenia was worst on corruption in the executive branch (0.55) and corruption in the legislature (0.53). With regard to Regulatory Enforcement, Slovenia scored worst on effectiveness of regulatory enforcement (0.50) and respect for due process (0.54). In the category of Civil Justice Slovenia scored worst on unreasonable delays (0.39) and effectiveness of enforcement (0.38). Within the

category of Criminal Justice, Slovenia was found to have the most problems with timely and effective adjudication (0.54), effectiveness of correctional system (0.43), discrimination (0.52), and corruption (0.58). It should be noted that the Rule of Law Index is just one of many databases measuring the rule of law globally.

Kunčič combines a wide range of institutional environment indicators from several international databases and divides them into three dimensions of institutions: legal, economic, and political.<sup>12</sup> This freely available database offers institutional indicators for most of the countries in the world for the period 1990-2010.<sup>13</sup> Among other things, it shows the deterioration of Slovenia's legal institutions in both relative and absolute terms. The ineffectiveness of the judiciary in Slovenia is also highlighted in a recent study by the Organisation for Economic Co-operation and Development (OECD), which singled out Slovenia as one of the worst ranked countries in the measurements of trial length, identification of problematic cases, and cost of the judiciary.<sup>14</sup>

The weakening of the rule of law, especially in the area of commercial crime, has a significant impact on trust in the rule of law, entrepreneurship, markets, and in general on the trust among the people of a society. Among the studies that confirm this are Jackson et al., which reports that, along with Bulgarians, Slovenes have the lowest trust in the competence of their judiciary (How often do you think the courts make mistakes that let guilty people go free?) and, along with Russians, Portuguese, and Bulgarians, Slovenes have the lowest opinion of the courts' procedural fairness and impartiality (How often do you think the courts make fair, impartial decisions based on the evidence made available to them?).<sup>15</sup> The same

study finds that Slovenes, along with Czechs, Russians, and Bulgarians, predominantly believe that their judges take bribes, in contrast to their assessment of the prevalence of bribes among the police, which is average. Jackson et al. observed that of the 26 countries included in the European Social Survey (Round 5) only Bulgaria is lower than Slovenia in public trust in the efficiency of the courts, while Slovenia ranks a bit better (20th place) on the issue of courts' procedural fairness. Since Slovenes strongly feel that the courts protect the interests of powerful and influential groups to the detriment and expense of the ordinary person, Slovenia ranks 19th (a score 0.09; on the scale 0-1) on the fairness of the courts.<sup>16</sup> Toš also observed a negative trend in Slovenes' trust in the rule of law, as based on public opinion polls reflecting a decline in their trust in the courts and the legal system from 34.7% in 1991 to 29.9% in 1998 and to 24.3% in 2009, while distrust rose from 51.6% in 1991 to 71.8% in 2009.<sup>17</sup> In the same study Slovenia ranks 30th among 40 countries based on the level of trust in the judiciary. While in 1994, 49.8% of the Slovenes were not pleased with the courts' fairness and impartiality, this number went up to 60.1% in 2009.

### **Institutions and economy**

The latest survey Entrepreneurship in the EU and Beyond, which was commissioned by the European Commission, offers an insightful, timely, and comparative analysis of the relationship Slovenes have toward entrepreneurship as an essential component of the economic system, for which Slovenia decided at the time of independence but has problems putting into place. Based on data from the summer of 2012, only 83% of Slovenians believe that entrepreneurs create

jobs (87% in the EU-27 and 97% in Finland). A belief that entrepreneurs take advantage of the workforce is held by 63% Slovenes (57% in the EU-27 and only 20% in Denmark). The general opinion about entrepreneurs and business owners in Slovenia was found to be 37% positive (53% in EU-27 and 74% in Denmark) and 16% negative (7% in the EU-27 and only 1% in Denmark). Similarly, public opinion of the management in large enterprises is dismal, with only 18% perceiving it positively (25% in the EU-27 and 45% in Denmark) and 36% negatively (30% in the EU-27 and 13% in Denmark). This negative attitude toward business is observed also in Toš with 72.7% in 1991 and 77.5% in 2009 of Slovenes distrusting factories and companies.<sup>18</sup>

Distrust in the rule of law creates an artificial conflict between employees and employers.<sup>19</sup> Among 38 countries, Slovenia is 34th in the belief that conflicts between the employees and management of companies are very sharp or harsh (71% of respondents). The weak rule of law in prosecuting economic crimes has undermined trust in private market initiatives. In 2011 only 34% of respondents strongly agreed or agreed with the statement that "private enterprise is the best guarantee for the solving economic problems in Slovenia" (placing Slovenia in the 25th place out of 32 countries), while in 1993 this share was 47.2%.

Weak rule of law also has a negative effect on general trust among the people of a society.<sup>20</sup> In 2008 Slovenia ranked 34th among 40 countries on general mistrust among the citizenry, since only 22% of Slovenes felt that people are almost always or usually to be trusted (80% in Denmark).

## Ideas matter

History teaches us that words and ideas are of great importance. People swim in words. We are realizing this after a very long infatuation with Marxist, Freudian, behavioral, neoclassical or neo-Keynesian claims that seen and unseen material interests spin the world, that the Founding Fathers of the United States of America were only protecting the value of their own property when writing their founding documents, that slavery was abolished in order to strengthen manufacturing, or that Slovenia became independent in order to protect its national economic interest.

A quarter of domestic product is generated by using "sweet words", that is, the persuasiveness of the retailer, manager, teacher, prosecutor, and lawyer while performing their work.<sup>21</sup> History also teaches us that the incredible rise in the welfare of the average person on the earth going from \$1-3 per day in 1800 to \$30 today (\$60 in Slovenia and \$270 in Norway) is not a consequence of international trade, capital accumulation, education, imperialism, private property, European style of marriage, greed, Protestant ethics, population growth, black plague, or advances in science, but rather is a consequence of the liberation and dignity of the bourgeoisie or middle class, which enabled the flourishing of market-tested innovation. Words, ideas, and ethics were that which facilitated a significant decline in poverty and a visible increase in spirit in the period after 1800.

Because ideas matter, a number of attitudes and concepts are crucial for society: our perception of the rule of law, the kind of attitude we have toward entrepreneurship, distinguishing entrepreneurs from tycoons and the market from

oligarchy, our understanding of the role and rights of employees, business owners, and management of companies in a market economy, our understanding of the market system as a positive-sum, not a zero-sum, game, our trust in state institutions and in people. We should not forget that the idea of class struggle, skepticism toward private entrepreneurial initiative, and a general mistrust gradually paved the way for the catastrophes of the 20th century.

The duty of the Slovenian judiciary is to do its part in strengthening the rule of law, which is essential in preventing the resurrection of both right-wing (e.g. Nationalism) and left-wing (e.g. Democratic socialism) ideologies, as they flourish in conditions of general distrust and pessimism in a society. Likewise it is also important for the prevention of widespread anti-market and anti-innovation rhetoric. Examples of such can be seen in the anti-globalization movement, radical environmentalism, the condemnation of the freedom of commercial free speech (advertising), the idea that the market system depends on an army of the unemployed, and the calls for a revival of Keynesian dirigisme and similar utopias.

The liberation and dignity of the middle class have been and continue to be necessary, key conditions for the progress of modern society. In this context, freedom is an economic factor and dignity, a sociological one. Being better at supporting the rule of law, the judiciary may have a positive influence on both. As a defender of the freedom of individuals against abuses by the legislative and executive branches, the judiciary can nourish liberation, while also, as a guardian of the legal system, creating conditions where innovation and entrepreneurship are cherished. Society and the economy are in constant

interaction, but they are not one as materialistic reductionism claims. Without dignity, the middle class is under constant attack by hostile rhetoric from politics, society, and art, as it had been under the Habsburgs and Bourbon, and in fascist Spain – in all, destined to \$3 per day. Without freedom, the middle class is doomed to return to the medieval hierarchy, as during the times of the hyper-regulated guild cities of Venice and Lübeck, again destined to \$1-5a day.<sup>22</sup>

In a society where the justice system is partly culpable for the erosion of trust in the rule of law, where politics blames capitalism and an alleged brutality of entrepreneurs for its own mistakes, where media constantly blame markets and entrepreneurs for any problem in society, where influential economists spread the archaic and mistaken ideas of the historically proven harmful notion of a middle way between capitalism and socialism – the middle way in reality always engaged in much plundering and virtually no market, with only a national industrial policy and almost no competition as well as national interest and no true interest in the consumer. In such society, it is impossible to create the conditions for healthy competition-based entrepreneurship.

### **The Rule of Law in Slovenia: Problems and Solutions**

In the private sector it is not a matter how much you work, but rather whether you are doing the right things in a proper way. The same should apply to the judiciary.

The length of court proceedings is one of the most important weaknesses in Slovenia with regard to the rule of law. The reasons for the excessive length of criminal proceedings are

many, most of which are related to organizational and technical problems.

One of the major problems is related to a provision requiring the presence of the accused and witnesses at hearings. Various tactics of evading arrival at court have become Slovenian folklore and are the cause for more than half of the hearings being postponed. For a trial not to be postponed due to the absence of a single witness, the courts should increase their competence in ensuring the presence of the accused and witnesses at hearings as well as better management of the hearings such that a large number of witnesses can be present at a single hearing.

The Slovenian courts lack the courtrooms to handle their current workload, making it impossible for a judge to process cases in the shortest possible time and for there to be short periods between hearings, which would enable greater focus, knowledge, and competence in a particular case. The procedural organization of the Slovene courts is at an unenviable low level.

Bošnjak also points out the conceptual confusion of Slovenian criminal justice procedure, which allows a lack of clarity regarding the subject of discussion at the main hearing, enables the parties in the trial to be too passive, and accepts evidence very late in the process, resulting in the postponement of a quarter of all hearings.<sup>23</sup>

Slovenia is unique in the fact that the judges themselves, without meaningful support of the professional and technical personnel, engage in tasks that should be delegated to professional support services. Courts have major organizational problems with technical tasks, such as getting and sending documentation.

The Slovenian judiciary is trying to deal with these problems in an utterly inefficient way. Instead of reducing the number of judges and organizing the work of professional and technical services better, they have increased the number of judges, costing the national budget much more than support staff would. The judges not only preside over cases but also do much of the administrative work related to them. According to the European Commission for the Efficiency of Justice (CEPEJ), in 2010 Slovenia spent €87 per capita for the courts, while the average in the EU-27 is only €40 per capita.<sup>24</sup> For Slovenia that translates to 1% of government expenditure, while the average of the EU-27 was only 0.4%. The catastrophic organization of the judiciary is also evident in the comparative data on the number of judges per 100,000 population. Slovenia has 71 judges per 100,000 population (EU-27 has only 30 per 100,000 population) and 50 full-time professional judges per 100,000 population (EU-27 has 18 full-time professional judges per 100,000 population). Also of note is that along with the administrative staff the Slovenian courts have twice as many people employed (209.6 employees per 100,000 population) than is the average in the EU countries (92.3 employees per 100,000 population).<sup>25</sup>

Reducing the number of judges and support staff is essential, but the prerequisite is a drastic reduction in the number of first-instance cases, where Slovenia has 33 non-criminal cases per 100,000 population and the average of the EU-27 is 7 non-criminal cases per 100,000 population. The first reason for this lies in the lack of decisiveness in the elimination of allegations, since as many as 99 percent of them result in a trial regardless of how well the case is argued and

the evidence supporting it.<sup>26</sup> The second reason is the lack of established alternative dispute resolutions, such as arbitration and mediation.

There is no good reason for senior judicial advisers to be promoted automatically to the position of judge after a certain period at their position. On the other hand, as is the case in the rest of the world, judges should come to a greater extent from the ranks of prosecutors, attorneys, and lawyers who have years of experience on the opposite side of the courtroom. These invaluable experiences would help judges discover the law, since not all law is enshrined in the laws as Hayek<sup>27</sup> observed and Cicero before him.

The management of the Supreme Court should design a system for early detection of delays, bottlenecks, and incompetent judges. A simulation of the market is a necessary tool here. Just as the market eliminates bad lawyers, the judicial system must also create the most objective system of a regular and politically independent monitoring of judges, which would end the term of a poorly performing judge. The incompetence of some judges and their lack of being prepared for trials is often a reason for the postponement of hearings and the emergence of a backlog. Thus far, the practice has been to transfer poorly performing judges to a district court, or even to a higher court where verdicts are reached by a senate of judges and thus the slacking of a judge easily going unnoticed. In addition to the negative measurements, the system must have incentives for judges, prosecutors, and attorneys who are performing well. The reward could be financial or non-financial, thereby preventing the exodus of the best legal professionals into the private sector.

The quality of the management of a private enterprise is left to the owners' decision (*ius utendi*

*et abutendi*). Providing the best possible management of the courts is a legal, but above all a moral obligation to the citizens and taxpayers, which is why tolerance of poor performance should not be an option. The next president of the Supreme Court will have to be either a very good manager or surround himself with professionals who have experience in managing and reforming large systems as well as in IT support for such organizations, human resources in large systems, psychology, sociology, and economics of large-scale systems. Unfortunately there are not many people with such skills in Slovenia, mostly because managers of large companies and organizations were not forged, but were in most cases appointed by way of political considerations. Most importantly, before opening ourselves to knowledge and experience from abroad, we should acknowledge our shortcomings as it applies to both the judiciary and Slovenian society as a whole.

In the declaration and enforcement of criminal justice sanctions there is often a divergence between jurisprudence and economic logic. The current paradigm of sanctioning in the criminal justice system is based on an outdated utilitarian philosophy of instrumentalizing the penalties with an aim to achieve the prevention of further offenses by the offender, rehabilitation of the offender, and a deterrence of others committing the same crime. As professor Randy Barnett observes, it is time for a new paradigm of criminal law, based on the restoration model, under which the offender is asked to restore harm done to the stakeholders of the company (its shareholders, creditors or employees) and not to the company itself. Unless serious crime has been committed, imprisonment is not necessary, since

such a form of punishment is not meant to achieve the three criteria mentioned above: prevention, deterrence, and rehabilitation. It should be noted that the current system of retributive justice did not develop from a justice system in place 900 years, which was rooted in restoration. The emergence of the absolutist state and the consequent transfer of the judiciary to being under the influence of the rulers instrumentalised the courts to engage in aggression against the people of the state.<sup>28</sup> Such a justice system does not offer credible, theoretical, let alone a consequentialist, argumentation. Instead of punishment, the outcome of the restoration model of justice system is reparation and reconciliation. The aim is to restore the victim, offender, and community to their pre-crime status. In the restoration model the victims report offences to a greater extent, while the “rehabilitation” of offenders enables them to return to their pre-crime status in the society. In addition, with offenders making an effort to make amends to victim and community as soon as possible, the crime would not be worth it anymore, and at the same time the cost of the justice system from public finances would dramatically shrink. To summarize, the restorative model of justice system would benefit victims, taxpayers, and even offenders. At the same time, the justice system would meet the aims of prevention, deterrence, and rehabilitation to a much greater extent<sup>29</sup>.

Formally Slovenia has a separation of the judiciary, legislature, and executive branches of government. However, I claim that is not the case in practice. The judiciary in Slovenia does not perform its most important function: to protect individuals from abuses by the state. The judiciary must not accept a mere implementation of the law, as legal positivism is incompatible with a free

market economy, for which the Slovenes decided with independence and accession to the European Union.

Referencing an inadequate legal basis or procedural loopholes for numerous unpunished violations of the law in the transition process is unacceptable. Judges must measure up to their moral responsibility, stop being robots reading the law letter by letter, and rather be the last bastion of the defense of individual personal and property rights. The law must originate in what is right, and everything that is understood as right in our society cannot be part of the normative legal code. Legal positivism is to some extent, of course, a necessary component of the rule of law, as the society needs some kind of anchors that prevent major deviations and provide transparency and predictability of general rules. At the same time legal positivism must allow for adjustments and a search for law outside the domain of strict but limited legal codes.

Reaching a verdict should not be merely subjective (judge’s discretion) or merely objective (legalism), but conjunctive, i.e., a bringing together of the subjective and objective, neither of which is ever purely one or the other. This is a difficult and responsible task for the judges.

Justice must be blind but not deaf and numb. If the task of the judiciary is to protect individual rights and property against abuses by other persons or the state, then the Slovenian judiciary should take a more active stance in the implementation of this goal. In particular, the Constitutional Court should monitor the legislative and executive branches much more closely, and participate in public discourse to a greater extent, especially to draw attention to violations of the

powers of the other two branches of the government.

The courts, public prosecutors, and public defenders should establish closer cooperation with the legislative and executive branches by regularly providing feedback on proposed bills, implementation of laws, procedural obstacles, and opportunities for simplification of the legal code. Any new bill before becoming a law should be scrutinized by the Bar Association and the Supreme Court, in order for all stakeholders to weigh in an opinion on what a proposed bill may bring.

We should always keep in mind that democracy is beneficial to individual freedom as long as the majority of the society is in favour of individual freedom, the rule of law, and limited power of the state. For this reason, Herodotus preferred isonomy (equality before the law) “the most beautiful name of all” political systems, over democracy.<sup>30</sup>

## Conclusion

A misunderstanding of the role of the rule of law in society is present in Slovenia to a certain degree. Among the reasons is the courts’ prevailing practice of resorting to the comfortable shelter of legal positivism, which is unrelated to the moral and ethical foundations of the rule of law.

With regard to the economic sphere, such a modus operandi of the Slovene judiciary enabled unhindered illegitimate appropriation of property at the time of transition to independence, impunity on restriction of competition, abuse of inside information and the small shareholders, state backing of inefficient firms and banks from foreign competition by invoking “the national interest”, destruction of the trust in the private ownership of

companies and the stock market, and a widespread lack of payment discipline. All this has a negative impact on the economic climate and discourages individuals from entrepreneurship, as it further increases risk and at the aggregate level inhibits the restructuring of the economy.

A breakthrough in the development of the Slovenian economy will happen or break down on the issue of the rule of law. Hence, the organizational and ethical transformation of the Slovenian judiciary is essential for strengthening the rule of law in Slovenia. The development of all advanced societies has been built on a shift from Status to Contract.<sup>31</sup> In Slovenia it is also time to move from “*Privi-leges*” towards “*Leges*”.

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