

Preface

Two countervailing trends have challenged scholars and policy makers in the debate about law and economics in the past two decades. The first was the emergence of legal origins theory in the late 1990s, which asserts the economic superiority of common law over civil law. The second, beginning simultaneously, was a sequence of crises of increasing magnitude in the very financial markets on which that assertion was based. Both trends seemed to unsettle cherished certainties about the rule of law and the proper institutional environment of market economies. They also deprived the American, European, and Japanese donor community of its shared sense of legitimacy in offering advice for legal reforms in developing and transforming countries.

Traditionally, scholars of comparative law focused on functional equivalences and increasing convergence between common law and civil law rather than on their obvious historical differences. On that basis, legal reforms in developing and transforming countries in the 1990s, and Western support for them, could proceed on the assumption that both common law and civil law were functional pillars of institutional economics. Institutional economists tended to share that assumption. The older *ordo-liberal* school led by Walter Eucken, Franz Böhm, and Friedrich von Hayek, a great admirer of judge-made law, was developed in a civil law country, and neither Ronald Coase's nor Douglass North's new institutional economics based on transaction costs made any distinction between common law and civil law.

In the mid-1990s, however, a group of political scientists and economists led by Rafael La Porta, Florencio Lopez de Silanes, Andrei Shleifer, and Robert Vishny, commonly known as "LLSV," began asking the important question why the stock markets of London and New York were so much larger and dynamic in the 1990s than those of Paris and Frankfurt. Their first bold step was to look for behavioral patterns and legal rules encouraging the provision of capital to financial markets. They assumed that common law favors the trust of uninformed capital owners in professional insiders acting as agents in the best interest of their principals. The second, even bolder, step was to base this hypothesis on religious sociology and political theory: Robert Putnam's field research in Italy on Catholic distrust of strangers, which they assumed to be manifest in civil law, and LLSV's own

political theory that civil law, since Roman times, had been the expression of the will of the ruler rather than of free citizens wishing to protect their economic interests.

Their most important contribution, however, was to marshal impressive resources for cross-country econometric analyses relating the economic performance of more than 100 countries of the world to their legal origins. This effort was unprecedented and has never been rivaled until today. The resulting “legal origins theory” concluded that there were higher levels of regulation and lower levels of economic performance in civil law than in common law countries. The new theory left its mark on the “Doing Business Reports” of the World Bank IFC, which in turn inform country analyses of rating agencies and hence tend to affect the credit worthiness of developing and transforming countries reforming their legal systems with civil law advice.

Inversely, the recent financial crises have led to calls for more regulation in common law countries. Government interventions in US and UK financial and industrial sectors have been more massive in some areas than in civil law countries. The subprime crisis in the US was perceived by leading economists as an unforeseeable fundamental shock to the discipline of economics. In the *Financial Times* of March 8, 2009 Lawrence Summers spoke of a “fatal blow to the theory of self-stabilizing markets.” The World Bank IEG evaluation of the “Doing Business Reports” in 2008 cast doubt on a simple dichotomy of presence or absence of regulation as a criterion for measuring the ease of doing business. It called for the design and international discussion of new indicators beyond those used in the “Doing Business” reports. Meanwhile, the American legal profession, which had been instrumental in the securitization of risk-diffusing collateralized debt obligations, remained, with a few outstanding exceptions, conspicuously silent about solutions to the subprime crisis based on American common law.

The two shocks to theory and policy in law and economics motivated the initiation, in 2008, of the international and interdisciplinary project “Institutional Competition between Common Law and Civil Law” at the University of Louvain in Louvain-la-Neuve (Belgium) under the joint auspices of the *Centre de recherche interdisciplinaire droit, économie et société* of the Faculty of Law, and the *Institut de recherches économiques et sociales* as well as the *Institut de science politique* of the Faculty of Economic, Social and Political Sciences. This book presents results of two international conferences in Louvain-la-Neuve, one in March 2009 and one in February 2012, as well as of intermittent and ongoing research of participants from the University of Amsterdam, the Asian Development Bank Institute in Tokyo, the University of Bremen, Cambridge University, the University of Chicago, the German Society for International Cooperation, the International Labor Organization, the Japanese Ministry of Justice, Keio University, the University of Kinshasa, the University of Kolkata, the Max-Planck Institute for Comparative Law and International Private Law in Hamburg, the University of Paris X-Nanterre, Tsinghua University, and the World Bank IEG. For comparisons of efficiency of, and access to, justice, the “Questionnaire on rules and structures of civil procedure affecting access to justice as cost and time factors” was prepared for the February 2012 conference

(Louvain Questionnaire). It contains 8 categories of evaluation comprising a total of 55 indicators. These served as a matrix for data collection and reservoir of research topics.

The introductory Chap. 1 (Part I of the book) maps the interdisciplinary landscape of institutional competition and its sources of worrying issues for theory and policy. It surveys the political, sociological, and economic areas covered by LLSV with its amazing footprint of econometric, though not always historical, and legal, robustness. It also points to large swaths of the same areas, which LLSV left aside as *terra incognita*, such as the economic liberalism of the French, German, and Japanese civil codes, non-protestant explanations of medieval European as well as contemporary Asian capitalism, and, most remarkably in Andrei Shleifer's own domain of financial markets, the theory of bubbles such as the one leading to the subprime crisis. The chapter submits an agenda for deepening research in the areas of comparative law, legal history, legal sociology, econometrics, institutional economics, and philosophy of science.

Part II of the book is dedicated to testing the economic impact of common law and civil law in today's developed and newly industrialized countries. In Chap. 2, Frédéric Docquier leads off with a discussion of the current state of the difficult art of measuring the impact of institutions on economic growth. He points to the limits of both static cross-country analyses with large samples, which has the advantage of econometric robustness but cannot capture legal change, and dynamic panel analysis of small samples, which does have that potential but is compelled to focus on small samples and therefore falls short of economic robustness. He proposes to compensate that shortcoming by counterfactual evidence in "quasi-natural experiments" of different institutional regimes such as those competing in the economic histories of divided countries like China, Germany, and Korea.

This is what Raouf Boucekkine, Frédéric Docquier, Fabien Ngendakuriyo, Henrik Schmiegelow, and Michèle Schmiegelow attempt to achieve in Chap. 3 by combining their complementary interests in economics, econometrics, legal history, comparative law, and political science. With the aim of complementing the "Enforcing Contracts Indicator" of the "Doing Business Reports" by an indicator of transaction costs in concluding contracts, we focus on codified default rules of contract law making costly draft agreements unnecessary. Our sample of eight countries (France, Germany, Japan, South Korea, Switzerland, Taiwan, UK (England and Wales), and US) is small but significant on several levels: four "mother countries" of legal origins, three major financial centers, two newly industrialized countries and three postwar divided countries. Dynamic panel analysis over prolonged periods (1870–2008) shows that codified default rules favor economic performance, the higher the number the better the performance. The default rule advantage of civil codes can compensate a lack of financial center advantage. Cumulating the two advantages as in the Swiss case results in the best conceivable performance.

In a policy-oriented case study (Chap. 4) Henrik Schmiegelow and Michèle Schmiegelow elaborate on the potential of one particular default rule as a way to resolving economic crises triggered by massive unforeseen changes in price levels.

Having “migrated” from medieval international law to continental European civil codes to England, the US, East Asia, and most recently France, the principle of contract discharge or modification in cases of changed circumstances has become a common heritage of civil law and common law in jurisprudential, judge-made, or legislated variations under designations such as *rebus sic stantibus*, *Wegfall der Geschäftsgrundlage*, *frustration of purpose*, *jijou henkou*, *shiqing bianheng*, or *imprévision*. The rule made economic history as judge-made law in Germany’s hyperinflation of 1919–1923 (RG 103,328) and in the oil crises of the 1970s in the US (*ALCOA vs. Essex Group*). In the case of unforeseen house price deflation in the subprime crisis, the Obama administration made a legislative attempt at mortgage modification, which failed in the US Congress. The question of why there was no civil trial at a Federal Court to rise to the challenge remained open until the time of writing this chapter.

The case illustrates the problems that may arise if substantive law remains “law on the books” without being translated into practice by efficient procedural rules and judicial structures. In Chap. 5, Henrik Schmiegelow discusses the assertion of legal origins theory that civil law procedure is systematically associated with more formalism, longer duration, more corruption, less consistency, less honesty, less fairness, and inferior access to justice. A closer look reveals that the large country samples, on which this assertion is based, with an overwhelming majority of economically struggling developing countries, more of 50 % of which coded as of “French legal” origin, unwittingly measure the negative “transplant effect” of imperial imposition of foreign laws to unreceptive British and French colonies rather than the intrinsic qualities of common law or civil law. Data from the US Court Statistics Project, the European Commission for the Efficiency of Justice, and national reports to the XVIIIth World Congress of Comparative Law in Washington in 2010 show that there is no common law/civil law divide in a large majority of the 55 indicators of the Louvain Questionnaire. The single most important divide has been identified by authoritative American comparative law literature and English reform proposals for civil procedure in England and Wales: lawyer-dominated common law procedure takes more time and is more costly than judge-managed civil law procedure. This leads to a much deplored “vanishing” of the civil trial and hence to a drying up of judge-made common law, the principal pillar of legal origins theory.

With chapters on access to justice and inclusive development in Asia, Africa, Eastern Europe, and Latin America, Part III of the book focuses on how developing and transforming countries are attempting to overcome the legacies of colonial transplants of common or civil law and of socialist legal origins, respectively. Simon Deakin, Colin Fenwick, and Prabirjit Sarkar lead off with an analysis of reform legislation of substantive labor law in the middle income countries Brazil, China, India, Russia, and South Africa. Though small, their sample of five countries is particularly instructive as it represents three civil law and two common law countries having attracted the attention of economic discourse as the so-called BRICS countries in view of their remarkable growth in recent decades. For the purpose of this book, the sample is of added significance as it includes three

developing countries (Brazil, India, and South Africa) and two countries in the process of transformation from socialist economies to market economies (China and Russia). The remarkable commonality of their economic performance in recent years appears to reduce the profile of the great diversity of their legal origins in LLSV's coding: English (India, South Africa), French (Brazil, Russia), and German (China). Using the database of the Cambridge Center for Business Research (CBR) on comparative labor law as well as their most recent field research, they find that codified default rules grant workers higher degrees of protection in India's and South Africa's formal labor market than in the UK. Refining the econometric analysis of legal change developed since 2006 at the CBR and with time series covering the period since the early 1970s, or, in the case of Russia, the early 1990s, they are able to show that reforms of workers representation tend to correlate with higher scores on the Human Development Index (HDI), while in the case of laws on industrial action, some negative effects on human development indicators are reported. But they find no rise in unemployment due to more protective labor laws (Chap. 6). Of course, just as Boucekkin et al.'s hypothesis on codified default rules of contract law, Deakin et al.'s hypothesis on substantive labor law will require control for procedural efficiency.

For the purpose of such control, Neela Badami and Malavika Chandu offer hard-to-come-by data on India's civil procedure and multiple modes of alternative dispute resolution. They respond to the extraordinary complexity of the Indian case by differentiating responses to the Louvain Questionnaire in three time periods (pre-colonial, colonial, and post-Independence) and on two levels of analysis (de facto conditions and legislative intent). They report that the question whether the common law civil procedure codified for British India was "ideal for Indian conditions . . . has given scholars, legislators and stakeholders sleepless nights," but that the "reluctant consensus" after Independence was that after 200 years of British rule it was too late to revert to indigenous systems. Since then the legislature and the Supreme Court have garnered an "activist" reputation, but failed so far to remove the massive barriers of poverty and procedural inefficiency impeding access to justice in India (Chap. 7).

In Chap. 8, Helen Ahrens warns against the wholesale dismissal of Latin American legal institutions (coded by LLSV as of French legal origin) as "failed law." She emphasizes both the domestic fragmentation of national legal cultures and the strong transnational influence, especially from the US, on Latin American legal and economic discourse and policies. While deregulation and rising complexity of commercial transactions in the late 1980s and 1990s have increased judicial conflicts, a change in the role of judges and their legal reasoning can be detected. Shedding their traditional role as mechanistic applicers of the wording of codified laws, they have begun to interpret the codes in accordance with their countries' new constitutions adopted in the course of the region-wide process of democratization. They are starting to look for, as well as to set, judicial precedents. They appear to be joining the process of convergence between common law and civil law countries with the importance of judge-made law declining in the former and increasing in the latter.

The fundamentally different challenges which transforming countries face in overcoming what LLSV call their “socialist legal origin” are explained by Hiroshi Matsuo in Chap. 9 on Indochina and Hans-Joachim Schramm in Chap. 10 on Central Asia. In both regions the first priority was to replace vertical centralism in social and economic organization by civil and procedural codes as framework for decentralized transactions between free citizens. Although Vietnam, Laos, and Cambodia did have the colonial heritage of French civil law, they made the significant choice of Japan (with its history of autonomous selection of various civil law patterns in the nineteenth century) as the principal advisor in designing their new civil law codes in their own languages and with adjustments to their own cultural context. The major challenge was to promote awareness of the laws protecting the new liberties among the population as well as legal aid. Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan have adopted constitutions guaranteeing access to courts, the independence of the judiciary, and the principle that judges are bound but by the law. New civil codes and civil procedure codes have been adopted, which are more or less similar in the five countries, reflecting both the tradition of Imperial Russia’s participation in the European codification movement at the end of the nineteenth century and today’s influence of western, mostly German consultants. Just like the Indochinese countries, Kazakhstan and Kyrgyzstan are also renewing older cultural practices as modes of alternative dispute resolution (ADR).

In Part IV on “Legal Cultures and Legal Reforms,” three case studies of particular salience focus more closely on the relationship between legal cultures and judicial supply. Two of these concern countries with traditionally low but recently rising litigation rates. The third analyzes cultures of legal commentaries and a new project for advancing this genre as an instrument to make new codes and precedents transparent and accessible. All three demonstrate the potential of functional interaction between culture and law in legal reforms. Erhard Blankenburg and Bert Niemeijer analyze the dramatic increase in legal action in the Netherlands since the 1980s, a country long considered as a paradigm of low litigation propensity. He relates this evidence to sociological changes affecting judicial supply and demand for law. Supply push and demand pull may have reinforced each other. A micro-analysis of problem-solving strategies of households with different “legal needs” in Dutch-British comparison explains part of the change on the demand side. Available comparative surveys of the density, quality, and costs of judicial systems and their budgets across the common law/civil law divide offer clues on the supply side (Chap. 11). Yukio Nakajima reports a similar change in Japan, Asia’s paradigm of cultural litigation abhorrence. He argues that a series of reforms of the Japanese judicial system carried out since 2001 in order to enhance access to justice did have the effect of increasing the litigation rate. The establishment of the Japan Legal Support Center appears to be reflected in this remarkable trend. This suggests that citizens are actually willing to go to court, provided they receive proper information and assistance (Chap. 12). Shiyuan Han describes a project of advancing the genre of commentary in China’s legal literature as part of the country’s legal transformation. Reflecting upon the long traditions of commentaries of codes or precedents in

German-speaking countries as well as in ancient China, he advocates a revival of this tradition in order to make the evolving interpretation of China's new codes and judicial rulings transparent for the legal professions as well as for the general public. Recent guidelines of the Supreme Court of China for the interpretation of the Contract Law of 1999 in cases of changed circumstances are evidence of the demand for commentaries (Chap. 13).

Part V moves from functional comparisons of legal systems to issues of strategic choice in legal reforms. Linn Hammergren turns decades of experience in overseeing World Bank projects in different parts of the world into proposing an alternative approach. It would combine bottom-up and top-down approaches to reforms of judiciaries and alternative modes of dispute resolution, both of which have disappointed expectations if carried out as single strategies. And it would add policies dealing not only with disputes but also with reducing their occurrence by solving the social and economic problems at their roots (Chap. 14). Masahiro Kawai and Henrik Schmiegelow analyze the Asian financial crises of 1997–1998 as catalysts of legal reforms. The origins of the financial crisis in emerging economies of Indonesia, Korea, Malaysia, the Philippines, and Thailand were different from the Japanese banking crisis. The former was triggered by massive capital inflows followed by massive outflows, the latter by the collapse of the real estate bubble in 1991. But the legal reforms required for financial and corporate restructuring were comparable. Remarkably, both the origins and the solutions of the crises cut across the common law/civil law divide, a rather serious challenge to legal origins theory in its preferred area of financial markets (Chap. 15). Grégoire Bakandjea makes the case for a strategy of legal reforms by regional integration as in the case of the Organization for the Harmonization of Business Law in Africa (OHADA). While the legacy of French legal origin is unmistakable in today's 17, mostly francophone, member states of OHADA (Benin, Burkina Faso, Cameroon, Chad, Comoros, Republic of the Congo (Brazzaville), Ivory Coast, Gabon, Guinea-Conakry, Guinea Bissau, Equatorial Guinea, Mali, Niger, Senegal, Togo, Central African Republic, and the Democratic Republic of the Congo), the legal process initiated by OHADA tends to substitute colonial transplants by innovative and pragmatic solutions suitable for cross-border business operations. This may explain the attraction it has for some anglophone African countries of common law legal origin, which appear to consider joining the organization (Chap. 16). Albrecht Stockmayer reflects upon his experience as an advisor on governance and legal reforms in projects of the German Society for International Cooperation. Although trained in civil law, he adamantly advocates leaving the choice for one or the other type of legal system as a whole to the country concerned. Advisory work should respond to the demand of the reforming country, take its political, economic, and cultural context into account and proceed by dialogue. He cites Amartya Sen: Legal development must enhance the people's freedom to exercise the rights and entitlements that we associate with legal process (Chap. 17).

In their conclusion (Part VI, Chap. 18), the editors attempt to integrate the conclusions of each contribution to this book as well as other results of the Louvain project in a functional framework of theory and policy. The pieces appeared to fall

into place in a remarkably easy and straightforward way on several levels of social structures and action. The cumulative scholarship of our global network of research brought together theoretical and empirical resources of comparative law, development theory, economics, econometrics, economic history, legal history, legal sociology, and political science. It succeeded in breaking down a considerable number of the merely mental, or in taking due account of seriously methodological, barriers between these disciplines. This opens the way to filling the large areas left unexplored by legal origins theory.

With only 64 countries covered in more or less detail, of which 12 by dynamic panel analysis, we would not even try to compete with LLSV's large samples of over 100 countries and the econometric robustness they offer. Our goal was not to refute legal origins theory. The Asian financial crises of the 1990s and the subprime crisis 2007–2009 in the US have challenged LLSV's bold assumptions of behavioral finance and their assertion of an economic superiority of common law much more fundamentally than any theoretical discourse could have done. Our purpose is to rebalance and deepen the debate on policies of legal reforms and economic development, which LLSV have had the great merit to open. We propose to use the four requirements of goal attainment, adaptation, pattern maintenance, and integration in Talcott Parsons' sociological functionalism as a simple matrix for balanced reform policies. In their path towards convergence, both common law and civil law fulfill these functions in changing degrees of judge-made and codified, substantive and procedural law.

Louvain-la-Neuve, Belgium
November 2013

Michèle Schmiegelow
Henrik Schmiegelow

Institutional Competition between Common Law and
Civil Law

Theory and Policy

Schmiegelow, M.; Schmiegelow, H. (Eds.)

2014, XXIX, 475 p. 33 illus., 15 illus. in color., Hardcover

ISBN: 978-3-642-54659-4