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9 Legal Traditions and economic performance: theory and evidence

*Carmine Guerriero**

A legal tradition . . . is not a set of rules of law . . . rather it is a set of deeply rooted, historically conditioned attitudes about . . . the proper organization and operation of a legal system. The legal tradition relates the legal system to the culture of which it is a partial expression. (Merryman, 1969, p. 2)

1. Introduction: A Primer on Legal Traditions

The law and the economy are profoundly influenced, in much of the world, by either the civil or the common law legal tradition. A legal tradition or origin is a bundle of well-defined institutions governing either the creation of the law or the procedural style of dispute adjudication, and sharing a common “historical background, [a common] characteristic mode of thought in legal matters [and a common] ideology” (Zweigert and Kötz, 1998, p. 68). Common law originated in thirteenth century England, and has been transplanted through colonization to England’s ex-colonies.¹ Civil law has its roots in Roman law, and has been imported through the Napoleonic codes to Italy, Belgium, the Netherlands, Spain and Portugal. These last four powers, along with France, spread it to the Near East, Latin America, Northern Africa and Indochina. Structurally the two traditions operate in different ways: while common law accords a key role to precedents and allows more procedural discretion to lower adjudicating courts, civil law relies on legal codes and bright-line adjudication rules (Zweigert and Kötz, 1998).

Building on the wide differences between the French civil law and the English common law,² Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny (or LLSV) proposed, in two influential papers (LLSV, 1997 and 1998), the idea that the exogenous transplantation process brought not only

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¹ These are the United States, Canada, Australia, and many countries in Africa and Asia.

² While the Austrian and Russian empires designed legal systems that were quite similar to the French, Germany, Switzerland and the Scandinavian countries embraced judge-made law along with bright-line adjudication rules (David et al., 1995). However, this variation is of little relevance because Scandinavian countries did not have colonies and Germany had a strong influence only on China, Japan, Korea and Taiwan.

specific laws and regulations, but also a more “general style of the legal system”, as well as human capital from the mother-country.³ Consequently, even if the original transplanted laws adapted to local circumstances and to technological progress, the basic legal institutions, with their ideological content and their impact on the judiciary, remained unaltered, continuing to shape the quality of the new laws. Accordingly, the “legal origins” movement has provided evidence suggesting that, compared to the countries to which the French civil law was originally transplanted, those that initially received common law show:

(a) better investor protection, which in turn is associated with improved financial development . . . , (b) lighter government ownership and regulation, which are in turn associated with less corruption, better functioning labor markets, and smaller unofficial economies, and (c) less formalized and more independent judicial systems, which are in turn associated with more secure property rights and better contract enforcement (La Porta, Lopez-de-Silanes and Shleifer (or LLS), 2008, p.298)

Yet, increasingly recent legal studies have criticized the “legal origins” assumption that transplanted legal infrastructures remain unchanged over time, noticing, in the first place, the growing importance of legislation in common law countries (Roe, 2004 and 2006). Inspired by this crucial observation, Guerriero (2010) has recorded: (1) the law-making institution in place at independence and in 2000 in 156 “transplanted” countries, i.e. countries that received their initial legal order externally; (2) the four most relevant adjudication institutions in place in 98 of these 156 countries at the same points in time.⁴ Contrary to the “legal origins” hypothesis, 26 countries have reformed their law-making institution and 91 their law-making and/or at least one of their adjudication procedures.⁵ This pattern casts two fundamental doubts on the “legal origins” approach. First, how can we give a causal interpretation to the impact of institutions which were not even in place? Second, even if we take into account the observed reforms, how can we defend the exogeneity assumption if the evolution of legal systems is driven by primitive forces that also affect the economic performances we want to explain? Before discussing these points at length, along with the other challenges to the “legal origins” theory in Section 4, I will summarize the theoretical works comparing civil and common law in

³ Ethiopia, Japan and Thailand voluntarily chose their legal order with the intention of modernizing their economy (David et al., 1995); excluding these countries does not affect the gist of the present discussion.

⁴ The adjudication rules distinguishing the French civil law from common law are: (1) an extensive supreme court review of lower courts’ decisions; (2) a judgment based on law and not also on equity; (3) inquisitorial dispute resolution; (4) the requirement of written evidence (see Merryman, 1969; Zweigert and Kötz, 1998).

⁵ Of the 145 countries common to LLS (2008), 26 changed their law-making institution and 88 at least one rule.

Section 2. Also, in Section 3, I will review the conclusions of those empirical papers that have looked at the effect of the initially transplanted legal tradition – that is, legal origin. Finally, in Section 5, I will argue that future studies should carefully consider the evolution of legal institutions.

2. The Putative Primacy of Common Law: Theory

Many academics have been using the diversity of the rules sustaining the two traditions and the historical narrative about their origins to put forward two grounds for the alleged superiority of common law: (1) historical events in England and in France have built into the common law a stronger emphasis on the independence of the judiciary in resolving private disputes and a deeper respect for private ordering; (2) judge-made law makes common law more adaptable to the contracting needs of the economy. I will first illustrate the strengths and weaknesses of these two points and, then, discuss a new synthetic theory.

2.1 A Historical Common Law Emphasis on Private Ordering?

Several legal historians, including Dawson (1960) and Berman (1983), make sense of the divergence between French and English law through the following interpretation of the medieval history of the two countries. In the twelfth century, the French crown, struggling to control the Ile de France, adopted the bureaucratic system of the Roman Church as a way to unify the country. Over the centuries, the power of the judges increased because they started to buy their office from the crown and, not surprisingly, the revolutionaries, seeing such judicial independence as an expression of the loathed monarchic order, proclaimed legislation to be the sole source of law. Napoleon enshrined this idea in his codes, turning the judiciary into a bureaucracy employed and controlled by the State. Twelfth century England, instead, developed jury trials and established, in the 1215 Magna Carta, the idea that the crown could not take the life or property of the nobles without due process. Such judicial independence was continuously challenged, and the courts of royal prerogative, subordinate to the crown, grew in importance in the sixteenth century. This struggle ended only with the 1688 Glorious Revolution, when the independence of the English judges from the crown was finally established. In particular, judges gained lifetime appointment in the 1701 Act of Settlement and, shortly after, the power to review administrative acts.

Informed by this reconstruction, Glaeser and Shleifer (2002) contend that the development of a system of adjudication by lay juries in England and one of adjudication by professional judges in France were conscious choices reflecting the different political power of the English and French barons.

The former were concerned about the powerful English king's ability to interfere in adjudication and bargained for trial by local, lay juries, a right enshrined in Magna

Carta. The relatively weak French crown, by contrast, was less a threat than other barons. French barons accordingly desired a centralized adjudication system controlled by royal judges who would not be easily captured by local interests (Klerman and Mahoney, 2007, p. 279)

The post-revolutionary facts just reinforced these structural dissimilarities, reinforcing a stronger emphasis on judicial independence and on the protection of private property and ordering into the common law.

Even if fascinating, this economic justification of the medieval facts has been proved wrong due to the inaccurate selection of sources. Building on more recent historical accounts (Holt, 1992; Macnair, 1999), Klerman and Mahoney (2007) conclude that a system of adjudication by lay juries was initially favored, in England, due to low literacy levels and later enforced, contrary to Glaeser and Shleifer's (2002) view, in order to place the judicial power in the hands of the crown.⁶ Moreover, during the Middle Ages, not only did both French and English judiciaries have *de facto* power to make law through precedent, but French judges enjoyed a greater independence exactly because their office was a heritable property shielded from the crown. Hence, the only permanent and consequential divergence between the legal orders in England and in France originated from the different fortunes of the judiciary in the aftermath of their respective revolutions. Crucially, the idiosyncratic nature of these shocks also throws doubt on the corollary of Glaeser and Shleifer's (2002) "coercion" theory, which LLS (2008) have christened "the legal origins theory". According to the latter, given that all legal systems seek to simultaneously address the problems of disorder and state abuse (see also Djankov et al., 2003a), the long-lasting legacy of the two differing medieval experiences is that French civil law has remained a system of social control that is relatively more concerned with disorder and less with state abuse. Hence, in the spirit of Hayek (1960), the common law will always solve the private disorder-public abuse trade-off by shoring up markets, and the civil law will always even it out by restricting markets or even replacing them with state commands.⁷ Next, I turn to comment on the more serious argument dealing with the adaptability of common law.

⁶ Also, as clarified by Roe (2007), not only should the jury system be considered an adjudication procedure weaker than that based on expert judges, but it was not even transferred to the majority of the colonies.

⁷ LLS (2008) acknowledge that the "legal origins" theory admits state control as an efficient response to disorder when common-law solutions fail to sustain markets. Accordingly, Glaeser and Shleifer (2003) interpret the early twentieth century rise of the regulatory state in the USA as a defense from the subversion of the justice system by large corporations. Recently, Knittel (2006) and Benmelech and Moskowitz (2010) have shown that the regulatory expansion was, instead, a response to sector-specific technological needs.

2.2 *The Adaptability of Common Law?*

As seen above, the key institution differentiating the two legal traditions is the law-making rule, which constitutes the mechanism aggregating citizens' preferences over the harshness of punishment. While common law relies on case law – that is, the precedents of appellate courts guide subsequent adjudication by courts of the same or lower standing and can be changed by appellate judges only with a costly effort at justification, civil law is grounded on acts of legislation by the democratically elected representatives of the people – i.e. statute law.

Three main properties of judge-made law have been identified as justifying its superior adaptability to social and economic changes: (1) the evolutionary properties of overruled precedents; (2) the ability of appellate judges to introduce new information into the law by distinguishing the existing precedent; (3) the tendency of inefficient rules to be more often evaluated by the law-maker under case law. In order to clarify each of these, I present in the following a simplified version of the model of law-making recently proposed by Fernandez and Ponzetto (2008) and Guerriero (2010). Although the comparative merits of statute and case law have been debated for centuries,⁸ these works represent the first attempt to formalize this comparison. Moreover, these papers have the merit of encompassing, for the first time, three key stylized facts about law-making: (1) there are systematic differences across cultural and economic groups in their preferences regarding the harshness of punishment for deviant actions (see Herrmann, Thöni, and Gächter, 2008); (2) statute law can be seen as the product of the bargaining interaction between the legislator – that is, the government, the legislature or the president – and the lobbies interested in favoring special interests (Grossman and Helpman, 1994); (3) appellate judges change the law to reflect their own preferences (Posner, 1973; Gennaioli and Shleifer, 2007a and b).⁹

The regulation problem Consider a two-tier legal system concerned with the regulation of a harmful act: at the upper tier, the law-maker – i.e., either the Legislator or an appellate judge – decides the prevailing law, at the lower tier, adjudicating courts rule accordingly. At adjudication, lower courts observe only one of two signals – $a \in [0,1]$ and $u \in [0,1]$ – on the defendant's culpability. The signals are independently and uniformly distributed in the population of cases

⁸ While Hobbes (1681) and Bentham (1891) exalted the democratic nature of legislation, Cardozo (1921) and Hayek (1960) emphasized the evolutionary properties of judge-made law.

⁹ Klein (2002) documents that US appellate courts overrule precedents incompatible with their political orientation, follow only those prior court decisions that are compatible with their own ideologies, and do not revise their past votes after the court they sit on has established a new legal rule they had voted against.

and such that the defendant should be convicted if $a + u \geq 1$. Since only a is observable: (1) under institution $i \in \{s, c\}$, the law-maker needs just to find the level of a – call it A^i – such that the defendant is convicted if and only if $a \geq A^i$; (2) the probability of a false positive is $(1/2)(1 - A^i)^2$ and that of a false negative is $(1/2)(A^i)^2$.¹⁰ The cost of the former (latter) equals the foregone utility from acting net of the expected harm (the expected harm less the foregone utility), and the relative cost of a false positive is .

The population is equally split into two groups $j \in \{L, H\}$ caring only about the minimization of statistical errors, which they weigh differently and according to the “perceived” relative cost of a false positive β_j . In particular, the ex post loss of welfare with respect to the first best for a type j citizen is $\Lambda_j(A^i) = (1/2) \{ \Gamma(\beta_j)(1 - A^i)^2 + [1 - \Gamma(\beta_j)](A^i)^2 \}$, where the relative weight function is $\Gamma(x) \equiv x(1 + x)^{-1}$.¹¹ While the unconcerned group L has $\beta_L = \lambda\pi$ and thus prefers the lenient rule $\hat{A}_L = \lambda\pi(1 + \lambda\pi)^{-1}$, the concerned group has $\beta_H = \lambda\pi^{-1}$ and would rather have more convictions or $\hat{A}_H = \lambda(\pi + \lambda)^{-1}$. Hence, $\pi \in (1, \infty)$ should be correctly considered as a measure of preference heterogeneity – i.e. the extent of disagreement about the perceived harm associated with the action among citizens belonging to groups with different ethnic, religious or political ideologies. In a forward-looking society – i.e. one concerned only with future efficiency, the optimal law-making institution should minimize the expected loss of social welfare $(1/2)E(\Lambda_L(A^i) + \Lambda_H(A^i))$ which is proportional to $(1/2)(A^i - E(\hat{A}_j)) = (1/2)V(\hat{A}^i) + (1/2)(E(\hat{A}^i) - \tilde{A})^2$. Also, the socially optimal law should be a certain threshold $\tilde{A} = E(\hat{A}_j) = (1/2)\hat{A}_L + (1/2)\hat{A}_H$, which is the statistical compromise between the divergent visions of the world held by the two groups.

Statute law As noticed before, statute law can be seen as essentially shaped by the activity of lobbies that provide contributions to elected officials in order to move A^s toward the preferences of the special interest they represent. Following Grossman and Helpman (1994), Fernandez and Ponzetto (2008) capture this interaction assuming that A^s is chosen by a Legislator minimizing $(1/2)[A^s - (1 - \mu)\tilde{A} - (\mu/L)\sum_{j \in L} A_j^2]$ where μ is a measure of the quality of the political process and L is, with a slight abuse of notation, the number and the set of exogenously formed lobbies. L gathers either one or two lobbies, which end up representing the interests of randomly drawn citizens. Hence, there is no average bias in the expected threshold but statute law still delivers a loss

¹⁰ Indeed, a false positive (negative) happens for $a \geq A^i$ and $a < 1 - u$ ($a < A^i$ and $a \geq 1 - u$).

¹¹ Under complete information, the defendant is optimally convicted in half the cases.

due to the uncertainty over the bias, which is proportional to $(\mu^2/2L)V(A_j) = (\mu^2/2L)(1/4)(\hat{A}_L - \hat{A}_H)^2$ and thus higher the less democratic policy-making is – i.e. the higher μ is.

Case law As proposed by Posner (1973), *stare decisis* only binds in so far as it is costly for judges to change the precedent.¹² Building on this intuition, Fernandez and Ponzetto (2008) suppose that a judge, inheriting a rule $A^{c,t-1}$ and setting $A^{c,t} \neq A^{c,t-1}$, can introduce any change in the law provided that she incurs a persuasive effort whose cost rises with the relevance of the doctrine of *stare decisis* $K > 0$ and the magnitude of the legal revision. Indeed, the further away a decision drifts from precedent the harder is the justification work of an appellate judge, who clearly needs to illustrate the novel aspects of the case and the legal arguments that shield the ruling from the scrutiny by both the legal doctrine and extra-judicial institutions.¹³ Hence, a type j judge minimizes both the loss she bears as part of group j when $A^{c,t}$ differs from $\hat{A}_j$ and that of justifying an $A^{c,t}$ far from $A^{c,t-1}$ – i.e. $(1/2)(A^{c,t}(j) - \hat{A}_j)^2 + (K/2)(\hat{A}_j - A^{c,t-1})^2$. There is a unique optimal threshold $\Gamma(K)A^{c,t-1} + [1 - \Gamma(K)]\hat{A}_j$ and, consequently, case law follows a first order auto-regressive process converging upon the distribution with mean $\hat{A}$ and variance $V(\hat{A}_j)(1 + 2K)^{-1}$. Thus, the only expected loss of social welfare under case law is given by the uncertainty over future overruling which is proportional to $V(\hat{A}_j)2(1 + 2K)^{-1}$.

The optimal law-making institution All in all, in Fernandez and Ponzetto's (2008) view, while statute law possibly brings with it the cost of a rule biased by the imperfection of the political process, case law always comes at the cost of a rule distorted by a combination of judicial activism and imperfect *stare decisis*. Yet, whenever a society is sufficiently able to enforce *stare decisis* – i.e. when $(1 + 2K)^{-1} < \mu^2/L$ or $K > (L/\mu^2 - 1)^{-1}$, case law is bound to outperform statute law, due to the disciplining effect of scrutiny by differently biased judges.

The effective existence of the evolutionary properties paraded by Fernandez and Ponzetto (2008) has been heavily challenged by recent theoretical and empirical contributions. Starting with the former, Baker and Mezzetti (2010)

¹² Ruling after economic choices are sunk, courts have a temptation to be excessively lenient – from an ex-ante point of view. Starting from this observation, Anderlini, Felli and Riboni (2010) rationalize *stare decisis* as a disciplinary device prompting courts to consider also the benefits of tougher current ruling on future rulings.

¹³ Gennaioli and Shleifer (2007b) question this assumption, contending that overruling costs should be considered as fixed. In this case, for a low level of preference heterogeneity π the first appellate judge ruling will stick forever and, for a sufficiently high level of preference heterogeneity, case law will bounce between $\hat{A}_L$ and $\hat{A}_H$. In any case, the evolutionary properties of case law will be lost and statutes will always constitute a better option.

posit that appellate judges design opinions to maximize the new information arising in future disputes. This incentive promotes rulings that are broad at the beginning and then more refined later; yet, in general, judge-made law never reaches optimality because the refinement stops because of hearing and adjudication error costs. The same result is obtained by Anderlini, Felli and Riboni (2010) in another dynamic model where time-inconsistent judges are forced by *stare decisis* to consider the effect of their ruling on the decisions of future time-inconsistent colleagues. Since *stare decisis* is unable to nullify short-termism, case law is bound to be inefficient. Crucially, this legacy of impossibility results is increasingly supported by empirical evidence. Looking at the evolution of legal doctrine governing construction disputes in the USA over the period of 1970–2005, Niblett, Posner and Shleifer (forthcoming) find little evidence of either convergence or evolution toward efficiency. Also, Hefeker and Neugart (2009) show that divergent rulings by discretionary appellate judges lead governments to be more actively involved in labor market reforms in common law countries.

This highly pessimistic assessment of the quality of legal evolution under overruling has urged Gennaioli and Shleifer (2007a) to discuss the idea that, in reality, the real central property of case law is to allow appellate judges to introduce new information by identifying the existing precedent. Responding to factual circumstances – i.e. in the model discussed above, information on the initially unobserved u , distinguishing refines and improves the law on average without, however, assuring convergence upon the efficient legal rule.¹⁴ This aspect is also related to another long strand of literature, started with the seminal works of Priest (1977), Rubin (1977) and Cooter and Kornhauser (1980), claiming that another informational advantage of case law is the tendency of inefficient rules to be more often evaluated by the law-maker. Miceli (2009) evaluates this claim in the environment presented above and concludes that this selective litigation property could lead to the efficient rule being achieved only when the margin of judicial bias is not too great.¹⁵ Should the latter not be the case, judge-made law inexorably tends to float off from efficiency.

2.3 Endogenous Legal Traditions

A completely new perspective on the issue has recently been offered by Guerriero (2010), who has pointed out that, regardless of the specific hypotheses on the

¹⁴ In a two-periods version of the model discussed above, Gennaioli and Shleifer (2007a) assume that appellate judges choose thresholds $\bar{B}$ and $\bar{b}$ such that the defendant is convicted if and only if $a < \hat{A}^c$ and $b \geq \bar{B}$ or $a \geq \hat{A}^c$ and $b \geq \bar{b}$. Fernandez and Ponzetto (forthcoming) attack this set-up, affirming that, in reality, appellate judges can always implement the optimal two-dimensional rule $B = 1 - a$ as soon as u becomes observable.

¹⁵ Luppi and Parisi (2010) reach a similar conclusion, putting a stronger focus on adjudication procedures.

incentives moving appellate judges, it is a peculiar feature of statute law that shapes the comparison between the two institutions. Indeed, growing empirical evidence has proved the inconsistency of the exogenous lobbying model assumption that all groups are equally willing to participate in policy-making (Wright, 1996). Hence, it makes sense to think, as advised by a recent work on endogenous lobbying (Felli and Merlo, 2006), that in the above model: (1) the Legislator has as an outside option the optimal rule and chooses one among the possible coalitions of the cultural groups; (2) the winning coalition has to pay a fixed “collective action” cost.¹⁶ Clearly, when the cultural distance between groups is limited, statute law will prevail over case law because the “collective action” costs will discourage side contracts and the prevailing rule will be unbiased and certain.¹⁷ In a sufficiently polarized society the Legislator will, instead, favor one of the two coalitions and select a rule further away from the optimal rule the less democratic the political process is. In the last scenario, statute law could outperform case law only when the political process is sufficiently efficient – i.e. when is sufficiently small with respect to.¹⁸ The model also shows that the use of limited discretion by lower adjudicating courts curbs the volatility costs associated with judge-made law and makes statute law volatile. Thus, a pure common (civil) law tradition where case (statute) law is used along with flexible (bright-line) adjudication rules will endogenously arise. The model’s message – common law is optimal in relatively heterogeneous and/or less democratic societies – stands: (1) when there is also a third unbiased group; (2) when the Legislator is elected among citizen-candidates; (3) where appellate judges are corruptible or forward looking; (4) under both overruling and distinguishing, whether the cost of changing the precedent is fixed or variable; (5) when the institutional choice is taken by a corruptible Constitutional table. This last point gives a positive characterization to the model’s normative results, and it is simply driven by the fact that, even when one group is penalized by one rule, she will be compensated by the other exactly because optimal institutions deliver a higher expected long-run social welfare.

¹⁶ Formally, the Legislator now maximizes the function $-(1/2)(1-\mu)(A^s - E(\hat{A}_j))^2 + \mu W_l(A^s, \bar{A})$, where $W_l(A^s, \bar{A}) = (1/4)\sum_{j \in l}[(\bar{A} - \hat{A}_j)^2 - (A^s - \hat{A}_j)^2] - \Psi$ is the sum of the maximum individually rational side contracts each lobby j in the coalition j is willing to pay less the fixed “collective action” fee Ψ .

¹⁷ To see this, notice that each coalition’s willingness to pay increases with the extent of disagreement between groups $\bar{A} - A$, which, in turn, rises with the degree of polarization π .

¹⁸ Unlike Fernandez and Ponzetto (2008), this theory makes the very reasonable point that, in a world where the disagreement among citizens is limited, special interests would not bear “collective action” costs in order to distract the Legislator from the maximization of social welfare.

As discussed below, Guerriero (2010) confirms the model's empirical implications using data on 156 transplanted countries. This evidence represents one of the key criticisms of the "legal origins" theory. Before analyzing this result, I will review the most interesting empirical exercises looking at the impact of legal origins, as coded by LLSV (1997), on prevailing laws. I will not discuss the related strand of literature investigating the relation among these regulations and economic outcomes. A clear survey of these papers is given by LLS (2008), who also out point correctly that two-stage approaches, using the initial transplantation as an instrument, are unreliable because it is virtually impossible to include in the second stage all the relevant omitted variables related to legal traditions.

3. The Putative Primacy of Common Law: Evidence

The available studies, which are all cross-country, can be divided into three categories depending on whether legal origins are related to: (1) investor protection; (2) government regulation or ownership of economic activities; (3) the characteristics of the judiciary and of the government. Some of these rules are "laws on the books", others are mixtures of procedural and substantive rules. This choice has "advantages and problems" (LLS, 2008).¹⁹

Starting from investor protection, LSSV (1997 and 1998) document that the laws in the countries they assign to the common law group are more protective of outsider shareholders and senior creditors than those in the countries whose legal origin is civil law. Also, LLSV show that, in accordance with the basic agency theory of corporate law (e.g., Shleifer and Wolfenzon, 2002), legal investor protection from expropriation by corporate insiders promotes financial development. Following these two influential works, several studies have: (1) devised improved indexes of shareholder protection;²⁰ (2) found qualitatively similar differences between the two legal origins groups, looking however at different proxies of the efficiency of financial markets, such as: ownership dispersion (La Porta, Lopez-de-Silanes and Shleifer, 1999), dividend payouts (La Porta et al., 2000), Tobin's Q (La Porta et al., 2002), the voting premium (Dyck and Zingales, 2004), external finance (Beck, Demircuc-Kunt and Ross, 2005), the size and the perceived quality of private debt markets (Djankov et al., 2007 and 2008a), the ratio of stock market capitalization to GDP and the

¹⁹ This methodology could lead to inconsistent estimates if the indicators are not equally informative about the underlying concept or do not measure a single dimension (Rosenthal and Voeten, 2007).

²⁰ While La Porta, Lopez-de-Silanes and Shleifer (2006) have focused on a measure of shareholder protection through securities laws in offerings of new issues, Djankov et al. (2008b) have analyzed the existing remedies against self-dealing by corporate insiders through corporate law.

pace of public offering activity (Djankov et al., 2008b), first lead investments (Cumming, Schmidt and Walz, 2010), and tax aggressiveness (Atwood et al., 2010). Other contributions have proposed different channels through which legal origins may shape finance: while Amin (2008) shows that firms in countries with a common law legal origin perceive the government as less helpful for doing business, Julio and Yook (2009) document that firms in the same group face a stronger political uncertainty which, in turn, depresses corporate investments.

Turning to market regulation, Djankov et al. (2002) calculate that: (1) the number of procedures and the administrative costs that a start-up must bear before it can operate legally are significantly higher in countries that are part of the the French civil law group; (2) such proxies of entry regulation are correlated with more dramatic corruption, a larger unofficial economy, and a poorer quality of public or private goods. Looking at labor market regulation, Botero et al. (2004) obtain qualitatively similar patterns. Finally, the estimates discussed by Djankov et al. (2003c) (La Porta, Lopez-de-Silanes and Shleifer, 2002) reveal that government ownership of the media (banks) is significantly higher in countries whose legal origin is civil law. The latter also rely more heavily on military conscription (Mulligan and Shleifer, 2005a and 2005b).

A smaller body of literature has been interested in the characteristics of the judiciary and the government. While La Porta et al. (1999) focus on summary measures of government intervention and public sector efficiency, Djankov et al. (2003b) build a synthetic index of the formalism of adjudication procedures, linking it to the time it takes to evict a non-paying tenant or to collect a bounced check. Also, La Porta et al. (2004) try to characterize the interplay between judicial independence, as proxied by Supreme Court judicial tenure and case law, and the quality of contract enforcement, and Djankov et al. (2010) study the relation between the rules of financial and conflict disclosure by members of Parliament and the extent of corruption. The basic message coming from these four papers is that the countries that received at independence institutions typical of the common law have less formalized adjudication, longer constitutional tenure of Supreme Court judges, greater recognition of case law as a source of law, and major disclosure by politicians.²¹ Berkowitz and Clay (2005, 2006) observe similar patterns, though exploiting the fact that ten US states were initially settled by France, Spain or Mexico. In recent decades, these states have granted less independence to their judiciary, and used different judicial budgeting procedures. Kim (2009) reaches similar conclusions focusing on Virginia and Massachusetts only.

²¹ Ben-Bassat and Dahan (2008), however, report that common law countries place less emphasis on constitutional commitments to the right to social security, education, health, housing and workers welfare.

4. Criticisms: Legal Origins and Dynamics

Based on the evidence summarized above, LLS (2008) conclude that “compared to French civil law, common law countries have less formalized contract enforcement, [a stronger judicial independence], and greater recognition of case law as a source of law . . .; these characteristics of legal systems predict both the efficiency of contract enforcement . . . and the security of property rights. [Also] civil law countries are more likely to address social problems through government ownership and mandates” (LLS, 2008, p. 309–10). In the following, I will clarify how weak this conclusion is, basing my argumentation on the two main groups of criticisms dealing with the “legal origins” project’s empirical approach. While the first complains of the omission of other relevant determinants of policy-making, the second shows the inconsistency of LLSV’s original (1997) codification.

4.1 Omitted Variables and Observational Equivalence

The first immediate objection to the evidence summarized in Section 3 is the existence of omitted variables: since legal origins are an expression of colonial history, how can we claim that the effect of differences among colonizers’ strategies is not misattributed to differences in their legal systems? As acknowledged by LLS (2008), three key colonizers’ characteristics may possibly be confused with legal origins: their culture, their politics and their history.

Starting from culture, while Stulz and Williamson (2003) suggest that the hostility of some religions to lending on interest may be more relevant in determining creditor protection, Licht, Goldschmidt and Schwartz (2005) claim that cultural attitudes toward individualism could predict legal rules supporting a free market better than legal origins. LLS (2008) have replied to these alternative theories showing that neither of the two proxies for culture makes much of a dent in the explanatory power of legal origins. A more devastating attack has been launched by Klerman et al. (2009), who have noticed that, although common law countries have experienced higher growth rates since 1960, this advantage disappears when one controls for the dominant pre-independence colonial power or for human capital in 1960. The latter was significantly higher in the countries aggregated by LLSV (1997) into the common law group (Rostowski and Stacescu, 2006). Agbory, Fedderkez and Viegi (2010) confirm this idea, looking at sub-Saharan regions.

Another challenge to the “legal origins” literature has been posed by political economy theories of policy-making. A first body of literature (Pagano and Volpin, 2005 and 2006; Roe, 2006; Perotti and Von Thadden, 2006) has advanced the hypothesis that following the major crises of the twentieth century, many powerful Continental European families that controlled firms and/or labor formed alliances with the aim of drawing up self-protecting regulations. Rich capitalistic families obtained rules shielding their private benefits to the

detriment of outside shareholders; the organized labor got social security and worker protection laws. Also, these families and labor joined forces against product market competition, pushing for stricter regulation of entry. Hence, clusters of countries with weak shareholder protection, strong protection of labor and high regulation of entry formed, alongside clusters of countries with the opposite characteristics. In this perspective, using the civil law legal origin just picks up the role of proportional representation (Pagano and Volpin, 2005 and 2006), socialist politics (Roe, 2006) and social democracy (Perotti and Von Thadden, 2006) in favoring the rise of the “insiders”. Even though appealing, this political account fails to explain the differences between civil and common law countries when tested in samples bigger than those studied in the original papers (see LLS, 2008).²² Instead, a stronger point, has been made by more recent contributions that looked at the political mechanisms transmitting colonial origins into economic development. Acemoglu and Johnson (2005) find that, once one takes into consideration the European colonization strategy as shaped by the settler mortality rate and the population density before colonization, legal origins have no first-order effect on long-run economic growth, investment, and financial development. A possible explanation for this pattern is that individuals often find ways of altering the terms of their formal and informal contracts to avoid the adverse effects of weak contracting institutions, but find it harder to mitigate the risk of expropriation in this way.²³ Two recent papers confirm this view, looking to well-defined study cases. Henry and Miller (2009), in the first place, show that the income levels of Barbados and Jamaica, two countries assigned by LLSV (1997) to the common law group, significantly diverged over just 40 years because of the quality of macroeconomics policies alone.²⁴ Similarly, looking at US states, Arruñada, Williamson and Zamarone (2009) discover that, once the impact of intra-state special political interests is controlled for a state’s legal origin has no significant effect on courts’ output.

The last line of attack has claimed that if one looks at historical data the correlations discussed in Section 3 vanish. Rajan and Zingales (2003) open this body of research, presenting evidence showing that in 1913 French civil

²² Along the same lines, looking at a panel of 85 countries over the period 1975–2004, Gourevitch, Pinto and Weymouth (2009) find evidence that, contrary to the political economy view, not only are legal origins relevant but also left-leaning governments are more likely to be associated with higher stock market capitalization. LLS (2008) document that the legal origins theory continues to work outside democracies.

²³ Similarly, Bloom and Echeverri-Gent (2010) find that, in a panel of 197 countries over 34 years, the consideration of regulatory resources leaves almost no role to legal origins in explaining financial market development (see also the evidence on public enforcement in Jackson and Roe, 2009; Nee and Oppen, 2009).

²⁴ A similar exercise is carried out, focusing on the last two decades in India, by Armour and Lele (2009).

law countries had more developed financial markets than did common law countries. Yet, as proved by LLS (2008), their conclusions rest mainly on several questionable data construction assumptions. More compelling, however, is historical evidence on the quality of prevailing regulations. Sgard (2006) builds an original database of 51 bankruptcy laws, ranging over 15 European countries and more than a hundred years: i.e. between 1808 and 1914. There are two key conclusions of the analysis of these data: (1) over the entire period, all legal traditions except English law strongly protected creditors' rights; (2) the evolution of financial regulation was influenced crucially by continent-wide trends and not by legal origins (similar conclusions are reached by: Lamoreaux and Rosenthal, 2005; Deakin, 2009; Serpoul, 2009; Roe and Siegel, 2009; Musacchio, 2010). This expanding literature on the evolution of legal traditions has paved the way to a more fundamental criticism of the legal origins theory.

4.2 Codification Failures and Endogenous Legal Traditions

As seen above, increasingly legal studies have criticized the basic assumption of the legal origins theory that transplanted legal infrastructures remained unchanged over time (Roe, 2004 and 2006). Starting from this crucial observation, Guerriero (2010) has recorded: (1) the law-making institution in place at independence and in 2000 in 156 transplanted countries; (2) the four most relevant adjudication institutions in place in 98 of these 156 countries at the same points in time and listed in footnote 4 above.²⁵ Consistent with the theoretical account given in Section 2.3, instrumental variables estimates reveal that, in countries in which statute (case) law was transplanted, reforms toward case (statute) law were more likely the broader (smaller) was the long-run cultural heterogeneity as proxied by: (1) the genetic distance between the plurality ethnic group in the country which chose the law-making institution and the one in the transplanted country; (2) the ethnic fractionalization in the transplanted country.²⁶ Also, moves toward common law – i.e. case law and flexible adjudication rules – in countries on which statute law was imposed are

²⁵ Apart from attempts to understand the extent of transplantation (Berkowitz, Pistor and Richard, 2003), Guerriero (2010) is the first economics work that has taken up the largely unheard request by legal scholars that “robust micro-based assessments of rules and legal institutions should prevail over macro generalizations and ‘cherry-picking’ theories” (Garoupa and Gomez Ligerre, forthcoming). A complementary effort has recently been made to obtain more accurate measures of the prevailing regulations (Graff, 2008; Spamann, 2010).

²⁶ Recently, Dari-Mattiacci and Guerriero (2010) have been studying the evolution of law-making in ancient Rome to confirm this pattern in a case in which more than one switch can be observed. Between the fifth century BC and the fifth century AD Rome went through two momentous law-making reforms.

found where the long-run quality of the political process is poorest.²⁷ Hence, the distribution of the key institutions shaping the functioning of actual legal systems is neither fixed nor randomly given. Instead, it is the outcome of a unique historical shock and of the welfare-maximizing effort of the society as a whole. This evidence constitutes a decisive critique of the legal origins literature. Not only is the evolution of legal traditions driven by factors affecting those economic outcomes we want to explain (see Alesina et al., 2003; Persson and Tabellini, 2009), but the LLSV's (1997) classification is also plagued by several inconsistencies.

In the first place, the authors do not notice the evolution of transplanted law-making institutions.²⁸ In the second place, among countries for which data on the adjudication rules are available, 54% (39%) of the observations coded by LLSV (1997) as having an English (French) law origin have reshaped their legal order in such a way as to be nearer to a pure civil law (common law) legal system. In other words, these countries have reformed the fundamental structures of their legal order in a direction showing a *de facto* interest in aggregating the citizenry preferences with rules different from those transplanted.

5. Conclusions: A New Legal Origins Literature

This chapter has discussed the main achievements and failures of the legal origins literature. From a theoretical point of view, the legal origins project has been challenged on two grounds: (1) more careful historical analyses have refuted the medieval-grounded (Klerman and Mahoney, 2007) primacy of common law in protecting private contracting and ordering; (2) consistent with recent evidence (Niblett, Posner and Shleifer, forthcoming), a growing series of models has clarified that the evolutionary efficiency of case law is far from obvious (Gennaioli and Shleifer, 2007a; Anderlini, Felli and Riboni, 2010; Baker and Mezzetti, 2010). On empirical grounds, the evidence on legal origins has been proved inconsistent because of its codification. The latter, which is based essentially on colonial origins, raises two main issues: (1) the correlation between the LLSV (1997) groups and economic development reveals a correlation between specific features of colonization, such as human capital and the public enforcement of property rights, and economic development; (2)

²⁷ These results also cast doubt on the literature on legal formalism (Djankov et al., 2003b) which sees the higher number of bright-line rules in civil law as driving less efficient adjudication. The pattern speaks, instead, of an optimal choice driven by the preference aggregation properties of statute law.

²⁸ Also three non-Scandinavian countries coded as having some form of civil law origin (three countries assigned to the English law group) were instead using case (statute) law over the whole independence period.

econometricians cannot give a causal interpretation to legal institutions that, for the vast majority, were not even in place.

Driven by this raging storm of criticism, I close by highlighting two avenues for further research. The first obvious need for the new legal origins literature is a structural and evidence-based theory of precedent and statute formation and evolution, bringing together the preference and information aggregation role of law-making institutions.²⁹ Second, the empirical literature on comparative legal and economic systems should not only consider all the different institutions characterizing the two traditions, but also the fact that the design of these arrangements is driven by long-lasting cultural features which also affect the economic performances we are interested in. Such an exercise will help to deal with two immediate policy issues: (1) understanding whether, as claimed by Acemoglu and Johnson (2005) and contrary to the incomplete markets intuition, contracting institutions, as driven by prevailing legal institutions, have no first-order effect on long-run economic growth, investment, and financial development;³⁰ (2) avoiding the implementation of ineffective or even harmful restructuring based on the results obtained by the old legal origins literature.³¹ All in all, the new legal origins literature constitutes a crucial challenge for law and economics scholars to be met by both in-depth theoretical effort and solid statistical work.

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²⁹ A first attempt along these lines has been undertaken by Dari-Mattiacci, Deffains and Lovat (forthcoming), who study the relationship between litigation rates and the balance between case law and legislation.

³⁰ Should the groups weigh preferences aggregation against technological efficiency – i.e. the distance $(A^i - A^*)^2$ – the analysis in Guerriero (2010) would still hold and, for negligible switching costs, we should observe no differences between the two traditions, provided that the performance proxies used capture both preferences and technological efficiency. Yet, those employed in the existing literature measure only the second dimension. Based on the latter, at a low level of π statute law outperforms case law because it produces certain and unbiased rules. If, instead, π is sufficiently high and only the long-run bias (both the long-run bias and volatility) of the law affects performance, case (statute) law is welfare maximizing (provided that democracy is sufficiently strong) because unbiased (certain).

³¹ The World Bank "doing business" project reports yearly advances in regulatory reforms identified as key by the old legal origins literature – for example, reducing the steps necessary to open a new business, to obtain a new license or to employ a worker. See <http://www.doingbusiness.org/Documents/FullReport/2009>.

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